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Global Production Networks and Foreign Direct Investment by Small and Medium Enterprises in ASEAN

Henry Wai-chung Yeung*

This paper examines cross-border investments by small and medium enterprises (SMEs) from member states in the Association of South-East Asian Nations (ASEAN). It explains this relatively under-researched topic from the perspective of SMEs' strategic coupling with or "plugging into" regional production networks coordinated by global lead firms. Facilitated by growing regional integration, these SMEs create and capture significant value added from their involvement in these production networks. The paper first highlights the different drivers of SME-specific FDI activities in ASEAN that contribute to strengthening regional economic integration through intra- and inter-firm activities in the region. The paper then explains the working of their strategic coupling with ASEAN-based production networks through different coupling mechanisms, such as international partnership, industrial specialization and production platforms. The key challenges confronting SME regionalization are highlighted. Finally, the paper considers the policy and practice of promoting SME regionalization so that they can plug into the growth dynamics of different regional production networks.

Key words: small and medium enterprises, regional production networks, strategic coupling, South-East Asia

1. Introduction

Global production has become much more organizationally fragmented and spatially dispersed since the 1990s. In its *World Investment Report 2013: Global Value Chains: Investment and Trade for Development*, UNCTAD (2013) estimates that some 80 per cent of global trade is now organized through global production networks (GPNs) that

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are coordinated by lead firms investing in cross-border productive assets and trading inputs and outputs with partners, suppliers and customers worldwide. Analysed in depth in Coe and Yeung (2015), GPNs and global value chains (GVCs) are now the most critical organizational platforms through which economic production in primary, manufacturing and service sectors is structured on a global basis (see also Neilson et al., 2015). A 2010 World Bank report on the post-2008 world economy further claims that “given that production processes in many industries have been fragmented and moved around on a global scale, GVCs have become the world economy’s backbone and central nervous system” (Cattaneo et al., 2010: 7).

GPNs and GVCs are highly relevant for understanding economic development and industrial change in the member states of the Association of South-East Asian Nations (ASEAN). To date, some of the more advanced ASEAN economies, such as Singapore, Malaysia and Thailand, have played major roles in global trade, producer services and manufacturing, and served as the key locations for the regional operation of GPNs – known as regional production networks (RPNs) – oriented towards the regional and the global market. This in turn creates ample opportunities for small and medium enterprises (SMEs) in various ASEAN countries to be involved or “plugged” into these production networks located in their home countries (UNCTAD, 2010; ASEAN Secretariat, 2013; 2014; Asian Development Bank, 2015a).¹

Facilitated by the regional integration of ASEAN economies, cross-border investment by a growing number of ASEAN SMEs from different member states serves as another important mechanism through which such “plugging in” works. In trade and services, SMEs in leading ASEAN hubs for transport (sea and air), logistical, legal and accounting, and financial services have invested regionally in order to offer value added activities to lead firms and their strategic partners in cross-border production networks. In manufacturing, ASEAN SMEs with greater technological and production capabilities have established operations in the region to provide critical and high-value

¹ The definition of SMEs in ASEAN varies by countries (Asian Development Bank, 2015b: 300–303). In general, most ASEAN countries define SMEs in terms of turnover, capital/fixed assets, or employment. But the thresholds for these characteristics differ significantly. In terms of turnover, it varies from lows of K 1000 million (US\$0.12 million) in the Lao People’s Democratic Republic to Rp 50 billion (US\$3.8 million) in Indonesia to highs of RM50 million (US\$12.7 million) in Malaysia and S\$100 million (US\$74.3 million) in Singapore. In some countries (e.g. Malaysia and Myanmar), the threshold for service SMEs is lower than that for manufacturing SMEs. In terms of assets, the threshold can be K,1200 million (US\$0.1 million) in the Lao People’s Democratic Republic and Ks1,000 million (US\$0.85 million) in Myanmar to B 200 million (US\$5.7 million) in Thailand. Finally, most ASEAN countries define SMEs as providing employment for fewer than 200 people, except Cambodia (fewer than 100) and the Lao People’s Democratic Republic (fewer than 100). In Myanmar, labour-intensive manufacturing SMEs can qualify with up to 600 employees. Exchange rates of ASEAN currencies with US dollars are accurate as of April 2016.

intermediate inputs to lead firms that produce industrial or final goods in multiple ASEAN locations. In so doing, SMEs can create and capture significant value added from their cross-border investment in RPNs (Yeung, 2001; 2009; Kuroiwa and Toh, 2008). These ASEAN SMEs both contribute to and benefit from increasing economic integration in the region and the emergence of RPNs.

This paper describes and explains how the regional dynamics of foreign direct investment (FDI) by ASEAN SMEs can be better understood through the concept of strategic coupling (Yeung, 2015; 2016). In this context, strategic coupling refers to SMEs intentional participation in RPNs controlled and coordinated by global lead firms, such as major brand-name manufacturers and global service providers. For ASEAN SMEs to benefit from evolving opportunities in global industries, their firm-specific assets (cost, capability, market access and so on) must match or be “coupled” with the strategic requirements of lead firms in RPNs (e.g. cost reduction, production efficiency and market development) so that their inter-firm transactions can lead to mutual gains and benefits, such as profits, technology transfer, product development, employment and so on. In general, strategic coupling can take place through four mechanisms:

1. ASEAN SMEs serving as local suppliers in domestic production networks or as exporters in their home countries (e.g. Thanh et al., 2010; Harvie et al., 2015; Wignaraja, 2016)
2. ASEAN SMEs investing in other ASEAN locations to directly support the production or service activity of their lead firm customers
3. ASEAN SMEs following the regionalization of their domestic and larger firms to serve their common global lead firm customers
4. ASEAN SMEs regionalizing to develop their own markets and production networks

Focusing on the FDI activity of ASEAN SMEs, this paper will examine mostly the second and third mechanisms for strategic coupling with RPNs. Although this SME-specific FDI serves as a major mechanism enabling such coupling, it is important to note that this SME-RPN coupling is often mediated through different actors (e.g. global lead firms and state institutions) and supported by broader policy initiatives (e.g. the ASEAN Economic Community starting in 2015; see ASEAN Secretariat, 2016).

The paper is organized in three sections. The next section highlights the drivers and motivations of SME-specific FDI activities in ASEAN. This analysis shows why ASEAN SMEs are contributing to strengthening regional economic integration; that is, connecting firms and national economies through intra- and inter-firm activities in the region. The influence of regional integration initiatives on SME FDI is also discussed. The second section then explains how the strategic coupling of SMEs with ASEAN-based production networks works through different coupling mechanisms,

such as international partnership, industrial specialization and production platforms. The key challenges confronting SME regionalization in production networks are also highlighted. The final section considers the policy and practice of SME regionalization by specifying the kind of RPN-friendly policy that can enable SMEs to plug into the growth dynamics of RPNs. This policy for strategic coupling requires not only reconfiguring existing and conventional policy instruments, but also a significant shift in the mindset of policy makers and practitioners towards a dynamic view of SME development in a world of GPNs.

2. Drivers and motivations of SME-specific FDI activities in ASEAN: who and why?

2.1. FDI activities in ASEAN, 2000–2014

Since 2013, the ASEAN Secretariat, in cooperation with UNCTAD, has produced an annual *ASEAN Investment Report* that documents the nature and distribution of FDI in ASEAN. Table 1 presents the total flows of inward FDI to ASEAN since 2000. Over the 2000–2014 period, inward FDI to ASEAN grew rapidly, from US\$21.8 billion in 2000 to US\$84.9 billion in 2007 and eventually to a record level of US\$136.2 billion in 2014. Despite a short pause in growth in the immediate aftermath of the 2008–2009 global financial crisis, inward FDI to ASEAN surpassed US\$100 billion for the first time in 2010. This rapid growth represents the deeper integration of ASEAN countries into GPNs in major industries, such as consumer, financial, and logistics services; apparel, automotive, and electronics manufacturing; agro-food and forestry; and mining and oil and gas.

Among ASEAN countries, five stand out as the largest recipients of FDI during this period. Between 2000 and 2014, Singapore received some US\$508 billion in inward FDI, accounting for over 51 per cent of the ASEAN total of US\$986 billion. Indonesia and Thailand were the next two largest recipients at US\$121 billion and US\$113 billion. Malaysia and Viet Nam followed closely with US\$95 billion and US\$77 billion. These five ASEAN countries absorbed the lion's share (92.8 per cent) of inward FDI to ASEAN during the 2000–2014 period. Not surprisingly, they have been the major host countries for the GPNs in various industries.

As these ASEAN countries have become more strategically coupled with GPNs since the 2000s, their domestic firms have also accumulated sufficient ownership-specific advantages and developed stronger enough market orientations to benefit from expanding economic opportunities in ASEAN-based RPNs. More ASEAN firms have invested in neighbouring ASEAN countries to take advantage of such regionalization opportunities. The importance of this intra-ASEAN FDI has grown substantially over time (table 1). In 2000, only 5.6 per cent of the US\$21.8 billion total of inward FDI flow to ASEAN came from firms based in other ASEAN countries. But the significance of

Table 1. Total flows of inward direct investment to ASEAN by host country, 2000–2014 (US\$ million and intra-ASEAN share in per cent)

Host ASEAN country	2000	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2000–2014
Brunei	550 (2.0)	289 (6.9)	434 (2.3)	260 (23.8)	330 (0.3)	371 (0.8)	625 (14.4)	1,208 (5.5)	865 (3.6)	725 (-8.0)	568 (24.8)	11,291
Cambodia	149 (0.0)	381 (33.9)	483 (32.3)	867 (31.3)	815 (29.6)	539 (32.3)	783 (44.6)	892 (25.1)	1,557 (33.6)	1,275 (23.5)	1,727 (21.5)	9,977
Indonesia	-4,550 (5.1)	8,336 (10.6)	4,914 (27.6)	6,928 (16.0)	9,318 (36.5)	4,877 (28.3)	13,771 (42.9)	19,242 (43.3)	19,138 (39.6)	18,444 (47.3)	22,276 (60.4)	121,159
Lao People's Democratic Republic	34 (41.2)	28 (25.0)	187 (5.9)	324 (30.9)	228 (21.1)	319 (17.9)	333 (40.5)	467 (16.1)	294 (25.2)	427 (24.6)	913 (15.1)	3,640
Malaysia	3,788 (6.8)	4,064 (17.7)	6,072 (7.6)	8,538 (44.3)	7,248 (22.7)	1,405 (-4.3)	9,156 (5.7)	12,001 (22.2)	9,400 (29.9)	12,297 (17.8)	10,714 (25.9)	95,537
Myanmar	208 (35.6)	236 (16.1)	428 (16.6)	715 (13.1)	976 (10.6)	963 (7.1)	2,249 (1.2)	2,058 (4.1)	1,354 (11.2)	2,621 (45.3)	946 (72.3)	13,679
Philippines	2,240 (5.6)	1,854 (0.2)	2,921 (24.1)	2,916 (-24.2)	1,544 (19.9)	1,963 (-0.3)	1,298 (3.1)	1,816 (-4.1)	2,797 (5.2)	3,860 (-1.1)	6,201 (1.3)	32,326
Singapore	14,752 (2.6)	17,299 (4.0)	36,613 (3.2)	46,338 (4.2)	11,115 (13.4)	25,036 (12.6)	55,035 (10.2)	46,774 (3.7)	60,980 (13.6)	56,138 (6.5)	72,098 (6.3)	508,377
Thailand	3,350 (11.6)	8,048 (18.0)	9,460 (48.4)	11,330 (21.7)	8,539 (5.9)	4,853 (30.1)	9,112 (13.6)	3,861 (-1.3)	10,699 (-3.2)	13,000 (9.7)	11,538 (5.7)	113,283
Viet Nam	1,289 (15.7)	1,954 (7.8)	2,400 (7.6)	6,700 (8.1)	9,579 (28.2)	7,600 (5.6)	8,000 (16.3)	7,519 (20.2)	8,368 (15.1)	8,900 (23.4)	9,200 (16.8)	77,069
Total	21,809 (5.6)	42,489 (9.6)	63,912 (13.6)	84,917 (11.3)	49,693 (21.0)	47,927 (13.9)	100,360 (15.1)	95,838 (15.2)	115,453 (17.8)	117,687 (16.5)	136,181 (17.4)	986,341

Source: ASEAN Secretariat, calculated from data in the ASEAN FDI Database as of 26 May 2015, <http://aseanstats.asean.org>. Data are compiled from submissions of ASEAN central banks and national statistical offices through the ASEAN Working Group on International Investment Statistics.

Note: 2014 data are preliminary. Net FDI = Equity + Net Inter-company Loans + Reinvested Earnings. If intra-ASEAN share exceeds 100%, it means at least one of the three components of FDI is negative and not offset by positive amounts of the remaining components.

such ASEAN-origin FDI varies by host countries. In the Lao People's Republic and Myanmar, intra-ASEAN FDI contributed to 35 and 41 per cent, respectively, of total inward FDI in 2000.

Since the mid-2000s, the share of intra-ASEAN FDI in the much larger flow of total inward FDI to ASEAN has hovered around 13.6 per cent in 2006 to 17.4 per cent in 2014 and 18.5 per cent in 2015 (ASEAN Secretariat, 2016: 5). In 2008, intra-ASEAN FDI contributed to 21 per cent of total inward FDI flows, a reflection of the significant drop in outward FDI from developed countries in the midst of the global financial crisis. During the 2013–2014 period, intra-ASEAN FDI was very significant for Myanmar (45–72 per cent share), Indonesia (47–60 per cent share), Malaysia (18–26 per cent share), and Viet Nam (17–23 per cent share). Whereas Indonesia and Malaysia have been the second and fourth largest recipients of inward FDI (after Singapore and Thailand), Myanmar and Viet Nam have also benefited much from their openness to foreign investments.

In sectoral terms, five industries received the most total inward FDI from all countries in 2014 (table 2a): financial and insurance activities (US\$43.1 billion), manufacturing (US\$22.2 billion), other services (US\$19.3 billion), wholesale and retail trade (US\$17.1 billion), and real estate services (US\$10 billion). These industries accounted for 82 per cent of total FDI inflow. The share of intra-ASEAN FDI in total inward FDI was the highest in agriculture, forestry and fishing (87.5 per cent); real estate services (44.9 per cent), manufacturing (30.4 per cent), and administrative and support services (30.4 per cent). Interestingly, TNCs from non-ASEAN countries dominated inward FDI in major service industries, such as wholesale and retail trade (93.7 per cent), financial and insurance activities (91.9 per cent), and other services (91.9 per cent).

Among all ASEAN countries, Singapore received the lion's share of FDI – in financial and insurance activities (US\$34.3 billion), wholesale and retail trade (US\$12.2 billion), and real estate services (US\$5.2 billion). As shown in table 2b, Singapore was also the largest contributor to intra-ASEAN investment in (a) agriculture, forestry and fishing; (b) manufacturing; (c) wholesale and retail trade and (d) financial and insurance activities. This pattern indicates the significance of Singapore as a regional centre for the control and coordination of production networks in these four diverse industries. Playing host to many of the world's lead firms in these industries, Singapore-based investors have been very active in the development of agriculture, forestry and fishing, manufacturing, wholesale and retail trade, and financial and insurance activities in other ASEAN countries. In real estate services, investors from Indonesia and Malaysia are as significant as those from Singapore. Together, these three ASEAN countries accounted for 98 per cent of total intra-ASEAN FDI in the industry in 2014.

In the CLMV countries (Cambodia, The Lao People's Democratic Republic, Myanmar, and Viet Nam), intra-ASEAN FDI tends to focus on manufacturing in Viet Nam's

industrial estates and on agricultural industries in Cambodia. Meanwhile, FDI from Viet Nam focuses on agriculture and extractive industries in neighbouring countries, such as Cambodia and the Lao People's Democratic Republic. In 2014, for example, Viet Nam was Cambodia's second largest investor, whereas Singapore was the second largest investor in Myanmar and Viet Nam in 2013 (ASEAN Secretariat, 2015: Table 1.4; 10).

2.2. SME-specific FDI activities in ASEAN

Due to the lack of any official statistics on FDI activities by SMEs from ASEAN, existing studies tend to rely on SME surveys, firm interviews and case studies.² The *ASEAN Investment Reports* from 2013 to 2015 included only publicly listed SMEs with a regional presence (e.g. ASEAN Secretariat, 2013: Table 4.7, 60; 2014: Box 1.4, 37-38).³ Mostly from Singapore, Malaysia and Thailand, these selected SMEs often have annual revenues or total assets far greater than the usual definition of SMEs in their home countries.⁴ As table 3 makes clear, SMEs account for the overwhelming majority of business establishments in each ASEAN country, except in Myanmar (87.4 per cent), where large State-owned enterprises are still significant. However, the contribution of SMEs to total employment varies substantially, from 97 per cent in Indonesia to 57.5 per cent in Malaysia and 46.8 per cent in Viet Nam. This variation in employment share reflects the relative dominance of State-owned enterprises, large domestic business groups and, to a certain extent, foreign firms in ASEAN countries. In the manufacturing sector, the share of SMEs in employment remains generally low, ranging from 11.7 per cent in Indonesia to a high of 31.8 per cent in Viet Nam. Their share in total exports also does not exceed 25 per cent (e.g. Thailand). Generally well integrated in production networks, manufacturing industries in ASEAN reflect a very substantial presence of large domestic firms and global lead firms and their international suppliers.

² Even the Singapore Department of Statistics, which has published *Singapore's Investment Abroad* since the early 1990s, does not publish any information on the turnover and employment size of Singapore-based investors (<http://www.singstat.gov.sg/publications/publications-and-papers/investment/singapore's-direct-investment-abroad>). It is therefore impossible to estimate the flow and/or stock of FDI by SMEs from Singapore or any other ASEAN country.

³ The most recent *ASEAN Investment Report 2016*, as an exception, included many more ASEAN SMEs and analysed their diverse involvement in regional production networks.

⁴ For example, Malaysia and Thailand define their SMEs as having annual revenue of less than RM50 million (US\$12.7 million) in Malaysia or total assets of less than B200 million (US\$5.7 million) in Thailand. Even Singapore defines its SMEs as having annual turnover of less than S\$100 million (US\$74.3 million). Only a very few firms from Singapore in the ASEAN Investment Report (2013: Table 4.7, 60; 2014: Box 1.4; 37-38) truly qualify as SMEs.

Table 2a. Total intra-ASEAN flows of inward direct investment by major industries and source ASEAN countries, 2014 (US\$ million and per cent)

Major industry	Total (Intra-ASEAN)	Total inward FDI (all)	Share of intra-ASEAN
Agriculture, forestry and fishing	3,928.9	4,492.6	87.5
Mining and quarrying	1,213.3	7,295.1	16.6
Manufacturing	6,757.6	22,215.4	30.4
Electricity, gas, steam and air conditioning supply	-53.9	460.4	-11.7
Water supply; sewerage, waste management activities	8.9	98.2	9.1
Construction	182.2	1,187.9	15.3
Wholesale and retail trade; repair of motor vehicles and cycles	1,071.3	17,055.2	6.3
Transportation and storage	435.3	2,612.8	16.7
Accommodation and food services	-35.8	158.0	-22.7
Information and communication	435.8	2,546.9	17.1
Financial and insurance activities	3,485.8	43,052.2	8.1
Real estate activities	4,508.8	10,040.0	44.9
Professional, scientific and technical activities	124.8	1,048.3	11.9
Administrative and support service activities	65.9	216.7	30.4
Education	8.7	61.6	14.1
Human health and social work	39.9	210.5	19.0
Arts, entertainment and recreation	-5.0	-47.4	10.5
Other services activities	1,572.4	19,311.3	8.1
Others/unspecified	0.0	4,165.3	0.0
Data suppressed by a Member State for confidential reasons	-72.7	0.0	87.5
Total	23,672	136,181	17.4

Source: ASEAN Secretariat (2015: Table 1.2; 8) and ASEAN Secretariat, calculated from data in the ASEAN FDI Database as of 26 May 2015, <http://aseanstats.asean.org>.

Table 2b. Total intra-ASEAN flows of inward direct investment by major industries and source ASEAN countries, 2014
 (US\$ million and per cent)

Major industry	Source ASEAN country									
	Brunei Darussalam	Cambodia	Indonesia	Lao People's Democratic Republic	Malaysia	Myanmar	Philippines	Singapore	Thailand	Viet Nam
Agriculture, forestry and fishing	0.2	0.0	17.3	0.0	162.7	0	0.1	3,575.4	10.9	162.3
Mining and quarrying	1	0.0	46.6	0.0	467.3	0	3.5	425.5	202.5	66.9
Manufacturing	30.6	0.5	50.5	0.0	352.9	6.6	-25.3	6,062.4	287.1	-7.7
Electricity, gas, steam and air conditioning supply	0.4	0.0	0.2	0.0	-0.1	0	0.1	-59.3	4.3	0.5
Water supply, sewerage, waste management activities	0.1	0.0	0.1	0.0	3.0	0	0.0	5.4	0.3	0.0
Construction	1.8	0.0	-1.4	0.0	129.4	0	0.2	43.9	4.0	4.3
Wholesale and retail trade; repair of motor vehicles and cycles	-1	0.2	236.0	0.0	-416.5	10	1.6	1,448.9	-219.7	11.8
Transportation and storage	0.3	0.0	5.1	-0.1	290.0	0	0.0	42.7	97.3	0.0
Accommodation and food services	-2.1	0.0	0.5	0.0	3.4	0	0.1	-47.9	4.8	5.4
Information and communication	0.1	0.0	2.3	-0.1	679.0	-0.1	0.0	-244.3	-1.4	0.3
Financial and insurance activities	-3.9	19.0	112.3	0.0	-470.5	20.7	22.9	3,530.4	252.4	2.5
Real estate activities	15.2	1.1	1,518.4	1.9	1,434.5	65.2	-43.5	1,463.9	12.8	39.3
Professional, scientific and technical activities	1	0.0	2.2	0.0	3.5	-0.9	0.7	120.8	0.5	-3.0
Administrative and support service activities	0	0.0	0.0	0.0	5.3	0	0.0	59.2	1.4	0.0
Education	0.1	0.0	0.1	0.0	0.6	0	0.0	7.4	0.4	0.1
Human health and social work	0.7	0.0	0.4	0.0	3.2	0	0.1	33.6	1.9	0.0
Arts, entertainment and recreation	-0.1	0.0	-0.1	0.0	-0.6	0	0.0	-3.6	-0.4	-0.2
Other services activities	0.5	0.0	93.3	0.0	1,222.9	7.8	126.6	29.5	78.2	13.6
Others/unspecified	0	0.0	0.0	0.0	0.0	0	0.0	0.0	0.0	0.0
Data suppressed by a Member State for confidential reasons	0.6	0.0	-183.1	0.0	0.0	0.4	-18.7	33.6	81.2	13.3
Total	45.5	20.8	1,900.7	1.7	3,870.0	109.7	68.4	16,527.5	818.5	309.4

 Source: ASEAN Secretariat (2015: Table 1.2; 8) and ASEAN Secretariat, calculated from data in the ASEAN FDI Database as of 26 May 2015, <http://aseanstats.asean.org>.

Table 3. Significance of SMEs in ASEAN Countries, 2012–2014

ASEAN country	Share of total establishment (%)	Share of total employment (%)	Share of manufacturing employment (%)	Share of GDP (%)	Share of total exports (%)
Brunei Darussalam ^a	98.2	58.0	-	23.0	-
Cambodia (2014)	99.8	71.8	15.2	76.7 ^a	-
Indonesia (2013)	99.9	97.0	11.7	60.3	15.7
Lao People's Democratic Republic (2013)	99.8	82.9	17.4	69.0 ^a	-
Malaysia (2013)	97.3	57.5	18.9	33.1	19.0
Myanmar (2014)	87.4	70.0 ^a	-	-	-
Philippines (2012)	99.6	64.9	16.6	36.0	10.0
Singapore (2014) ^b	99.0	70.0	-	50.0	16.0 ^a
Thailand (2013)	97.2	81.0	23.7	37.4	25.5
Viet Nam (2012)	97.7	46.8	31.8	40.0	20.0

Source: Asian Development Bank (2015b).

^a Data from Tambunan and Chandra (2014: Table 3), though the year of the data is unknown.

^b Data from www.spring.gov.sg.

Taken together, these data indicate that a very high proportion of ASEAN SMEs are primarily oriented towards domestic end-market sectors, such as retail, food and consumer services. Most of them are not well “plugged into” any form of production networks through direct exports and/or FDI.⁵ A modest number of SMEs are involved in the manufacturing sector as local suppliers to other domestic firms or foreign enterprises in the same home country. An earlier study of 85 foreign firms by Giroud and Mirza (2006: 7) found that ASEAN-side regional linkages between global lead firms and different ASEAN suppliers were “less common and patchy”. But they did note the emergence of RPNs to which ASEAN suppliers increasingly have had to adjust. Foreign firms in consumer electronics also tend to develop higher levels of local supply linkages. In another study of the internationalization of 77 SMEs from the northern region of Peninsular Malaysia, Chelliah et al. (2010: 32) found that some 60 per cent of these SMEs had fewer than three subsidiaries or joint ventures abroad. However, SMEs that had internationalized were able to create knowledge

⁵ Even Ando's (2010: Table 3; 474) study of Japanese SMEs in FY2007 found that the percentage of Japanese SMEs with foreign operations ranged only from 2 per cent in general machinery and 2.3 per cent in electrical machinery to 4.7 per cent in ICT equipment. These Japanese SMEs in machinery industries accounted for some 40 per cent of all manufacturing affiliates in Southeast Asia.

and technology skills, diversify resources and stimulate development, growth and success. Other economic studies of the internationalization of ASEAN SMEs tend to focus on their exports rather than on their FDI activities (e.g. Tambunan, 2008; Nguyen et al., 2013; Troilo, 2013; Tambunan and Chandra, 2014).

When ASEAN SMEs invest in neighbouring countries, what are their key drivers and motivations? In general, four such drivers can be identified:

1. Enhancing cost-capability ratios
2. Market-seeking
3. Access to local resources and products
4. Reaping benefits of regional integration

These drivers and motivations of ASEAN SMEs differ slightly from those of Japanese SMEs engaging in foreign operations (Ando, 2010: Table 4; 475). They are also quite different from those of larger firms from ASEAN, such as the acquisition of assets in regional and international markets that provide access to brand names, technology and skills, business networks and so on (ASEAN Secretariat, 2013: 84–88; 2016: 107–109).

First, manufacturing SMEs from relatively higher-cost ASEAN countries, such as Singapore and Malaysia, are under pressure to reduce their production costs in order to compete against suppliers from China and other ASEAN countries. SMEs need to calibrate their cost-capability ratios carefully, particularly those competing in highly globalized industries, such as electronics and apparel. To reduce their cost-capability ratios, these SMEs can find ways to reduce production costs and/or innovate to improve their process and product capabilities. Establishing operations in neighbouring countries can often help reduce production costs while the home operations work on improving firm-specific capabilities (e.g. new technologies, organizational routines and market know-how). SMEs from other low-cost ASEAN countries (e.g. Indonesia and Thailand), however, are less motivated to invest in nearby ASEAN countries in order to lower their cost-capability ratios. Most of them are satisfied with serving as low-cost local suppliers embedded in their domestic production networks.

Second, ASEAN SMEs can regionalize to develop new markets and/or to serve existing markets and customers. This driver is particularly strong for SMEs from Singapore and, to a certain extent, Malaysia, as their domestic markets are relatively small and saturated and the opportunities for growth are limited. But for these SMEs to venture abroad, they must possess firm-specific advantages, such as unique technologies, cost competitiveness or market knowhow. In a study by Senik et al. (2010: 294), a panel of 55 experts on Malaysian SMEs has identified domestic conditions and market issues as the most significant influence on their internationalization. As ASEAN is expected to sustain its growth trajectory in the next

5–10 years, some SMEs with larger market ambitions are particularly driven to grow through foreign operations.

According to a report by the Boston Consulting Group (Khanna, 2014), ASEAN's share of global GDP has risen rapidly, from 0.7 per cent in 2003 to 2.4 per cent in 2013, representing a cumulative annual growth rate of 12 per cent. This double-digit growth is certainly comparable with that of the BRIC (Brazil, Russian Federation, India, China) countries during the same period and places ASEAN – if it were a country – as the world's seventh largest economy after the United States, China, Japan, Germany, France, and the United Kingdom. Between 2013 and 2020, the Boston Consulting Group estimates that ASEAN will continue to grow at 12 per cent annually and become the world's fifth largest economy, accounting for 5.1 per cent of global GDP. Interestingly, a very large domestic market will be created by the rapid growth of the middle and affluent classes. By 2020, some 120 million ASEAN nationals will join these classes, mostly in emerging markets of the largest ASEAN countries, such as Indonesia, Viet Nam, the Philippine, Thailand and Myanmar.

Third, ASEAN SMEs can be motivated to invest in specific ASEAN destinations for access to local resources and products, such as natural resources in Indonesia, Viet Nam and Myanmar. In primary industries, this accessibility driver is combined with a relatively low cost of extraction and production that can be exploited by some SMEs from more developed ASEAN economies, such as Singapore, Malaysia and Thailand. In CLMV countries, geographical proximity can also enhance such access to local resources and products in agriculture and extractive industries (e.g. emerging Vietnamese SMEs in Cambodia and the Lao People's Democratic Republic).

Fourth and finally, more than two decades of regional integration initiatives in ASEAN have created a fairly conducive investment environment, characterized by stable political environments and economic liberalization, increases in FDI and better networking with host governments. These initiatives are attractive to ASEAN SMEs that can benefit directly from various regional cooperation initiatives and free trade agreements (FTAs). First conceived in 1992, the ASEAN FTA was signed by six ASEAN members with the eventual goal of removing both tariff and non-tariff barriers and improving the region's competitiveness as a key platform in GPNs. Since then, import tariffs on almost all goods traded among the original six countries have been removed or at least reduced to less than 6 per cent. In 2008, the ASEAN member states agreed to pledge to work toward a full single market and production base within ASEAN by 2015, culminating in the establishment of the ASEAN Economic Community (AEC) (see Chia, 2010; Tambunan and Chandra, 2014; Harvie et al., 2015).

Substantial progress has been made in relation to the AEC Blueprint by 2012 (table 4). According to Lim Hong Hin (2014), deputy-secretary general for the AEC, SMEs in ASEAN have benefited from the ASEAN benchmarks and baselines for SMEs, the

SME credit rating methodology and the SME policy index.⁶ Those ASEAN SMEs that are motivated to invest regionally are also involved in selective initiatives for ASEAN integration, such as technical workshops on trade, finance, FTA negotiations⁷ and trade facilitation, as well as the annual attachment of CLMV officials. In conjunction with the full implementation of the AEC beginning in 2015, ASEAN SMEs now expect a shared market, simplified rules and/or greater access to trade, easier movement of their professionals and expanded access to SME finance.

According to the 2014 ASEAN Economic Integration survey (Boston Consulting Group, 2014: 8–9), some 78 per cent of all 150 responding firms perceived ASEAN integration as an opportunity, whereas 82 per cent thought ASEAN integration would accelerate economic growth as well as increase competition. Some 76 per cent of them intended to expand market share by 2017, and 65 per cent planned to expand their ASEAN-based revenue by 2019.

Table 4. Strategic Schedule, ASEAN Economic Community Blueprint, 2008–2015

ASEAN Economic Community Blueprint			
(67.5% of targets achieved under Phases 1 and II by 2012)			
Pillar 1: Single market and production base (65%)	Pillar 2: Competitive economic region (67.9%)	Pillar 3: Equitable economic development (66.7%)	Pillar 4: Integration into the global economy (85.7%)
<ul style="list-style-type: none"> • Free flow of goods, services, investment and capital • Free flow of skilled labour • Priority integration in 12 sectors • Strengthening security and cooperation in food, agriculture and forestry 	<ul style="list-style-type: none"> • Competition policy • Consumer protection • Intellectual property rights • Infrastructure development • Taxation • E-commerce 	<ul style="list-style-type: none"> • SME development • Initiative for ASEAN integration 	<ul style="list-style-type: none"> • Coherent approach to external economic relations • Enhanced participation in global supply networks
Human resource development		Research and development	

Source: ASEAN Scorecard (2012) and Lim (2014).

⁶ These policy tools are developed under the ASEAN SME Projects (<http://asean.org/asean-economic-community/sectoral-bodies-under-the-purview-of-aem/small-and-medium-enterprises>, accessed on 10 March 2017). On the one hand, SME benchmarks and baselines are meant for establishing a common standard for credit rating and other SME evaluations in order to enhance objectivity and transparency among stakeholders (e.g. lenders and government offices) and to facilitate SMEs' access to credit. On the other hand, the ASEAN SME policy index is used to evaluate government policy designs and implementation across ASEAN countries with the view of adopting a common SME policy platform.

⁷ With China in 2005, the Republic of Korea in 2007, Japan in 2008, Australia in 2010 and India in 2010; negotiations with Hong Kong (China) started in July 2014.

3. Strategic coupling of SMEs with ASEAN production networks: How does it work?

3.1. Strategic coupling with GPNs: Some conceptual issues

In their essence, GPNs are organizational configurations of intra-firm coordination of economic activity and inter-firm transactional relationships that take place in two or more national economies (Coe and Yeung, 2015; Neilson et al., 2015). Intra-firm coordination of economic activity involves equity investment and is therefore expressed in the organizational form of a transnational corporation (TNC). Inter-firm transactional relationships across economies do not necessarily include TNCs since each transactional firm can be active only within their home economies and engage with each other through international trade. When firms from different national economies fulfil production functions that lead to final goods or services, a GPN is deemed to exist. In international economics, this vertical specialization by firms at different stages of global production is commonly known as “production fragmentation” and “task trading”. Using input-output tables and international trade data, economic analyses of GVC and GPN activity focus on the international outsourcing of economic functions in order to understand the efficiency gains by national economies that specialize in different value added activities. This approach in international economics is often couched at the *national* scale, as if countries were inserted into GVCs and became economic actors in their own right (e.g. Elms and Low, 2013; Milberg and Winkler, 2013; Wignaraja, 2016).

This paper focuses on diverse firm actors and their interests and strategies in the different functional segments associated with GVCs and global industries. A GPN comprises a wide range of firm types, ranging from lead firms and strategic partners to specialized suppliers (industry-specific or multi-industrial), as well as generic suppliers and customers. Taking the initial step of differentiating firms on the basis of their roles and functions in a GPN, table 5 identifies a broad range of participating firm types. This approach to defining diverse firm-specific roles in the same or different networks and industries overcomes one of the shortcomings in the existing GVC model of industrial governance, namely, that it often fails to explain how a model of dyadic inter-firm exchange can translate beyond the inter-firm nexus or even within the same value chain.⁸

⁸ For example, the reformulated theory of GVC governance (Gereffi et al., 2005) places analytical emphasis on characterizing the governance of the entire value chain on the basis of discrete and dyadic (network) coordination of relations between lead firms and their immediate (first-tier) suppliers. The transactional characteristics and firm capabilities shaping these discrete governance relations are also assumed to be applicable to the entire value chain and, by inference, the entire global industry. As pointed out critically by Bair (2008: 354) and others (Yeung and Coe, 2015; Neilson et al., 2015), what characterizes this

Table 5. Firms as actors in a global production network

GPN actors	Role	Value activity	Examples in manufacturing	Examples in service industries
Lead firms	Coordination and control	Product and market definition	Apple and Samsung (ICT), Toyota (automobiles)	HSBC (banking), Singapore Airlines (transport)
Strategic partners	Partial or complete solutions to lead firms	Co-design and development in manufacturing or advanced services	Hon Hai or Flextronics (ICT), ZF (automobiles)	IBM Banking (banking), Boeing or Airbus (transport)
Specialized suppliers (industry-specific)	Dedicated supplies to support lead firms and/or their partners	High value modules, components or products	Intel (ICT), Delphi and Denso (automobiles)	Microsoft (ICT), Fidelity or Schroders (banking), Amadeus (transport)
Specialized suppliers (multi-industrial)	Critical supplies to lead firms or partners	Cross-industrial intermediate goods or services	DHL (ICT), Panasonic Automotive (automobiles)	DHL (banking), Panasonic Avionics (transport)
Generic suppliers	Arm's length providers of supplies	Standardized and low-value products or services	Plastics in ICT and automobile manufacturing	Cleaning in banking and transport services
Key customers	Transfer of value to lead firms	Intermediate or final consumption	Other lead firms or consumers	Other lead firms or consumers

Source: Yeung and Coe (2015: Table 3, 45).

This firm-specific approach offers some possible configurations of a stylized GPN and shows how such multiple networks can intersect both to form an industry and to bridge different industries and sectors. Figure 1 illustrates two common configurations, each having a distinctive lead firm and encompassing a wide range of other firm and non-firm actors. In the first configuration, known as a strategic partnership model, a global lead firm directly engages another firm as a strategic partner to provide partial or complete solutions for its product or service delivery to key customers. This inter-firm partnership is underpinned by interactive relations among the three entities, from joint product development between the lead firm and its strategic partner to product delivery and fulfilment by the strategic partner to customers and provision of post-sale services to customers by the lead firm. These interactive relations also intersect with tangible and intangible inputs (indicated in dotted lines in figure 1) from specialized suppliers and intersect with broader structural initiatives intermediated

dyadic coordination relation in one part of the value chain (e.g. "relational governance" between a lead firm and its first-tier supplier in the automobile industry) may not necessarily be applicable to other inter-firm relations further down the same chain (e.g. "captive governance" between the first-tier supplier and other tiers of suppliers).

by industrial associations, such as standardization and modularization. Within a specific production network, these inputs are necessary but not the most direct and constitutive relationships among the lead firm, its strategic partner and its customers.

In contrast, the second configuration of a GPN shown in figure 1 does not provide for the role of a strategic partner. Instead, this is a lead firm-centric model of organizing a GPN in which the lead firm dominates and drives the entire network. It is positioned centrally within the network of interactive relations involving its specialized suppliers and its diverse customers. This model is often observed in such industries as automobiles, information and communication technology (ICT) and banking. In each of these industries, lead firms take charge of a significant proportion of the production of goods or services. In the automobile and ICT industries, a lead firm may bring together material inputs from specialized suppliers (e.g. key modules and core components) and generic suppliers (e.g. plastic parts) to produce finished or intermediate goods (e.g. semiconductors). Similar to the first configuration, the dotted lines in this model refer to the involvement of other actors and institutions.

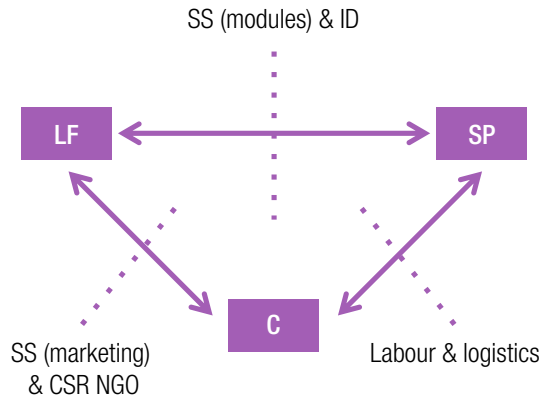
Most ASEAN SMEs tend to be involved in RPNs as generic or specialized local suppliers in their home countries. In each global industry (e.g. apparel, agro-food, electronics, automotive), we can identify such production networks involving a significant number of large and small firms that are responsible for different functional segments of global production, ranging from initial resource extraction to the entire manufacturing process and, equally important, service inputs. In fact, OECD-WTO-UNCTAD (2013: 16) estimates that as intermediate inputs to global production, service inputs contribute directly and indirectly to over 30 per cent of the total value added in manufactured goods. In turn, several of these service activities are themselves organized and delivered through GPNs, as evident, for example, in finance, advertising, logistics and retailing.

Understanding how SMEs can couple with lead firms in RPNs and GPNs requires an analytical perspective that connects two critical and yet relatively independent sets of economic dynamics – territorial dynamics at the local or regional scale and network dynamics at the global scale (Coe and Yeung, 2015). Territorial dynamics refer to the pre-existing political and social institutions and economically productive assets that give rise to the unique character and composition of a local economy in which SMEs are located. They provide the home environment for the nurturing and growth of these SMEs (Henderson et al., 2002; Coe et al., 2004). Network dynamics are much less governed by pre-existing institutions at the local and regional or even the national level. Instead, they are primarily driven by economic actors, such as global lead firms, strategic partners, specialized suppliers, industrial and final customers, and the like. Some of these are large TNCs, whereas others are national or local firms.

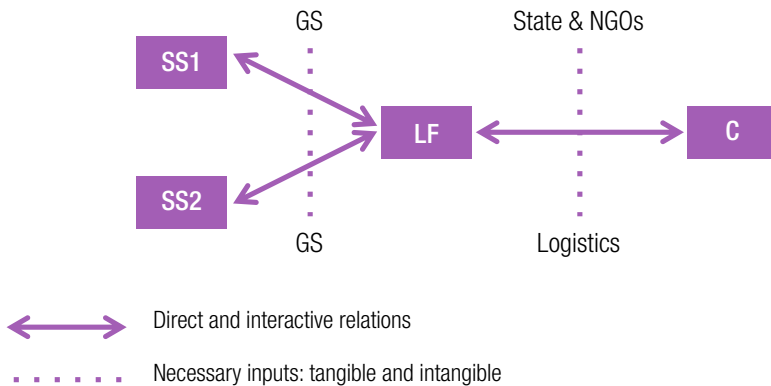
Although these economic actors are embedded in specific national or regional economies, they are mostly driven by the competitive logics of seeking cost efficiency,

Figure 1. Two organizational configurations of a global production network

(a) Strategic partnership model: e.g. apparel, ICT, transport and retail



(b) Lead firm-centric model: e.g. automobiles, ICT, aerospace, banking, and oil and gas



Source: Adapted from Coe and Yeung (2015: Figure 2.2, 60).

Note: LF = lead firm; SP = strategic partner; C = customer; SS = specialized supplier; GS = generic supplier; ID = industry association; NGO = non-government organization.

market access and development, financial market pressures and capital gain, and risk minimization through GPN organization (Yeung and Coe, 2015). The logic behind these GPNs is therefore firm- and industry-specific, and does not necessarily align with the logic behind the political and policy moves of actors in their home economies. In short, GPN dynamics are qualitatively different from territorial dynamics. The lead firm or firms in a GPN define its products and/or control its markets. Such

capability in product specification or market definition, often at the global scale, is fundamental to the corporate power of lead firms in coordinating GPNs that span multiple industries (e.g. electronics and automobiles) and macro-regional economies (e.g. ASEAN, Northeast Asia, Western Europe and North America).

Although territorial dynamics (e.g. industrial estates and business clusters) are necessary for SME development to take place, their cumulative effects on SMEs can be greatly enhanced and sustained if they interact positively with broader network dynamics at the regional and global scales. Most important, the positive outcome of these twin “engines” for economic development hinges on their mutual complementarity and dynamic articulation. This is where the concept of strategic coupling becomes useful, by bringing together territorial dynamics and GPN dynamics to account for economic development outcomes, such as SME growth and industrial transformation (Yeung, 2015; 2016). This mutual articulation provides the underlying strategic platform that enables SME development to occur. Strategic coupling is a mutually dependent and constitutive mechanism involving shared interests and cooperation between two or more groups of actors who otherwise might not act in tandem for a common strategic objective. This interaction involves both material flows in transactional terms (e.g. equity investment and movement of intermediate or final goods) and non-material flows (e.g. information, intelligence and practices). As argued by Buckley and Prashantham (2016: 42), strategic coupling works best when an SME “plays a crucial role in reducing imperfections in information markets – about local supply conditions, labor availability, employment law, and all the other types of tacit knowledge a local entrepreneur possesses”. With their better local know-how and market access, ASEAN SMEs can become strategically coupled with lead firms in RPNs.

3.2. ASEAN SMEs in RPNs

This section analyses in detail how ASEAN SMEs have become increasingly integrated with RPNs through their domestic and foreign operations. Three ASEAN economies – Singapore, Malaysia, and Thailand – have developed a significant role in GPNs because of their growing share in world trade in intermediate manufactured goods between 1988 and 2006 (table 6). This substantial share of the three ASEAN economies in the global trade in intermediate manufactured goods validates that they play a fairly important role in the global automotive, electronics, apparel and agro-food industries (see also ASEAN Secretariat, 2014: Chapter 5).

Since the late 2000s, academic and policy interest has been increasingly focused on the role of ASEAN SMEs in RPNs. Nevertheless, most studies tend to focus on the participation of ASEAN SMEs in domestic production networks within their home countries and/or through the import of intermediate inputs or export of their products (e.g. Harvie et al., 2010a; 2015; Lim and Kimura, 2010; Thanh et al., 2010; Wignaraja,

Table 6. The role of ASEAN in global production networks measured by value of total trade in intermediate manufactured goods, 1988–2006 (US\$ billion and per cent)

Economy	World rank	Total trade in intermediated manufactured goods, 2006	Share of world total, 2006	Cumulative average growth rate, 1988–2006
Tiger economies				
Republic of Korea	12	286.4	3.0	10.6
Taiwan Province of China	14	246.2	2.6	14.3
Singapore	11	289.6	3.0	17.2
Hong Kong (China)	6	372.3	3.9	17.7
Total	-	1,194.7	-	14.9
China	3	807.9	8.5	24.0
Mexico	15	228.8	2.4	23.3
Malaysia	17	162.3	1.7	12.5
Thailand	18	121.1	1.3	13.2
India	21	114.1	1.2	11.7
Japan and North America	-	1,928.4	-	6.9
Western Europe	-	3,377.1	-	6.7
Top 50 economies	-	9,110.9	-	12.4

Source: Based on UN COMPTRADE data presented in Whittaker et al. (2010: Table 1, 449).

2012; 2013). Based a 2012 survey of 234 exporters and importers in Malaysia, the recent study by Arudchelvan and Wignaraja (2016) continues to use trade in domestic production networks as a proxy for understanding the internationalization of SMEs. In many ways, these studies do not differ fundamentally from earlier studies of industrial linkages between foreign firms and domestic SMEs in ASEAN (e.g. Giroud and Mirza, 2006). Even when some of these studies consider the role of foreign ownership in enhancing the participation of ASEAN SMEs in domestic production networks, the mere presence of foreign lead firms in these domestic industrial clusters cannot indicate the size and extent of international operations by ASEAN SMEs in these networks.

On average, only 37.3 per cent of all firms in ASEAN countries participate in some form of domestic production network (table 7). Not surprisingly, this participation ratio is higher in ASEAN countries that are more involved in the RPNs of manufacturing industries, such as Malaysia (59.7 per cent), Thailand (59.3 per cent), and Viet Nam (36.4 per cent). In general, however, the proportion of SMEs (22 per cent) integrated into these domestic production networks is far smaller than that of large domestic firms (72 per cent). But in the more industrialized ASEAN countries (e.g. Malaysia and Thailand), a greater proportion of their SMEs are plugged into domestic production

networks. In many cases, this integration is stimulated by the presence of foreign lead firms and their international suppliers.

In Singapore, for example, global lead firms have established a direct presence through inward FDI. This linkage effect, either through transactional relationships with foreign firms or the direct presence of foreign firms, brings significant growth potential to local SMEs that eventually grow into regional players. An earlier study of over 50 SMEs in Singapore by Chew and Yeung (2001) found that local SMEs were more capable than their foreign TNC customers in such aspects as local knowledge and soft technology. Through various government-led programmes, the productivity of Singapore's SMEs has been improving over time (Lee et al., 2013; Bhullar et al., 2014). As shown in Table 8, local knowledge included local technical specifications, standards, management styles, and local culture. The presence of expertise in soft technology, such as process and product technologies, also led local SME suppliers to participate more in customers' product designs. This proactive role of SME suppliers was developmental rather than dependent. The growth of such developmental linkages was deemed vital in pushing local supporting industries towards the status of technological graduation when local SMEs served as not only suppliers to foreign and local large firms, but also innovative suppliers capable of creating new ideas and solutions (see also Wee and Chua, 2013).

Still, very few studies specifically examine how ASEAN SMEs regionalize through FDI and/or joint ventures in order to develop or sustain their strategic coupling with lead firms in RPNs. Using a case study approach, this section explains the different mechanisms through which ASEAN SMEs can venture abroad within the region. Previous studies have pointed to three component mechanisms of strategic

Table 7. Role of ASEAN SMEs and large firms in domestic production networks

	All countries	Malaysia	Thailand	Philippines	Indonesia	Viet Nam
Number of firms in domestic production networks	2,203	646	619	352	206	380
Share of such firms as a percentage of all firms (%)	37.3	59.7	59.3	26.9	14.5	36.4
SMEs in domestic production networks as a percentage of all SMEs (%)	22.0	46.2	29.6	20.1	6.3	21.4
Large firms in domestic production networks as a percentage of all large firms (%)	72.1	82.4	91.1	51.1	52.0	64.6

Source: Wignaraja (2012; Table 3; 2013: 290), based on World Bank's Enterprise Surveys in 2006 (Malaysia and Thailand) and 2008 (the rest).

Note: SMEs defined as 1–99 employees.

Table 8. Rationales for SMEs to couple with lead firms in production networks

Reasons for SMEs to supply lead firms	Reasons for lead firms to buy from SMEs
1. To access regional and global markets	1. Reasonable pricing
2. To gain technological exposure and technical assistance	2. Quality of products
3. To offer local adaptation of products	3. Good personal relations
4. To enhance the company's image	4. Long-term customers
5. To add features to customers' products	5. Good product design
6. To gain assistance from state agency and other intermediaries	6. Introduction by state agency or other intermediaries
7. To leverage access to financing	

Source: Based on Chew and Yeung (2001).

coupling that enable SMEs in some East Asian economies to plug into the growth opportunities in RPNs (Yeung, 2010; 2016). Examining several case studies of SMEs from Thailand, Singapore, Malaysia and the Philippines (see also ASEAN Secretariat, 2016: 173–179), this section shows that their FDI and development trajectories are fairly variegated, and some have experimented with one or more component mechanisms of strategic coupling with RPNs: international partnership, industrial specialization and production platforms.

1. *International partnership*: This first component mechanism of strategic coupling represents the deliberate and mutually beneficial linkages developed between external actors in RPNs and local SMEs. These industrial linkages are often functional in nature because of well-defined divisions of labour among different firms within each RPN (e.g. marketing and R&D, manufacturing, logistics and distribution, post-sale services). It is particularly prevalent among SMEs from more developed ASEAN countries, such as Singapore, Malaysia and Thailand. In these cases, SME regionalization takes place through international partnership with lead firms in different RPNs. This coupling mechanism supports the strategic partnership model in figure 1.

Thailand's Cool Group exemplifies this successful international partnership in its regionalization drive. Founded in Bangkok in 2001, the Cool Company Ltd. (formerly AHT Asia Company) has won six times the SMEs National Awards launched by the Office of Small and Medium Enterprises Promotion (OSMEP) of the Thai Government (<http://smesnationalawards.com>). The Cool Group is a Thai manufacturer, distributor and service provider of commercial freezers, coolers and cold-chain products for the food and beverages and retail industries in ASEAN (www.coolinspired.com). As a specialist equipment provider, it partners with and serves leading global and regional customers (e.g. Unilever, Nestle, F&N, Cremo, Haagen Dazs, the CP group, S&P restaurant, PFP) and leading supermarket and convenience store chains

(e.g. Giant, Citimart Mini Shop, Lotte), as well as beverage companies, restaurants, and bakery and coffee shops around the region. By partnering with these leading brand-name retailers and manufacturers in ASEAN, the Cool Group expands its market presence in Malaysia, Indonesia, Viet Nam and the Philippines. Although locating its manufacturing base in Thailand can sustain its competitive production costs, the Cool Group's regional presence has greatly improved its customization and service capabilities for its key partners. This regional organization of the production network reduces the firm's cost-capability ratio and improves its competitiveness. Through its partnership with a well-known European OEM in commercial freezers and coolers, the Cool Group also benefits from the OEM's strong R&D support and brand name. In return, the Cool Group offers firm-specific market know-how and broader customer reach within ASEAN to its OEM partner.

2. Industrial specialization: In some ASEAN economies, the presence of strong government assistance and favourable policies has created the possibility for the strategic coupling of domestic SMEs with global lead firms through industrial specialization, by engaging in indigenous innovation and developing new product and process technologies for the niche segments of different production networks. These technologically capable SMEs emerge from long-standing industrial promotion policies that work in tandem with the return of technological and business elites from advanced economies. Such ASEAN SMEs often accumulate substantial technological capabilities and managerial expertise in their home bases before they venture abroad to serve existing or new markets in other ASEAN countries. Their specialized expertise in niche segments, rather than end markets or finished products, means that these SMEs are likely to be plugged into the regional expansion of their key lead firm customers. It resembles the lead firm-centric model in figure 1.

In the cases of both ATC and Eftech, industrial specialization in cutting-edge surface-coating technologies and process and pipeline technologies in oil and gas has enabled them to develop niche markets in their respective home bases in Singapore and Malaysia. Founded in Singapore in 2004 as Applied Total Control Treatment, ATC is an SME specializing in a wide range of advanced surface treatments for high-end equipment parts in the aerospace, oil and gas, medical and electronics industries (www.atc-treatment.com). As a leading player in the metal finishing industry, ATC benefited first from the rapid growth of electronics and then from oil and gas and aerospace RPNs in Singapore and other ASEAN countries. Specializing in secondary processes in these major industries, ATC works very closely with its lead firm customers to fulfil their sophisticated needs and special requirements.

By 2009, ATC had realized that some of its lead firm customers in Singapore, particularly those in the semiconductor industry, were either withdrawing or relocating their operations to elsewhere in Southeast Asia or China. To maintain its growth and to diversify from its reliance on semiconductor customers, its founder

Marcus Sia decided to look for expansion opportunities in Southeast Asia. With the help of International Enterprise (IE) Singapore, the focal government agency promoting the internationalization of Singaporean firms, ATC participated in IE Singapore's investment mission in Malaysia and found Penang to be the most suitable site for locating the first overseas investment (Goh, 2014). Penang hosts one of Southeast Asia's largest clusters of electronics production networks and has a long history of SME development (Chik et al., 2013). Malaysia's aerospace and defence industries are also growing. IE Singapore supported ATC through its Global Company Partnership (GCP) programme. ATC received help with the entry tariffs and market information and through the cost subsidization of its Penang factory and two business development employees there.

Established in Johor Bahru, Malaysia, in 2001, Efficient Technology (Eftech) originally specialized in providing mechanical services to the Malaysian energy markets (www.eftech.com.my). As an SME, it partnered with Hedley Purvis (United Kingdom) and BJ Process and Pipeline Services (United States) in 2001 and 2002 to bring their process and pipeline technologies to the oil and gas industry in Malaysia. It grew rapidly with the domestic market and, in 2005, became an authorized local supplier of bolted-joint integrity and nitrogen-helium leak testing services to Petronas, the national oil and gas company, under the latter's vendor development programme. Since then, Eftech has developed other technical partnerships with Hydratight (United States) and Sparrows (United Kingdom). As the oil and gas industry became more regionalized in the 2010s, Eftech began to go international by incorporating Eftech International in Singapore in 2013 to bring its expertise in engineering services to global lead firms in Singapore and the broader ASEAN region. Eftech International not only provides technical and operational expertise to support its expanding work in the ASEAN region and beyond, but also builds important relations with lead-firm customers in Singapore and in other operational facilities in Indonesia, Myanmar, Thailand and the Republic of Korea. To fulfil its first major services contract for liquified natural gas in Australia, Eftech invested in a A\$5 million new facility in Perth in 2015.

Industrial specialization has provided both ATC and Eftech with stronger firm-specific advantages when they establish foreign operations and develop new markets. Both SMEs have benefited from strong institutional support from their home governments. The role of IE Singapore in ATC's successful venture in Penang, Malaysia, was crucial. By moving its more technologically mature coating operation to Penang, ATC Singapore could specialize further by developing more cutting-edge and proprietary surface-coating technology in its parent operation. Through this industrial specialization, ATC can serve its expanding regional base of lead firm customers in the aerospace, oil and gas, and electronics industries. Similarly, Malaysia's Eftech has benefited from Petronas' vendor development programme and acquired highly specialized and sophisticated industrial knowhow in providing engineering solutions and services to lead firms in the oil and gas RPNs in ASEAN.

3. *Production platforms*: This mechanism has a long history in labour-intensive global industries and is particularly associated with the emergence of the new international divisions of labour (Lane and Probert, 2009; Pickles and Smith, 2015). But it has a tendency to create structural dependency by local SMEs on lead firms and those firms' access to markets in advanced industrialized economies. To engage foreign lead firms in this coupling mechanism, the host state has often developed proactive policies and strategies at both national and regional levels to attract labour-intensive production that might otherwise go elsewhere. This coupling, while fragile and unequal, results from conscious efforts by policy makers and SMEs to connect to relevant players in RPNs.

Since the early 1980s, SMEs in developing regions in ASEAN, such as Malaysia's Penang, Thailand's Greater Bangkok region and Viet Nam's new industrial parks, have been strategically coupled with RPNs through the huge demand for cost-competitive production platforms by lead firms (Yeung, 2009; 2010). As production platforms, these regions provide very competitive cost structures, abundant labour supply, stable policy environment, fiscal and other financial incentives, and so on. Their institutional set-up is geared not so much towards developing indigenous capability as in the case of industrial districts in the Republic of Korea and Taiwan Province of China. Rather, these developing-country regions are actively coupled with evolving regional divisions of labour spearheaded by brand-name lead firms and their key suppliers from Japan, North America and Western Europe. To a certain extent, large firms from Singapore and Malaysia also play a strong role in mediating between global lead firms and local SMEs.

KLT Fruits is a Filipino SME, which has taken advantage of the opportunities created by the production platform mechanism. Established in 1984, it specializes in the processing of tropical fruit purees, concentrates and jams for international markets (www.kltfruits.com). As an agro-food processing firm with its then state-of-the-art manufacturing plant, completed in 1993, in the First Cavite Industrial Estate, KLT has developed over three decades of partnership with small and large fruit traders and growers throughout the Philippines (e.g. Cavite, Batangas, Quezon and Tarlac). It employs about 200 staff members, with 10–20 of them being R&D personnel. KLT has benefited from the State-sponsored industrial development zone in Cavite, where its only food processing plant is located. KLT has also benefited from the Philippines' FTAs with the Republic of Korea, China, Japan, Australia and New Zealand where tropical fruit purees enjoy zero or reduced tariffs. Although it enjoys lower production costs and domestic access to key raw material, KLT does not want to be locked into the limited business segment of food processing in the global agro-food production network. Taking advantage of the AEC since 2015, KLT plans to expand into the regional market by developing its own brand of consumer products. By establishing its marketing offices in Singapore and elsewhere, KLT will build on its manufacturing competence and cost advantage to diversify into the growing ASEAN

regional market. In doing so, it will upgrade from its earlier position as a fruit processor embedded in the production platform mechanism to become a specialized lead firm in its own right.

3.3. Key challenges for the coupling of ASEAN SMEs with RPNs

The preceding analysis showcases the possible gains and benefits that ASEAN SMEs can reap through their regionalization efforts and their strategic coupling with RPNs. But the reality is that such successful cases of SME regionalization are rather limited. With the exception of SMEs from Singapore,⁹ most ASEAN SMEs are first and foremost domestically oriented and do not have any ambition of venturing abroad. A much smaller number of these ASEAN SMEs have participated in domestic production networks as local suppliers or exporters. In short, the challenges are very immense for those ASEAN SMEs seeking to couple with lead firms in RPNs by establishing operations in other ASEAN countries.

A comprehensive survey by the Organization for Economic Cooperation and Development (OECD) (2008: 23) of 978 SMEs in the economies of the OECD and the Asia-Pacific Economic Cooperation group has identified a wide range of obstacles to SME internationalization; in rank order:

1. Obtaining reliable foreign representation
2. Adjusting export promotional activities to the target market
3. Slow collection of payments from abroad
4. Complexity of foreign distribution channels
5. Difficulty in matching competitors' prices
6. Unfavourable foreign rules and regulations
7. Inadequate quantity of and/or untrained personnel for internationalisation
8. Shortage of working capital to finance exports
9. Lack of managerial time to deal with internationalisation
10. Granting credit facilities to foreign customers
11. Unreliable data on the international market
12. Difficulties in enforcing contracts and resolving disputes
13. Accessing export distribution channels

⁹ Singapore's definition of SMEs as having annual turnover of less than S\$100 million (US\$74.3 million) is highly generous. This higher-threshold definition allows for many more successful cases of Singapore-based firms to be classified as SMEs. Combined with the highly limited domestic market – the singular most important “push” factor – it is not surprising that many SMEs from Singapore have ventured abroad and regionalized their operations.

14. Offering satisfactory prices to customers
15. Lack of home government assistance and/or incentives
16. Keen competition in overseas markets
17. Inability to contact potential overseas customers
18. Maintaining control over foreign middlemen
19. Limited information to locate and/or analyse markets

The following key issues are particularly challenging to the regionalization efforts of ASEAN SMEs: (a) firm-specific challenges; (b) network-specific issues; (c) national and regional challenges (see also Asian Development Bank, 2015a).

First, firm-specific capabilities are fundamental to SMEs' propensity to go regional and invest in other ASEAN countries. These capabilities broadly include capital, labour, technology and expertise, and markets. The lack of adequate working capital and of access to formal finance remain two of the most critical barriers to SME regionalization. In a study of seven ASEAN countries, Harvie et al. (2010b; 2010c) argue that access to finance is among the most critical success factors of SME internationalization. Shinozaki's (2012: Table 3) study shows that Indonesia (0.7 per cent) has the lowest value of outstanding SME loans as a percentage of GDP; Singapore (15 per cent) and Malaysia (17.4 per cent) are fairly low. At 30.7 per cent, only Thailand's share is close to those of Japan (35.9 per cent) and the Republic of Korea (37.4 per cent). And yet Thai SMEs are not much more active in regionalization than SMEs from Singapore and Malaysia. In short, access to finance and loans is a serious challenge that must be overcome. But resolving this challenge is not sufficient to ensure the successful regionalization of SMEs.

Equally important are the challenges of labour, technology and expertise, and markets for ASEAN SMEs. Labour issues are particularly difficult for SMEs because of the general scarcity of local and skilled talent. Constrained by size, SMEs often find it hard to compete against large domestic firms and foreign firms in recruiting and retaining skilled labour. Charoenrat and Harvie's (2013) econometric study of manufacturing SMEs in the north-eastern area of Thailand identified the lack of skilled labour as the main firm-specific factor leading to their low technical efficiency. This area hosted some 28.1 per cent of all SMEs between 1994 and 2008, and was the second largest area outside the Bangkok metropolitan area (30.5 per cent). In the case of Singapore's ATC, its founder faced significant difficulty with human resource management in its Penang operation in the initial years (Chia, 2016). It had very high turnover in its Malaysian workforce. This challenge was resolved only after the introduction of flexible working and transport arrangements.

Overcoming the challenges of capital and labour might enable some ASEAN SMEs to develop and sustain cost advantages. But without firm-specific capabilities in technology and expertise and in markets, these SMEs are unlikely to be able to

support and sustain their international operations. As was evident in the case studies of ATC and Eftech, the technical expertise of these SMEs is vital to their competitive advantage. Although this specialized expertise is developed primarily in their home bases, it can be transferred to new locations in other ASEAN countries. In short, developing firm-specific capabilities that can be transferred geographically and applied in different ASEAN locations is a critical challenge to SMEs' regionalization. In this sense, political and social connections in the home markets are less transferrable than firm-specific technological and product expertise. SMEs that are not coupled yet with domestic production networks are therefore less likely to develop such transferrable firm-specific capabilities.

This points to the final challenge of developing firm-specific capabilities in serving different markets. Changing their market orientation from domestic end users and consumers to customers embedded in RPNs is a major obstacle for most ASEAN SMEs. In ASEAN countries with large domestic markets, most SMEs are contented with serving their home markets. Their weaker firm-specific managerial and marketing capabilities also reduce their incentives to engage in new market development beyond their existing markets. Even for SMEs that have developed specific technologies (e.g. ATC and Eftech) and/or products (e.g. the Cool Group and KLT Fruits), capturing markets beyond their home bases represents a fundamentally new challenge. Singapore's ATC, for example, was fairly happy with its growing domestic market in the semiconductor industry during the 2000s. It ventured to Penang in 2012 only after its domestic business had stagnated. Still, its first two years in Penang were difficult and unprofitable, as the firm had few customers there and had to build its customer base slowly in a wider range of industries. In the case of Thailand's Cool Group, its successful regionalization is premised on its firm-specific capability in offering highly customized cooling products and services across ASEAN countries.

Second, network-specific issues represent both significant barriers to entry and opportunities for growth for ASEAN SMEs. Table 9 summarizes some influential factors shaping SME coupling with GPNs that have been identified by five international organizations. For global lead firms and their strategic partners (often large firms) that are coordinating RPNs, their key considerations in picking SMEs as suppliers are defined in terms of cost, delivery, quality, compliance ability and expertise in meeting the standards and specifications of products or services. Implemented by each lead firm across its entire RPN, these parameters for SME suppliers are clearly much more demanding than those of local customers and end users. Not surprisingly, a large majority of ASEAN SMEs are unable to meet the demanding requirements of serving lead firms or their strategic partners in RPNs.

More specifically, the challenges to SMEs aspiring to participate in these RPNs are related to information asymmetry, capability development, and credit and financing.

Table 9. Key factors influencing SME coupling with global production networks: a global comparative perspective

Factors	UNCTAD	OECD	WTO	APEC	ASEAN
Product quality	✗	✓	✗	✓	✗
Product price	✓	✗	✓	✓	✓
Product delivery	✗	✓	✓	✓	✗
Use of e-mail communication	✗	✓	✓	✓	✗
Internationally recognized quality certification	✗	✓	✗	✓	✗
Global standards	✗	✓	✗	✗	✗
ICT technologies	✗	✓	✓	✓	✗
Electronic marketplaces	✗	✓	✓	✓	✗
Financial stability	✗	✓	✗	✓	✗
Changing business practices	✗	✓	✗	✓	✗
Human capital (human resources)	✗	✓	✗	✓	✗
Fragmentation of production	✗	✓	✓	✓	✗
Buyer-supplier relations	✗	✓	✓	✓	✗
Cooperation within GVCs	✗	✓	✓	✓	✓
Cooperation with MNCs and large firms	✗	✓	✗	✓	✓
Structural and policy characteristics	✗	✓	✓	✓	✗
Business environment	✗	✓	✓	✓	✗
Productive capacity	✗	✓	✗	✓	✗
Physical and informational infrastructure	✗	✓	✓	✓	✗
Flexibility and adaptability	✗	✓	✗	✓	✗
Geographic location	✓	✓	✓	✓	✓
Innovative capacity	✗	✓	✗	✓	✗

Source: Asian Development Bank (2015a: Table 1.1, 14).

For SMEs new to participation in RPNs, it is fairly challenging to find more information about the kind of product and/or service expectations and the availability of customers in these networks. These SMEs often do not have access to information on vendor selection and development. Those SMEs already involved in domestic production networks, however, face a different challenge of information asymmetry as their key lead firm customers may not share sufficient information about future business expansion plans within ASEAN. These SMEs also may not have sufficient managerial capabilities and resources to plan for new operations in other ASEAN countries.

Finally, the challenge of avoiding captive relationships with lead firms is significant for SMEs that have already participated in domestic production networks. Most global lead firms tend to control their own products and technologies through strictly enforced patents, product specifications and industrial standards. Their SME suppliers in ASEAN can become “locked” into the specific demands of these lead firms (e.g. standards, pricing and cost reduction). The tendency towards a “race to the bottom” is also high among low-cost SME suppliers. They may lose out badly when their key customers switch orders to other suppliers and/or relocate completely out of the country. This significant risk of excessive dependency on a few key customers tends to reduce the appetite of SMEs to venture abroad in other ASEAN countries.

Third, national and regional challenges can be significant for the regionalization of ASEAN SMEs. These challenges are related to the ease of doing business in individual ASEAN countries and the perceived uneven outcomes of regional integration initiatives. At the national level, the complexity of setting up new ventures or acquiring existing entities varies significantly among ASEAN countries (see table 9). Some of these countries are still characterized by widespread corruption or by changing or opaque regulations. Highly concentrated domestic business ownership and currency restrictions in some ASEAN countries further increase business costs to SMEs from others. In some ASEAN countries, the legal, infrastructure, and banking and financing systems are not yet ready to facilitate investment by other ASEAN SMEs. Given the very limited managerial resources of most ASEAN SMEs, these high barriers to entry pose a serious challenge to establishing competitive advantage.

At the regional level, whereas ASEAN economic integration has received a lot of policy attention, its implementation and outcomes are perceived as highly uneven. According to the 2014 ASEAN Economic Integration survey by the Boston Consulting Group (Khanna, 2014), the overwhelming majority of responding firms thought ASEAN regional champions and global lead firms would emerge as winners in an integrated ASEAN. However, only 41 per cent of them believed that mid-sized firms could be winners and less than 19 per cent of respondents saw domestic SMEs in ASEAN as possible winners of regional integration. More than two thirds of responding firms were not convinced that ASEAN governments would actively push regional integration forward. These firms perceived protectionism and a general lack of will as common among ASEAN countries. For example, a financial firm in Malaysia noted that “government policies are heavily influenced by strong indigenous corporate groups that could dictate the speed of opening of markets and subsequent integration” (Khanna, 2014: 5). Still, another survey by the ASEAN Secretariat (Martono, 2014: 7) showed that 75 per cent of the 93 ASEAN SMEs surveyed thought the AEC will positively affect their business. The case of KLT Fruits from the Philippines showcases the potential and actual benefits of such regional economic integration for ASEAN SMEs.

4. Promoting SME regionalization in ASEAN production networks: Towards more targeted policies and new practices

This section engages critically with the policy recommendations by various international organizations in relation to increasing participation of domestic firms in GVCs and GPNs (Cattaneo et al., 2010; Elms and Low, 2013; UNCTAD, 2013; ASEAN Secretariat, 2014; Asian Development Bank, 2015a).¹⁰ UNCTAD's *World Investment Report 2013* contains the most comprehensive policy framework for promoting the strategic coupling of domestic firms with GPNs. UNCTAD (2013: 175–176) has identified the following key policy challenges for SME development in a world economy organized through the extensive presence of GPNs and GVCs:

1. How to gain access and connect local SMEs to GPNs
2. How to maximize the development benefits from GPN participation
3. How to ensure that opportunities for industrial and social upgrading in GPNs are realized for SMEs
4. How to mitigate the risks associated with GPN participation
5. How to align and synergize trade and investment policies in a world in which the two are inextricably intertwined

As one might imagine, these challenges are presented mostly at the national level, as if the entire country could be plugged into GPNs, and existing development policies could be reworked to stimulate such national strategic coupling. To attain this policy effect, UNCTAD (2013: 175) recommends that “[a]ctive promotion of GVCs and GVC-led development strategies imply the encouragement and provision of support to economic activities aimed at generating exports in fragmented and geographically dispersed industry value chains, based on a narrower set of endowments and competitive advantages. And they imply active policies to encourage learning from GVC activities in which a country is present, to support the process of upgrading towards higher value added activities and diversifying into higher value added chains”.

This national approach to promoting the strategic coupling of SMEs with GPNs, as recommended in most reports by major international organizations, is problematical at two levels, particularly for ASEAN countries. First, it does not take into account sectoral differentiation within and between ASEAN economies. Variations in

¹⁰ This policy discussion draws upon my experience in conducting GPN-GVC conceptual training and capacity-building sessions for government policy makers and regional regulatory practitioners from East and Southeast Asian economies. These seminars and workshops were organized by national governments (e.g. the Malaysian Investment Development Authority), regional development organizations (e.g. the Asian Development Bank, the ASEAN Secretariat, the Asia-Pacific Economic Cooperation-Pacific Economic Cooperation Council), or international organizations (e.g. the World Free Zone Organization).

resource endowments and institutional repertoires can make a very significant difference in ensuring successful and positive outcomes of strategic coupling with GPNs in different sectors. This in turn explains why different regions in the same ASEAN economy can experience very different strategic coupling and outcomes. We can witness these differences in newly industrializing ASEAN economies (e.g. ICT in new industrial estates versus traditional agricultural industries in Viet Nam) and more industrialized ASEAN economies (e.g. ICT in Malaysia's Penang versus extractive industries in Terengganu; automotive in Thailand's Rayong Province versus agricultural industries in other provinces in southern Thailand). Policies targeting the coupling of SMEs with RPNs should be explicitly constructed to take advantage of the appropriate combination of sector-specific assets and institutions in different ASEAN economies.

Second, there is a tendency for these GPN-oriented policy recommendations to eschew industrial policy in favour of generic pro-GPN policies. This is because industrial policy is often misconstrued as "an industrial development strategy aimed at building domestic productive capacity, including for exports, in *all* stages of production (extending to the substitution of imported content of exports) to develop a *vertically integrated industry* that remains relatively independent from the key actors of GVCs for its learning and upgrading processes" (UNCTAD, 2013: 175; emphasis added). While it is indeed much harder for almost any national economy to develop fully vertically integrated industries that are competitive in today's globalized world economy, there remains significant room for industrial policy that taps into the developmental opportunities inherent in the sectoral specificity of most GPNs (Cimoli et al., 2009; Lin, 2012; Yeung, 2016). As argued rightly by Gereffi and Sturgeon (2013: 330), "Companies, localities and entire countries have come to occupy specialized niches within GVCs. For these reasons, today's industrial policies have a different character and generate different outcomes from before. Intentionally or not, governments currently engage in GVC-oriented industrialization when targeting key sectors for growth".

Drawing on a 2014 survey by the Asian Development Bank (2015a), table 10 summarizes the critical elements of policy interventions that can facilitate SME participation in GPNs in different global industries. Some policy interventions (e.g. infrastructural improvement) are more effective in the primary and service sectors, whereas others (e.g. technological upgrading) are particularly necessary for manufacturing SMEs. In the ASEAN context, there is no doubt that the strategic coupling of SMEs with automotive RPNs can be much more challenging than with apparel or agro-food production networks. Interestingly, there is also substantial intra-sectoral differentiation. In the global ICT industry, integrating SMEs into RPNs in the labour-intensive assembly segment of consumer electronics is relatively more actionable in policy terms than is strategic coupling of SMEs with GPNs in such segments as advanced semiconductors or high-end electronics equipment

(e.g. medical devices or computing servers). Developing industrial policy oriented towards promoting niches in a particular sector or intra-sectoral segments can therefore make good sense for SME development. Recognizing such sectoral differences in any GPN-oriented policy recommendations can provide a more appropriate and nuanced understanding of SME policy and practice.

On the basis of this paper's analysis of the regionalization of ASEAN SMEs (see also Habaradas, 2009; Aldaba, 2012; APEC Policy Support Unit, 2014), policies for GPN-led development and regionalization of SMEs should incorporate the following key considerations:

1. *Moving from developing vertically integrated industries to creating specialized niches for SMEs to participate in RPNs*: This includes improving their technological capabilities and technical standards and strengthening their supply chains, which in turn enable them to develop new or enhance existing linkages with lead firms in production networks. As SMEs develop more capabilities through government-assisted programmes and firm-specific upgrading initiatives, they can start as local suppliers in domestic production networks. As they gain more experience, know-how, and customer trust, these domestic SMEs can consider venturing into neighbouring ASEAN countries where their key customers are located and/or where new markets can be developed. This policy approach requires focused attention on industrial sectors that have greater potential for integrated RPNs, e.g. the electronics, automotive, apparel, agro-food, and oil and gas industries.

2. *Recognizing the need for detailed knowledge and analysis of SME prospects in different RPNs*: This need requires raising awareness of the potential of participation in RPNs and creating a fuller understanding of the advantages and the potential of subcontracting and regionalization. Obtaining and analysing reliable information on foreign markets and investment locations can be daunting to most domestic SMEs, given their limited human resources. Identifying relevant value chain segments for potential market entry represents another major step forward for most SMEs. IE Singapore, as an example, offers quite useful "market readiness assistance" in the form of market knowledge resources, learning and networking seminars, and co-funding for SMEs venturing abroad for the first time. Singapore's ATC benefited much from such assistance when it set up its first overseas venture in Penang. SME Corp Malaysia also offers specific programmes of market access and outreach to help SMEs.

3. *Promoting new domestic capacity and/or foreign investment in value-adding segments of RPNs in specific local and regional economies*: This means developing a national supply base through the targeted matching of capable local SMEs with global lead firms and their strategic partners. Sector-specific industrial linkage programmes are likely to be more effective in this targeted form of intervention. For example, SME Corporation Malaysia tries to motivate domestic SMEs to venture into

Table 10. Critical elements of policy interventions facilitating SME coupling with global production networks

Ranking	Critical elements of public interventions	Effectiveness by sectors and firm categories
1	Tax incentives for small suppliers	No significant difference
2	Trade facilitation measures	Primary and services sectors; GVC players Medium to large firms and small firms
3	Simple procedures for trade	Primary sector; medium to large firms
4	Improving domestic infrastructure	Firms in the Philippines and Sri Lanka; primary and manufacturing sectors; GVC players; small firms
5	Reform of transport, telecommunication and ICT	All three sectors (primary, manufacturing, services); medium to large firms
6	Education and training for skill development	No difference
7	Access to trade finance	No difference
8	Access to growth capital through innovative financing	Primary sector; firms intend to expand globally
9	Access to nonbank financing (e.g. factoring and leasing)	Firms in Kazakhstan and Sri Lanka; firms intend to expand globally
10	Development of trade corridors	No significant difference
11	Innovation policies and incentives (i.e. R&D)	Firms in the Philippines and Sri Lanka; all three sectors (primary, manufacturing, services); medium to large firms
12	Development of e-commerce	Firms intend to expand globally
13	Promotion of quality standards and certificates	All three sectors (i.e. primary, manufacturing, and services)
14	Intellectual property protection	Firms intend to expand globally
15	Development of special economic zones (SEZs)	Firms in the Philippines, Sri Lanka and Kazakhstan; all three sectors (primary, manufacturing, services); firms intend to expand globally
16	Competition law and enforcement	GVC players; small firms and medium to large firms
17	Creation of clusters	No significant difference
18	Revision of labor regulations	Medium to large firms and small firms
19	Removing restrictions and barriers to foreign investment	Firms in Sri Lanka and the Philippines; small firms and medium to large firms; firms intend to expand globally

Source: Asian Development Bank (2015a: Table 2.7, 58).

Note: Data from the 2014 ADB survey of 194 SMEs in Kazakhstan (n = 98), Papua New Guinea (n = 19), the Philippines (n = 63) and Sri Lanka (n = 14).

high-tech and innovation-driven sectors by sponsoring annual events to showcase their products and technologies to global customers. Efectech has accumulated crucial engineering capabilities through Petronas' vendor development programme. The Malaysian Investment Development Authority (MIDA) also has a funding scheme for subsidizing 20 per cent of the cost within five years of a Malaysian firm acquiring a foreign high-tech firm. The extent to which this scheme is applicable to Malaysian SMEs, however, remains limited. In Singapore, SPRING Singapore and IE Singapore, both of them government agencies charged with helping domestic SMEs, offer financial support and trade missions to help over 1,500 enterprises to go regional (Boston Consulting Group, 2014: 6; Ramly, 2014: 18–28).

4. Facilitating trade and investment in production inputs and intermediate goods and services: This requires ASEAN governments to continue to work with each other to implement fully the ASEAN Single Window initiative (signed in 2005)¹¹ and to protect the achievements of the AEC (since 2015). As ASEAN economies become more liberalized and integrated through these trade and investment facilitation initiatives, global lead firms in different industries can take better advantage of cross-border cost reduction and market opportunities in order to expand and deepen their RPNs in ASEAN. This in turn will create more opportunities for different ASEAN SMEs to couple with the production and market development activities of global lead firms.

5. Leveraging RPNs for international market access by and capability development in domestic SMEs: ASEAN governments can fund more programmes that strengthen SMEs' branding and marketing expertise, improve their understanding of regional markets, facilitate their joint ventures with foreign firms, and increase their productivity and access to talent through closer partnerships with training and educational institutions. In particular, SME promotion agencies in ASEAN countries can consider setting up dedicated overseas investment centres to assist domestic SMEs in their regionalization efforts. Currently, some ASEAN countries have established such outward FDI promotion centres, but they are embedded only within the main investment promotion agencies (e.g. the Board of Investment in Thailand). It might be more effective for SMEs if such centres were institutionally located within SME promotion agencies.

6. Providing basic prerequisites for promoting SME activity, such as finance, skills, infrastructure, logistics, tax regimes and so on: Addressing financing issues including inadequate working capital, insufficient equity, difficulties in finding credit and high

¹¹ This regional initiative was launched to support the electronic exchange of export declaration information and data so that cargo clearance through customs across borders in participating ASEAN Member States can be expedited (<http://asw.asean.org>).

costs of credit, Talib (2014) proposes the establishment of an ASEAN SMEs Bank, the obligation for ASEAN-based banks operating in other ASEAN countries to provide facilities to SMEs, and a deepening of the liberalization of financial services in ASEAN. ASEAN governments should also expand talent pools through investment in higher education and vocational training and should upgrade infrastructure through direct investment or public-private partnership. SME agencies in ASEAN countries can develop specific human resource development programmes that enable SMEs to recruit and retain a skilled workforce. These programmes can include SME-university partnerships in training, foreign market attachments, and international human resource strategy development.

To operationalize these recommendations for promoting SMEs in RPNs, three policy practices are both necessary and vital: (a) engagement with transnational communities, (b) policy credibility and institutional consistency, and (c) pragmatic choices and flexible pathways. The critical role of transnational communities in SME development is now well recognized. One such transnational community refers to the business and technology professionals who originate from any ASEAN economy and shuttle constantly around the globe. This transnational community has rewritten the concept of international knowledge formation from one of “brain drain” to a two-way process of “brain circulation”. Through their constant movements between different world regions, these technologists and entrepreneurs originating from ASEAN have formed a transnational community of informal brain networks forged by certain common social identity and, sometimes, regional sentiments. In some Asian high-growth regions, these transnational business practices have contributed to the formal coupling of SMEs in regional economies with lead firms in GPNs through a variety of organizational arrangements (Wang and Lin, 2013; Lin and Rasiah, 2014; Yeung, 2016).

For these coupling policies to work, a more systematic engagement with these transnational communities matters. Policy makers should make conscious efforts to identify such actors who have established themselves in different global industries. Because of their international perspectives, these transnational actors are more likely to identify and take advantage of the opportunities arising from vertical specialization in GPNs. Tapping into their knowledge and network repertoires can allow economic planners and policymakers in ASEAN countries to develop a more thorough understanding of the relevance to GPNs of their capabilities and positions in different value chain segments. This understanding is crucial to embedding their SME development strategy in evolving RPNs. In more practical terms, engaging these transnational communities can enable a more direct participation in RPNs through new SME formation and the capability development of SMEs. The classic cases of this successful engagement are between Silicon Valley and Taipei-Hsinchu (Taiwan Province of China), Bangalore (India) and Beijing and Shanghai (China) in the global ICT industry (Saxenian, 2006; Lüthje et al., 2013).

In more traditional industries, such as agro-food processing and consumer goods manufacturing, the key intermediaries in GPNs are quite different from high-tech industries. Engaging with transnational communities that hold important positions in these intermediaries (e.g. international trading companies, and sourcing and supply chain firms) can be equally critical to the successful coupling of local SMEs with RPNs in ASEAN. This practice of building strong bonds with transnational communities from ASEAN can be very helpful to the upgrading of skills and knowledge – ranging from industrial to services to managerial – that might be lacking among domestic SMEs and policy actors.

Moreover, the promotion of SMEs' strategic coupling with production networks through regionalization should not occur in an institutional vacuum. Industrial initiatives formulated and implemented by state and non-state institutions matter for establishing successful strategic coupling of SMEs with lead firms in RPNs. Apart from the successful examples in East Asia, it is also evident in the incorporation of SMEs from Tunisia (North Africa) and Slovakia (Eastern Europe) into apparel GPNs coordinated by lead firms from the European Union (Pickles and Smith, 2015). But all these successful cases point to similar institutional practice – the need for policy credibility and institutional consistency. In many ASEAN economies, it is one thing for policymakers to develop a set of GPN-led promotional policies. It is quite another for these policies to be bold enough and consistently implemented.

Finally, promoting SME coupling through industrial policy necessitates a fundamental shift in practice towards the recognition of greater pragmatic choices and flexible pathways. Two of the greatest dangers exhibited in the “dark side” of SME development through strategic coupling with RPNs are external path dependency and industrial lock-ins. This dependency is particularly troubling if SMEs are locked into a “race to the bottom” pathway to industrial development and upgrading. Unlocking this path dependency becomes very difficult once sector-specific endowments (e.g. land) and assets (e.g. labour) are committed. Recent studies of such decoupling and disarticulations have shown the severe consequences of this kind of lock-in in the global apparel and agro-food industries (Bair and Werner, 2011; Folds, 2014; Zhu and Pickles, 2014).

To anticipate and prevent this debilitating effect, policymakers and practitioners must remain pragmatic in their policy choices and developmental pathways. More precisely, they must adopt a dynamic view of SME development and avoid following a one-size-fits-all approach. Although a pragmatic approach to policy is useful in coupling SMEs with the most immediately available global industry (e.g. agro-food, apparel, or electronics), policy makers and practitioners must be constantly looking out for new opportunities *beyond* these industries to upgrade SMEs' industrial and social capabilities and to prepare them for another pathway towards a higher value-captured mechanism for strategic coupling with RPNs. This pragmatism and flexibility in SME policy and practice may appear to contradict the earlier point about

policy credibility and consistency. But the two are not mutually exclusive. It is entirely conceivable for policymakers to achieve policy credibility and yet remain pragmatic in their choices of pathways for development over time. In several ASEAN regions (e.g. Singapore's "growth triangle", Malaysia's Penang, and Thailand's Rayong), such policy successes are evident in the adoption of a more dynamic approach to practising SME promotion strategies in a world economy dominated by GPNs.

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Indian outward FDI: a review of recent developments

Jaya Prakash Pradhan*

This paper reviews the recent developments of Indian outward foreign direct investment (OFDI), which has been expanding rapidly, against the backdrop of liberalization and openness policies that have been instituted since the 1990s. The Indian OFDI landscape is changing with the participation of increasing numbers of Indian firms from a wide range of industries, the proactive role of State-owned enterprises in seeking overseas energy resources, and the growing distribution of investments, which are now geographically well spread across developed and developing regions. Indian firms are turning into global players with a global market focus and are undertaking overseas investments for international production, acquisition of foreign-created assets and foreign R&D activities.

1. Introduction

A few decades back, Indian industries and firms were taken to be inward looking, seeking protection from foreign direct investment (FDI) and imports. They were highly dependent upon domestic markets and operated with a production base marked by inadequate scale and over diversification, insufficient technological capabilities, poor product quality and low productivity growth. This behaviour of Indian firms was perfectly in tune with the inward-looking policy and controlled industrial productive system that the country adopted between the 1960s and the 1980s.

The period since the 1990s saw India moving away from the low-growth phase during the 1960s–1980s to a high-growth phase, significantly facilitated by the adoption of liberal and open policy measures with respect to the private sector, FDI, trade, technology and competition. India's efforts to steadily integrate her economy with the dynamics and networks of global markets have been complemented by cross-country liberalization of economic policies at the regional and global level, offering easier access to regional and global market opportunities. On the one hand, rapidly expanding FDI inflows and imports have intensified competition in the domestic market, challenging Indian firms, which were thus forced to look for foreign markets

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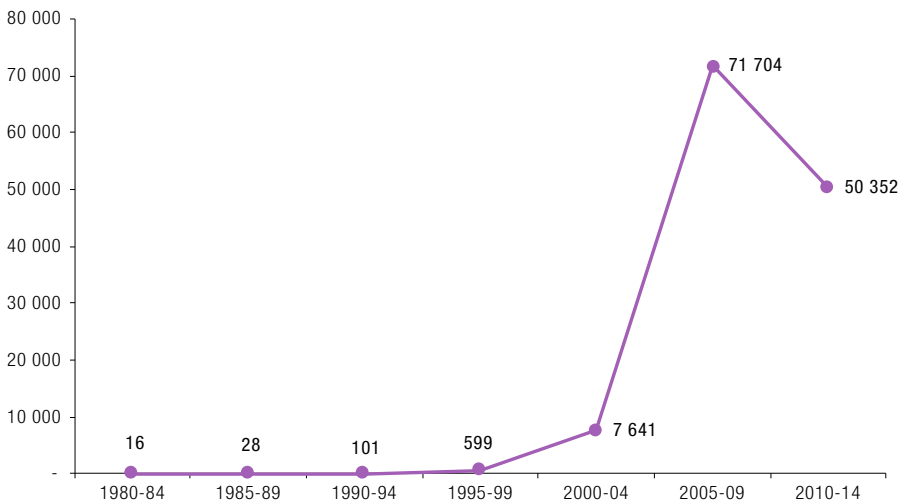
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with ever-increasing significance for growth. On the other hand, multilateral, bilateral and unilateral policy liberalization by other countries involving trade, investments and industries has made overseas markets with attractive business opportunities more accessible.

It comes as no surprise that Indian firms, while adjusting to the increasingly open and competitive business environment initiated in the 1990s, have been aggressively pursuing a strategy of outward FDI (OFDI) as a means of survival and competitiveness in global markets. The last two decades have witnessed a dramatic rise in cross-border investment activities by Indian enterprises from a broad spectrum of industries (Pradhan, 2008a; Sauvart et al., 2010). The low volumes of Indian OFDI flows in the 1980s (\$44 million) had increased 16-fold to \$700 million by the 1990s (figure 1 and table 1). Between the 1990s and 2000s, it increased more than 113-fold, reaching \$79 billion in the 2000s. This dramatic expansion is reflected in the relative size of overseas investments by India with respect to her inward FDI flows, gross fixed capital formation (GFCF) and gross domestic product (GDP). The OFDI stock was equivalent to 51 per cent of inward FDI stock and 6.4 per cent of GDP in 2014, and 17 per cent of GFCF in 2010. The number of Indian firms undertaking outward investment stood at 7,793 in 2014 as compared with just 60 in the early 1980s.

The analysis of the evolution of Indian OFDI during 1975–2001 reveals that Indian firms that invested overseas before the 1990s consisted mostly of a small number

Figure 1. Indian outward FDI flows, cumulative over five-year periods.
(US\$ million)



Source: Calculation based on UNCTADStat (2015), available at <http://unctadstat.unctad.org/>.

of firms from large Indian business conglomerates, overwhelmingly belong to the manufacturing sectors (mainly low-technology and labour-intensive sectors), invested predominantly in developing countries, held minority equity ownership in most of the overseas ventures, and were basically market-seeking in character (Pradhan, 2008b; UNCTAD, 2004). Since the 1990s, such firms have been arising in almost all sectors of the Indian economy but increasingly in the services sector, led by the software industry; have been progressively targeting markets in developed countries; have been majority owned in most cases; and increasingly have been strategic asset-seeking and trade-supporting types of investment. The activities of outward-investing Indian firms are no longer confined to greenfield investments but include an increasing drive for overseas mergers and acquisitions (M&As). Some of these are of international significance, such as the acquisition of Corus (United Kingdom) by Tata Steel, Jaguar Land Rover (United Kingdom) and Daewoo Commercial Vehicle Company (Republic of Korea) by Tata Motors, Tetley Tea (United Kingdom) by Tata Tea and Flag Telecom (United Kingdom) by Reliance Infocomm (Pradhan, 2008a; Pradhan and Abraham, 2005).

Table 1. Indian outward FDI flows and stocks, 1980–2014

Period or year	OFDI (\$ million)	OFDI as % of			Outward-investing firms (no.)
		Inward FDI flows/stock	Gross fixed capital formation	GDP	
<i>Cumulative OFDI flows</i>					
1980–84	16	5.97	0.01	0.00	60
1985–89	28	3.59	0.01	0.00	100
1990–94	101	4.90	0.03	0.01	496
1995–99	599	4.57	0.12	0.03	883
2000–04	7,641	30.82	1.07	0.28	1,350
2005–09	71,705	52.71	3.84	1.28	2,742
2010–14	48,416	32.19	1.98	0.51	4,576
Total	128,506	39.24	2.00	0.54	7,793
<i>OFDI stock</i>					
1990	124	7.49	0.15	0.04	169
1995	495	8.78	0.51	0.13	750
2000	1,733	10.61	1.58	0.37	1,658
2005	9,741	22.55	3.70	1.16	2,693
2010	96,901	47.14	16.80	5.68	5,140
2014	129,578	51.35	..	6.35	7,793

Source: Based on UNCTADSTAT (2015), available at <http://unctadstat.unctad.org/>; Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up To December 1993, New Delhi: Government of India.

Note: The number of outward-investing firms for cumulative OFDI flows was obtained by single-counting the names of firms undertaking outward investment during the respective period. For OFDI stock, the number of outward-investing firms was obtained by single-counting the names of outward-investing firms from 1980 to the year concerned. In calculating these numbers, 277 cases of OFDI ventures by individuals were excluded.

Indian firms are still relatively small in terms of production size when compared with developed-country multinational enterprises (MNEs) but are turning into truly global firms in terms of market focus. Pradhan and Aggarwal (2011) found that about 44-45 per cent of global sales well as assets of the top 15 outward-investing Indian firms were accounted for by foreign affiliates in 2009–10. Of seven outward-investing Indian firms for which geographical distribution of global sales was available, six were present in North America, in Europe, in Asia, and in the rest of the world in 2009–10, with no one region providing more than 50 per cent of global sales.¹ Clearly, a number of Indian firms have emerged as global firms in recent years, and some of them are less dependent on their home region (i.e. Asia) but more dependent on non-home regions.

With the continuation of current trends of policy liberalization and globalization, outward-investing Indian firms are expected to be more visible in world markets in the near future. As the number of Indian firms joining international production systems increases with the growing quantity of capital outflows, it becomes more important to measure the extent and impact of their activities on the host and home economies. Understanding the nature and patterns of Indian OFDI flows, the behaviour and strategies of Indian MNEs, and their determining forces may have important implications for growth and development at the sectoral level in both home and host countries.

2. Recent Developments in Indian Outward FDI Flows

The considerably increasing volumes of Indian OFDI flows in the past two decades are associated with a number of important structural transformations in their characteristics. What follows is an account of these distinctive changes in Indian OFDI flows.

2.1. Sectoral Diversification

With the participation of Indian firms from across all three sectors of the home economy, Indian cross-border investments have become sectorally broad based. The primary sector, which had hardly any presence in Indian OFDI flows during the 1980s and 1990s, accounted for as much as 19 per cent of such flows during 2000–09 (table 2). The services sector reclaimed its position as the leading OFDI sector during 2010–14, displacing manufacturing, which had dominated Indian

¹ The firms are Tata Motors Ltd., Suzlon Energy Ltd., Tata Chemicals Ltd., United Phosphorus Ltd., Wipro Ltd. and Dr. Reddy's Laboratories Ltd.

OFDI flows for two decades covering 1990–2009. The largest number of outward-investing firms originated from the services sector, at 4,407, followed by 2,356 firms from manufacturing and 270 from the primary sector.

The Primary Sector

Indian investments in the primary sector have evolved, largely led by Indian firms, both State- and privately owned, seeking to secure access to natural resources such as oil and gas. Over 87 per cent of Indian OFDI flows from the primary sector relate to the extraction of crude petroleum and natural gas (table 3). The key driving factors appear to be the significant surge in the price of crude oil since 1999 and acute competition among fast-growing emerging economies and high-energy-

Table 2. Sectoral composition of Indian OFDI flows, 1980–2014

Period	<i>Cumulative OFDI flows by sector of investing firms (\$ million and per cent)</i>				
	Primary	Manufacturing	Services	Others including diversified	All sectors
1980–89	–	56 (36.9)	82 (54.4)	13 (8.7)	152 (100)
1990–99	13 (0.4)	1,713 (51.1)	1,404 (41.9)	221 (6.6)	3,351 (100)
2000–09	12,181 (18.6)	25,895 (39.6)	23,133 (35.4)	4,158 (6.4)	65,368 (100)
2010–14	10,122 (6.0)	65,845 (39.2)	89,355 (53.2)	2,564 (1.5)	167,886 (100)
1980–2014	22,316 (9.4)	93,509 (39.5)	113,975 (48.1)	6,957 (2.9)	236,757 (100)
Memorandum items for the period 1980–2014:					
<i>Investing firms (no.)</i>	270	2,356	4,407	774	7,793
<i>Per firm outward investment (\$ million)</i>	83	40	26	9	30

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up To December 1993, New Delhi: Government of India.

Note: Data is on approval basis comprising remittances done by Indian firms for overseas investments under Automatic Route as well as those permitted under Approval Route; data for 2001 are only from January to March; data for 2002 are from October to December; and data for 2007 are from January to March and from July to December. The number of outward-investing firms for a source sector is obtained by single-counting names of firms that are undertaking outward investment from the sector during the respective period. The total number of outward-investing firms for all the sectors is not the sum total of the numbers of outward-investing firms from different sectors, as the same firm could have invested abroad in more than one sectors. Similarly, the total number of outward-investing firms for the study period 1980–2014 is not the sum total of the information pertaining to different sub-periods, as the same firm could have invested abroad during different sub-periods. In calculating the number of outward-investing firms, a number of cases of outward FDI ventures by individuals were excluded.

dependent developed countries for energy security (UNCTAD, 2007). Given India's high economic growth, expanding energy deficit and higher dependence on energy imports – including imports of petroleum – and the limited growth opportunity in the domestic crude petroleum and gas sector, India has proactively used State-owned petroleum and natural gas enterprises to undertake FDI in overseas oil and gas drilling activities. ONGC Videsh Limited, a public sector company, is the most aggressive player, leading the pack with its acquisition of a 15 per cent state in the Russian oil field of Vankor from Rosneft for \$1.3 billion in 2016, a 16 per cent stake in Mozambique's offshore Rovuma Area 1 for \$4.1 billion in 2013, all of Imperial Energy for \$2.1 billion in 2009, and a 20 per cent interest in the Sakhalin 1 oil and gas field for \$1.7 billion in 2001.

Table 3. Composition of Indian OFDI flows in primary sector, 1980–2014

<i>Cumulative OFDI flows by sector of investing firms (\$ million and per cent)</i>					
Period	Crop and animal production, hunting and related service activities	Extraction of crude petroleum and natural gas	Mining and quarrying	Other primary sector activities	Total primary sector
1990–99	4 (32.3)	5 (39.9)	2 (13.6)	2 (14.2)	13 (100)
2000–09	536 (4.4)	11,531 (94.7)	89 (0.7)	24 (0.2)	12,181 (100)
2010–14	1,279 (12.6)	7,891 (78.0)	936 (9.2)	17 (0.2)	10,122 (100)
1980–2014	1,820 (8.2)	19,427 (87.1)	1027 (4.6)	43 (0.2)	22,316 (100)
<i>Memorandum items for the period 1990–2014:</i>					
<i>Investing firms (no.)</i>	95	31	128	16	270
<i>Per firm outward investment (million)</i>	19	627	8	3	83

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up To December 1993, New Delhi: Government of India.

Note: Data is on approval basis comprising remittances done by Indian firms for overseas investments under Automatic Route as well as those permitted under Approval Route; data for 2001 are only from January to March; data for 2002 are from October to December; and data for 2007 are from January to March and from July to December. The number of outward-investing firms for a source sector is obtained by single-counting names of firms that are undertaking outward investment from the sector during the respective period. The total number of outward-investing firms for all the sectors is not the sum total of the numbers of outward-investing firms from different sectors, as the same firm could have invested abroad in more than one sectors. Similarly, the total number of outward-investing firms for the study period 1980–2014 is not the sum total of the information pertaining to different sub-periods, as the same firm could have invested abroad during different sub-periods. In calculating the number of outward-investing firms, a number of cases of outward FDI ventures by individuals were excluded.

The Manufacturing Sector

Indian manufacturing OFDI flows reflect two noticeable structural shifts since the 1980s. First, the rise of Indian manufacturing FDI has become widely spread across originating industries. Chemicals and chemical products accounted for more than half of Indian manufacturing OFDI flows during the 1980s (51.7 per cent), followed by coke and refined petroleum products, and food products, beverages and tobacco, each with a 9 per cent share, and paper and paper products with an 8 per cent share (table 4). These top four industries together, with a total share of 78 per cent, have dominated Indian manufacturing OFDI flows during 1980s. This concentrated pattern of Indian manufacturing OFDI flows has evolved into a more diversified one, with the share of the top four industries (basic metals and fabricated metal products, at 20.9 per cent; coke and refined petroleum products, at 20.7 per cent; pharmaceuticals, medicinal chemical and botanical products, at 13.9 per cent; and chemicals and chemical products, at 8.7 per cent) having declined to 64.2 per cent during 2010–14. Outward-investing firms from Indian manufacturing have emerged from a broader range of industrial activities, ranging from low-technology products such as food and textiles to high-technology products such as chemicals and pharmaceuticals. Second, Indian manufacturing OFDI flows are being increasingly led by comparatively technology-intensive industries. Excluding chemicals and chemical products, the combined share of remaining technology-intensive industries (i.e. pharmaceuticals; medicinal chemical and botanical products; motor vehicles, trailers and other transport equipment; machinery and equipment n.e.c.; electrical equipment; and computer, electronic and optical products) rose significantly, from 10.9 per cent during 1980–89 to 31.8 per cent during 2010–14. A rapidly growing home economy may be facilitating technologically capable manufacturing firms – for example, in pharmaceuticals or transport equipment – to seek exploitation of their ownership advantages in overseas markets or to support exports from India by establishing sales and marketing networks abroad. In part, such manufacturing OFDI flows could also be of the efficiency-seeking type, motivated to leverage the superior locational advantages offered by host countries.

The Services Sector

The services sector hosts the largest number of outward-investing firms from India. This fact may not be surprising, as India emerged as a services-dominated economy and economic growth since the 1980s has been led primarily by services, notwithstanding the low level of per capita income. Technological progress, improving telecommunication infrastructure and the availability of low-cost, highly skilled human resources are adding to the global competitiveness of India in broad areas of services covering information and communication technology (ICT), ICT-enabled services, contract R&D, legal services, business services and the like. An

Table 4. Indian manufacturing OFDI flows, 1980–2014

Industry name	Cumulative OFDI flows by industries of investing firms (\$ million and per cent)					Memorandum items for the period 1980–2014:	
	1980–89	1990–99	2000–09	2010–14	1980–2014	Investing firms (no.)	Per firm outward investment (\$ million)
Basic metals and fabricated metal products	3 (4.5)	159 (9.3)	2,164 (8.4)	13,775 (20.9)	16,100 (17.2)	315	51
Chemicals and chemical products	29 (51.7)	394 (23.0)	2,502 (9.7)	5,725 (8.7)	8,650 (9.3)	343	25
Coke and refined petroleum products	5 (9.4)	179 (10.5)	1,332 (5.1)	13,645 (20.7)	15,161 (16.2)	36	421
Computer, electronic and optical products	0.01 (0.0)	311 (18.2)	1,322 (5.1)	2,006 (3.0)	3,639 (3.9)	154	24
Electrical equipment	1 (2.4)	30 (1.8)	476 (1.8)	2,539 (3.9)	3,047 (3.3)	145	21
Food products, beverages and tobacco	5 (8.7)	91 (5.3)	1,405 (5.4)	2,776 (4.2)	4,278 (4.6)	207	21
Gems and jewelry	–	12 (0.7)	368 (1.4)	1,098 (1.7)	1,478 (1.6)	69	21
Leather and related products	2 (4.3)	18 (1.1)	17 (0.1)	309 (0.5)	347 (0.4)	42	8
Machinery and equipment n.e.c.	1 (2.0)	43 (2.5)	3,719 (14.4)	4,800 (7.3)	8,563 (9.2)	177	48
Motor vehicles, trailers and other transport equipment	1 (1.8)	8 (0.5)	5,573 (21.5)	2,419 (3.7)	8,001 (8.6)	104	77
Other non-metallic mineral products	0.03 (0.1)	77 (4.5)	222 (0.9)	1,560 (2.4)	1,859 (2.0)	60	31
Paper and paper products	5 (8.1)	3 (0.2)	156 (0.6)	1,443 (2.2)	1,607 (1.7)	19	85
Pharmaceuticals, medicinal chemical and botanical products	3 (4.7)	186 (10.9)	4,404 (17.0)	9,154 (13.9)	13,747 (14.7)	153	90
Printing and reproduction of recorded media	–	3 (0.1)	40 (0.2)	9 (0.0)	52 (0.1)	29	2
Rubber and plastics products	0.5 (0.9)	43 (2.5)	928 (3.6)	1,437 (2.2)	2,408 (2.6)	123	20
Textiles and wearing apparel	1 (1.2)	114 (6.7)	961 (3.7)	2,768 (4.2)	3,845 (4.1)	220	17
Wood, products of wood and cork, straw and plaiting materials	–	3 (0.2)	6 (0.0)	75 (0.1)	84 (0.1)	19	4
Other manufacturing	0.2 (0.3)	38 (2.2)	299 (1.2)	306 (0.5)	643 (0.7)	150	4
Total manufacturing	56 (100)	1,713 (100)	25,895 (100)	65,845 (100)	93,509 (100)	2,356	40

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IC, Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up to December 1993, New Delhi: Government of India.

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Data is on approval basis comprising remittances done by Indian firms for overseas investments under Automatic Route as well as those permitted under Approval Route; data for 2001 are only from January to March; data for 2002 are from October to December; and data for 2007 are from January to March and from July to December. The number of outward-investing firms for a source sector is obtained by single-counting names of firms that are undertaking outward investment from the sector during the respective period. The total number of outward-investing firms for all the sectors is not the sum total of the numbers of outward-investing firms from different sectors, as the same firm could have invested abroad in more than one sectors. Similarly, the total number of outward-investing firms for the study period 1980–2014 is not the sum total of the information pertaining to different sub-periods, as the same firm could have invested abroad during different sub-periods. In calculating the number of outward-investing firms, a number of cases of outward FDI ventures by individuals were excluded.

Table 5. Indian services OFDI flows, 1980–2014

Industry name	Cumulative OFDI flows by services of investing firms (\$ million and per cent)					Memorandum items for the period 1980–2014:	
	1980–89	1990–99	2000–09	2010–14	1980–2014	Investing firms (no.)	Per firm outward investment (\$ million)
Accommodation and food service	10 (11.7)	176 (12.6)	155 (0.7)	803 (0.9)	1,144 (1.0)	97	11.8
Administrative and support services	1 (1.0)	38 (2.7)	928 (4.0)	4,541 (5.1)	5,508 (4.8)	596	9.2
Communication services	–	560 (39.9)	3,361 (14.5)	37,046 (41.5)	40,968 (35.9)	153	267.8
Construction	3 (3.2)	117 (8.3)	2,149 (9.3)	9,928 (11.1)	12,198 (10.7)	316	38.6
Education	–	1 (0.1)	37 (0.2)	125 (0.1)	162 (0.1)	53	3.1
Electricity, gas and water	–	1 (0.0)	1,290 (5.6)	3,866 (4.3)	5,156 (4.5)	79	65.3
Financial and insurance activities	56 (68.5)	113 (8.0)	2,515 (10.9)	6,850 (7.7)	9,534 (8.4)	416	22.9
Human health activities	–	8 (0.6)	70 (0.3)	1,267 (1.4)	1,345 (1.2)	89	15.1
IT and IT-enabled service, including software publishing	8 (9.1)	183 (13.0)	6,779 (29.3)	6,541 (7.3)	13,510 (11.9)	1,172	11.5
Legal and accounting activities	–	5 (0.4)	73 (0.3)	413 (0.5)	492 (0.4)	182	2.7
Professional, scientific and technical activities	0.2 (0.3)	22 (1.6)	426 (1.8)	1,899 (2.1)	2,348 (2.1)	157	15.0
Real estate activities	0.1 (0.2)	3 (0.2)	671 (2.9)	813 (0.9)	1,488 (1.3)	113	13.2
Transportation and storage	1 (1.6)	16 (1.2)	1,879 (8.1)	6,743 (7.5)	8,639 (7.6)	133	65.0
Wholesale and retail trade	3 (4.1)	155 (11.1)	1,924 (8.3)	6,220 (7.0)	8,303 (7.3)	673	12.3
Other service	0.3 (0.4)	5 (0.4)	876 (3.8)	2,299 (2.6)	3,181 (2.8)	182	17.5
Total services	82 (100)	1,404 (100)	23,133 (100)	89,355 (100)	113,975 (100)	4,407	26

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up to December 1993, New Delhi: Government of India.

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increasing number of Indian services firms are internationalizing because of their growing competitiveness. As a result, India has seen a sustained increase in market-seeking OFDI flows in services since the 1980s. Indian service providers in a number of activities, including those in ICT and ICT-enabled service, cannot provide effective and secure services along with adequate after-sales support without having a local presence in overseas markets.

The composition of India's services OFDI flows in the 1980s was heavily concentrated in financial and insurance activities, with more than two thirds of the flows (68.5 per cent), followed by accommodation and food service with 11.7 per cent and IT and IT-enabled services, including software publishing, with 9 per cent (table 5). By 2010–14, communication services had become the leading source with a 41.5 per cent share, followed by construction with 11 per cent, financial and insurance activities with 7.7 per cent, transportation and storage with 7.5 per cent, and IT and IT-enabled service, including software publishing, with 7.3 per cent.

2.2. Geographical Distribution

The geography of India's OFDI flows has overcome the hesitation of Indian firms to invest in developed regions that was observed during the 1980s. In that decade, less than one-fourth of such flows went to developed regions and the remaining, dominant share went to developing and transition regions (table 6). Indian firms possessing modest technological advantages, derived from reverse engineering and adaptive R&D activities related to imported technologies for cost-effective manufacturing, were generally more attracted to developing and transition economies that were similar to India in terms of level of development and business environment.

However, the role of developed economies as hosts to Indian OFDI flows has greatly increased, with their share rising to the highest level ever observed – 49.5 per cent during 2000–09. The increase in the number of Indian firms entering developed regions is driven by firm-specific objectives of exploitation and acquisition of intangible assets. The technological capabilities of Indian firms in a number of manufacturing industries such as pharmaceuticals, automotive, and steels have improved, thus driving them to seek access to the large, competitive markets of developed economies. Moreover, Indian firms have resorted to M&As to acquire new technologies, skills and marketing networks overseas, and developed economies with an abundance of such resources are natural targets of these M&As. Indian services OFDI flows, specifically from ICT and ICT-enabled services, have also been driven more to developed regions.

Transition economies, mainly led by the Russian Federation and Kazakhstan, saw their share of Indian OFDI flows falter, dropping to a historically low level of less than 1 per cent during 2010–14 from the 19 per cent observed during 1980–99.

Table 6. Geographical distribution of Indian OFDI flows, 1980–2014

Period	<i>Cumulative OFDI flows (\$ million and per cent)</i>			
	Developing region	Transition region	Developed region	All regions
1980–89	86 (56.9)	29 (19.4)	36 (23.7)	152 (100)
1990–99	1,793 (53.5)	81 (2.4)	1,476 (44.1)	3,351 (100)
2000–09	30,721 (47.0)	2,316 (3.5)	32,331 (49.5)	65,368 (100)
2010–14	100,494 (59.9)	1,304 (0.8)	66,088 (39.4)	167,886 (100)
1980–2014	133,095 (56.2)	3,730 (1.6)	99,931 (42.2)	236,757 (100)
Memorandum items for the period 1980–2014:				
<i>Investing firms (no.)</i>	4,752	144	3,992	7,793
<i>Per firm outward investment (\$ million)</i>	28	26	25	30

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up To December 1993, New Delhi: Government of India.

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A long-term view of Indian OFDI flows to developing regions reveals a significant shift in their spatial distribution. During 1980–99, the majority of Indian OFDI flows destined to developing regions went to developing Asia, accounting for an average 75.5 per cent of the total flows (table 7). Developing economies such as Singapore and the United Arab Emirates turn out to be the largest host countries largely because of their geographical proximity, the similarity of their business environments, and their strong historical and cultural relationship with India. However, the share of developing Asia in Indian OFDI directed at developing regions has steadily declined, to 49 per cent during 2010–14. Africa's share in Indian OFDI flows into developing regions, by contrast, increased to 37.6 per cent during 2010–14 from 17.7 per cent during 1990–99. Indian OFDI flows into Africa are mainly driven by large inflows into

Mauritius, which is increasingly acting as a gateway for Indian firms to target Africa. In addition to closer historical relations with India, Mauritius offers the fastest-growing economy; a pro-business climate; a well-developed physical, financial and digital network infrastructure and preferential access to African markets. The share of Latin America and the Caribbean in Indian OFDI flows jumped from less than 2 per cent during 1990–99 to 13 per cent during 2010–14, owing to the attraction of the tax haven of the British Virgin Islands.

Indian investments in developed regions have surged since the 1980s, with a distinct shift in favour of Europe. The share of Europe in Indian OFDI flows into developed regions increased from 51.7 per cent during 1980–89 to 75.5 per cent during 2010–14 (table 8). By contrast, North America saw its share decline from 48.3 per cent to 18.2 per cent between these periods. The increased share of Europe largely reflects the expansion by Indian firms of their overseas operations in European markets as a strategy for reducing their disproportionate focus on the United States market. This is particularly true for Indian ICT, pharmaceutical, automotive and steel companies that are undertaking M&As as well as greenfield investments in European countries as part of their geographical diversification strategies. It is important to note that these transformations in outflows to developed regions have taken place with two major traditional developed-host economies, namely the United States in North America and the United Kingdom in Europe, registering significant declines in their share between 1980–89 and 2010–14. However, the Netherlands and Switzerland have achieved rising shares of Indian OFDI flows to developed regions during the recent periods.

It is clear that Indian OFDI flows are dominated by economies considered to have an advantageous fiscal regime such as Mauritius, Singapore, the British Virgin Islands, the Netherlands, Switzerland and Cyprus. In addition to possessing favourable treaties covering bilateral investment, double-taxation avoidance or comprehensive economic partnerships with India, many of these countries also offer low tax rates and access to international financial markets in order to attract Indian firms. As such economies are less likely to be the ultimate destination of Indian OFDI flows, one part of such flows may be redirected to other countries while another part could be round-tripping, i.e. coming back to India as FDI inflows. Therefore, the regional distribution of Indian OFDI flows should be interpreted with caution.

Table 7. Indian FDI flows into developing economies, 1980–2014

Region/country	<i>Cumulative OFDI flows (\$ million and per cent)</i>					<i>Memorandum items for the period 1980–2014:</i>	
	1980–89	1990–99	2000–09	2010–14	1980–2014	Investing firms (no.)	Per firm outward investment (\$ million)
Africa	25 (29.4)	317 (17.7)	9,918 (32.3)	37,752 (37.6)	48,012 (36.1)	1,126	43
Eastern Africa	5 (5.7)	226 (12.6)	8,242 (26.8)	36,903 (36.7)	45,376 (34.1)	846	54
Ethiopia	–	–	12 (0.0)	57 (0.1)	68 (0.1)	59	1
Kenya	1 (0.8)	13 (0.7)	138 (0.4)	19 (0.0)	170 (0.1)	72	2
Mauritius	0 (0.5)	201 (11.2)	8,019 (26.1)	34,083 (33.9)	42,303 (31.8)	596	71
Mozambique	–	–	18 (0.1)	2,655 (2.6)	2,674 (2.0)	25	107
Middle Africa	–	–	74 (0.2)	32 (0.0)	106 (0.1)	16	7
Northern Africa	1 (1.3)	41 (2.3)	1,119 (3.6)	433 (0.4)	1,594 (1.2)	56	28
Egypt	1 (1.3)	8 (0.5)	445 (1.4)	155 (0.2)	609 (0.5)	27	23
Sudan	–	–	525 (1.7)	14 (0.0)	539 (0.4)	9	60
Southern Africa	–	22 (1.2)	177 (0.6)	257 (0.3)	456 (0.3)	138	3
South Africa	–	21 (1.2)	159 (0.5)	237 (0.2)	416 (0.3)	125	3
Western Africa	19 (22.4)	29 (1.6)	306 (1.0)	126 (0.1)	480 (0.4)	156	3
The Americas	0 (0.2)	31 (1.7)	2,956 (9.6)	13,127 (13.1)	16,114 (12.1)	291	55
Caribbean	–	3 (0.2)	2,163 (7.0)	10,638 (10.6)	12,805 (9.6)	140	91
British Virgin Islands	–	–	1,904 (6.2)	7,460 (7.4)	9,364 (7.0)	99	95
Cayman Islands	–	–	184 (0.6)	3,023 (3.0)	3,207 (2.4)	30	107
Central America	0 (0.2)	9 (0.5)	211 (0.7)	2,261 (2.2)	2,480 (1.9)	73	34
Panama	0 (0.2)	3 (0.2)	121 (0.4)	2,211 (2.2)	2,335 (1.8)	22	106
South America	–	19 (1.1)	582 (1.9)	228 (0.2)	829 (0.6)	101	8
Brazil	–	3 (0.1)	505 (1.6)	101 (0.1)	609 (0.5)	75	8
Asia	61 (70.3)	1,445 (80.6)	17,845 (58.1)	49,608 (49.4)	68,958 (51.8)	3,826	18
Eastern Asia	–	470 (26.2)	859 (2.8)	2,367 (2.4)	3,696 (2.8)	548	7

Table 7. Indian FDI flows into developing economies, 1980–2014 (concluded)

Region/country	Cumulative OFDI flows (\$ million and per cent)					Memorandum items for the period 1980–2014:	
	1980–89	1990–99	2000–09	2010–14	1980–2014	Investing firms (no.)	Per firm outward investment (\$ million)
China	–	27 (1.5)	293 (1.0)	295 (0.3)	615 (0.5)	177	3
Hong Kong (China)	–	443 (24.7)	509 (1.7)	1528 (1.5)	2,480 (1.9)	362	7
Korea, Rep. of	–	1 (0.0)	2 (0.0)	542 (0.5)	545 (0.4)	20	27
Southern Asia	15 (17.2)	230 (12.8)	521 (1.7)	1,198 (1.2)	1,964 (1.5)	608	3
Sri Lanka	8 (8.7)	91 (5.0)	322 (1.0)	722 (0.7)	1,142 (0.9)	295	4
South-Eastern Asia	38 (44.4)	285 (15.9)	12,625 (41.1)	36,589 (36.4)	49,538 (37.2)	1,815	27
Indonesia	2 (2.4)	26 (1.5)	234 (0.8)	680 (0.7)	943 (0.7)	132	7
Malaysia	7 (8.1)	60 (3.3)	164 (0.5)	663 (0.7)	894 (0.7)	194	5
Singapore	24 (27.3)	158 (8.8)	11,525 (37.5)	34,685 (34.5)	46,392 (34.9)	1,403	33
Thailand	6 (6.4)	35 (2.0)	311 (1.0)	194 (0.2)	546 (0.4)	128	4
Western Asia	7 (8.6)	460 (25.7)	3,839 (12.5)	9454 (9.4)	13,760 (10.3)	1,388	10
Oman	0 (0.3)	141 (7.9)	159 (0.5)	572 (0.6)	872 (0.7)	106	8
Saudi Arabia	1 (0.6)	42 (2.4)	132 (0.4)	495 (0.5)	670 (0.5)	53	13
United Arab Emirates	2 (1.8)	240 (13.4)	3,345 (10.9)	7,861 (7.8)	11,448 (8.6)	1,164	10
Oceania	0 (0.1)	–	3 (0.0)	8 (0.0)	11 (0.0)	8	1
Total, developing regions	86 (100)	1,793 (100)	30,721 (100)	100,494 (100)	133,095 (100)	4,752	28

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up To December 1993, New Delhi: Government of India.

Note: Only leading host countries by region are shown. Data is on approval basis comprising remittances done by Indian firms for overseas investments under Automatic Route as well as those permitted under Approval Route; data for 2001 are only from January to March; data for 2002 are from October to December; and data for 2007 are from January to March and from July to December. The number of outward-investing firms for a host region is obtained by single-counting names of firms that have undertaken outward investment in the said host region during the respective period. The total number of outward-investing firms for all the regions is not the sum of the numbers of outward-investing firms from different regions, as the same firm could have invested abroad in more than one host regions. Similarly, the total number of outward-investing firms for the study period 1980–2014 is not the sum total of the information pertaining to different sub-periods, as the same firm could have invested abroad during different sub-periods. In calculating the number of outward-investing firms, a number of cases of outward FDI ventures by individuals were excluded.

Table 8. Indian OFDI flows into developed economies, 1980–2014

Region/country	<i>Cumulative OFDI flows (\$ million and per cent)</i>					<i>1980–2014</i>	
	1980–89	1990–99	2000–09	2010–14	1980–2014	Investing firms (no.)	Per firm investment (\$ million)
Northern America	17 (48.3)	404 (27.4)	7,182 (22.2)	12,032 (18.2)	19,636 (19.6)	2,433	8
Bermuda	–	16 (1.1)	820 (2.5)	430 (0.7)	1,265 (1.3)	12	105
Canada	–	5 (0.3)	598 (1.8)	600 (0.9)	1,202 (1.2)	132	9
United States	17 (48.3)	384 (26.0)	5,764 (17.8)	11,003 (16.6)	17,168 (17.2)	2,340	7
Asia	–	40 (2.7)	75 (0.2)	107 (0.2)	222 (0.2)	88	3
Israel	–	25 (1.7)	12 (0.0)	32 (0.0)	69 (0.1)	16	4
Japan	–	15 (1.0)	63 (0.2)	75 (0.1)	153 (0.2)	73	2
Europe	19 (51.7)	1,028 (69.7)	24,295 (75.1)	49,866 (75.5)	75,208 (75.3)	1,871	40
Austria	–	37 (2.5)	30 (0.1)	5 (0.0)	72 (0.1)	22	3
Belgium-Luxembourg	–	17 (1.1)	367 (1.1)	937 (1.4)	1,321 (1.3)	93	14
Channel Islands	–	–	35 (0.1)	783 (1.2)	818 (0.8)	12	68
Cyprus	–	20 (1.3)	5,240 (16.2)	2,109 (3.2)	7,369 (7.4)	114	65
Denmark	–	–	706 (2.2)	362 (0.5)	1,068 (1.1)	12	89
France	–	3 (0.2)	312 (1.0)	195 (0.3)	511 (0.5)	68	8
Germany	0 (0.6)	24 (1.6)	298 (0.9)	449 (0.7)	771 (0.8)	266	3
Ireland	–	38 (2.6)	82 (0.3)	488 (0.7)	608 (0.6)	29	21
Isle of Man	–	–	480 (1.5)	138 (0.2)	618 (0.6)	14	44
Italy	–	12 (0.8)	195 (0.6)	128 (0.2)	334 (0.3)	59	6
Netherlands	–	57 (3.9)	5,469 (16.9)	34,233 (51.8)	39,759 (39.8)	234	170
Spain	–	1 (0.0)	220 (0.7)	405 (0.6)	626 (0.6)	38	16

Table 8. Indian OFDI flows into developed economies, 1980–2014 (concluded)

Region/country	Cumulative OFDI flows (\$ million and per cent)					1980–2014	
	1980–89	1990–99	2000–09	2010–14	1980–2014	Investing firms (no.)	Per firm investment (\$ million)
Switzerland	0 (1.0)	7 (0.5)	865 (2.7)	3,564 (5.4)	4,436 (4.4)	113	39
United Kingdom	17 (48.5)	798 (54.0)	9,723 (30.1)	5,829 (8.8)	16,367 (16.4)	949	17
Oceania	–	3 (0.2)	779 (2.4)	4,083 (6.2)	4,866 (4.9)	226	22
Australia	–	3 (0.2)	775 (2.4)	4,070 (6.2)	4,849 (4.9)	206	24
Developed economies	36 (100)	1,476 (100)	32,331 (100)	66,088 (100)	99,931 (100)	3,992	25

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up To December 1993, New Delhi: Government of India.

Note: Only leading host countries by region are shown. Data is on approval basis comprising remittances done by Indian firms for overseas investments under Automatic Route as well as those permitted under Approval Route; data for 2001 are only from January to March; data for 2002 are from October to December; and data for 2007 are from January to March and from July to December. The number of outward-investing firms for a host region is obtained by single-counting names of firms that have undertaken outward investment in the said host region during the respective period. The total number of outward-investing firms for all the regions is not the sum of the numbers of outward-investing firms from different regions, as the same firm could have invested abroad in more than one host regions. Similarly, the total number of outward-investing firms for the study period 1980–2014 is not the sum total of the information pertaining to different sub-periods, as the same firm could have invested abroad during different sub-periods. In calculating the number of outward-investing firms, a number of cases of outward FDI ventures by individuals were excluded.

2.3. Ownership Choices

The long-term shift in the preference of Indian firms for wholly owned subsidiaries (WOSs) relative to joint ventures (JVs) is also distinctly apparent in the composition of Indian OFDI flows. JVs accounted for close to two thirds of Indian OFDI flows during 1980–89 (63 per cent), reflecting the fact that Indian firms with their modest technological advantages and inadequate experience in operating cross-border businesses at that time overwhelmingly chose joint ownership as the more preferred choice of internationalization (table 9). JVs provided these firms with a less risky mode for trans-border expansion when a local partner is participating in the proposed ventures by contributing capital, management and information on the local market and regulatory environment. WOSs emerged as the largest form of Indian OFDI flows during 2010–14, accounting for 69 per cent, more than double their share during 1980–89 (32.6 per cent). The choice of Indian firms to resort overwhelmingly to WOSs in recent periods is due to a number of factors, including the need to

protect firm-specific assets that are getting sophisticated due to indigenous R&D and M&As, liberalization of home-country OFDI policy permitting full ownership and the investment climate turning favourable at the global level.

The ownership choices of Indian firms as revealed by the composition of OFDI flows also exhibit interesting regional differences. For the period 1980–99, JVs and WOSs had equal shares in Indian OFDI flows to developing regions, but WOSs accounted for the dominant share going to developed regions (table 10). In the case of flows

Table 9. Ownership choices in Indian investment abroad, 1980–2014

Ownership choice	1980–89	1990–99	2000–09	2010–14	1980–2014
<i>Cumulative OFDI flows associated with JVs or WOSs (\$ million and per cent)</i>					
Joint ventures	95 (62.7)	1,285 (38.4)	15,243 (23.3)	52,270 (31.1)	68,894 (29.1)
Wholly owned subsidiaries	49 (32.6)	2,065 (61.6)	50,118 (76.7)	115,616 (68.9)	167,849 (70.9)
Unclassified	7 (4.7)	0.2 (0.0)	7 (0.0)	–	14 (0.0)
Total	152 (100)	3,351 (100)	65,368 (100)	167,886 (100)	236,757 (100)
<i>Outward-investing firms undertaking JVs or WOSs (no.)</i>					
Joint ventures	88	647	1,285	1,622	3,123
Wholly owned subsidiaries	34	714	2,735	3,395	5,592
Unclassified	49	1	3	–	53
Total	146	1,250	3,603	4,576	7,793
<i>Per firm outward investment associated with JVs or WOSs (\$ million)</i>					
Joint ventures	1	2	12	32	22
Wholly owned subsidiaries	1	3	18	34	30
Unclassified	0.1	0.2	2	–	0.3
Total	1	3	18	37	30

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up To December 1993, New Delhi: Government of India.

Note: Data is on approval basis comprising remittances done by Indian firms for overseas investments under Automatic Route as well as those permitted under Approval Route; data for 2001 are only from January to March; data for 2002 are from October to December; and data for 2007 are from January to March and from July to December. The number of outward-investing firms undertaking JV (or WOS) is obtained by single-counting names of firms that are undertaking outward investment for JV (or WOS) during the respective period. In the case of number of Indian investing firms, the sum of the JVs and WOS is not equal to total because a given Indian firm may undertake a JV and WOS simultaneously. Similarly, the total number of outward-investing firms for the study period 1980–2014 is not the sum total of the information pertaining to different sub-periods, as the same firm could have invested abroad during different sub-periods. In calculating the number of outward-investing firms, a number of cases of outward FDI ventures by individuals were excluded.

to transition economies, in contrast, JVs were the primary choice. The contrasting ownership choices of Indian firms across developed, developing and transition host economies could be due to regional differences in the nature of overseas operations undertaken by these firms.

Indian FDI projects in developed regions during 1980–99 predominantly consisted of services activities in trading, consultancy, hotel, software and financial services, and the like, while projects in developing regions were directed at manufacturing activities (Pradhan, 2008a, 2008c). The majority of these services activities require relatively fewer resources (relatively low capital intensity), unlike manufacturing operations, and investing companies were capable of meeting the financial commitment of these OFDI projects on their own. Also, services such as software and financial services involve close relationships with clients, personalized services and confidentiality of information, which make WOSs more attractive to Indian investing firms as a mode of overseas expansion than JVs in developed regions. In contrast, JVs provided a relatively less risky mode for Indian manufacturing firms entering developing regions, given the joint contribution of investments and other resources with local firms.

The ownership pattern of Indian investments by host region have changed over time, partly in response to the diversifying sectoral composition of such investments. Compared with 1980–99, for example, the share of WOSs in Indian investments in developing regions has risen to 80.5 per cent during 2000–14, while the share of JVs has decreased to less than 20 per cent (table 10). WOSs continued to dominate Indian OFDI flows into developed regions but were of less importance than before, given the increase in the share of JVs to 39 per cent. As outward investment by Indian manufacturing firms in developed regions and by Indian services firms in developing regions have been gaining momentum in recent periods, the relative importance of WOSs relative to JVs has been changing for these host locations.

2.4. Enterprise Type

In terms of the distribution of Indian OFDI flows by types of enterprises, the universe of overseas investing Indian firms is becoming dominated by the rise of domestic business groups. The share of such groups in Indian investment abroad had increased considerably, from 42 to 71 per cent, between the periods 1980–89 and 2010–14, while the share of stand-alone firms (i.e. firms that are not affiliated with any domestic business groups) declined from 20.5 to 7.9 per cent (table 11). Responding to continuing liberalization and increased competitive pressures, Indian domestic business groups have bolstered their overseas business operations more than stand-alone firms. Growing competition is driving these business groups – which possess superior bundles of competitive assets as compared with stand-alone firms (Pradhan and Singh, 2011) – to look at overseas markets through greater outward investments. The share of State-owned enterprises in Indian OFDI flows stayed at

Table 10. Ownership structure of regional Indian OFDI flows, 1980–2014

Region/country	Cumulative OFDI flows (\$ million and per cent)							
	1980–99			2000–14				
	Joint ventures	Wholly owned subsidiaries	Unclassified	Total	Joint ventures	Wholly owned subsidiaries	Unclassified	Total
Developing economies	932 (49.6)	942 (50.1)	6 (0.3)	1,880 (100)	25,582 (19.5)	105,627 (80.5)	7 (0.0)	131,215 (100)
Africa	152 (44.5)	188 (54.9)	2 (0.6)	343 (100)	5,678 (11.9)	41,985 (88.1)	7 (0.0)	47,670 (100)
Latin America and Caribbean	29 (94.5)	2 (5.5)	–	31 (100)	2,890 (18.0)	13,193 (82.0)	–	16,083 (100)
Asia	750 (49.8)	752 (49.9)	4 (0.3)	1,506 (100)	17,014 (25.2)	50,438 (74.8)	0.1 (0.0)	67,452 (100)
Oceania	0.1 (100.0)	–	–	0.1 (100)	1 (4.9)	10 (95.1)	–	10 (100)
Economies in transition	102 (92.4)	8 (7.6)	–	110 (100)	3,232 (89.3)	388 (10.7)	–	3,620 (100)
Asia	71 (96.0)	3 (4.0)	–	74 (100)	851 (83.9)	163 (16.1)	–	1,015 (100)
Europe	31 (85.1)	5 (14.9)	–	36 (100)	2,380 (91.4)	225 (8.6)	–	2,605 (100)
Developed economies	347 (22.9)	1,164 (77.0)	1 (0.1)	1,512 (100)	38,700 (93.3)	59,719 (60.7)	0.1 (0.0)	98,419 (100)
Northern America	155 (36.9)	266 (63.0)	1 (0.1)	422 (100)	4,970 (25.9)	14,244 (74.1)	0.1 (0.0)	19,214 (100)
Asia	36 (88.9)	4 (11.1)	–	40 (100)	80 (44.1)	102 (55.9)	–	182 (100)
Europe	36 (88.9)	4 (11.1)	–	40 (100)	80 (44.1)	102 (55.9)	–	182 (100)
All regions	1,381 (39.4)	2,114 (60.4)	7 (0.2)	3,502 (100)	67,513 (28.9)	165,734 (71.1)	7 (0.0)	233,254 (100)

Source: Based on Reserve Bank of India (various years). Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years); Joint ventures and wholly owned subsidiaries abroad, New Delhi: IC; Ministry of Commerce (1994). Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up to December 1993, New Delhi: Government of India.

Only leading host countries by region are shown. Data is on approval basis comprising remittances done by Indian firms for overseas investments under Automatic Route as well as those permitted under Approval Route; data for 2001 are only from January to March; data for 2002 are from October to December; and data for 2007 are from January to March and from July to December. The number of outward-investing firms undertaking JV (or WOS) is obtained by single-counting names of firms that are undertaking outward investment for JV (or WOS) during the respective period. In the case of number of Indian investing firms, the sum of the JVs and WOS is not equal to total because a given Indian firm may undertake a JV and WOS simultaneously. Similarly, the total number of outward-investing firms for the study period 1980–2014 is not the sum total of the information pertaining to different sub-periods, as the same firm could have invested abroad during different sub-periods. In calculating the number of outward-investing firms, a number of cases of outward FDI ventures by individuals were excluded.

10 per cent or less, largely targeted at securing access to energy resources. Overall, it is clear that the bulk of Indian OFDI flows is led by privately owned enterprises, while State-owned enterprises play a modest role.

It is important to note that different categories of Indian outward-investing firms differ markedly in terms of their geographical spread over time. Firms affiliated with domestic business groups were heavily focused on developing markets, which attracted as much as 71.4 per cent of their OFDI flows during 1980–99 (table 12). These firms began to invest an increasing proportion of their overseas investments in developed regions during 2000–14, with the share rising to 42 per cent from 26 per cent in the past. In contrast, stand-alone firms, after directing the major share of their OFDI to developed regions during the initial periods of the 1980s–1990s, invested more in developing regions than in any other region during 2000–14. Most OFDI by State-owned firms went to developing regions initially; however, the growing importance of economies in transition and developed regions during 2000–14 is also notable.

In terms of sectoral operations, services constituted a larger component of OFDI by stand-alone enterprises, accounting for 53 per cent, whereas manufacturing overwhelmingly dominated OFDI by domestic business groups, accounting for 65.5 per cent during 1980–99 (table 13). Since 2000–14, stand-alone firms have made a strong push towards manufacturing in their OFDI activities and as a result, the share of manufacturing (49 per cent) has slightly surpassed that of services (45 per cent). In contrast, services have received increasing focus from domestic business groups in their OFDI operations, whose share stood at 50 per cent, modestly exceeding the 45 per cent share of manufacturing. It is clear that stand-alone and domestic business groups are becoming increasingly involved in both manufacturing and services activities in their overseas investments whereas their FDI in primary sector remains low. State-owned enterprises invested in manufacturing and services overseas during 1980–99, but the primary sector became the dominant sector, with 75 per cent of OFDI during 2000–14. This reflects the strategy of State-owned firms using OFDI as a means of securing energy resources abroad.

2.5. Firm Size

The patterns of Indian OFDI flows by enterprise size confirm that large Indian firms are the biggest outward investors. The share of large firms in OFDI flows has increased consistently, from 64.4 per cent during 1980–89 to 83.6 per cent during 2010–14 (table 14). Small and medium-size Indian firms respectively accounted for only 1.8 and 0.7 per cent of Indian OFDI flows during 1980–2014. This supports the view that large firms that have advantages in terms of tangible and intangible resources are more capable of easily offsetting the sunk costs and meeting the risks involved in investing abroad. Although the number of small and medium-size Indian firms investing abroad is growing, they tend to invest in small-value projects.

Table 11. Types of enterprises involved in Indian investment abroad, 1980–2014

Enterprise type	1980–89	1990–99	2000–09	2010–14	1980–2014
<i>Cumulative OFDI flows associated with JVs or WOSs (\$ million and per cent)</i>					
Domestic stand-alone	31 (20.5)	247 (7.4)	6,309 (9.7)	13,268 (7.9)	19,855 (8.4)
Domestic business groups	64 (42.4)	2,011 (60.0)	38,991 (59.6)	119,843 (71.4)	160,910 (68.0)
State-owned enterprises ^a	11 (7.5)	133 (4.0)	6,733 (10.3)	10,724 (6.4)	17,602 (7.4)
Foreign affiliates	2 (1.3)	136 (4.1)	2,226 (3.4)	2,088 (1.2)	4,452 (1.9)
Unclassified	43 (28.4)	823 (24.6)	11,108 (17.0)	21,964 (13.1)	33,938 (14.3)
All enterprises	152 (100)	3,351 (100)	65,368 (100)	167,886 (100)	236,757 (100)
<i>Outward-investing firms (no.)</i>					
Domestic stand-alone	19	239	623	610	1,121
Domestic business groups	61	295	561	566	941
State-owned enterprises ^a	9	15	19	20	42
Foreign affiliates	6	28	63	56	96
Unclassified	51	674	2,341	3,327	5,602
All enterprises	146	1,250	3,603	4,576	7,793
<i>Per firm outward investment (\$ million)</i>					
Domestic stand-alone	2	1	10	22	18
Domestic business groups	1	7	70	212	171
State-owned enterprises ^a	1	9	354	536	419
Foreign affiliates	0.3	5	35	37	46
Unclassified	1	1	5	7	6
All enterprises	1	3	18	37	30

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up To December 1993, New Delhi: Government of India.

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^a Including co-operatives and enterprises run on public-private partnership modes.

Table 12. Types of enterprise and regional direction of Indian OFDI flows, 1980–2014

Enterprise type	Cumulative OFDI flows (\$ million and per cent)									
	1980–99					2000–14				
	Developing economies	Transition economies	Developed economies	World	Developing economies	Transition economies	Developed economies	World		
Domestic stand-alone	72 (26.0)	41 (14.7)	165 (59.3)	278 (100)	10,788 (55.1)	47 (0.2)	8,742 (44.7)	19,577 (100)		
Domestic business groups	1,482 (71.4)	52 (2.5)	541 (26.1)	2,075 (100)	92,397 (58.2)	273 (0.2)	66,164 (41.7)	158,834 (100)		
State-owned enterprises	111 (76.8)	1 (0.9)	32 (22.3)	144 (100)	8,823 (50.5)	3,180 (18.2)	5,455 (31.2)	17,458 (100)		
Foreign affiliates	36 (25.9)	(0.0)	102 (74.1)	138 (100)	1,326 (30.7)	9 (0.2)	2,979 (69.1)	4,314 (100)		
Unclassified	178 (20.6)	16 (1.9)	672 (77.5)	866 (100)	17,882 (54.1)	112 (0.3)	15,078 (45.6)	33,072 (100)		
All enterprises	1,880 (53.7)	110 (3.2)	1,512 (43.2)	3,502 (100)	131,215 (56.3)	3,620 (1.6)	98,419 (42.2)	233,254 (100)		

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai; Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi; IIC, Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up to December 1993, New Delhi; Government of India.

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Table 13. Types of enterprise and sectoral Indian OFDI flows, 1980–2014

Enterprise type	Cumulative OFDI flows (\$ million and per cent)							
	1980–99			2000–14				
	Primary	Manufacturing	Services	All sectors	Primary	Manufacturing	Services	All sectors
Domestic stand-alone	7 (2.6)	123 (44.2)	147 (52.9)	278 (100)	1,049 (5.4)	9,523 (48.6)	8,831 (45.1)	19,577 (100)
Domestic business groups	1 (0.0)	1,359 (65.5)	560 (27.0)	2,075 (100)	6,012 (3.8)	71,616 (45.1)	79,649 (50.1)	158,834 (100)
State-owned enterprises	–	72 (49.5)	60 (41.7)	144 (100)	13,099 (75.0)	1,956 (11.2)	2,402 (13.8)	17,458 (100)
Foreign affiliates	–	77 (55.7)	61 (44.3)	138 (100)	16 (0.4)	1,931 (44.8)	2,348 (54.4)	4,314 (100)
Unclassified	5 (0.6)	139 (16.0)	658 (75.9)	866 (100)	2,128 (6.4)	6,714 (20.3)	19,257 (58.2)	33,072 (100)
All enterprises	13 (0.4)	1,769 (50.5)	1,487 (42.4)	3,502 (100)	22,303 (9.6)	91,740 (39.3)	112,488 (48.2)	233,254 (100)

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai; Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi; IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up to December 1993, New Delhi; Government of India.

Note: Others are not shown. Data is on approval basis comprising remittances done by Indian firms for overseas investments under Automatic Route as well as those permitted under Approval Route; data for 2001 are only from January to March; data for 2002 are from October to December; and data for 2007 are from January to March and from July to December. The number of outward-investing firms is obtained by single-counting names of firms that are undertaking outward investment during the respective period and firm category. Similarly, the total number of outward-investing firms for the study period 1980–2014 is not the sum total of the information pertaining to different sub-periods, as the same firm could have invested abroad during different sub-periods. In calculating the number of outward-investing firms, a number of cases of outward FDI ventures by individuals were excluded.

Table 14. Enterprise size and Indian investment abroad, 1980–2014

Enterprise size	1980–89	1990–99	2000–09	2010–14	1980–2014
<i>Cumulative OFDI flows (\$ million and per cent)</i>					
Small enterprise	1 (0.7)	64 (1.9)	1,371 (2.1)	2,868 (1.7)	4,304 (1.8)
Medium enterprise	0.1 (0.1)	15 (0.5)	882 (1.3)	647 (0.4)	1,544 (0.7)
Large enterprise	98 (64.6)	2,301 (68.7)	51,236 (78.4)	140,269 (83.6)	193,904 (81.9)
Unclassified	53 (34.7)	971 (29.0)	11,880 (18.2)	24,101 (14.4)	37,005 (15.6)
All enterprises	152 (100)	3,351 (100)	65,368 (100)	167,886 (100)	236,757 (100)
<i>Outward investing firms (no.)</i>					
Small enterprise	10	68	169	121	287
Medium enterprise	1	35	72	57	115
Large enterprise	76	421	885	869	1,460
Unclassified	59	726	2,477	3,532	5,934
All enterprises	146	1,250	3,603	4,576	7,793

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up To December 1993, New Delhi: Government of India.

Note: Data is on approval basis comprising remittances done by Indian firms for overseas investments under Automatic Route as well as those permitted under Approval Route; data for 2001 are only from January to March; data for 2002 are from October to December; and data for 2007 are from January to March and from July to December. The number of outward-investing firms is obtained by single-counting names of firms that have undertaken outward investment during the respective period and firm category. Similarly, the total number of outward-investing firms for the study period 1980–2014 is not the sum total of the information pertaining to different sub-periods, as the same firm could have invested abroad during different sub-periods. In calculating the number of outward-investing firms, a number of cases of outward FDI ventures by individuals were excluded.

2.6. Enterprise Age

The distribution of Indian OFDI flows by enterprise age reveals that relatively younger firms are a leading source of FDI. During the study period 1980–2014, Indian firms age 11–20 years accounted for 32.5 per cent share in total Indian OFDI flows, followed by those age 41 and older (23 per cent), and those age 1–10 (17 per cent) (table 15). Thus, Indian firms up to 20 years old invested nearly half of Indian OFDI. The share of Indian firms in the middle age groups of 21–30 and 31–40 years respectively had 15.4 and 10.8 per cent shares. This may indicate that an increasing number of Indian firms are assuming investment in foreign markets sooner, contrary to the prediction

of the Uppsala model (Johanson and Vahlne, 1977) in which the internationalization of firms is a gradual process. It could be that the “born global” phenomenon (Oviatt and Patricia, 1995; Madsen and Per, 1997; Moen and Servias, 2002) is gaining ground among Indian firms, especially from knowledge-based services such as ICT and ICT-enabled industry.

Table 15. Enterprise age and Indian investment abroad, 1980–2014

Enterprise age	1980–89	1990–99	2000–09	2010–14	1980–2014
<i>Cumulative OFDI flows (\$ million and per cent)</i>					
1 to 10 years	24 (16.1)	725 (21.6)	16,302 (24.9)	23,126 (13.8)	40,177 (17.0)
11 to 20 years	60 (39.7)	1,634 (48.8)	14,399 (22.0)	60,879 (36.3)	76,971 (32.5)
21 to 30 years	36 (24.0)	388 (11.6)	11,713 (17.9)	24,392 (14.5)	36,530 (15.4)
31 to 40 years	5 (3.1)	210 (6.3)	2,775 (4.2)	22,586 (13.5)	25,576 (10.8)
41 years to above	26 (17.0)	394 (11.8)	17,424 (26.7)	36,890 (22.0)	54,734 (23.1)
Unclassified	–	0.2 (0.0)	2,755 (4.2)	13 (0.0)	2,768 (1.2)
All enterprises	152 (100)	3,351 (100)	65,368 (100)	167,886 (100)	236,757 (100)
<i>Outward investing firms (no.)</i>					
1 to 10 years	58	737	1,950	2,324	4,603
11 to 20 years	21	308	1,085	1,267	2,287
21 to 30 years	14	110	487	725	1,126
31 to 40 years	18	61	159	266	437
41 years and above	41	97	211	291	444
All enterprises	146	1,250	3,603	4,576	7,793

Source: Based on Reserve Bank of India (various years), Outward FDI from India, Mumbai: Overseas Investment Division, Exchange Control Department; Indian Investment Centre (various years), Joint ventures and wholly owned subsidiaries abroad, New Delhi: IIC; Ministry of Commerce (1994), Factsheet on Indian joint ventures and wholly owned subsidiaries abroad up To December 1993, New Delhi: Government of India.

Note: Data is on approval basis comprising remittances done by Indian firms for overseas investments under Automatic Route as well as those permitted under Approval Route; data for 2001 are only from January to March; data for 2002 are from October to December; and data for 2007 are from January to March and from July to December. The number of outward-investing firms is obtained by single-counting names of firms that are undertaking outward investment during the respective period and firm age category. However, for a given period, the name of a given firm may appear in more than one enterprise-age category. For instance, if the age of a firm-X is 9 years in 1980, then it will attain the age of 10 years in 1981, 14 years in 1985 and 18 years in 1989. Therefore, for the period 1980–89, the name of this firm will appear in both the age groups of 1 to 10 years and 11 to 20 years. Similarly, the total number of outward-investing firms for the study period 1980–2014 is not the sum total of the information pertaining to different sub-periods, as the same firm could have invested abroad during different sub-periods. In calculating the number of outward-investing firms, a number of cases of outward FDI ventures by individuals were excluded.

3. Conclusion

With the liberalization and openness measures underway since the 1990s, an increasing number of Indian firms have progressively taken to OFDI, in line with their efforts to diversify away from the domestic market. Against the backdrop of heightened market competition on home turf, continued high growth of the home economy and considerably expanding business prospects worldwide, Indian OFDI registered a phase of rapid expansion. This indicates that internationalization has clearly gained strategic importance for the survival and growth of capable Indian firms in recent periods.

It is not just an increase in terms of quantity: Indian OFDI flows have undergone significant shifts in characteristics, sectors, host regions, mode of ownership, size and age distribution, and enterprise type. The strong increase in Indian OFDI flows in recent periods has become sectorally broad based with a rising contribution from the primary sector, mainly extraction of crude petroleum and natural gas. Services turns out to be the leading OFDI sector during the current decade, dislodging manufacturing, which dominated Indian OFDI flows during the 1990s and 2000s. Both services and manufacturing OFDI in turn have become widely spread across economic activities. A broader range of industrial activities – ranging from low-technology products such as food and textiles to high-technology products such as chemicals and pharmaceuticals – have been the focus of in manufacturing OFDI. Such flows are being led more often by comparatively technology-intensive industries. The services sector has turned out to be home to the largest number of outward-investing firms from India.

Indian OFDI flows have also expanded geographically. The role of developed economies as host to these flows has increased greatly. All markets abroad, whether in developing or developed countries, are becoming equally important for emerging global players from India. What is also noticeable is the growing preference of Indian companies to go for majority ownership in their overseas investment projects. The marked improvements in the firm-specific capabilities of Indian firms as a result of more extensive in-house R&D, large-scale acquisitions of foreign-created assets and easier access to global capital markets could be adding to their preference for full ownership.

Overseas investments from India have begun to reflect a greater role for young enterprises, partly indicating that the new generation of Indian entrepreneurs is taking to internationalization very early. However, large firms still dominate the OFDI scenario even when small and medium-size firms participate. This may imply that reaching a critical firm size is important for Indian firms to be able to overcome the sunk costs associated with establishing overseas businesses and that only young firms that have such scale advantages are enjoying a prominent role.

Indian OFDI flows have also had distinctive features in terms of the profile of the investing enterprise. Domestic business groups have emerged as the largest contributor to Indian OFDI. They are expected to continue their global expansion as firms affiliated with business groups possess the superior advantages of created assets and complementarities. The bulk of Indian OFDI flows are led by privately owned enterprises. State-owned enterprises play a modest role limited to natural resource extraction activities.

Factors prompting Indian manufacturing firms to actively pursue OFDI include large size, experience, R&D and export orientation. Higher productivity and capital goods imports are other firm-specific factors that motivate these firms to expand their operations overseas (Pradhan, 2004; Thomas and Narayanan, 2017). The changing institutional configuration – state policies, corporate finance and governance, skills formation and technological upgrading – has critically shaped the evolution of enterprise competitiveness in the Indian pharmaceutical sector (Taylor, 2017). In contrast to the past, Indian pharmaceutical companies have sought to build their comparative advantages and market positions through the non-traditional mode of strategic alliances and partnership with global MNEs. These firms can no longer rely on reverse engineering or process developments alone and are upgrading their capabilities through internal R&D for product development and novel drug delivery, exports, overseas greenfield investments and acquisitions, and strategic alliances. In addition to specializing in generic drugs, these firms are diversifying into global markets by entering into contract manufacturing and services for global MNEs. Changing industrial policies, economic structures and institutional environments are critically shaping the evolution of Indian pharmaceutical firms in the global market place.

OFDI from India is not limited to production but also includes overseas R&D activities (De Beule and Somers, 2017). The most important gain that India as a home country could get from foreign R&D by her firms is the improved competitiveness of the firms and industries involved. The fact that overseas R&D by Indian firms is positively boosting parent firms' R&D in India reflects the process of knowledge transfers, linkages and interactions within Indian MNEs, which is likely to contribute to enhancing the competitiveness of the home economy.

As OFDI tends to enlarge market access for Indian firms and contribute to their technological upgrading through the acquisition of strategic assets or overseas R&D, the policy priorities should be aimed at promoting OFDI, especially into overseas knowledge-intensive sectors and R&D. These efforts may include the provision of fiscal supports such as tax breaks or lower tax rates for income from OFDI ventures, expansion of the insurance and risk-mitigating measures for OFDI, information provision, and the like.

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Offshore orientation of Russian Federation FDI

Alexander Bulatov*

The research note analyses the geographical profile of FDI of the Russian Federation, which is characterized by the prevalence of offshore entities and conduit (transshipment) countries. It puts forward a hypothesis about the traditional motives (tax minimization) and the non-traditional motives (insufficient safeguarding of legal business, poor level of financial market development, high incidence of monopolization) for this phenomenon. The hypothesis is supported by methodological and empirical arguments constructed against the background of trends and practices in the BRICS and developed economies.

Key words: Russian Federation, FDI, offshore, conduit (transshipment) countries, capital flight, capital round-tripping, BRICS

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1. Introduction

Traditionally the adjective “offshore” refers to tax havens and offshore financial centres. The lists of such entities differ. For example, in 2000 the Organisation for Economic Cooperation and Development (OECD) counted 41 tax havens plus 21 jurisdictions with potentially harmful preferential tax regimes, whereas the International Monetary Fund (IMF) and Financial Stability Forum counted 47 offshore financial centres. In 2005, the Tax Justice Network counted 69 tax havens. The lists differ because of the criteria adopted for identifying such entities and also some jurisdictions with potentially harmful preferential tax regimes can also contain tax havens or offshore financial centres (Tax Justice Network, 2007). International campaigns against offshore entities in recent years have attained some positive results, particularly in respect of transparency. However, such campaigns yielded little results in other aspects; e.g. the share of offshore entities in international banking assets has not changed since 2009 and remained close to 13–14 per cent (BIS, 2014) and even increased up to 17% by the end of 2016 (BIS, 2017).

The term “conduit countries” (sometimes called “transshipment countries”) as used in this analysis refers to jurisdictions that are not offshore entities (though some of them are included in the Tax Justice Network list) but are jurisdictions through which

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large volumes of foreign direct investment (FDI) transit because they host special purpose entities or other entities that facilitate transit investment and offer advantages to investors. UNCTAD's *World Investment Report* calls this type of jurisdiction a conduit country and applies the term "offshore hubs" to 42 tax havens and conduit jurisdictions (*WIR15*). Leading conduit countries are Luxemburg, Ireland, Austria, Switzerland, the United Kingdom and the Netherlands. The last two, in addition to special purpose entities, have international financial centres and their own nets of offshore entities. The United Kingdom has 14 British overseas territories (including Cayman and the British Virgin Islands) and 3 crown dependencies (Jersey, Guernsey and the Isle of Man), which are offshore jurisdictions financially served by the City of London.¹ The Netherlands has a smaller financial centre and a web of offshore jurisdictions – the Caribbean dependent territories of the Netherlands (Curacao, Bonaire, Sint Maarten, Sint Eustasius, Saba and Aruba). Both the United Kingdom and the Netherlands offer advantageous financial infrastructure and legal framework for offshore operations. The United Kingdom allows foreign residents to be taxed only on their United Kingdom income, applies a low corporate income tax rate², has a very liberal law on United Kingdom-controlled foreign companies, and allows the establishment of limited liability partnerships in England and limited partnerships in Scotland, which have less stringent auditing requirements (Tax Justice Network, 2015a). The Netherlands hosts 12,000 special financial entities (three quarters of them "letterbox" entities), used by foreign companies to route €4 trillion through the country every year using participation exemption (exempts international subsidiaries from Dutch corporation tax) as well as enjoying the absence of withholding taxes on interest and royalties (Tax Justice Network, 2015b). Transshipment mechanisms of the Netherlands and United Kingdom have been addressed in numerous studies (e.g. Brooks, 2013; Palan, 2012; Shaxson, 2011; Eurodad, 2015).

This research note uses the term "offshore orientation" with respect to FDI to describe a large share of tax havens, offshore financial centres and conduit countries in FDI flows. In this sense, all major countries participating in FDI are "offshore oriented" to a certain extent. However, the FDI of the BRICS countries (Brazil, the Russian Federation, India, China, South Africa) is significantly more oriented towards offshore entities than major economies of the developed world. Table 1 does not cover all offshore entities and conduit countries because the table has been brought into line with the less detailed statistics of some BRICS economies and because, for generalization purposes, it covers only those offshore entities and conduit countries that have substantial flows of FDI with at least two BRICS countries.

¹ The City of London is estimated to have 17 per cent of the global market in offshore financial services (Tax Justice Network, 2015a).

² The corporate income tax rate in the United Kingdom is set to be reduced from 28 per cent to 18 per cent by 2019.

Table 1. Russian Federation and some other countries: offshore focus of FDI outflows and inflows, US\$ billion

	Outflows						Inflows									
	Russian Federation, 2013	Brazil, 2014 **	India, 2011 *	China, 2013	South Africa, 2010 ***	United States, 2013	Japan, 2013	Germany, 2013	Russia, 2013	Brazil, 2014 **	India, 2011	China, 2013	South Africa, 2010 ***	USA, 2013	Japan, 2013	Germany, 2013
Total	86.7	19.6	16.9	107.8	86.7	328.6	135.7	40.9	70.7	47.3	23.5	117.6	148.5	230.8	2.3	10.5
Hong Kong (China)	0.2	...	0.2	62.8	0.1	5.4	1.8	0.3	0.1	0.4	0.3	73.4	...	1.4	0.2	-0.4
Singapore	0.3	0.1	4.0	2.0	...	17.5	...	1.5	-0.5	0.2	3.3	7.2	0.1	1.4	0.3	0.4
Mauritius	...	...	5.1	...	7.8	0.3	-0.5	0.01	...	...	8.1	...	0.3	0.2	0.0	0.02
Bermuda	0.6	...	...	...	...	5.6	-0.1	0.1	1.1	0.7	...	0.7	1.1	2.3	-0.02	0.4
Bahamas	0.6	0.4	...	...	...	1.8	0.01	0.5	2.8	0.2	...	0.1	...	0.5	0.0	0.3
Cayman Islands	0.5	6.0	0.4	9.3	...	16.6	0.4	0.1	-0.1	0.6	...	1.7	...	8.8	-1.0	3.8
British Virgin Islands	62.3	1.2	0.3	3.2	...	...	3.0	0.1	9.4	-0.1	...	6.2	...	...	-0.1	0.3
Cyprus	7.7	...	...	...	...	0.2	-0.1	0.1	8.3	...	1.6	0.1	...	...	0.0	0.1
Luxembourg	1.3	1.9	...	...	15.0	42.8	0.9	9.8	11.6	6.4	...	0.4	2.3	26.1	1.3	11.4
Ireland	0.3	...	...	...	0.4	29.6	1.7	1.3	10.4	0.1	...	0.1	0.3	15.4	-0.7	-2.9
Austria	5.3	2.2	...	...	3.8	2.0	0.02	2.9	-0.3	0.3	...	0.2	0.2	0.6	-0.1	2.0
Switzerland	1.4	0.2	0.2	...	1.2	5.3	-0.1	-2.5	1.1	1.9	0.2	0.3	6.7	17.0	-0.4	-0.9
Netherlands	-3.0	-0.9	1.5	...	2.5	57.6	8.7	-28.5	5.8	6.7	1.3	1.3	26.0	12.8	0.5	-12.7
United Kingdom	1.3	0.1	0.4	1.4	14.3	32.4	13.4	2.3	19.9	1.7	2.8	0.4	73.7	41.9	0.6	-3.6

Sources: OECD, 2014, 2015; Bank of Russia, 2015; Banco Central de Brazil, 2014b, 2013; China Statistical Yearbook, 2014; Khan, 2012.

... = negligible or no data

**2010/2011 financial year

** Stocks (shares) only

*** FDI accumulated by the end of 2010

Traditional explanations of FDI orientation towards offshore entities and conduit countries cite tax planning motives. In developing economies, this motive can explain why the focus of FDI on offshore entities is high but not why it is higher than in developed economies. Some studies have described the issue in general (e.g. Borga, 2016; Kalotay 2012). More attention is paid to the offshore orientation of Chinese FDI (e.g. Viecek, 2010; Xiao, 2004) and less to that of Russian Federation FDI (e.g. Peltó, Vahtra and Liuhio, 2004) – the latter sometimes focusing on corruption motives (Ledaeva, 2013, 2015).

We put forward a hypothesis about the traditional (tax planning) and non-traditional (insufficient safeguards for legal businesses, poor levels of financial market development, high incidence of monopolization) motives for FDI in offshore entities. The negative elements of the investment climate in developing economies generate additional, non-traditional motives for an offshore orientation. Among these countries, the Russian Federation is the champion in terms of the share of offshore entities in FDI flows, and its case gives substantial evidence to support the hypothesis.

2. Russian Federation and other developing economies in global FDI

Developed economies were traditionally the dominant sources and recipients of FDI. In the current decade, the trend has been changing: developing economies (including transition economies) are becoming the leading players as both host and home of world FDI.

The *World Investment Report* of the United Nations Conference on Trade and Development categorizes Hong Kong (China), Singapore, the Republic of Korea and Taiwan Province of China in the developing economies group, but international financial organizations (the Bank for International Settlements, the IMF, the World Bank Group) traditionally identify these as developed economies. Apart from the “four tigers”, the leading position in outward and inward FDI stock belongs to China, and the second position in outward FDI stock to the Russian Federation (which holds the fifth position in inward FDI stock, after China, Brazil, Mexico and India). Among other developing economies with substantial FDI flows are Indonesia, Malaysia, Saudi Arabia, Thailand and Turkey in Asia; Argentina, Chile and Colombia in Latin America; Nigeria and South Africa in Africa; and Kazakhstan in transition economies (UNCTAD, 2016).

The growing role of developing economies in the world’s FDI flows can be accounted for by two factors. On the one hand, it is the result of the rising level of their economic development, which generates traditional motives for FDI flows. On the other hand, the specificities of their investment climates (intrinsic to developing economies) add

Table 2. World FDI: outflow and inflow, US\$ billion (percentage of total in brackets)

	2007		2010		2014		2015	
	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow	Outflow	Inflow
World, total	2,272.0	2,002.7	1,467.6	1,422.3	1,354.0	1,228.3	1,474.2	1,762.2
	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)
Developing economies*	381.6	682.6	478.8	718.8	468.1	681.4	377.9	764.7
	(16.8)	(34.1)	(32.3)	(50.5)	(38.9)	(59.4)	(25.6)	(43.4)
Africa	10.6	63.1	9.3	44.1	13.1	53.9	11.3	54.1
Nigeria	0.5	6.1	0.9	6.1	1.6	4.7	1.4	3.1
South Africa	3.0	5.7	-0.1	3.6	6.9	5.7	5.3	1.8
Asia	225.6	338.2	284.1	401.9	431.6	465.3	331.8	540.7
China	26.5	86.7	68.8	114.7	116.0	128.5	127.6	135.6
Hong Kong (China)	61.1	54.3	86.2	70.5	142.7	103.3	55.1	174.9
India	17.2	25.4	15.9	27.4	9.8	34.4	7.5	44.2
Indonesia	4.7	6.9	2.6	13.8	7.1	22.6	6.2	15.5
Korea, Rep. of	15.6	2.6	28.3	9.5	30.6	9.9	27.6	5.0
Malaysia	11.3	8.5	13.4	9.1	16.4	9.8	9.9	11.1
Saudi Arabia	12.7	22.8	3.9	29.2	5.4	8.0	5.2	8.1
Singapore	27.6	35.8	33.4	55.1	40.7	67.5	35.5	65.3
Taiwan	11.1	7.8	11.6	2.5	12.7	2.8	14.8	2.4
Thailand	2.9	11.4	4.5	9.1	7.7	12.6	7.8	10.8
Turkey	2.1	22.0	1.5	9.1	6.7	9.1	4.8	16.5
Latin America and the Caribbean*	56.0	162.6	46.9	131.7	23.3	159.4	40.0	167.6
Brazil	7.1	34.6	11.6	48.5	-3.5	62.5	3.1	64.6
Chile	2.6	12.5	10.5	16.8	13.0	22.9	15.5	2.2
Colombia	0.9	9.0	5.5	6.4	3.9	16.1	4.2	12.1
Mexico	8.3	27.4	15.1	26.1	5.2	22.8	8.1	30.3
Transition economies	50.1	78.1	62.0	75.0	63.1	48.1	31.1	35.0
Kazakhstan	-	-	7.9	11.6	3.6	9.6	0.6	4.0
Russia	45.9	57.0	52.6	43.2	56.4	21.0	26.6	9.8

Source: IMF, 2015, 2008; UNCTAD 2016b, 2015, 2014, 2013a, 2013b, 2013c.

*Excluding financial centres in the Caribbean.

some non-traditional motives (from the point of view of FDI theories), expanding the scope of their FDI outflows. These non-traditional motives show themselves in the geographic orientation of developing economies' FDI, which is biased toward offshore entities and conduit countries.

Russia's FDI stock was growing rapidly until 2014, when economic crisis, the oil price drop and Western sanctions stopped this process. That said, 2015 data indicate that growth has resumed.

The ratio of outward and inward FDI stock to GDP in the Russian Federation is high and close to that of the top developed economies. Among other BRICS countries, only South Africa has a ratio of FDI stock to GDP that is close to those of developed economies. The high ratio of South Africa can be attributed to the fact that the country is a regional hub for Western transnational corporations (TNCs) in sub-Saharan Africa. But the Russian Federation case needs some other explanations because the country is rarely used by TNCs as a hub for investing in neighbouring countries. Instead its large FDI stocks can be attributed to intensive round-tripping FDI between firms owned by residents at home and abroad.

Table 3. Russian Federation: FDI stock, US\$ billion

	2000	2005	2010	2011	2012	2013	2014	2015
FDI outward stock	20.1	140.8	361.1	361.8	409.6	479.5	388.4	336.3
FDI inward stock	32.2	180.2	489.0	454.9	514.9	565.7	353.4	342.9

Source: Bank of Russia, 2016, 2015b, 2015c.

Table 4. Russian Federation and other countries: FDI outward stock and GDP ratio in 2014

	GDP, current US\$	FDI outflow stock, current US\$	Outward FDI stock to GDP ratio, per cent	Inward FDI stock, current US\$	Inward FDI stock to GDP ratio, per cent
Russia	1,861	432	23.2	379	20.4
Other BRICS					
Brazil	2,346	316	13.5	755	35.2
India	2,067	130	6.3	252	12.2
China	10,360	730	7.0	1085	10.5
South Africa	350	134	38.3	145	41.4
Developed countries					
United States	17,419	6,319	36.2	5410	31.1
Japan	4,601	1,193	25.9	171	3.7
Germany	3,853	1,583	41.1	744	19.3

Source: UNCTAD, 2015; World Bank, 2015.

3. Geographical pattern of Russian Federation FDI

The geographical pattern of FDI stock of the Russian Federation shows that the dominant sources and destinations of its FDI are offshore entities and conduit countries. No less than 75 per cent of the outward FDI stock is these jurisdictions, and the share of these jurisdictions in the inward FDI stock is 76 per cent.

Statistics on the geographical distribution of the FDI stock of the other BRICS states are scarcer, but the more readily available statistics on their FDI flows can compensate for that scarcity. Table 1 illustrates the prevalence of offshore entities and conduit countries in the geographic orientation of all BRICS states' FDI outflows. It allows us to conclude that:

- In Russian Federation FDI flows, offshore entities and conduit countries carry significant weight – 90 per cent of outflows and 97 per cent of inflows, with a focus on the Caribbean in outflows and Western Europe in inflows.
- In Brazilian FDI, offshore entities and conduit states account for 57 per cent of outflows and 41 per cent of inflows, particularly the Caribbean in outflows and Western Europe in inflows.

Table 5. Russian Federation: geographical allocation of outward and inward FDI stock in 2014, asset/liability concept, US\$ billion

	Outward stock	Inward stock
Total	384.7	365.4
Hong Kong (China)	1.3	0.4
Singapore	2.4	0.6
Mauritius	0.01	0.02
Bermuda	2.9	14.6
Bahamas	4.3	21.0
Cayman Islands	1.5	0.1
British Virgin Islands	47.1	14.3
Cyprus	105.2	100.9
Luxembourg	12.1	38.7
Ireland	2.7	0.02
Austria	36.1	6.3
Switzerland	17.7	10.9
Netherlands	49.1	51.4
United Kingdom	9.5	10.5

Source: Bank of Russia, 2015b, 2015c.

- In Indian FDI, 72 per cent of outflows and 75 per cent of inflows are through offshore entities and conduit states, in particular by Mauritius and Singapore, as well as by countries in the Caribbean and in Western Europe.
- In Chinese FDI, 80 per cent of outflows and 78 per cent of inflows are through offshore entities and conduit countries, especially Hong Kong (China) but also countries in Western Europe.
- In South African FDI, the share of offshore entities and conduit states is also very substantial – 53 per cent of the stock accumulated abroad and 75 per cent of FDI stock accumulated in the country, predominantly to and from Western Europe.

The high level of FDI in offshore entities is the principal feature of FDI outflows from and inflows to the Russian Federation, even in comparison with other BRICS countries. Moreover, this high level is a feature of other types of investment from the Russian Federation. Data from the Bank of Russia show that the above-mentioned set of offshore entities and conduit countries receives 76 per cent of the portfolio investment of Russia, at the expense of Western Europe (Bank of Russia, 2014b). As for other BRICS countries, data of the Banco Central do Brazil indicate that this set of countries receive 41 per cent of long-term securities invested abroad, especially those in the Caribbean and Western Europe (Banco Central do Brazil, 2015). Statistics of India's portfolio assets abroad shows that 50 per cent of them are located in those 14 countries, particularly in Luxemburg, Bermuda, Mauritius (IMF, 2017). According to the South African Reserve Bank, 66 per cent of outward portfolio investments are invested in that set of states and territories, particularly in the UK, Luxemburg and Bermuda (South African Reserve Bank, 2016).

Comparison with the United States, Japan and Germany (using the same set of offshore entities and conduit states) gives different results. Table 1 shows that although in 2013 this set of offshore economies received 66 per cent of United States FDI outflows and were sources of 56 per cent of United States FDI inflows, the distribution of FDI in Japan and Germany were very different. The set of offshore economies drew only 22 per cent of Japanese FDI outflows and delivered 27 per cent of Japanese FDI inflows. In Germany FDI outflows and inflows to and from offshore entities and conduit countries were negative in 2013; i.e. both German assets in these places and these places' assets in Germany were decreasing.

The UNCATD data corroborates this observation. In 2012, the share of investment stock from offshore and conduit countries in inward FDI was about 29 per cent in developed economies, in a declining trend, and 30 per cent in developing ones (24 per cent in Africa, 27 per cent in Latin America and the Caribbean, 31 per cent in developing Asia, 60 per cent in transition economies), in a rising trend (UNCTAD, 2015).

4. Instruments of offshore orientation of capital exports and imports

The majority of international investors from both developing and developed economies use offshore entities and conduit countries. However, the increasing scrutiny by the tax authorities in capital exporting countries has forced TNCs to take different approaches. In the Russian Federation, TNCs have resorted to following practices:

- To export capital first to conduit states and then to offshore entities affiliated with these states. For example, in 2010–2014, FDI flows from the Russian Federation to the United Kingdom and the Netherlands totalled US\$13.5 billion (excluding reinvestment), i.e. about 8 per cent of total FDI outflows from the country. Some offshore jurisdictions are also used by Russian Federation investors as conduits, especially Cyprus, where a relatively high corporate tax for an offshore economy (12.5 per cent) is offset by good financial infrastructure that is connected with other European Union (EU) member countries and numerous tax treaties with other offshore entities.
- To export capital without any registration in its country of origin, which is typical for many investors in offshore entities. For instance, in 2010–2014, unregistered capital outflows from the Russian Federation amounted to US\$43 billion (Bank of Russia, 2015d).³ Unregistered capital generated some 7 per cent of all capital outflows from the Russian Federation in this five-year period. Usually, unregistered assets cross borders as cash or contraband goods.
- Lending to non-residents without repayment. By the estimations of the Central Bank of Russia, by 2015 the total sum of outstanding loans from Russian Federation residents to non-residents that were not repaid was more than \$30 billion (Kommersant, 2015).
- To use so-called fictitious transactions, which predominantly consist of misinvoicing export and import contract prices and subsequently placing the difference between real and contract prices abroad, as well as making advance payments for imports that have not come into the country. This occurred in 2014 when the Central Bank of Russia discovered that in the two preceding years Russian Federation companies had paid \$48 billion to offshore entities for fictitious imports through Belarus and Kazakhstan, which do not have customs borders with the Russian Federation. A substantial part of fictitious transactions is fictitious securities trading, which

³ The IMF recommends identifying with it the systematically negative item, “net errors and omissions” in the balance of payments.

covers cross-border money transfers under the false pretext of purchasing foreign securities. Usually these transfers move through numerous bank accounts and after that are accumulated in a foreign bank account in offshore entities or conduit countries. Fictitious transactions with money transfers to non-residents comprise various operations, e.g. a fictitious honorarium for alleged consultation from abroad or alleged fines. In 2013–2014, several billion U.S. dollars were transferred from the Russian Federation to Moldova as fictitious fines for fictitious contracts signed by local affiliates of Russian Federation and offshore firms in Moldova. Later, the local Moldincombank transferred the money to offshore entities (OCCRP, 2014).

After registration of a firm in some offshore jurisdiction, a typical owner of FDI assets from developing economies traditionally exports a substantial part of these assets back to the home economy. Table 1 shows that the shares of offshore entities and conduit countries in FDI outflows and inflows are close. In FDI from the Russian Federation these shares are very close and high – 90 per cent and 97 per cent, respectively. The principal recipient of Chinese FDI outflows is Hong Kong (China), and from this offshore entity, China receives the bulk of its FDI inflows. For India, the principal FDI recipient is Mauritius and the principal FDI source is Singapore; for South Africa, Western Europe plays both roles. Brazil and the Russian Federation export their FDI mainly to the Caribbean and receive FDI from Western Europe (to which assets presumably flow from the Caribbean via European conduit countries).

This kind of capital movement is described by the term “round-tripping”. According to Sergey Glaziev, economic adviser to the president of the Russian Federation, 85 per cent of FDI in the country is investment by Russian Federation businesses through offshore entities (RBC, 2014). The treatment of round-tripping FDI gives rise to different estimates of the outward stock of Russian Federation FDI. The Bank of Russia assesses volumes of Russian Federation FDI outward stock using both the asset/liability concept (\$385 billion in 2014) and the directional concept (\$303 billion). The second method gives smaller stocks particularly in conduit countries: in the Netherlands in 2014, this stock was \$49 billion using the asset/liability concept and only \$37 billion using the directional concept. In the United Kingdom, the figures were \$10 billion and \$8 billion, respectively; in Switzerland, \$18 billion and \$13 billion; in Luxemburg, \$15 billion and \$14 billion; and in Cyprus (a combination of conduit country and offshore centre; see below), \$105 and \$93 billion. These five conduit countries account for \$60 billion of the total \$82 billion difference between the two methods of accounting.

The question is why offshore entities and conduit countries are preferable for such round-tripping FDI. The answer is evident: they are the best jurisdictions when the bulk of FDI exported to offshore entities is planned to be imported back to the country of origin. Offshore affiliates are designed as letter boxes and conduits for foreign capital because of the simplicity of registration, low transparency and the absence of currency regulation, not to mention the low tax rates.

We can infer that a predominant share of FDI coming into the BRICS economies is their national capital returning with a foreign passport. In the case of the Russian Federation, this share is especially high.

5. The causes of FDI offshore orientation

Chapter IV of the *World Investment Report 2015* analyses the traditional orientation of multinational enterprises towards offshore entities and conduit countries from the point of view of tax considerations. It states that “the root cause of offshore hubs in global corporate investments is tax planning, although other factors can play a supporting role” (UNCTAD, 2015). These other factors, according to *WIR15*, are investment treaties, low formalities for investment, strong legal and regulatory frameworks, good infrastructure and banking and business services environments, and economic and political stability. However, “the relative importance of non-tax factors ...should not be overestimated” (UNCTAD, 2015). In other words, this is the set of push-in factors (motives), dominated by the tax factor, which are ensuring the orientation of multinational enterprises towards offshore entities and conduit states.

Such an approach, with a focus on push-in factors, is predominant in analysis of FDI flows’ orientation towards offshore entities and conduit states. However, this analysis does not pay much attention to the link between push-out factors and orientation towards offshore entities and conduit states of FDI from developing economies. In part, this is a consequence of the fact that modern research on FDI flows (as well as capital movement as a whole) pays less attention to capital flight than in previous decades when substantial work on capital flight (including from the Russian Federation) was produced (e.g. World Bank, 2012; Schneider, 2003; Loungani and Mauro, 2000; Claessens and Naude, 1993; Lessard and Cuddington, 1987; Dooley, 1986). “Broadly speaking, capital flight refers to outflows of private capital from developing countries” (Davies, 2010), and capital flight analysis traditionally focused on specific factors (motives) pushing capital out of these countries (particularly motives connected with a bad business environment). We argue that the combination of the two approaches can shed more light on the high level of offshore orientation of FDI of the Russian Federation.

The important aspect of capital flight is its geographical pattern. Very frequently it is aimed at offshore entities and conduit countries. It occurs for two reasons: on the one hand, owners of assets are attracted by the tax, registration and transparency climate in those jurisdictions; on the other hand, offshore entities and conduit countries are convenient for returning assets to a home country, where owners of those assets are familiar with the local specificities of business (giving them a good chance of doing profitable business in their native country) and have lower risks (due to tax evasion through offshore entities and additional protection from arbitrary measures arising from the fact that they are formally foreign business).

The crucial question is why FDI flows from and to the Russian Federation are more offshore oriented than those of other BRICS economies. As an answer, we can hypothesize that in BRICS (as well in many other developing economies) a high level of offshore orientation of FDI is due to insufficient safeguards for local business, a low level of financial market development and a high level of monopolization. We can also hypothesize that for developing economies these motives are no less important than the tax avoidance motive. In the Russian Federation, these specific (non-traditional) motives are in greater force than in other BRICS economies, which results in a comparatively higher degree of offshore focus of Russian Federation FDI.⁴

6. Arguments to support the hypothesis

The hypothesis that emphasizes the role of the local business climate is supported by data from the Global Competitiveness Report issued annually by the World Economic Forum, with its 12 groups of indicators (from one to seven marks) for each participant country, illustrating strong and weak points of its economy.

Table 6 shows that the Russian Federation and other BRICS economies have worse business climates than leading developed economies. This is one of the causes of capital flight from developing economies in general. As for the Russian Federation, it has a total score close to those of other BRICS economies, though it generally lags behind in three groups of indicators – institutions, financial market development and business sophistication.

The worst scores are observed in the institutional sphere. Detailed indicators in this group – property rights, strength of investment protections, effectiveness of legal framework in settling disputes and challenging regulations, independence of judiciary, reliability of police services, scope of irregular payments and bribes – show that the safeguards for legal businesses in the Russian Federation are worse than in other BRICS economies. It is not surprising that for the protection of property rights, Russian businesses export capital to, for instance, the British Virgin Islands.⁵ They do so not only for the zero local corporate tax but also for the possibilities of applying to the local court in cases of violation of the company's rights in other countries – including the Russian Federation – and of lodging an appeal with the Judicial Committee of the Privy Council in London. For these reasons, the majority of major private companies in the Russian Federation are de jure owned by firms or

⁴ Some authors also include these specific motives in the set of push-out factors in FDI outflows from BRICS and other developing economies (e.g. Sauvart, Mallampally and McAllister, 2011; Kuznetsov, 2011; Gammeltoft, 2008).

⁵ In 2000–2014, investment flows from the Russian Federation to the British Virgin Islands accounted for 17 per cent of all flows to this jurisdiction (UNCTAD, 2016).

Table 6. BRICS countries versus developed countries: some investment climate indicators

	Russian Federation	Brazil	India	China	South Africa	United States	Japan	Germany
Institutions	3.5	3.2	5.5	4.2	4.4	4.8	6.7	5.2
Property rights	3.3	3.9	3.8	4.4	5.5	5.5	6.2	5.8
Judicial independence	2.9	3.4	4.0	3.9	5.4	5.3	6.2	5.8
Reliability of police services	3.2	3.9	3.8	4.3	3.6	5.7	6.0	5.9
Strength of investor protection	5.1	6.3	7.3	4.5	6.8	6.6	6.3	5.9
Irregular payments and bribes	3.4	3.1	4.1	4.0	4.3	5.1	6.3	5.5
Efficiency of legal framework in settling disputes	3.2	2.8	4.2	4.0	5.3	4.9	5.4	5.3
Efficiency of legal framework in challenging regulations	2.9	2.9	4.1	3.5	5.0	4.8	4.6	5.2
Infrastructure	4.8	3.9	4.4	4.7	4.1	5.9	6.2	6.1
Macroeconomic environment	5.3	4.0	3.7	6.5	4.5	4.4	3.7	6.0
Health and primary education	5.9	5.1	4.1	6.1	4.2	6.1	6.7	6.5
Higher education and training	5.0	3.9	3.9	4.3	4.1	5.9	5.4	5.6
Goods market efficiency	4.2	3.7	4.2	4.4	4.6	5.1	5.2	4.9
Labour market efficiency	4.4	3.7	3.9	4.5	3.8	5.4	4.8	4.6
Financial market development	3.5	4.0	4.1	4.1	5.0	5.5	4.7	4.7
Affordability of financial services	4.2	5.0	4.1	4.4	5.3	5.7	5.1	5.5
Financing through equity market	3.1	3.4	4.0	4.0	5.6	5.5	5.1	4.8
Soundness of banks	4.0	5.8	4.3	4.7	6.4	5.6	5.8	5.4
Regulation of securities exchanges	3.7	4.9	4.2	4.5	6.1	5.2	5.7	5.2
Technological readiness	4.2	4.4	2.7	3.7	4.6	5.9	5.7	6.0
Market size	5.8	5.8	6.4	7.0	4.9	6.9	6.1	6.0
Business sophistication	3.8	4.1	4.2	4.3	4.4	5.6	5.8	5.7
Extent of market domination	3.7	3.9	4.0	4.2	3.9	5.1	5.9	5.4
Effectiveness of anti-monopoly policy	3.7	3.9	4.1	4.2	5.1	5.2	5.4	5.1
Effect of taxation on incentives to invest	3.1	2.0	4.8	3.8	3.9	4.0	3.8	3.8
Total tax rate, as % profits	48.9	69.0	61.7	64.6	28.8	43.8	51.3	49.8
Local supplier quantity	4.4	4.7	4.6	5.2	4.6	5.4	6.2	5.8
Local supplier quality	4.1	4.3	4.3	4.3	4.8	5.5	6.2	6.0
Value chain breadth	3.5	3.8	4.4	4.2	3.9	5.5	6.2	5.9
Production process sophistication	3.5	4.0	3.9	4.1	4.4	6.1	6.4	6.2
Innovation	3.3	3.2	3.7	3.9	3.7	5.6	5.5	5.5
Total score	4.4	4.1	4.3	4.9	4.4	5.6	5.5	5.6

Source: World Economic Forum, 2015.

funds from offshore entities and conduit countries. Of the 50 top private companies of national origin (which produce one quarter of Russian Federation GDP), 23 were of this type. For instance, the controlling interest in the leading Russian Federation car producer AvtoVAZ is in the hands of a company registered in the Netherlands (Kheyfets, 2013).

The Global Competitiveness Report indicators on financial market development show low marks for the Russian Federation because of the weak local equity market, the undeveloped banking system and the inefficient regulation of securities exchanges. Consequently, Russian Federation companies use their offshore affiliates to reduce transaction costs when entering the financial markets of the United Kingdom, the Netherlands, Luxembourg and Switzerland. As in other BRICS economies (besides South Africa), for Russian Federation companies, the quickest way to place securities in the financial markets of developed economies is to create a firm in some offshore entities affiliated with these economies or in conduit countries with their international financial centres. This also is the traditional way for a Russian Federation bank to diversify its assets or assist its clients. For instance, at least five leading Russian Federation banks (VTB, Alfa Bank, AvoVAZbank, Privatbank, Promsvyazbank) have affiliates in Cyprus, as do numerous financial and investment affiliates of other Russian Federation parent companies. This island country is the most attractive offshore jurisdiction for Russian Federation investors (see table 5), not due to its corporate tax rate for offshore companies (which is higher than in many other offshore entities at 12.5 per cent) but due to numerous tax treaties with other offshore entities (which provide easy conduits to offshore entities with lower taxation rates) and also because the civil code of Cyprus is based on United Kingdom law. The last point is successfully used by Cypriot affiliates of Russian Federation banks and finance companies when, on behalf of their parent companies, they issue eurobonds in line with the standards of the London Stock Exchange in order to trade them at the exchange, the biggest in Europe. The issuance of those securities is less costly but more difficult in the Russian Federation with its continental law.

The indicators on business sophistication reveal other weak points of the Russian Federation economy that are pushing capital out of the country. First is the monopolization and oligopolization of the economy: 400 leading companies (with sales greater than 15 billion roubles; i.e. US\$700–750 million by purchasing power parity) produced 41 per cent of GDP in 2014 (Expert, 2015), and many of them were monopolies (Gazprom, Norulsky Nickel, Russian Railways, Aeroflot, Transneft) or leading oligopolies (LUKOIL, Rosneft, Sberbank, Rostelecom, Megafon) in their industries. It leads to a dominance of monopolies (oligopolies) and the ineffectiveness of the national anti-monopoly policy in Russia – even in comparison with other BRICS economies, where these indicators are also not high compared with leading developed economies (see table 6). As a result, the cost of entry to many industries in the Russian Federation is high for mid-sized local businesses not affiliated with

regional or federal authorities. As a result of this barrier to local markets, these investors often go abroad, including to offshore jurisdictions.

Another argument connected with business sophistication indicators is that though the corporate income tax is lower in the Russian Federation than in Brazil, India and China (see table 6), the tax system in the Russian Federation gives few allowances to companies reinvesting profits. At the beginning of the 2000s, the former finance minister Alexey Kudrin banned some of such deductions. This situation forces some Russian Federation investors to park their profit at affiliates abroad and finance their investment at home from those affiliates. Owing to their low taxes and liberal regulation, offshore financial centres are preferred by those investors.

Last but not least, the group of business sophistication indicators reveal a high level of de-industrialization of the economy in the Russian Federation, which lags those of other BRICS countries in quantity and quality of suppliers, value chain breadth and production process sophistication (see table 6). As a result, the scope of choice for national investors is limited, particularly when many profitable local industries are monopolized and local financial markets are not mature enough to provide credit for long-term projects in manufacturing. In this situation, some national investors prefer to keep part of their assets abroad, waiting for better times in the domestic economy.

Many weak points of the business environment and the economy as a whole are reflected in the growing debates among economists in the Russian Federation. They insist on structural reforms in the domestic economy, particularly when it is in recession (GDP growth was only 0.6 per cent in 2014 and -3.7 per cent in 2015 and is -0.2 per cent in 2016). The majority of economists stress the weakness of institutions, financial markets and business sophistication in the Russian Federation today. Whereas neo-liberal economists (e.g. Alexey Kudrin, 2016) focus on institutional reforms, neo-Keynesian economists (e.g. Sergey Glaziev, 2015) focus on a short- and mid-term approach – restructuring financial markets through quantitative easing and increasing business sophistication through re-industrialization. Nowadays in the Russian Federation neo-liberals have the upper hand in the government: in April 2016, Kudrin was appointed the deputy head of the Presidential Economic Council (President Vladimir Putin is the head) and the head of the Government's newly established Strategic Development Centre. The activity of the neo-Keynesians is increasing: they are the authors of the programme of the new Party of Growth, which is based on political activists from small and mid-sized enterprises. As for the de-monopolization of the economy, some practical steps have already been taken by the Government to support small and mid-size businesses, and each year the Russian Federation is improving its rank in the World Bank's annual "Doing Business" report.

7. Conclusion

The business environment in the Russian Federation and other BRICS economies provides non-traditional motives for private investors to use offshore entities and conduit countries, and these motives are not less important for them than tax avoidance. In the Russian Federation, some negative aspects of the business environment have deeper effects than in other BRICS economies, and this enlarges the scope of capital round-tripping from the country and strengthens its offshore orientation.

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Latin American governments in the promotion of outward FDI

Jorge Alcaraz and Johanan Zamilpa*

A main issue in growing outward foreign direct investment (OFDI) from emerging economies is the participation of home governments. This paper focuses on governments in Latin America and how they are promoting the OFDI of their domestic enterprises. Brazil, Chile and Mexico are the leading countries in Latin America supporting OFDI, although only Brazil has an active policy and institutional arrangements for supporting home enterprise internationalization. Governments in Latin America need to develop their institutional environments and create suitable conditions for enterprises to expand internationally.

Keywords: outward FDI, government policies, Latin American countries, emerging markets

1. Introduction

Expansion abroad by enterprises from emerging economies through outward foreign direct investment (OFDI) has become increasingly important during the last decade. The OFDI of emerging economies passed from US\$147 billion in 2000 to a high of US\$454 billion in 2013 (UNCTAD, 2015). Behind the internationalization of these enterprises are policy frameworks and government programmes specifically designed to support the foreign expansion of domestic firms (Economu and Sauvart, 2013), which have been recognized as providing significant assistance (Wang et al., 2012; Ramasamy, Yeung and Laforet, 2012; Stoian, 2013). There is a need for a clear understanding of how home governments are promoting the internationalization of domestic firms through OFDI (Luo, Xue and Han, 2010; Hong, Wang and Kafouros, 2015).

Hitherto, studies on this issue have focused on a relatively small number of firms and countries (Narula, 2010), partly because just a handful of emerging countries

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have developed an integral OFDI policy for their domestic enterprises (Economu and Sauvant, 2013). Emerging economies in Asia are part of this small group and have been the main focus of the research on the role of national governments in the promotion of OFDI. Some of the economies in this region that have been widely studied are the Republic of Korea, Malaysia, Taiwan Province of China, Singapore, Hong Kong (China) and China (Thomsen and Bang, 2013; Rasiah, Gammeltoft and Jiang, 2010; Zhao, 2011; OECD, 2013; Sim and Pandian, 2007; Narula and Nguyen, 2011; Child and Rodrigues, 2005).

China has received the most interest from scholars researching how domestic institutions promote the internationalization of domestic enterprises. However, owing to the special characteristics of the Chinese economy, the research findings and policy implications cannot be generalized to other economies (Stoian, 2013).

The aim of this paper is to identify what governments in Latin American countries are doing to support the internationalization of domestic enterprises through OFDI. Brazil, Chile and Mexico are the only 3 countries – out of 19 countries in Latin America – that have some mechanisms for supporting the internationalization of domestic enterprises. Brazil is currently the country with the most active policy in the region for boosting the foreign performance of domestic enterprises.

This paper follows the suggestions made by Luo, Xue and Han (2010) about comparing emerging countries in terms of government policies addressed to the promotion of OFDI, by focusing on countries in Latin America. We suggest that future research should examine the effects that foreign institutional pressures have on home institutions as well as the impact that home-government supports have on the internationalization of domestic enterprises.

2. Theoretical review

Home governments support international expansion of domestic enterprises for a number of reasons. The international expansion of domestic enterprises will have impacts not only for the enterprise that is doing business abroad but also for the home economy.

The beneficial impacts for the home economy include facilitating industrial transformation and increasing exports, as well as creating opportunities for local firms through linkages and spillovers, thus strengthening national competitiveness (Luo, Xue and Han, 2010; Sarmah, 2003). Furthermore, successful overseas expansion should generate earnings in the form of profit and royalties (UNCTAD, 2006).

Institutional support for the internationalization of domestic enterprises is aimed at improving their conditions and diminishing risks inherent in internationalization, including economic and political risks (Te Velde, 2007). Government involvement can

help overcome transactions costs as well as the lack of information and resources (Khanna, Palepu and Sinha, 2005). Evidence from other countries suggests that support for international expansion has produced positive outcomes for company performance and productivity (Bannò, Piscitello and Varum, 2014).

Despite the positive effects that the internationalization of domestic enterprises could generate for the home country, government institutions should be aware that OFDI promotion represents resources leaving the country, which could result in detrimental effects in terms of the balance of payments, employment and exports, among other factors. The role of home-government institutions is essential in ensuring that internationalization promotion programmes benefit the domestic economy (Rasiah, Gammeltoft and Jiang, 2010).

Home-government policies aimed at the promotion of OFDI are referred to as home-country measures (HCMs). Sauvant et al. (2014) define HCMs as “the granting of specific advantages by the home-country government (or one of its public institutions) in connection with the establishment, acquisition and expansion of an investment by a home-country firm in a foreign economy. They are meant to facilitate, support or promote outward FDI – in other words, to help firms establish foreign affiliates”. For Sauvant et al. (2014), OFDI policy is not just a liberalized system or neutral policy; they see it as a required condition, specifying that governments need to participate actively in facilitating, supporting and even promoting foreign investment. They consider the following general measures: institutional frameworks, information and other support services, financial measures, fiscal measures, investment insurance and treaties.

Measures and programmes that have not been explicitly developed to support the internationalization of domestic enterprises were not considered in this research. For instance, some local governments provide supportive measures, such as enterprise incubators, to create or improve the competitiveness of domestic enterprises. Such tools might enable firms to overcome some disadvantages in reaching foreign markets through FDI. However, following the definition above, such measures are not considered as HCM.

It is important to mention that all the countries examined in this study have signed bilateral investment treaties, double-taxation treaties or other international investment agreements.¹ These agreements are not taken into consideration for making comparisons of the Latin American countries under study. In emerging countries, such agreements are mainly designed to attract foreign capital (Neumayer and Spess, 2009), instead of promoting investment opportunities. This being the case, consideration of treaties related to international investment in this study would not add to the analysis.

¹ Brazil does not have any bilateral investment treaties in force.

3. Latin American governments and OFDI promotion

For this study, the classification of Latin American countries is based on the *World Investment Report* by UNCTAD. It considers that Latin America includes eight countries in Central America (Belize, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua and Panama) and 11 countries in South America (Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Uruguay and the Bolivarian Republic of Venezuela). All the countries – through policies, programmes and institutions – have policies for attracting investment or encouraging exports. However, regarding the promotion of the internationalization of domestic enterprises through OFDI, the situation is completely different. Within this group of countries, only Brazil, Chile and Mexico have activities related to such promotion.

As table 1 shows, the largest economies in Latin America are Brazil, Mexico, Argentina, Colombia, the Bolivarian Republic of Venezuela, Chile and Peru. This group represents 97 per cent of all the OFDI originating from this region. However, out of all Latin American countries, just three (Brazil, Mexico and Chile) account for 82 per cent of the total OFDI. These three countries are home to 75 of the 100 largest MNEs from the region, according to the ranking *Multilatinas 2014*, issued by the agency *América Economía*. The other 25 MNEs are based in Argentina (8), Colombia (9), Guatemala (1), Panama (1), Peru (5) and the Bolivarian Republic of Venezuela (1); the rest of the countries in this study (10) do not have any MNEs in the *Multilatinas* ranking.

3.1. *The evolution of national government measures in Latin America*

FDI from Latin American countries began to take off in the 2000s. Chart 1 shows the OFDI trends of the countries in the region and the timeline of domestic government institutional initiatives. Brazil is the country with the largest OFDI and is also the country with the most developed policy framework supporting the foreign expansion of domestic enterprises. In Brazil, OFDI policy measures are considered part of national industrial policy. However, the situation is less clear-cut in Chile or Mexico, despite the creation of ProMéxico and the establishment of Chile's regulatory framework. The effectiveness of these domestic institutions in boosting FDI remains an open question.

The following subsections highlight the measures that governments in Latin America are using to promote OFDI. The information was obtained mainly from reports of national and international agencies as well as government institutions' websites.

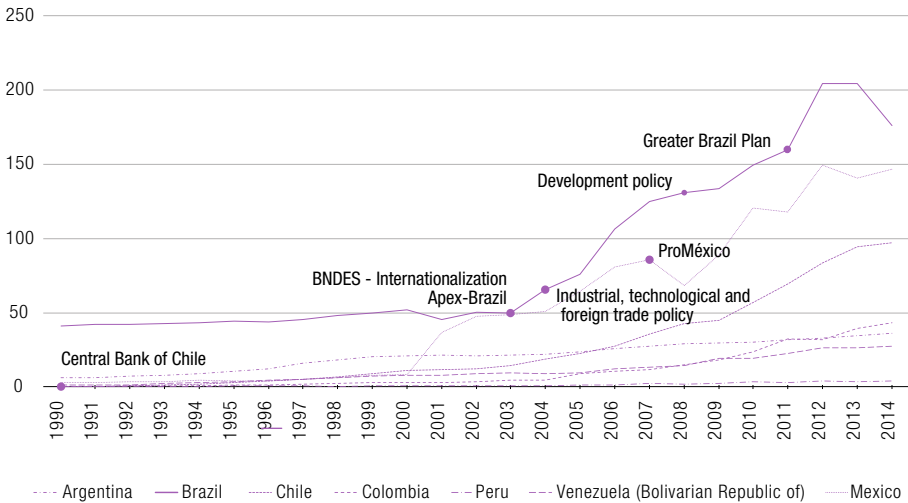
Table 1. Main indicators from Latin American countries in 2013

	GDP (US\$ million)	GDP per capita (US\$)	Population (thousands)	OFDI stock (US\$ million)	OFDI stock per capita (US\$)	OFDI* (%)	OFDI* (cumulative %)	IFDI (US\$ million)	Imports (US\$ million)	Exports (US\$ million)	Trade balance (US\$ million)	OFDI promotion measures
Brazil	2,243,854	11,199	200,362	293,277	1,464	44.46	44.46	724,644	250,559	242,034	-8,526	✓
Mexico	1,259,201	10,293	122,332	143,907	1,176	21.82	66.28	389,083	390,965	379,961	-11,005	✓
Argentina	611,726	14,760	41,446	34,080	822	5.17	71.45	112,349	73,656	81,660	8,004	x
Colombia	378,148	7,826	48,321	39,003	807	5.91	77.36	127,895	59,381	58,824	-558	x
Venezuela (Bolivarian Republic of)	371,339	12,213	30,405	22,915	754	3.47	80.83	55,766	54,420	88,962	34,542	x
Chile	277,043	15,723	17,620	101,933	5,785	15.45	96.29	215,452	79,249	76,477	-2,772	✓
Peru	200,269	6,593	30,376	4,122	136	0.62	96.91	73,620	43,357	42,474	-883	x
Ecuador	94,473	6,003	15,738	687	44	0.10	97.02	13,785	27,146	24,848	-2,298	x
Uruguay	55,708	16,351	3,407	428	126	0.06	97.22	20,344	11,642	9,067	-2,576	x
Guatemala	53,797	3,478	15,468	472	31	0.07	97.29	10,256	17,515	10,028	-7,487	x
Costa Rica	49,621	10,185	4,872	1,822	374	0.28	97.57	21,792	18,014	11,603	-6,411	x
Panama	40,467	10,472	3,864	3,556	920	0.54	98.11	31,413	21,795	14,755	-7,040	x
Bolivia (Plurinational State of)	30,601	2,868	10,671	8	1	0.00	98.11	10,558	9,338	11,657	2,319	x
Paraguay	29,208	4,294	6,802	238	35	0.04	98.14	4,886	12,142	9,432	-2,710	x
El Salvador	24,259	3,826	6,340	2	0	0.00	98.99	8,225	10,772	5,491	-5,281	x
Honduras	18,569	2,293	8,098	353	44	0.05	99.05	10,084	10,953	7,805	-3,147	x
Nicaragua	11,256	1,851	6,080	230	38	0.03	99.14	7,319	6,688	4,794	-1,894	x
Guyana	2,990	3,739	800	2	2	0.00	99.83	2,547	1,875	1,375	-500	x
Belize	1,624	4,894	332	53	159	0.01	99.95	1,621	928	608	-319	x

Sources: Based on UNCTADstat.

* Author's calculation.

Figure 1. Institutional changes and OFDI stocks in Latin American countries, 1990–2014 (Billions of dollars)



Source: Author's own elaboration, based on UNCTAD Stat.

3.2. Brazil

The expansion abroad of Brazilian enterprises is a relatively recent phenomenon. During the 1990s, Brazil was a net recipient of foreign investment, and this remained the case until the 2000s when, in common with several other emerging economies, it started to become an important foreign investor (Abreu, Stal and Muniz, 2012). From 2000 to 2003, OFDI averaged US\$0.7 billion, and from 2004 to 2008, this average increased to US\$14 billion (Lima and de Barros, 2013).

OFDI from Brazil from 2007 to 2011 did not perform as well as in previous years; Brazil was not among the top 10 emerging economies with the highest annual OFDI flows (UNCTAD, 2012). During this period, loans between subsidiaries registered negative amounts and equity contributions diminished. However, there were no significant disinvestments of overseas assets, which suggests that these enterprises have not stopped their expansion abroad but are simply prioritizing domestic investments (CEPAL, 2015).

According to recent studies, the expansion of Brazilian firms abroad has been positively affected by factors such as the availability of skilled labour, geographic proximity, host-country market openness, firms' financial strength and firms' own

expansion strategies (Nunes et al. 2016; Holtbrügge and Kreppel, 2012). In terms of home-country factors, access to domestic government programmes can contribute to the expansion of OFDI (Amal, 2016).

The Government of Brazil has active policies to support OFDI (Finchelstein, 2012) such as the Industrial, Technological and Foreign Trade Policy, the Productive Development Policy and the Greater Brazil Plan. The Government has included the internationalization of domestic enterprises in its industrial policy and has developed measures to support their expansion to other countries through direct investment (CEPAL, 2011). Government support received by Brazilian enterprises as a result of the internationalization policy has been extremely important (Sennes and Camargo, 2009).

A significant development in the internationalization of Brazilian enterprises came in 2008 with the introduction of the Productive Development Policy (Política de Desenvolvimento Produtivo). This policy has five strategic aims; two of them (world leadership and differentiation, also known as brand valorization) are directly related to the internationalization of home enterprises (table 2). Likewise, one of the four national goals (Macrometas) refers to the insertion of Brazil into international markets, and one way of achieving this is direct investment abroad in order to establish a commercial presence or to set up production units (BNDES, 2008).

Three government institutions support enterprise internationalization. They are the Brazilian Development Bank (Banco Nacional de Desenvolvimento Econômico e Social do Brasil, BNDES), the Brazilian Trade and Investment Promotion Agency (Agência Brasileira de Promoção de Exportações e Investimentos, Apex-Brasil) and the Ministry of Foreign Affairs (Ministério das Relações Exteriores, MRE). The first, the BNDES, has been supporting direct investment from Brazilian enterprises to foreign countries since 2003, mainly through funding and equity participation. In 2008 an international department was created within the BNDES with the aim of coordinating and implementing activities linked to the international performance of the organization (BNDES, 2015).

The BNDES offers different financial instruments for enterprise internationalization depending on the aim of the project.² General rules and the operating procedures for financing are stipulated for these instruments. Some instruments are financing lines aimed at specific clients, sectors and projects, and have more specific rules. In general, investments eligible for funding from the BNDES must be related to the setting-up of new productive units, acquisition, expansion, upgrading or shareholding. There

² During 2009 and 2014, the BNDES financed international firm activities, providing about US\$14.5 billion (Sheng and Carrera, 2016). Among the beneficiary firms are JBS, Geradau, Embraer, Banco Itaú, BRF Foods and Natura.

are also non-reimbursable funding for investments of a social, cultural (educational and research), environmental, scientific or technological nature.³ The BNDES is also involved in securities subscription and may participate as a subscriber to securities in publicly listed companies, in public or private issuances, or in companies that may join the capital markets in the short or medium term through a private issuance. Loan guarantees are another measure it offers (BNDES, 2015).

Apex-Brasil is the Brazilian agency for export and investment promotion, responsible for promoting Brazilian products and services abroad and attracting foreign investors (APEX-Brasil, 2015). This organization also supports enterprise internationalization, and there is even a special Enterprise Internationalization Programme (Programa de Internacionalização de Empresas). Through this programme, Apex-Brasil provides technical assistance and special information for OFDI. It provides training, workshops and seminars regarding internationalization; international management counselling; information about fiscal, accounting and legislative conditions, and the economic and political environment; market analysis; and match-making services, among others.

In the Ministry of Foreign Affairs, the Trade and Investment Promotion Bureau (Departamento de Promoção Comercial e Investimentos, DPR) is the unit responsible for the development of Brazilian exports and the implementation of foreign investment policies. It also supports the internationalization of Brazilian enterprise and publicizes national tourism statistics. The DPR also has an investment division (DINV) with an area dedicated to supporting the internationalization of Brazilian enterprises. Activities related to internationalization include compiling and publishing documents about opportunities in potential markets, and making arrangements and negotiating with foreign governments about the specific interests of Brazilian companies (Ministério das Relações Exteriores, 2015).

Another government initiative is Brasil Export, a centralized website that provides all the information regarding business and investment opportunities for foreign entrepreneurs who wish to invest in Brazil and for domestic entrepreneurs who wish to export to and invest in other countries. This information-sharing platform embraces several government agencies: the Ministry of Foreign Affairs; the Ministry of Development, Industry and Foreign Trade; and the Ministry of Agriculture, Livestock and Food Supply (Brasil Export, 2015).

There is little to suggest that the Brazilian Government is supporting OFDI through fiscal measures. There are programmes or fiscal incentives addressed to industrial

³ The BNDES offers nonreimbursable resources for specific projects. For instance, projects in applied research, technological development and innovation are supported as long as they address specific areas such as vehicles with low environmental impact, advanced manufacturing and intelligent systems, strategic mining and new technologies for the oil and gas sector. The BNDES can contribute up to 90 per cent of the total financeable items in a project.

development (RENAI, 2015), but these are not measures specifically oriented towards the promotion of OFDI. The Brazilian Government does not offer investment insurance in order to promote OFDI either.

Brazil has adopted an active policy for promoting OFDI and plans to maintain it. This intention has been clear since 2011 with the publication of the Greater Brazil Plan (Plano Brasil Maior), which explicitly cites the encouragement of investment as industrial policy (ABDI, 2015). The inclusion of the encouragement of foreign investment by domestic enterprises as explicit government policy is indicative of the government's commitment to promoting OFDI.

3.3. Chile

With regard to the Chilean industrial sector, the expansion of domestic enterprises during the period 1990–2000 had a significant impact on OFDI (Razo and Calderón, 2013). According to UNCTAD, Chilean MNEs began to take off in 2003, and from this year onwards, OFDI has grown steadily. Chile has the third-highest OFDI (stock) in Latin America, after Brazil and Mexico. In relative terms, (OFDI relative to the size of GDP), Chile led Brazil and Mexico (Razo and Calderón, 2010), and this remained the case even during the global crisis (e.g. 2008–2009).

The trends demonstrate the growing willingness of Chilean enterprises to invest in foreign countries. The intensifying external competition and domestic market saturation are often cited as the factors behind this trend (Calderón, 2007). Diversification is also a way for enterprises to protect themselves against local risks (Bengolea and Paúl, 1991), and represents another reason for Chilean enterprises to go abroad. Factors that facilitate Chilean OFDI include the democratization process in neighbouring countries, the privatization process in Latin America, and progress on economic integration processes and intergovernmental agreements that create a favourable business environment (DIRECON, 2015b).

Despite the importance of OFDI for Chile, no clear policy has been developed by the Government to support OFDI (Calderón, 2007). Chile, however, has a normative framework for investments abroad (table 3), with the Central Bank of Chile being the regulatory body overseeing OFDI (Bengolea and Paúl, 1991). Another Government programme in relation to OFDI is supervised by the Department of Investments Abroad (Departamento de Inversiones en el Exterior) and managed by the General Directorate of International Economic Relations (Dirección General de Relaciones Económicas Internacionales) (DIRECON, 2015a). The General Directorate of International Economic Relations is responsible for providing the background information that supports and facilitates economic policy, including those activities related to the internationalization of Chilean enterprises through OFDI. It also compiles statistics related to OFDI by Chilean enterprises.

Table 2. Home government measures for outward FDI promotion in Brazil

Economy	Home Institution	Measure	Support	Year	Main points
Brazil	Brazilian Industrial Development Agency (ABDI)	Institutional framework	Industrial, technological and foreign trade policy	2004	This policy considers three main pillars. One, the horizontal action lines, includes overseas investments.
			Productive Development Policy	2008	This policy has five strategic aims; two relate directly to the internationalization of home enterprises. The first, world leadership, has the intention of maintaining or positioning Brazilian companies among the five biggest world players in their area of activity. A further aim, differentiation, also known as brand valorization, works to position enterprises and Brazilian brands among the top five in their markets.
			Greater Brazil Plan	2011	This plan is aimed at improving the competitiveness of the industrial sector in both domestic and foreign markets. Some of the activities considered here relate directly to internationalization through OFDI.
	Brazilian Development Bank (BNDES)	Financial services	Equity participation Loans Grants Subscription of securities Guarantees	2003	Since 2003, the BNDES has supported the international expansion of Brazilian enterprises through direct investment abroad. The BNDES provides long-term financing, subscription securities and guarantees. The bank has specific finance lines, with the creditor receiving beneficial finance measures. Through BNDES Finem, the institution funds implementation, expansion and modernization projects. Home enterprises can request funding, as can their subsidiaries, as well as foreign enterprises, as long as the main shareholder is resident in Brazil. Funding can also be used to establish research and development facilities abroad. In 2008, the BNDES created an international area with responsibility for the coordination and implementation of activities linked to the international performance of both bonds and the BNDES.
	Brazilian Trade and Investment Promotion Agency (Apex-Brasil)	Information and other support services	Educational services Information support Matchmaking services Negotiation with foreign governments Brasil Export information platform	2003	Apex-Brazil is the Brazilian agency for export and investment promotion. However, it also supports enterprise internationalization and has a division named the Enterprise Internationalization Program. This program is for both enterprises wishing to expand abroad and those already performing in foreign markets. Some of the benefits: lowering risks, speeding up the internationalization process and lowering establishment costs. The pillars of this program are the following: readiness, strategic guidance, market analysis and international management. The Ministry of Foreign Affairs is another institution that conducts information activities. Its investment division develops and publishes investment opportunities in foreign markets and helps make arrangements and hold negotiations with foreign governments.

Source: Author's own elaboration, based on Brazilian Government websites.

Table 3. Home government measures for OFDI promotion in Chile

Economy	Home Institution	Measure	Support	Year	Main points
Chile	Central Bank of Chile	Institutional framework	Regulatory framework for OFDI	1990	The Central Bank of Chile regulates foreign investments by Chilean enterprises as specified in Chapter XII of the Compendium of Foreign Exchange. This legislative document contains information about investments, deposits, credits, disposal of funds, institutional investments and their respective regulations for Chilean investments abroad.
	General Directorate of International Economic Relations (DIRECON)	Information and other support services	OFDI reports and statistics	1990	The Department of Investments, managed by the General Directorate of International Economic Relations, carries out monitoring and tracking of direct investments from Chilean enterprises abroad and the compilation of reports related to this activity.

Source: Author's own elaboration, based on Chilean Government websites.

3.4. Mexico

Foreign expansion by Mexican companies was negligible until the late 1990s. However, the 2000s began with a notable increase in the flows abroad of domestic capital, and this trend has grown over subsequent years, with the exceptions of 2001, 2008 and, more recently, 2012. The growing internationalization of Mexican enterprises has been facilitated by the liberalization of the national economy (Basave and Gutiérrez-Haces, 2010), through its integration with other markets in and outside the region.

During the past two decades, government policy as well as academic research agenda have focused on the attraction of inward FDI. The Government has only recently (since 2007, as explained below) become concerned about OFDI, and its involvement in the foreign expansion of domestic firms is increasing (table 4).

ProMéxico is a Mexican government institution in the form of a public trust controlled by the Economy Secretariat (Secretaría de Economía), which is in charge of strengthening Mexico's participation in the international economy. This institution was created by presidential decree on June 13, 2007. The decree states (article 4-II) that one of the purposes of this public trust is to promote and to support export activity and the internationalization of Mexican enterprises (SEGOB, 2007). The same decree

states that the mission of ProMéxico is “to promote the attraction of foreign direct investment and the export of goods and services, as well as the internationalization of Mexican companies.”

One of the main aims of ProMéxico was the internationalization of Mexican enterprises, yet until recently there was little information about specific actions, programmes or initiatives. The only information available was documentation relating to the proposed promotion of OFDI by the Mexican Government. Some of these documents were the Guidelines for the Operation of ProMéxico Support and Services 2012 (*Lineamientos para la Operación de los Servicios y Apoyos ProMéxico 2012*) (ProMéxico, 2012a) and the ProMéxico Organic Statute (SEGOB, 2011). There has also been a special unit within ProMéxico referred to as the Coordination of Processes for Enterprise Internationalization (*Coordinación de Procesos para la Internacionalización de la Empresa*) (ProMéxico, 2012b).

In the past, although ProMéxico was undertaking activities aimed at supporting Mexican OFDI such as advisory support, technical training and assistance for business trips, in reality these instruments were also used to promote exports as well as to assist Mexican enterprises interested in developing production activities overseas. Thus, the foreign expansion of Mexican enterprises took place arguably without any measures specific to supporting OFDI (CEPAL, 2012).

The current situation is somewhat different. Internationalization is a matter that the Mexican government is taking increasingly seriously, and even when internationalization is part of the same structure that ProMéxico has for exports and for the attraction of FDI, the division between the three areas is clear. ProMéxico is assisting the internationalization of domestic enterprises in three ways, through services, support and advice (ProMéxico, 2015).

The measures offered by ProMéxico in the promotion of OFDI can be split into two categories. The first addresses domestic enterprises that have already expanded abroad and the second, domestic enterprises that are looking to expand their productive activities to foreign markets. For the first category, ProMéxico offers services and support. Services consist of activities related to international promotion, arrangement of meetings with foreign customers and advertising. In terms of support, ProMéxico offers technical, legal and marketing advice; business plans for internationalization of a company; business trips; and rent of overseas sales offices, among other services. These supports are offered as reimbursements; the firm pays for them and ProMéxico reimburses the costs afterwards.

The advisory measures are mainly directed towards enterprises that are planning to expand into foreign countries, although enterprises that already have an international presence are also eligible. Some of the benefits that firms can receive from these programmes are information about foreign markets and matchmaking services,

networking with foreign governments as well as with private institutions abroad, and intellectual property advice and viability studies.

For the remaining 16 countries in Latin America, available information suggests that there are few explicit policies promoting the internationalization of domestic enterprises. Investment promotion agencies from these countries only perform activities related to exports and the attraction of foreign capital.

4. Conclusion

Among Latin America countries that promote OFDI, Brazil has the most developed policy and institutional framework specifically addressed to this aim. Chile has only a regulatory framework for OFDI and periodic reports of such activity, which is important but does not qualify as proactively promoting OFDI. In Mexico, internationalized enterprises have access to export promotion measures. Additional support measures mainly consist of information provision.

Future research is needed in Latin American countries on institutional conditions, HCMs, features of ownership (e.g. public or private ownership), optimal measures for enterprises, and the effects and impacts of the internationalization of companies from the region.

Table 4. Home government measures for OFDI promotion in Mexico

Economy	Home Institution	Measure	Support	Year	Main points
Mexico	ProMéxico Information and other support services Financial services	Institutional framework	ProMéxico Organic Statute Guidelines for the Operation of ProMéxico Support and Services	2007	ProMéxico promotes the attraction of FDI and exports, and the internationalization of Mexican enterprises through OFDI. These documents suggest the promotion of the internationalization of Mexican enterprises although this action is not made explicit. Nowadays, internationalization is part of the structure that ProMéxico has for exports and FDI attraction, and promotion takes three different forms: services, support and advising.
		International promotion Matchmaking services Linking and networking with foreign governments Intellectual property advising and viability studies	Measures related to information about foreign markets and matchmaking services, networking with foreign governments as well as with private institutions abroad, and intellectual property advising and viability studies are available for enterprises that have already internationalized and for enterprises looking to expand their activities to foreign markets.	2012	
		Grants	Grants take the form of reimbursements; they are the only financial services measure. Among these measures can be named the following: advising (technical, legal, trademark registration, marketing, business plan, suppliers, international certifications), business trips and rent of overseas offices. These measures are mostly addressed to internationalized Mexican enterprises and their exports.	2012	

Source: Author's own elaboration, based on Mexican Government websites.

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International Investment Law and Development: Bridging the Gap

Edited by Stephan W. Schill, Christian J. Tams and Rainer Hofmann (Cheltenham: Edward Elgar, 2015), vii+473 pages

Conceptual issues underpinning the thorny relationship between international investment law and development can be grouped into a number of key themes. At the core of one such theme are questions pertaining to substantive and procedural investment protection rules. Are these rules development-friendly? Do they reflect the evolving views on development and the changing role of foreign investors who are now expected to not only create economic growth but also do so in environmentally and socially-friendly manner?¹ And, do international investment norms provide sufficient room for host states to retain their right to pursue public policy objectives, including policies fostering sustainable development?

Another key area of legal discourse straddling international investment law and development studies concerns the making and change of international investment norms. Does the international investment regime sufficiently enable developing countries to make a tangible input in the process of formation, reform and application of investment rules? Were the views and concerns of developing countries taken into account when international investment law was conceived – was development ever the driving force behind it?

The volume reviewed in this essay tackles these key themes from various perspectives. Schill, Tams and Hoffman's edited collection comprises an array of essays exploring numerous problems presented by the investment versus development conundrum. As the editors observe in the opening chapter, "the relationship between international investment law and international development law has long been a history of ignorance and mistrust" (p. 3). For decades, the fostering of economic development has been one of the key justifications for the existence of international investment treaties and of their investor-state arbitration mechanism. Yet the actual capacity of the international investment regime to promote development – the very question of whether concrete investment treaty rules and their application are development-friendly – continues to generate divided views. Both the doctrine and scholarship of international investment law had long persisted in either ignoring or

dismissing the need to engage with the law of international development. The edited collection seeks to bring together these hitherto autonomous strands of scholarship.

At one end of the spectrum is Muthucumaraswamy Sornarajah with his ever fierce and unwavering criticism of international investment law. He draws on recent empirical

¹ UNCTAD (2015, p. 127).

studies questioning the correlation between investment treaties and the flow of FDI and economic development. The true purpose of investment treaties, he argues, was to legitimize “plunder under the cloak of a law made through instrumentality of power” (p. 47). As the very proliferation of investment treaties in the 1980s is often seen as a direct consequence of diminished development assistance, Sornarajah argues that “investment treaty law lied when it stated that it is fashioned to promote economic development in the poorer world...Over three thousand treaties resulted from the pressures to conform to the lies or otherwise access to loans and other facilities would be denied” (p. 50). Similar skepticism can also be discerned in Celine Tan’s exposition of newly proliferating narratives proclaiming investment treaties to be vehicles of both economic development and good governance. As she insightfully notes, “the language of good governance, its associated rule of law narrative and their relationship to development outcomes have been used to justify the normative and institutional evolution of law and policy in this area” (p. 147). Tan cautions “against the ahistorical import of the good governance agenda into the international investment law and policy unless accompanied by broader systemic review and reform of the regime” (p. 148).

In a stark contrast, Yannick Radi advances a narrative of international investment law as a regime that has been created to, and is driven by, the development rationale. He argues that despite the fact that some arbitrators have applied investment treaties in a way that “fails to adequately take into account the public interests attached to the concept of the right to development and sustainable development” (p. 72), development still constitutes the teleological focus of international investment law. Regrettably, however, Radi’s claim that international investment law “has always aimed primarily at the promotion of economic development, with the protection of foreign investors being only instrumental to it” (p. 75) is not borne out by other constitutive features of the regime. On the contrary, as Krista Nadakavukaren Schefer argues in her chapter on investment treaty law and poverty reduction, international rules on investment protection “did not originate from any development impulses” (p. 379). International investment law may well proclaim wealth creation to be one of its key objectives, but to understand the regime’s capacity to promote development, we need to examine concrete rules on investment protection which are first and foremost concerned with property rights of investors. Once we look beyond the preambles and analyse the way substantive investment protections have been framed and construed – including provisions (or lack thereof) on investor misconduct, on contributory negligence and the calculation of damages awards – the development promise of international investment law and its feasibility become highly questionable. Consider, for example, the investor’s right to claim damages. Ever since its inception in early investment treaties, the right to damages has been justified by reference to the need to lower risks associated with investing in a foreign country and reducing the cost of capital for host states, which would arguably accelerate

their economic development. If investment treaties are aimed at attracting low-cost capital for development, this objective appears to be countered by the extent of the host states' actual and potential exposure to staggering damages awards – with the amounts claimed by investors at times exceeding the foreign exchange reserves of a respondent state.² As the number of investment arbitration cases brought against developing countries and the amount of compensation sought by claimant investors have risen sharply,³ the question arises whether the development rationale at the heart of investment treaty protection should “innately extend to a willingness to attract any kind of foreign capital, at all costs” (García-Bolívar, 2011, p. 587).

Radi's argument is also confounded by multiple instances of arbitral tribunals dismissing the relevance of express references to development featuring in the ICSID Convention and investment treaties.⁴ As the opening chapter of the volume concedes, arbitration practice and scholarship are divided over “whether the inclusion of the reference to economic development in the preamble of the ICSID Convention should inform the interpretation of the term investment” (pp. 24–25) and whether economic development should be regarded as a relevant criterion in determining the level of protection investors can enjoy under substantive standards such as fair and equitable treatment.

Radi is certainly correct that investment arbitration jurisprudence is not pro-investor in its entirety, yet this alone does not change the fact that currently the regime has limited capacity to accommodate development concerns. As acknowledged in a recent UNCTAD report, far from being development-orientated, traditional investment treaties – with their silence on investor responsibilities and lack of safeguards for the right to regulate – need to be reformed to maximize the positive contribution investment can make and to avoid negative impacts on the host communities. To Radi, however, such gaps in investment treaty rules are precisely the opposite: instead of seeing them as an impediment to development-friendly interpretation, he argues that the indeterminacy of the early treaties have created considerable space for arbitral law-making. Yet Radi's claim that arbitrators have harnessed that space to construe investment treaties in a development-friendly manner is belied by incontrovertible evidence from investment arbitration awards. Efforts by some tribunals to deploy proportionality and other such legal devices to achieve a more balanced interpretation of treaty provisions does not change the fact that a series of arbitration awards – including those against Argentina – have been largely inimical to development concerns. While Radi claims that civil society critiques of investment law are “misled by deficiencies of legal reasoning”, his call to pierce the veil of awards

² See Sornarajah (2011, p. 640).

³ UNCTAD (2015, p. 124).

⁴ See for example *Fakes v Turkey*, Award, 12 July 2010 (ICSID Case No ARB/07/20) para 11.

and uncover their *ratio decidendi*, if applied to his own narrative, might render the latter unconvincing.

Christina Binder's analysis of international investment law and its implications for indigenous people also falls within the more optimistic end of the spectrum: whilst acknowledging the potential for conflict, she argues that there are ways in which the existing regime can accommodate the protection of indigenous people's rights, thus promoting a more inclusive concept of development alongside safeguarding economic interests of foreign investors. Such solutions range from provisions on jurisdiction and applicable law in investment arbitration to the greater use of the principle of systemic integration under Article 31(3) (c) of the Vienna Convention on the Law of Treaties and the use of provisions on third party participation in arbitral proceedings. Binder also concurs with other contributors to the volume in highlighting the importance of treaty reform and the use of impact assessments.

Markus W. Gehring and Marie-Claire Cordonier Segger are cautious in their evaluation of international investment law's capacity to facilitate development. They point out that FDI may "directly promote sustainable investments, for instance generating capital for renewable energy technologies and infrastructure which help mitigate climate change" (p. 95). However, the authors are also cognizant of empirical evidence showing that FDI "can also adversely affect the global environment particularly ill-considered new investments relying on obsolete technologies in the extractives etc." (p. 96). They suggest enhancing sustainability of investment treaties by increasing the opportunities for public participation, building negotiation and drafting capacity for developing countries, and the use of impact assessments, and recalibrating investment treaty provisions. A contribution by Andrea Saldarriaga and Kendra Magraw is similarly forward-looking in engaging with the question of how substantive and procedural norms of international investment law could be reinvented in a more development-friendly key. They highlight a crucial part UNCTAD has come to play in fostering development-friendly investment policies, including through its Investment Policy Framework for Sustainable Development, which comprises guidelines for national investment policies and options for international investment agreement negotiators. These are designed to help policymakers to harness investment rules supportive of sustainable development. The importance of an innovative approach to treaty-making – to mainstream sustainable development and in particular to reconcile investment protection with labour rights—is further explored by Vid Prislan and Ruben Zandvliet. They note that although the imposition of higher labour standards has not yet been challenged in investment arbitration, there is a string of arbitral cases where the disputed legislation concerned labour regulations.

The fact that development concerns are currently far from being fully operationalized in investment treaty law and arbitration is clearly demonstrated in two contributions which explore, through meticulous analysis of treaty rules and arbitral awards,

problems arising in countries in transition from authoritarian to democratic rule. Jonathan Bonnitcha argues that currently international investment law is indifferent to changes in the form of government in a host state. The fact that an investment was made during a period of authoritarian rule does not change its eligibility for treaty protection. Investment treaty law, as it stands today, in particular rules on protected investment and principles of compensation, delimits the capacity of incoming democratic governments to reorganize their economies in pursuit of new development priorities. In his examination of the cognate issue of international protection of contracts concluded with non-democratic governments, Walid Ben Hamida shows that international investment law does not distinguish such contracts as a separate category and thus protects them in the same manner as any other foreign investment contracts. Although many scholars argue that democracy and good governance have a positive impact on economic growth, Ben Hamida insightfully points to evidence which counters this view. Investors do not necessarily value democracy (and, one could argue, export democratic values in their operations); indeed, “for a commercial company trying to make investments, you need a stable environment. Dictatorships can give you that” (p. 314).⁵ This, however, may change if the new generation of treaties follows some of the recent models, such as that set by the Cotonou Partnership Agreement where the promotion of peace, security, stability and democracy features as one of the key treaty objectives. The inclusion of express references to democracy in investment treaties may necessitate tribunals to take into account the impact of an investment on the promotion of stable and democratic political environment.

The emergence of new and arguably more progressive models of treaties raises the question about the sites where such progressive drafting originates and the factors driving the process of renewal and change. Do these new treaty models reflect the nationally-felt rather than internationally-imposed approaches to investment protection? Do developing countries have a say in shaping the evolving landscape of investment treaty law?

These questions are alluded to in Diane A. Desierto’s exploration of how the right to development could be mainstreamed into international investment law. One way to achieve this would be for states to reconfigure their own internal decision-making structures relating to investment. For instance, a host state should, prior to approving investment projects, put in place adequate regulatory safeguards to ensure environmental and social compliance and to design the investment projects so that it enables the participation of affected communities and allows fair distribution of benefits among the relevant constituencies. To establish a process of economic, social, cultural and political development, it is crucial that an architecture

⁵ Quoting from Avery (2000).

for compliance with the host state's human rights obligations is built directly into "the contractual, administrative, and regulatory infrastructure of the international investment project, operationalized under current corporate social responsibility mechanisms, human rights due diligence processes, environmental and social impact assessments accompanying the contract planning, formation and monitoring processes" (p. 351).

While this proposal indeed goes a step further by bridging the gap between calls for a more development friendly international investment law and the reality of investment decision-making at a national level, it also highlights the problem with shifting the burden of creating a more development-friendly investment framework onto developing states which frequently lack the requisite human, institutional and economic capacity. Likewise, the unresolved issue here is whether the creation of domestic mechanisms fostering more development-friendly investments can be reconciled with the bulk of investment treaties and arbitration jurisprudence that remain open to criticism for a failure to adequately accommodate development concerns. There is a need to align domestic investment protection rules with states' investment treaty commitments: these two frameworks often evolve under disparate influences and do not always reinforce and replicate one another. One manifestation of such discrepancy was highlighted in my recent study of investment law-making in Central Asia where instances of progressive and innovative rules on socially responsible investment can be found in national legislation of Kazakhstan but not in its investment treaties.⁶ This brings into a spotlight the fact that many developing states continue to be rule-takers and their national law and international commitments are often the product of distinct international influences, including donor-sponsored legal reform initiatives and pressures to sign international investment treaties.

The fact that developing countries are frequently rule-takers and have thus been able to make a limited input in the shaping of international investment norms is explored in Antonius R. Hippolyte's contribution which focuses among other things on regime bias which can manifest itself in the interpretation and application of international investment law in ways that are biased systematically against developing countries' interests. "Regime bias illustrates how international law commonly serves as an agent of First World interests and overwhelmingly reflects continental legal thought shaped during colonialism" (p. 195). Hippolyte claims that "nowhere is regime bias clearer than in international investment law and the manner in which developing countries have engaged with this regime" (p. 197). He also draws attention to the lack of real participation of developing countries in international investment law-making: in addition to having very limited input into drafting and negotiation of investment treaty norms, developing countries are also minimally involved in the current recalibration

⁶ See Sattorova (2015).

of investment treaties the process which resulted largely due to dissatisfaction by developed states with the invocation of investment treaties against them. One could also add to this the comparatively low number of arbitrators from developing countries that could influence the formation of investment jurisprudence by being appointed to panels and partaking in shaping investment jurisprudence. Whilst offering a useful conceptual framework for problematizing the thorny relationship between investment protection and development, the chapter would have been even more valuable if it had offered more concrete examples of such bias.

To conclude, the edited volume offers a rich and varied array of contributions all of which go some way towards bridging the long-standing divide between international investment law and development studies. It most certainly provides further food for thought about international investment law, its *raison d'être* and consequences. The importance of the volume for contemporary legal discourse on investment protection and development stems from its timeliness, far-reaching scope and the fact that it highlights new areas and problems on which future scholarship should focus its attention. The volume is likely to become an important point of reference for academics, policy-makers as well as students of international investment law and development.

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The Eclectic Paradigm: A Framework for Synthesizing and Comparing Theories of International Business from Different Disciplines or Perspectives
Edited by John Cantwell (Basingstoke: Palgrave Macmillan, 2015), vii + 280 pages

This edited volume by John Cantwell, the outgoing editor-in-chief of *Journal of International Business Studies* (JIBS), presents a special compilation of articles on the eclectic paradigm. Cantwell has done an excellent job in selecting articles from *JIBS*, which is the leading journal in the field of international business (IB), and writing up the introductory piece. The book has nine chapters including the introduction by Cantwell, which provides a holistic account of the eclectic paradigm – how it emerged and developed over time. The introduction is split into five sections: a) the origins of the eclectic paradigm; b) the age of the powerful hierarchical large firm, and rising industrial concentration; c) the age of the knowledge-driven global economy; d) the “new age” of more open and informal business networks; and e) the eclectic paradigm in the new era.

Cantwell presents the eclectic paradigm as a meta-framework for the cross-disciplinary analysis of IB activities. He suggests that the major aim of the book is to enable conversation between scholars, interested in the theoretical explanation of IB activities, from cognate backgrounds. The “O”, “L” and “I” variables provide a bond and a common language through which fragmented explanations of multinational enterprise (MNE) activities can be brought and analysed together to enhance academic understanding.

The selection of articles in the edited volume adequately reflects on the development of eclectic paradigm from the viewpoint of allied disciplines, primarily institutional economics, strategic management and political science. As far as Cantwell introduces the eclectic paradigm as a framework for synthesizing and comparing theories of IB from different disciplines or perspectives, he succeeds in broadening the original perception about the eclectic paradigm as an envelope for economic theories of IB.

Interestingly, Cantwell stresses on the contribution *JIBS* has made in the development of eclectic paradigm. Indeed *JIBS* has played a significant role in the development of the eclectic paradigm but the contribution has been both ways. Moreover, there is a range of books and articles (for example, Dunning, 1977, 1979, 1981, 1991, 1993, 1997, 1998, 2000, 2001, 2002, 2006a, 2006b; Dunning and Lundan, 2008a, 2008b, 2010) in mainstream economics and other IB journals, where Dunning proposed, extended and defended the eclectic paradigm.

In the edited volume, Cantwell has carefully selected three exclusive pieces by John Dunning: “Towards an Eclectic Theory of International Production: Some Empirical Tests” (Dunning, 1980) – chapter 2; “The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions” (Dunning, 1988) – chapter 3; and “Reappraising the Eclectic Paradigm in an Age of Alliance Capitalism”

(Dunning, 1995) – chapter 5. These articles largely focus on the original formulation and initial developments of the eclectic paradigm.

Chapter 2 puts forward the original formulation of the eclectic paradigm, which was initially proposed as an “eclectic theory” of international production. Cantwell (2015) gives a useful account of the classical perspectives of international business as a background of the origin of the eclectic paradigm. He emphasizes the fact that in the early 1970s, Dunning was “influenced” by the work of Hymer (1960), which led to a shift in Dunning’s focus on the firm level activities. By mid-1970s, this focus eventually culminated into the initial formulation of the eclectic paradigm, and Dunning (1980) set out ownership (O), location (L) and internalization (I) as the determinants of international production, and conceptualized an interrelation between these variables.

Chapter 3 presents the more mature version of the eclectic paradigm. In fact, it is the most significant article in the book. In this article, Dunning (1988) presented a restatement of and some possible extensions to the eclectic paradigm, while addressing various criticisms made of the eclectic paradigm. Cantwell argues that the restatements of the eclectic paradigm in 1988, and later, made the eclectic paradigm “a mean by which the various relevant theories of IB could be identified (according to which question was being asked), and then suitably combined or compared as appropriate” (p. 1).

Chapter 5 presents a reappraisal of the eclectic paradigm in the age of alliance capitalism. In this article, Dunning (1995) discussed the implications of the “advent” of alliance capitalism for the theorization of MNE activity. He emphasized that the eclectic paradigm needs to account for the competitive advantages arising from the interdependence and interconnectedness of the firm and the way it organizes transactions with related parties. Dunning suggested that the boundaries of the firms, countries and markets are increasingly becoming porous and therefore seeing them within their restricted boundaries gives an incomplete view of the MNE activity.

Emphasizing the importance of network for the IB field, Cantwell links the flagship firm’s ability to derive “O” advantages from increasingly organizationally and geographically dispersed networks with the notion of dynamic capabilities. He stressed that the “O advantages entail the capabilities to orchestrate IB networks so as to generate a more powerful and a more sustainable stream of innovation, and to cultivate new combinations of knowledge especially at those nodes in global value chains in which the greatest value creation can be achieved” (p. 14).

Cantwell addresses the debate regarding the relevance of “O” and “I” advantages. He emphasizes that the analysis of the transaction costs explain the boundaries of the firm (Buckley and Casson, 1976), while the generation of the firm’s capabilities explains its evolutionary path (Dunning and Lundan, 2008b). He thinks that “it is unfortunate that in the IB field a continuing undercurrent of scholarship has persisted

that has treated these two approaches as mutually exclusive alternatives” (p. 7). He views the eclectic paradigm as a holistic framework for analysing a wider system of IB relationships that reach beyond the firm and other actors.

He also briefly touches upon the debate regarding the relevance of the Linkage, Leverage and Learning (LLL), as proposed by Mathews (2006). He suggests that the LLL framework is not an alternative to the OLI framework, as also empirically tested in recent research (Buckley, Forsans and Munjal, 2012; Munjal, 2014). The evolving stream of research in this area suggests that the LLL mechanisms instead provide useful insight into the formation of sustainable “O” advantages that are particularly relevant in the age of alliance capitalism and knowledge-driven global economy (e.g. Buckley et al., 2016a, 2016b; Munjal et al., 2013).

Chapter 4 includes a seminal piece on the “Political Aspects of MNE Theory”, authored by Boddewyn (1988). This is an extremely useful inclusion because this chapter highlights the fact that non-market behaviour of MNE is not included in traditional MNE theory and extends the eclectic paradigm by weaving political dimensions within the “O”, “L” and “I” advantages. Empirical research in this area suggests that the inclusion of the non-market variables enhance the explanatory power of the eclectic paradigm (Buckley et al., 2013). Furthermore, the article criticized the eclectic paradigm for being limited to explaining the necessary conditions for the FDI by MNEs. Boddewyn (1985) suggested that for a complete explanation of MNE behaviour motivations and precipitating circumstances should be considered together.

Cantwell seems to have broadly packed political aspects within the “O” and “L” advantages. He stresses that the competence to coordinate own activities in the external social and political environment reflects the MNE’s capability to manage non-market relationships (Oi). He argues that this classification can help us understand how the eclectic paradigm has been applied in the IB scholarship and its approach to political scientists engaged in IB research.

Chapter 6, “Is Dunning’s Eclectic Framework Descriptive or Normative?”, by Brouthers, Brouthers and Werner (1999), examines the prognostic power of the eclectic paradigm. The authors conclude that the eclectic paradigm is descriptive but it has the characteristics of being a normative model. The empirical analysis show that the interaction between “O”, “L” and “I” variables, as proposed by Agarwal and Ramaswami (1992), makes it normative adding valuable implications for managers. Cantwell states that “the eclectic paradigm can equally well frame both the analysis of the objective reality of received patterns of IB activities, and the strategies and intentions of the firms and actors that are engaged in these activities” (p. 17).

Chapter 7 “Is Knowledge Power? Knowledge Flows, Subsidiary Power and Rent-Seeking Within MNCs”, by Mudambi and Navarra (2004), discusses the effect of knowledge creation and knowledge flows within dispersed MNE network. This

chapter also argues that the subsidiary's own objectives may diverge from the MNE's overall objective. In such case, a subsidiary can bargain power within the firm, given that the subsidiary is able to create and reverse transfer the knowledge back into the MNE's network. This important contribution sheds light on the process of how MNE's scope gradually enhance over time. Recent work by Pereira, Munjal, and Nandakumar (2016) weaves these aspects into a theoretical framework on headquarter-subsidiary relationships. They suggest that creation and reverse transfer of knowledge by subsidiary back into the MNE's network leads to interdependence between headquarter and subsidiary. A moderate degree of interdependence is "best for both" while higher degree of interdependence may lead to the MNE's "transformation".

Cantwell emphasizes in the present age of global interconnectedness and advances in information technologies, MNE structures are constantly transforming. Subsidiaries with a greater degree of autonomy, and embeddedness in host country networks generate "new domains of capabilities" for the MNE. In terms of the "O", "L", and "I" advantages, this reflects that intense interaction between "O" and "L" advantages and the power of the eclectic paradigm to analyse the headquarter-subsidiary relationship.

Chapter 8 presents "An Evolutionary Approach to Understanding International Business Activity: The Co-evolution of MNEs and the Institutional Environment", authored by Cantwell, Dunning and Lundan (2010). It is one of the last articles authored by John Dunning. The acknowledgement in the chapter states that Dunning died while this article was still in the second round of revise and resubmit. Although this article does not directly focus on the eclectic paradigm, it stresses that the eclectic paradigm includes "institutional ownership advantages (Oi) that incorporate the firm-specific norms and values guiding decision-making, as well as an imprint of the institutional environment (L attributes) of the home country", through a reference to Dunning and Lundan (2008a, 2008b). Cantwell says, "Dunning never lost sight of the wider agenda for IB studies beyond the more specific question of the role of the MNE and the determinants of the boundaries of the firm. Part of this agenda has been to examine the interaction (or co-evolution) of the MNE with other organizations and with their institutional environment" (p. 7).

The book also includes an article by Teece (2014), in chapter 9, who puts forward "A Dynamic Capabilities-Based Entrepreneurial Theory of the Multinational Enterprise". Teece's contribution is primarily based on the analysis of internalization theory. He highlights a few shortcomings of transaction-cost based theories and proposes a capability-based theory of MNE by integrating the international management outlook with the IB perspective. Teece argues that the capability-based theory juxtaposes with traditional MNE theory, as traditional MNE theory does not adequately cover

the role of entrepreneurs, managers and leaders in the growth of MNE. Cantwell seems to support Teece's argument as he quotes in Cantwell (2014) that "the conceptualization of O advantages is akin to the to the notion of dynamic capabilities when translated into the IB context, as opposed to the more widely prevalent ordinary capabilities" (p. 14). These nuanced theoretical foundations on the dynamic capability building and evolutionary aspects are paving the way for new empirical studies, which suggest that the MNE's experience and learning mitigate the risk associated with the institutional environment at host country (Munjal and Pereira, 2015).

Overall, the book presents a very useful collection of articles that provide a panoramic view of MNE activities through the eclectic lenses of the OLI framework. In the last four decades, there has been an extensive volume of research that significantly contributes towards the development of the eclectic paradigm, published both within *JIBS* and in other mainstream IB journals, such as the *Journal of World Business*, *Management International Review*, *International Business Review*, *Transnational Corporation*, *Journal of International Management and Global Strategy Journal*. IB scholars can argue that the current book is a rather short collection and many deserving articles have not been included. This leaves scope for other similar compilations in the future on this important subject.

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Developing China: the Remarkable Impact of Foreign Direct Investment

By Michael J. Enright (Abingdon and New York: Routledge, 2017), 260 pages

At a time when globalization is increasingly challenged, it is rewarding to read a book that touts the promise of globalization, in particular the benefits of foreign direct investment (FDI). While international trade takes centre stage in the popular media, FDI is not only related to it but also at least as important in its own right, not just economically but also politically, geopolitically, socially, and otherwise. As most economic and social phenomena, it has multiple facets, of which the author chooses to highlight one, namely its critical role in economic growth and development.

The book starts with a very brief historical introduction, frankly too brief for my taste though understandable given the focus on the modern, post 1979 period. To me, the importance of a historical perspective rests not only with the 19th century humiliation of the country which the author rightly noted as a guiding light in China's approach to FDI, but with a lot more, starting with the limited entry of foreign influences millennia earlier and continuing with the "Self-Strengthening" search for "Western technology without western values", which underwrote much of the later ambivalence towards FDI. I am also missing a comparative perspective as the Government of China looked closely at the experience of Japan, in particular, and later also the Republic of Korea and Taiwan Province of China, imitating some of the relevant policies (e.g. limits on full foreign ownership in the early reform phases). At the same time, China did not follow Japan and the Republic of Korea in democratizing its political system, defying traditional economic views on the correlation between such reform and FDI volume. Indeed, one underexplored angle here is how the Government of China and the ruling party have leveraged China's unique system to extract concessions from foreign investors. This comparative angle merits, perhaps, a separate book, which may now include the lessons other nations have learned (or should learn) from the Chinese experience with FDI.

The book's focus is clearly on the modern reform period, where it does a good job in describing, in some detail, how China has leveraged foreign investment to transform a stagnant, backwater struggling economy, representing a mere three percent of global GDP, into what is now the second largest world economy and a foreign investor in its own right. To be sure, foreign investment was not the only factor catapulting China's rise, and most of the benefits accrued to the country would probably not have been materialized without concomitant internal changes, a point that should not be lost on those seeking to learn from the Chinese experience. Without market liberalization (albeit limited and incremental), property rights (ambiguously drawn and enforced but a huge step forward), and other transformational changes, FDI would have had but a limited value to the Chinese economy. Though the linkage between FDI and internal changes is not the focus of this book, it must be considered by any government fancying to replicate China's advance.

Among the book's many advantageous points are the accounts of FDI impact across industries (though not strictly from a comparative perspective, that is, FDI in different industries is outlined but rarely compared directly) and regions (where a map would have helped, also showcasing the impact on economic and social disparity), and the various case studies of different locals (e.g. Chongqing) and different companies (e.g. P&G). Here too it would have been helpful to develop some cases of Chinese companies of different sectors (state-owned, collective, private, hybrid) and how they have benefited from knowledge spillovers by foreign investors, intentioned or not. And again, it would have been instructive to note the negative impact in terms of company closures and the like, macro bird's view notwithstanding.

In its overall tone, the book is more descriptive than analytical, a plus for those looking for a fairly concise, yet comprehensive and full of relevant details, summary of foreign investment in China, but somewhat less useful to those seeking a deeper level of understanding and, in particular, debate; including scholars (more on that later) and other readers looking for, perhaps, a more balanced treatment, inclusive of negative repercussions for Chinese society and the rest of the world. For example, while foreign investment has helped China achieving double digit growth for decades, in the process lifting millions of Chinese from poverty and enabled its companies catch up with competitors, it also played a role in causing grave pollution, something that is acknowledged by the author but more in passing. Again, this should not be construed as criticism as every book has a domain and there will always be a limit in the extent to which a topic can be treated. Still, I expected to see more on the increasing disparities in China which FDI has surely impacted, in more ways than one, the current lamentation about the creation of a moral vacuum, and the resurfacing theme of "with Chinese characteristics", which can be partially seen as a backlash to FDI and its correlate influences, whether in media industries or otherwise. And, returning to the point of having a comparative perspective, what about the other dark side of China's inward FDI showing up in thousands of shutdown factories in the United States, Mexico, and other parts of the world, the impact of the rampant expropriation of intellectual property rights by any means possible (e.g. forcing foreign investors to transfer their technology, piracy, counterfeiting), and its possible squelching influence on global innovation. Again, this is probably beyond the scope of the book, but avoiding the issue does not help answer criticism that globalization is a zero-sum game. It is easy to label foreign investment as a "win-win" situation, it is more difficult, but important, to confront its dark side and convince people of the overall positive balance, if done right.

The book may appeal to policymakers, though those from developed nations in particular may find its treatment a bit one-sided. Adding a social and political context and, especially a comparative perspective, to the macro-economic perspective presented here should make this book even more potentially useful for policy makers who should also be reminded that "Chinese characteristics" is not only a slogan used

by Chinese leaders but also a relevant context without which any policy analysis will come short.

The book will also appeal to broader readership who seeks a good and succinct yet detailed descriptive summary of one of the biggest waves of foreign investment ever launched, a backdrop as well as an enabler to multiple other giant waves such as the rural to urban migration of hundreds of millions of Chinese. The book will be of more limited value to executives, not only for its macro-economic thrust but also, perhaps, because there are only brief case descriptions of foreign multinationals and, importantly, no cases written from the perspective of the knowledge recipients (or takers...).

Finally, the book will be of marginal benefit to most scholars except the uninitiated seeking a summary introduction to FDI in China as it does not (and, again, in all fairness, is not set to) address most of the theoretical issues and concepts in the field, such as entry mode choice and performance, knowledge transfer and management, knowledge management, cross-border alliances, and so on. For those, FDI in China provides a series of unmatched opportunities with which to test and or develop theory. Indeed, while the book is rich in references, the work of major international business and management scholars such as Peter Buckley and John Child is missing, among that of many others leading scholars. Once again, this is not a criticism of the book itself, which is comprehensive and insightful, but rather a reminder for readers that many of the questions raised by the phenomenon of FDI in China are answered elsewhere.

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Dunning, John H. (1979). “Explaining changing patterns of international production: in defence of the eclectic theory”, *Oxford Bulletin of Economics and Statistics*, 41 (November), pp. 269–295.

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