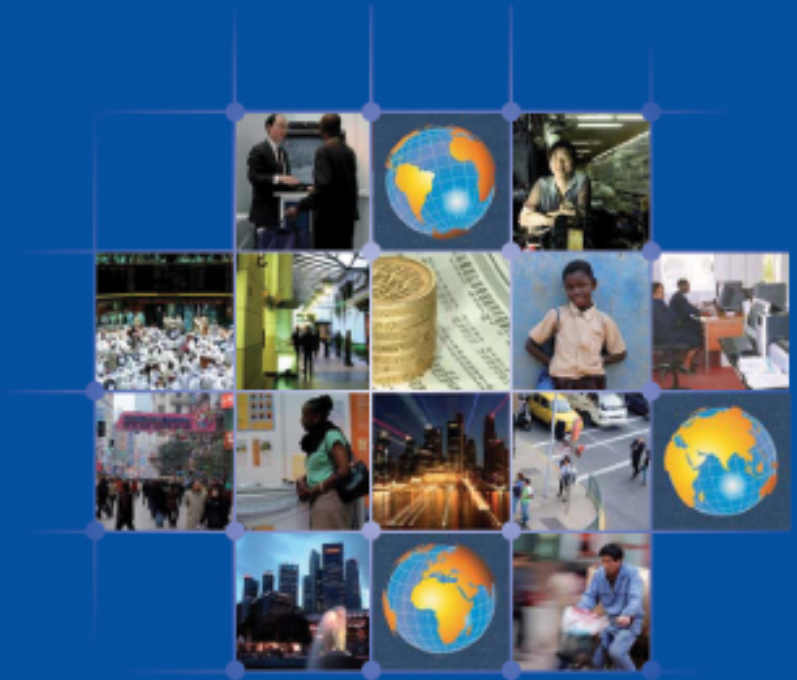
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

GLOBAL PLAYERS FROM EMERGING MARKETS:

Strengthening Enterprise Competitiveness through Outward Investment



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GLOBAL PLAYERS FROM EMERGING MARKETS: STRENGTHENING ENTERPRISE COMPETITIVENESS THROUGH OUTWARD INVESTMENT

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Preface

The landscape of international investment has taken on an important new dimension in recent years, with the advent and rapid expansion of foreign direct investment (FDI) from developing countries. Total outward FDI (OFDI) by firms from developing and transition economies reached $133 billion in 2005, the highest level ever recorded and 10 times higher than in 1990. This corresponds to about 17 per cent of world outward flows in 2005; in 1990 that share was only 5 per cent. The rise in the number of large transnational corporations (TNCs) from developing and transition economies is a reflection of this trend. For example, in the year 1990, only 19 companies based in developing and transition economies featured in the Fortune 500 list of the world's largest companies; by 2005, that number had risen to 47; and by 2006, it had reached 58. The trend is led by Asia, where three quarters of the top 100 TNCs from developing countries are headquartered, but there are significant numbers of TNCs from Africa and Latin America as well. Beyond the larger companies, there are vast numbers of small and medium enterprises investing abroad. Most investments by enterprises from developing economies go to other developing economies, often in the same region. This facilitates South-South cooperation and can result in the transfer of good practices to host country firms, especially through measures to enhance absorptive capacity.

Many firms from developing countries are now investing abroad to enhance their competitiveness by acquiring market access, technology, skills, natural resources and R&D facilities; they are also improving efficiency and building international brand names. Governments have recognized the developmental impact of this recent phenomenon and have introduced a number of support policy measures, ranging from liberalization and reforms of the regulatory environment to active promotion of OFDI. Regional integration has also played a role in encouraging outward investment by developing country firms.

Developing countries should not fear encouraging their firms, particularly those that possess competitive advantages, to go abroad. However, there is a need to embed specific investment policies that would include both inward and outward investment in a coherent economic development policy framework. In addition, dialogues among stakeholders should increase awareness and understanding of the factors driving OFDI from the South, as well as their potential impacts. There are risks and challenges for developing country enterprises investing abroad. If they are appropriately addressed, the risks of failure can be minimized and the positive impact on development maximized. Building enterprise capacity is one of the key success factors in this regard. This task entails efforts across a wide range of areas, from entrepreneurship and enterprise development to technology and education policy.

UNCTAD and other international organizations have an important role to play in increasing awareness and understanding of this phenomenon by providing analysis, technical assistance and a forum to exchange views and experience, fostering the building of consensus to realize the full benefit of the rise of FDI from developing economies. The development of the domestic industry or service networks, which would be able to link effectively with international production networks, also requires the promotion of entrepreneurship and enhancing competitiveness at firm levels, through technology and business linkages. UNCTAD's EMPRETEC programme has been effective in many countries in helping unleash entrepreneurial potential, introducing behavioural change and promoting the entrepreneurial culture. Business linkages programmes initiated by UNCTAD in various countries have facilitated the upgrading of suppliers and the integration of SMEs in regional or global value chains.

UNCTAD has initiated a broad dialogue to increase awareness and discuss issues on enterprise internationalization through OFDI. In May 2005, UNCTAD jointly organized with Fundação Dom Cabral (FDC) and the Ministry of Development, Industry and Foreign Trade of Brazil a national workshop in São Paulo on Global Players from Emerging Markets, which focused on Brazil's experience. UNCTAD also participated in the forums on internationalization of Chinese firms in April 2005 and 2006 in Beijing. Issues related to

enterprise internationalization and the role of OFDI were further discussed in the World Investment Report 2006 and at different intergovernmental meetings that identified the need to continue the policy dialogue and awareness building of this phenomenon at the regional and international levels.

UNCTAD has also conducted an Expert Meeting on Enhancing Productive Capacity of Developing Country Firms through Internationalization, held in Geneva, 5–7 December 2005. During this meeting, OFDI issues were discussed in depth from different perspectives, including those of policymakers, regulators, large and small firms, international organizations, researchers and others. This publication contains proceedings and case studies of this meeting. It is an initial attempt to promote better understanding of enterprise internationalization by developing country firms, including SMEs, through OFDI, especially as it relates to corporate strategies, trends, drivers, challenges, supporting policies and impact on enterprise competitiveness, as well as a base for further research and policy analysis of key issues in this area.

I hope this publication will constitute a useful input towards efforts on building awareness and capacity on enhancing enterprise competitiveness though OFDI.

Supachai Panitchpakdi
Secretary-General of UNCTAD

Acknowledgements

This publication is an initial attempt to promote better understanding of enterprise internationalization by developing country firms, especially on corporate strategies, trends, drivers, challenges and policy measures supporting OFDI. It was prepared by Fiorina Mugione and Kee Hwee Wee under the overall supervision of Tatiana Krylova. The support from the Investment Issues and Analysis Branch of the Division of Investment, Technology and Enterprise Development is gratefully acknowledged. Rosalina Goyena helped with the desktop publishing.

The following authors prepared country case studies for the publication, which were also distributed at the Expert Meeting on Enhancing Productive Capacity of Developing Country Firms through Internationalization, 5–7 December 2005, Geneva: André Almeida, Márcia Tavares, Erika Penido Barcellos, Álvaro Calderón, Sherban Leonardo Cretoiu, Álvaro Bruno Cyrino, Asim Erdilek, Alexe Giroud, Ana Vitória Alkmim de Souza Lima, Kari Liuhto, Hafiz Mirza, Hwy-Chang Moon, Jaya Prakash Pradhan, Caio César Radicchi, Reginald Rumney, Manoj Kumar Sahoo, Peeter Vahtra, Henry Wai-chung Yeung and Zainal Aznam Yusof.

Other authors have also prepared background documents distributed at the above-mentioned Expert Meeting: Federico Bonaglia, Peter Brimble, Andrea Goldstein, John Mathews, Michael Mortimore, Atchaka Sibunruang and Marjan Svetlicic.

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CHAPTER I

STRENGTHENING ENTERPRISE COMPETITIVENESS THROUGH OUTWARD INVESTMENT

A. Introduction

Enterprise internationalization encompasses exporting, integration into global value chains, small and medium-sized enterprises–transnational corporations business linkages and outward foreign direct investment (OFDI). The internationalization of developing-country enterprises through OFDI is receiving increasing attention from policymakers, business organizations, the international community and academia. The rise in OFDI from emerging economies[1] has resulted in a growing stock of such investment from these economies, providing an opportunity for a greater South-South cooperation and helping them better integrate into the global economy.

This publication examines why developing country firms are investing abroad more so than in the past, what drives their investment abroad, what the implications are for enterprise competitiveness, what the best practices and policy options are for supporting enterprise internationalization from emerging economies. It is based on a series of country case studies prepared by consultants and coordinated by UNCTAD in 2005–2006.[2]

[1] Refers to all developing economies and economies in transition.

[2] Including the issues note "Internationalization of developing country enterprises through outward foreign direct investment" (TD/B/COM.3/EM.26/2) prepared for the Expert Meeting on "Enhancing the Productive Capacity of Developing Country Firms through Internationalization", Geneva, 5-7 December 2005; Argentina (TD/B/COM.3/EM.26/2/Add.1); India (TD/B/COM.3/EM.26/2/Add.2); Singapore (TD/B/COM.3/EM.26/ 2/Add.3); the Russian Federation (TD/B/COM.3/EM.26/2/Add.4); and South Africa (TD/B/COM.3/EM.26/ 2/Add.5), as well as case studies on Brazil, Chile, China, Egypt, Malaysia, Mexico, the Republic of Korea, Slovenia, Thailand and Turkey.

B. Increasing OFDI from emerging economies

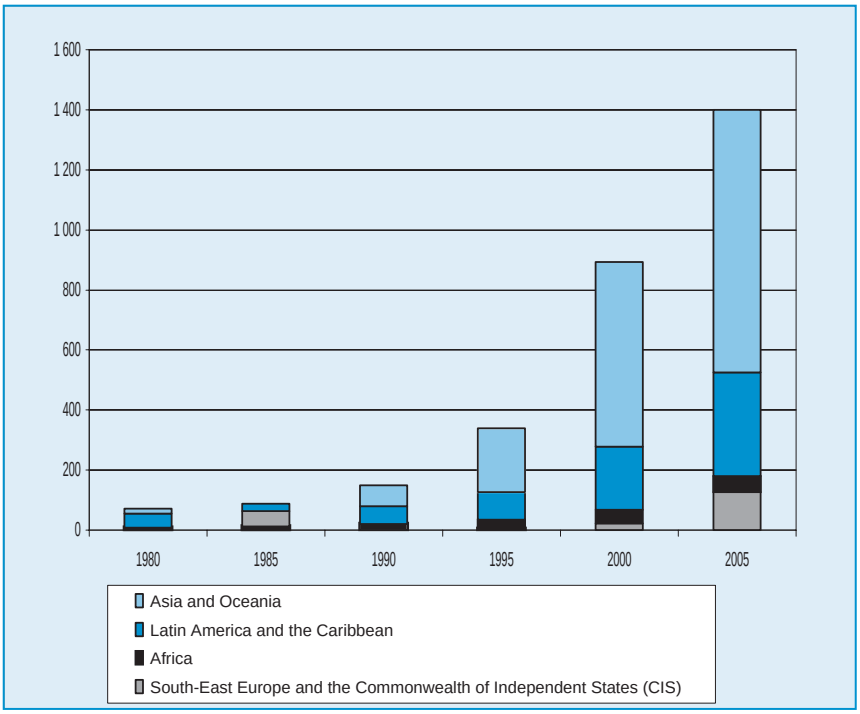
OFDI is not just associated with transnational corporations (TNCs). Small and medium-sized enterprises (SMEs) from developing countries and economies in transition are also investing abroad. They do so for various reasons, not least to increase competitiveness (see Section C). The process in which firms internationalize has shortened and enterprises do not need to expand domestically before they start operating in foreign markets as they did in the past (UNCTAD 2005a). The advent of technology and opportunities provided by globalization and regional integration have hastened the pace in which enterprises internationalize or/and regionalize their activities. The increase in enterprise internationalization from emerging economies has contributed to a rise in the number of TNCs from these economies, as has been documented in various UNCTAD publications.[3]

OFDI from developing countries and transition economies has risen rapidly, from $149 billion in 1990 to $1.4 trillion in 2005 (figure 1). These economies together accounted for 13 per cent of the world's OFDI stock in 2005, compared with 8 per cent in 1990. The compound growth rate of OFDI between developed countries and developing and transition economies is impressive. For instance, the developed countries recorded a 13 per cent growth in 1990–2005, and the developing and transition economies 17 per cent. More enterprises from emerging economies are now among the global players. The number of such firms reported in the Fortune Global 500 rose from 19 in 1990 to 58 in 2006.

[3] See UNCTAD (2003, 2004a, 2004b, 2004c, 2005a, 2005d and UNCTAD 2006).

Figure 1. Developing economies: OFDI stock, by region, 1980–2005

(Billions of dollars)



Source: UNCTAD, W*orld Investment Report 2006.*

Geographical distribution. Developing regions and countries have not participated equally in international investment flows. The internationalization of enterprises from developing countries is strongest in Asia, in particular East Asia, followed by Latin America. OFDI from Brazil, the Russian Federation, India and China is now growing rapidly. Other significant investors from developing countries include the Republic of Korea and Singapore. New emerging OFDI economies include Argentina, Chile, Malaysia, Mexico, South Africa, Thailand and Turkey. Different regions witnessed different OFDI patterns. However, most regions have seen an increase in OFDI, dominated by a few countries, as was the case in inward FDI. The lion's share of OFDI from developing countries goes to other developing countries. Most are within the same region and concentrated in the neighbouring countries.

Enterprises in Asia are the most active in investing abroad. They contributed to the region's OFDI stock of $874 billion in 2005, and a significant portion of the flows is intra-regional. Enterprises from economies in East Asia (e.g. China, Republic of Korea), South-East Asia (Malaysia, Thailand and Singapore) and South Asia (India) are internationalizing farther and faster. They cover a wide range of industries such as mining, manufacturing and services, including establishment of quality hotels and business processing operations. In mining, Asian enterprises have significant investment abroad. They include China: Minmetal, Baosteel, Sinopec and CNOOC; India: ONGC-Videsh; and Malaysia: Petronas. In manufacturing, they include China: Haier, Huawei Technologies, TCL and Lenovo; India: Tata, Reliance and Ranbaxy (many Indian SMEs are also expanding abroad, such as Roto Pumps (transport equipment), B4U Multimedia (music and entertainment), Cipla Ltd. (drug manufacturer) and ACE Laboratories (pharmaceutical)); Republic of Korea: Samsung, LG Electronics; Malaysia: enterprises that started small, such as Top Glove, Ingress and Munchy Food Industries, which have grown to sizable international enterprises; and Thailand: Siam Cement, Saha Union Group (textile and garments products) and Mitrphol Sugar.

Latin America and the Caribbean is the second largest source of OFDI from developing regions. Excluding the Cayman Islands and the Virgin Islands, which are offshore tax havens, Brazil, Mexico, Argentina and Chile (in that order) are the region's dominant investors. Most of the OFDI is within Latin America. Investment opportunities emanating from privatization in host countries, regional and geo-cultural factors encouraged intra-regional investment. Some Argentine companies such as Tenaris Siderca (steel), Techint (steel), YPF (natural resources), Pèrez Companc (oil and gas) and Accor (conglomerate) invest abroad to build up production

network, ensure better control of value chain and access to markets in Latin America. Argentine SMEs such as software industry enterprises Idea-Factory, Cubika and Sistemas Estratégios S.A., and industry and agricultural machinery SMEs such as Plà and Metalfor, have also invested abroad, mainly in the region. Brazilian firms such as Petrobras (oil and energy), Odebrecht (construction), Gerdau (steel) and Ambev (beverages) invest abroad to enhance their capabilities and market reach.[4]

Enterprises from *Africa* are less internationalized and those that have invested abroad are usually within the region. OFDI from the African continent rose from $20 billion in 1990 to $54 billion in 2005, but the pace of growth has been much slower compared with the 10-fold increase in Asia. Improved investment environment in host countries, regional integration, improvements in regulatory environment for OFDI and emerging investment opportunities (privatization) in Africa facilitated the emergence of regional investors. South Africa is the largest investor in the region, accounting for over 70 per cent of the region's OFDI stock in 2005. Most of the enterprises that have internationalized are large firms such as AngloGold Ashanti (gold production), Illovo Sugar (sugar production), Mondi (paper production), Steinhoff (furniture manufacturing) and the MTN group (cellular phone services). Small- and medium-sized South African enterprises such as Spanjaard Ltd., Metorex and DPI Plastics have also invested abroad.

Enterprises from the transition economies are also engaged in OFDI (Andreff 2003). Since the 1990s, most OFDI in the region came from the Russian Federation, which invested in energy- and mining-related industries, including gas and oil refining and distribution. Major investors include Lukoil, Gazprom, Novoship, Norilsk Nickel, Primorsk Shipping Corporation and the Far East Shipping Company. Russian SMEs have also invested abroad in neighbouring countries and Europe in IT and telecommunication activities. For instance, the LCS Group (IT) has invested in the United Kingdom as part of its corporate expansion and market access strategy. Galaktika (also IT) has done the same by investing in the Commonwealth of Independent States (CIS) markets.

Sectoral distribution. The industries where OFDI by developing country firms are most prominent include oil, gas and mining. OFDI in natural resources is significant for some economies, such as Argentina, China, Chile, India, Malaysia, the Russian Federation and Turkey. Manufacturing industries such as electrical, electronics, information technology, food and beverages are also important. In services, telecommunication, transport, utilities and tourism-related activities are key sources of OFDI.

Types of enterprises. Government linked companies (GLCs) contributed significantly to enterprise internationalization in some countries (e.g. Malaysia, China, Russian Federation, Singapore). Their size, financial resources and public status facilitated their internationalization as compared with the non-GLCs, in particular SMEs.

C. Drivers and motivations of OFDI

The economic literature identifies two waves of OFDI: the first was during the 1960s and 1970s, and the second from the 1980s onwards. During the first wave, firms were driven abroad mainly by efficiency and market-seeking factors (identified in literature as push factors[5]); their investments were mainly directed towards other developing countries, often to neighbouring countries, and were dominated by firms from Asia (India, the Republic of Korea, Hong Kong (China), Malaysia, Singapore) and Latin America (Argentina, Brazil, Mexico). The second wave was more strategic-asset-seeking and driven by a combination of "pull" and "push" factors (with pull factors dominating). During the second wave, developing country firms invested more in developed countries and other developing countries outside their own region. Hong Kong (China), Taiwan Province of China, Singapore and the Republic of Korea were the main players (Dunning et al. 1996).

A key driver of OFDI is competitive pressure. In a rapidly globalizing world, companies can no longer count on their home markets as a relatively secure source of profits. Competition from foreign firms is everywhere – through imports, inward FDI and non-equity forms of participation. These conditions make it all the more important for firms to pay attention to their competitiveness, and OFDI can influence and even be a dominant factor for the growth and success of businesses (Sauvant 2005, p. 16). Another significant driver is the improved

[4] Ambev has established a "trans-Latin" network of beverage and food production, and recently concluded a deal with Interbrew to create a new global brewing and beverages giant, InBev AS, based in Belgium.

[5] "Push" factors relate to economic environments in the home country as well as corporate strategies that encourage firms to go abroad. They include saturated home markets, currency appreciation, cost disadvantages, limited land, limited labour supply, and the need to follow competitors and suppliers. "Pull" factors relate to location-specific advantages of the host countries such as market potential, low-cost labour, incentives, investment opportunities, technology and skills.

regional economic environment. In all regions, geo-cultural proximity and affinity, and regional economic integration were important influencing factors. The need to follow customers, to offset competitors' strengths, to access low-cost labour and to take advantage of business opportunities (such as in real estate, infrastructure or services projects and privatization) were specific motives. The drivers of OFDI from developing countries fall into the following broad groups:

1. **Home-country environment.** It includes economic and policy factors, home market growth constraints, currency appreciation, improvements in the home country OFDI regulatory framework, capital account liberalization (relaxed exchange controls), signing of trade, investment agreements and double taxation treaties, and incentives (e.g. tax rebates and investment insurance for OFDI) by Governments in the country of origin.

2. **Host-country environment.** It covers *pull factors a*ssociated with host country attractiveness or opportunities for investment such as growth prospects and privatization, lower production costs, availability of natural resources, host Government incentives and regional development.

3. **Corporate-specific influences.** These include:

   - *Push factors* (e.g. rising costs in the home market, following competitors and suppliers, corporate internationalization strategy).
   - *Management factors* (e.g. availability of skills and knowledge needed to internationalize successfully).
   - *Chance factors* (e.g. being invited to supply a customer abroad).

The *motives* of enterprise internationalization by developing country firms can generally be clustered under four key areas.

1. *Market-seeking.* This relates to securing markets abroad, supporting trade channels and establishing new markets. For instance, South African companies have been actively investing in the rest of Africa to gain access to and secure markets in sectors such as food and beverages, other light manufacturing and services. Indian information technology (IT) and pharmaceutical companies have been investing abroad for market-related reasons as have Mexican, Russian, Turkish and Slovenian companies in neighbouring countries. To gain access to industrialized country markets, some garment manufacturing companies from China, for example, have invested in least developed countries (LDCs) that enjoy preferential trade privileges in the United States and European markets.[6] Russian oil companies have invested abroad to strengthen their distribution networks and to secure greater influence over their supply chains. For instance, they acquired petrol stations abroad for better control of value chain in retail distribution of their petroleum products.

2. *Efficiency-seeking***.** By extending their production value chains into low-cost locations, developing country firms are investing in other lower-cost developing countries (e.g. Korean and Singaporean manufacturing companies investing in Indonesia, Thailand and Viet Nam, or textiles and clothing companies extending their activities to Cambodia and parts of Africa to take advantage of low-cost production).

3. *Strategic-assets-seeking.* Strategic-assets-seeking FDI is an investment to increase or enhance the *existing* competitive advantages of a firm by acquiring or accessing *new* competitive advantages (Dunning and McKaig-Berliner 2002, p. 7). Developing country enterprises invest abroad to acquire brand names and strategic production facilities. For instance, Tata Tea's (India) acquisition of Tetley Tea (United Kingdom) and the acquisition of Daewoo Commercial Vehicle Company (Republic of Korea) by Tata Motors Ltd. (India). Ranbaxy **(**Indian pharmaceutical company) OFDI motives include acquiring brand names and technologies. Lenovo's (China) acquisition of IBM's personal computer division (United States) and the merger of the television and DVD operations of TCL (China) with Thomson (France) are further examples of strategic-asset-seeking OFDI for acquiring brand names, production facilities and technologies. The Shanghai Automotive Industry Corp. has significant investment overseas, including in a GM-Daewoo project and a joint venture with Volkswagen. These investments were made primarily to gain access to production facilities and brand names. Another important reason for FDI by developing country firms has been to access technologies and knowledge. A number of software development firms from Malaysia, the Republic of Korea, Singapore and Thailand have set up research and development (R&D) activities in India for this reason. Indian companies such as I-Flex and Wipro had invested abroad to access technologies and knowledge.

[6] See "China: An emerging FDI outward investor", E-brief, 4 December 2003 (http://www.unctad.org/sections/dite_fdistat/docs/china_ebrief_en.pdf).

Other Indian companies such as Infosys, Aditya Birla and HCL Technologies have invested in the United States and elsewhere in IT-related activities. Superhouse Ltd., an Indian footwear enterprise, has development and design centres in Italy and the United Kingdom. Firms from other developing countries acquired companies abroad to gain access to technology. Bionova (Mexico) acquired DNA Plant Technology (United States), and Cordlife (Singapore) acquired Cytomatrix (United States). Access to technologies also involves setting up R&D centres in key locations. Chinese firms Huawei Technologies, ZTE Corporation, Haier (white-goods producer) and UTStarcom (IT) have established R&D centres abroad.

4. *Resource-seeking.* A main force driving OFDI has been the desire to secure long-term supplies of natural resources (particularly oil and natural gas, iron ore and other minerals). An Indian state-owned company, Oil and Natural Gas Commission, invested in an oil field in Sudan and in the Sakhalin oil and gas field in the Russian Federation. Chinese companies such as Sinopec, Petrochina, CNPC and China National Offshore Oil Corporation have invested in oil, gas and mining activities in Asia, the Middle East and Africa. Russian TNCs such as RusAl and Lukoil have been investing abroad to access to natural resources and export markets.

The various UNCTAD country studies suggest that the motivations behind OFDI, while in general are similar, do differ across industries (mining vs. services), host locations (geographical proximity, historical ties, cultural affinity), enterprise size (large companies vs. SMEs), orientation (Asset and resource-seeking, market-seeking, efficiency-seeking), market entry strategy (mergers and acquisitions (M&As), greenfield investment) and types of institutions (private enterprises vs. state-owned enterprises). The motives were largely similar across regions and were dependent on the types of OFDI (market-seeking, efficiency-seeking, resources-seeking, strategic assets acquisition).

The reasons for investing abroad are largely the same for SMEs as for large firms, but the relative importance of the different factors may vary. In particular, while SMEs can be found in all types of OFDI, they tend to cluster in market-seeking and efficiency-seeking activities. SMEs are more inclined to invest abroad for supporting trade channels and operating closer to home, often in neighbouring countries. SMEs that invest abroad are usually more export-oriented and already have some international experience. The exception is high-technology SMEs, which more often start investing abroad despite a lack of international experience (UNCTAD 2005c). Because of their size and limited financial resources, SMEs are less inclined to pursue an M&A strategy in entering foreign markets than larger enterprises. Some SMEs follow their main customers in going abroad.

The factors driving OFDI are not significantly different between developed and developing country firms, but the latter are less driven by production cost considerations, which is a prime motive for firms from advanced industrialized countries (UNCTAD 2005a). Building brand names and access to technologies and R&D facilities are more notable features of the current wave of OFDI from emerging economies.

D. OFDI and implications for enterprise competitiveness

There are important implications of OFDI for enterprise competitiveness (table 1). They include knowledge and technology acquisition, market expansion, increased profitability, improved corporate image and international experience.

The country case studies presented have indicated that OFDI has helped enterprises increase their revenues, assets, profitability, market reach and exports. In Singapore, some two thirds of the 204 companies surveyed agreed that OFDI had increased their enterprise competitiveness by improving market access, strengthening market position, increasing the company's international image, and the familiarity with and experience in conducting international business. In South Africa, companies such as Illovo Sugar and MTN Group saw profits increase as a result of OFDI. In the case of Malaysia, a number of company cases showed that OFDI had enabled them to grow, expand their businesses and stayed competitive through securing contracts overseas and strengthening trade channels. Company cases in Turkey, Slovenia, Republic of Korea and South Africa suggested that enterprise internationalization for some is not just to increase competitiveness but to ensure survival.

The Argentinean company cases suggest that OFDI has contributed to the expansion of companies' resources, strengthening of sales and exports, better management of risk through geographical diversification of assets, increased efficiency in suppliers, improvement in productivity and quality standards driven by demands of global customers, and facilitated technology transfer owing to mobility of human resources. These benefits can increase the overall value of a business. Similarly, OFDI has increased the strategic assets and revenues and strengthened the market position of Russian

Table 1. OFDI: Some possible benefits and costs

Benefits	*Costs*
• Increased profitability, revenues and assets • Market expansion and greater market reach • Securing contract overseas and strengthening trade channels • Better control of supply chains • Access to knowledge, management skills and technology • Acquisition of brand names • Improved enterprise competitiveness • Improved corporate image • Increased international experience and exposure • Access to natural resources	• Losses and loss of capital • Risk of business failure and closure • Risk of being taken over as a result of expanding market networks • Resources spread too thin, which may undermine overall business operations

Source: Country case studies prepared for this publication.

enterprises, including efficiency gains from control of supply chains and access to natural resources.

OFDI has helped Indian enterprises, particularly SMEs, increase their export competitiveness and R&D intensity, and strengthened their trade support and marketing channels, including contribution to skills upgrading. Indonesian firms investing abroad have improved their performance dramatically in terms of management expertise, exports, quality and assets relative to their past performance and to the performance of firms in the sample that did not make such investments (Lecraw 1993).

As developing country firms become more competitive through OFDI, they can contribute to the competitiveness of their home countries by increasing national productive capacity and productivity. Investing abroad may be necessary in order to market a product or service a host country and to sell it more effectively there. While this applies to many "non-tradable" services, it may also be relevant for manufactured goods that need adapting to local conditions (UNCTAD 2005d, pp. 9-10). In this regard, OFDI is likely to complement home country production. Securing access to natural resources could have complementary effects on home country operations and increasing productive capacity. Access to new technologies can increase the productivity, knowledge transfer and management skills of the investing company in its home country.

OFDI by SMEs has the potential to increase the international competitiveness of the SME sector of both home and host countries. Greater flexibility, better capacity to serve small communities, relatively labour-intensive technologies and greater adaptability to local economic conditions can in some cases make SMEs better suited to conditions in other developing countries than large TNCs (Dhungana 2003). For example, the length of time required for Asian SMEs to establish initial international activity is 0.7 years, compared with 3.9 years for large firms (UNCTAD 1998). OFDI from SMEs is more likely to lead to multiplier effects in terms of technology and knowledge transfer and productivity increases through linkages to local industry. Furthermore, it can strengthen the entrepreneurial base in the host country by providing local entrepreneurs with management skills and new experiences. It can also help fill the "missing middle" by promoting the growth of medium-sized enterprises.

OFDI can be risky and requires well-thought-out strategies and management skills. Not all attempts to internationalize will succeed. Companies that try to seize all investment opportunities that come along may not achieve synergies or improve their chances of meeting overall corporate objectives. Some OFDI leads to losses instead of profits, especially if the assets acquired are overpriced or not in the acquirer's core area of business. When internationalizing, enterprises should not spread their resources too thin, generating excessive operational and financial risks and burdening the overall business operations.

E. Policy measures that support OFDI

The policy environment that supports OFDI in general has improved. More countries have removed barriers and simplified regulations for OFDI. A few developing country Governments, mainly in Asia,

have introduced specific promotion policies on OFDI. Other countries have made specific policy statements encouraging their enterprises to internationalize through OFDI. A brief description follows:

- *Policy statement.* The Government of Singapore announced 2004 as the year of internationalization, the Government of China established a policy of "go global" in 2000, President Luiz Inácio Lula da Silva urged Brazilian entrepreneurs to "abandon their fear of becoming multinational business persons" in 2003,[7] the Government of India has specifically encouraged Indian enterprises to go global,[8] and South Africa's Government has encouraged enterprises to invest abroad. In the 2001 budget, the country's Finance Minister wrote, "The global expansion of South African firms holds significant benefits for the economy – expanded market access, increased exports and improved competitiveness."[9]

- *Regulatory framework.* Improvements in the regulatory framework played an important role in supporting the increased internationalization of developing country firms. Some developing countries such as China, India, South Africa and Turkey have liberalized their regulatory framework and relaxed exchange controls for OFDI (see respective country cases in this publication). Other supportive measures include the streamlining OFDI approval procedures, and raising the investment permit ceiling and the conditions governing equity ownership of affiliates abroad (China and India).

- *Institutional support.* Some developing countries have gone beyond liberalization to active promotion – for example, providing institutional support to help their firms internationalize, and organizing OFDI missions to target host countries (Malaysia, Thailand). For instance, President Lula led an investment mission of 500 Brazilian business entrepreneurs to China in May 2004. Countries such as Singapore and the Republic of Korea have supported the creation of foreign enclaves such as industrial parks in host countries. Some even provide incentives and market intelligence information to encourage internationalization of their firms (Singapore). Some countries have private-sector cooperation and networking to promote South-South investment (Malaysia) and investment in other countries (Singapore).

[7] President Lula's address to the Portuguese Industrial Association, Lisbon, 11 July 2003.

[8] Speech given by Prime Minister Manmohan Singh at "The Indian CEO: Competencies for Success Summit", 22 January 2005.

[9] Budget Speech, Trevor A. Manuel, Minister of Finance, South Africa, 21 February 2001.

Based on the case studies conducted, a number of measures can be considered in supporting enterprise internationalization. They include the following:

(a) Capacity building. There is room for developing country enterprises, including SMEs, to improve their understanding of the benefits, risks and challenges of OFDI. Increased knowledge of cross-cultural matters and international management issues can mitigate the risk of failure. Networks, clusters, business schools and business associations can help transmit the necessary information and enhance the capacity of developing country enterprises to internationalize:

  - Linking with TNCs can help businesses, particularly SMEs, to upgrade their activities, access know-how and technology, and get direct or indirect exposure to the international business community. This process will strengthen their ability to undertake OFDI.
  - Working in a cluster supports the deepening and broadening of knowledge, provides quality control and information related to markets and marketing, and helps establish appropriate linkages to a wider set of technology inputs and actors. Such an environment gives companies the information and capability they need to set up foreign affiliates.
  - Networking with key business schools in the country could help strengthen managerial skills and build capacity in investing and managing international enterprises.
  - Strengthening business associations can support the learning process of firms, providing contacts and a forum for sharing experiences.

Capacity building programmes such as the making of "global players" offered by business schools (Brazil, Singapore) can help developing country firms strengthened their managerial capacity, increase knowledge of cross-cultural and internationalization issues.

(b) Market intelligence. Home-country Governments could provide market intelligence and information on investment opportunities in target host countries, including consultancy services to help their firms grow through OFDI. A dedicated OFDI department or an institution in charge of coordinating initiatives could be envisaged. Such institutions could provide direct assistance to developing country firms, particularly SMEs, by improving their market intelligence and overcoming some of their fears and obstacles

in venturing overseas. Other services that home Governments could provide include OFDI risk insurance and awareness, and capacity building. Promoting a greater awareness of existing BITs and bilateral and regional free trade agreements that contain OFDI provisions could be helpful. Regular seminars on internationalization issues could include exchanges of experiences among companies that have been successful in internationalizing and have overcome challenges in venturing abroad. Financial institutions such as export-import banks of home-country could play an important role in providing insurance coverage, financial facilities and market intelligence information to support OFDI (e.g. India, Malaysia, Thailand and Turkey).

(c) *International Investment Agreements.* Developing country Governments have also increased the number of concluded bilateral investment treaties (BITs) and double taxation agreements and, more recently, bilateral and regional free trade and investment agreements (e.g. the ASEAN Investment Area Agreement and the South Asia Free Trade Area.) To the extent that these agreements protect investment and open up industries for FDI, they facilitate FDI among the contracting parties. Questions that need to be addressed in this context are how to adequately reflect the development dimension in IIAs that involve developing country partners that are themselves home to TNCs, and how to devise provisions supporting OFDI from these countries. Examples of the latter could include provisions aimed at enterprise development, OFDI promotion programmes and outbound investment missions in conjunction with investment promotion authorities.

(d) *International forum and network.* The international community can play an important role in supporting OFDI from developing countries. It can help with policy analysis, identifying best practices, networking, and raising awareness at the international level regarding the benefits, challenges, impact and steps to take to minimize the risks of going abroad by developing country firms. Investment promotion agencies for inward FDI and OFDI, both in developing and developed countries, could coordinate their efforts. For example, international organizations such as the World Association of Investment Promotion Agencies (WAIPA) could coordinate such cooperation. Other policy options were suggested at an UNCTAD meeting on enterprise internationalization in December 2005 (box 1).

(e) *Incentives.* Financial and fiscal incentives including for example loans and support for feasibility studies could encourage SMEs to invest abroad.

(f) *Availability of statistics.* The lack of statistics has hampered analysis of the internationalization strategies of developing country enterprises, particularly SMEs. Such statistical limitations restrict analysis on areas such as the potential benefits of OFDI, where developing country firms invest and in which industries, and which policies have worked or not worked. Developing country Governments could consider improving their statistical systems to ensure provision of such data.

F. Conclusion

More firms from more developing countries are internationalizing and their Governments are encouraging them to do so, adding to an increasing pool of internationalized enterprises – and for some, achieving the status of global players. OFDI contributes to the changing geography of international trade and investment flows. Increasing competition, saturated markets, the need to secure natural resources and declining competitiveness of industries at home drive enterprises from developing countries to go abroad to overcome these problems, improve competitiveness, increase efficiency and to survive. The desire to be global players or key players in global industries also drives OFDI from developing countries. SMEs from developing countries have started the internationalization process, which has in turn facilitated their growth to a critical size. Unlike in the past, firms do not need to grow to a certain size before they internationalize; they now internationalize to grow and investing abroad could facilitate this process.

The prospect of enterprise internationalization from developing countries is promising, given the increasing capacities of these firms to invest abroad. There is also an increasing interest by developing country firms, home and host Governments, and the international community to support such enterprise internationalization. There is now awareness that enterprise internationalization is a means to increase the productive capacity of developing countries and a growing source of business linkages with TNCs. The liberalization of OFDI policies and relaxation of exchange controls have also increased these opportunities.

OFDI provides a channel for developing country enterprises to improve their competitiveness. Its impact on competitiveness includes: increased profitability; expansion of markets; access to natural resources; better control of value chain; increased overseas contracts; and access to brand names,

Box 1. Enterprise internationalization through OFDI: Selected policy recommendations

To the extent that OFDI contributes to improving enterprise competitiveness, developing countries should support the internationalization of their enterprises and adopt appropriate policies. Various policy suggestions were made at the Expert Group Meeting on "Enhancing the Productive Capacity of Developing Country Firms through Internationalization". They include the following:

- Ensure coherent and targeted government policies to support the long-term vision for internationalization of firms and to move to higher value added, knowledge-based activities and expand a pool of competitive and efficient local enterprises.
- Build institutional support to facilitate and encourage OFDI, including improved access to finance. Market entry can also be facilitated through matching of joint venture partners and provision of industrial parks.
- Consideration should be given to the different levels of economic development of home countries and a need for a differentiated approach to different types of SMEs (active vs. passive investors).
- Establish effective public-private sector dialogue to exchange information and facilitate policy discussion.
- International organizations such as UNCTAD could help address the issue of data limitation and data collection, framing the arguments of what is meant by OFDI, and assisting in institutional support, policy advice and capacity building.
- Develop a "Global or Regional Players Programme" to allow firms and countries to share experiences on enterprise internationalization.
- Provide training courses on internationalization for policymakers and managers of developing country enterprises, including events that would help raise awareness of the benefits of enterprise internationalization. This could help countries to understand that OFDI is a micro instrument, which helps firms to increase competitiveness and to be integrated in the global economy, rather than as an unpatriotic development.
- Mitigate risks of internationalization by ensuring that developing country enterprises are better prepared for the challenges.

Source: Report of the Expert Meeting on "Enhancing the Productive Capacity of Developing Country Firms through Internationalization", Geneva, 5-7 December 2005 (TD/B/COM.3/EM.26/3).

technologies and R&D, and production facilities. Other implications on enterprise competitiveness relate to the increase in the value of firms because of international exposure, improved image and experience in sophisticated markets. However, the impact on competitiveness is difficult to assess because of the lack of information. The analysis is based on limited case studies, which often do not include SMEs. It would be worth deepening research and analysis in this area.

There are undesirable effects or risks of internationalization. They include business failures, the loss of capital or closure and the takeover by foreign firms. The lack of knowledge and misperception about foreign regulatory framework including legal issues, unfamiliar business environment, languages and customs contribute to augment such risks. Given existing risks, a prudent and gradual approach to internationalization would be wise. Companies should have strong economic fundamentals before attempting expansion abroad and develop a sound business model and strategy. The use of risk assessments, the exchange of experiences, and provision of policy and institutional support are important to cushion any negative impact. Home country Governments should tailor OFDI policies to the needs of their firms, with special support measures for SMEs. The private sector could also provide support, facilitating the exchange of experience and carrying out capacity building activities through industry clubs and business associations.

OFDI has desirable and undesirable effects Governments wishing to promote enterprise competitiveness through OFDI should weigh its potential costs against its benefits to their economies and enterprises, and should then determine appropriate

policy approaches. On one hand, to the extent that developing country firms become more competitive, and to the extent that the home economy keeps important aspects of its activities at home, OFDI is likely to benefit firms from better connections to international markets, increased productive capacity, and more access to natural resources and strategic assets (UNCTAD 2005b). On the other hand, there may be adjustment costs, especially social costs in the case of offshoring of labour-intensive activities. Therefore, in developing policy options, consideration should be given to maximizing the benefits of OFDI and minimize the possible negative effects.

While there are some enterprises that would internationalize even without government support, some firms are constrained by a restrictive regulatory framework. As firms face growing competition and other constraints operating at home, policies that hinder enterprise internationalization would undermine the overall efforts to build national competitiveness. There are also some firms that have the capability to internationalize but are shying from doing so because of the lack of information and the fear of unknown. Developing country Governments could consider adopting appropriate policy options, commensurate with its stages of development, to encourage, support and facilitate enterprise internationalization. A capacity building programme that aims to increase the understanding of managers on the risks, challenges and cultural issues regarding enterprise internationalization would be useful. The international community can play a role in increasing the awareness of enterprise internationalization and its beneficial impact (as well as risk) on the home and host countries. A capacity building programme such as the making of global players offered by business schools and international institutions is an area worth consideration.

SMEs encounter a number of obstacles for internationalizing. The common internal obstacles are lack of international experience and management skills. Lack of information on investment opportunities and the host investment environment (including unfamiliarity with the legal system and OFDI regulations in the host country) is a more serious problem for SMEs than for large companies. Limited access to finance and cultural differences also hinder OFDI by SMEs, as does difficulty in finding suitable joint venture partners. Since the majority of OFDI by SMEs is in the form of joint ventures, it is important that host countries encourage the development of their SME sector so that local enterprises have the capability to form strategic alliances or joint ventures with investing SMEs from abroad.

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CHAPTER II

OUTWARD FOREIGN DIRECT INVESTMENT BY ENTERPRISES FROM ARGENTINA*

A. Introduction

This paper examines the trends, drivers, motivations, policy developments and challenges relating to outward foreign direct investment (OFDI) from Argentina. It also highlights how OFDI has increased the competitiveness of selected Argentine firms.

B. OFDI from Argentina: Trends and development

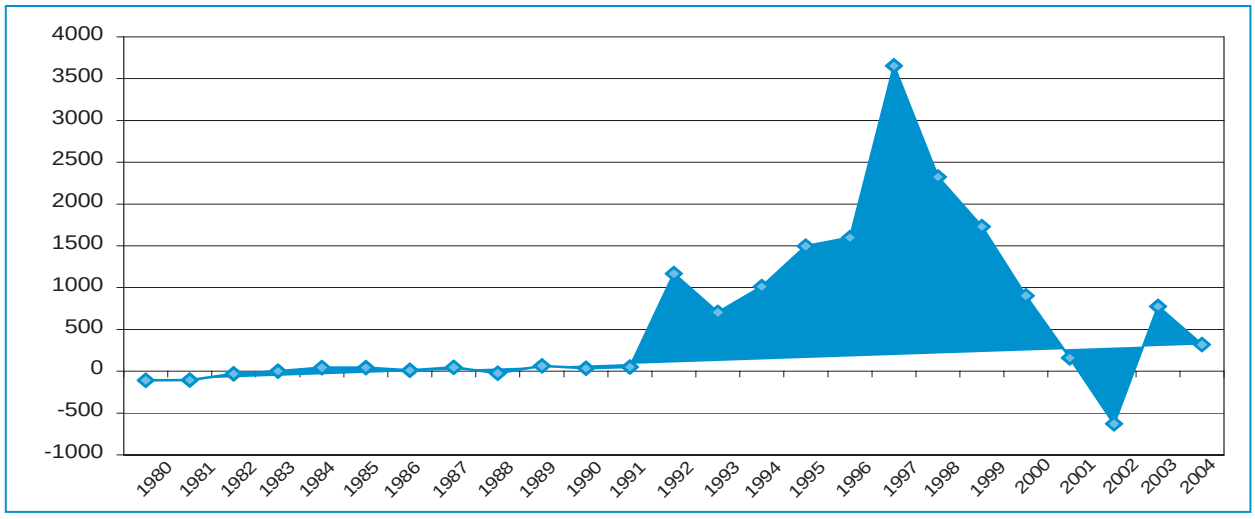
Until the 1980s, Argentina – like other countries in the region – pursued inward-oriented industrialization policies. At that time, OFDI was not considered a priority and there was no specific policy dealing with enterprise internationalization. However, the Government's support to indigenous private sector development facilitated the growth of a small number of companies that were domestically strong, with the capability to internationalize their operations. Once the country started to open up, enterprises looked at the benefits of internationalization in an increasingly integrated global market.

Argentinean overseas investments from the 1930s to the 1970s were negligible. Domestic enterprises had the following general characteristics:

(i) firms were often family businesses related to the personal skills and visions of recent immigrant entrepreneurs and their families;

Figure 1. Argentina: OFDI flows, 1980-2004

(Millions of dollars)



Source: UNCTAD FDI database.

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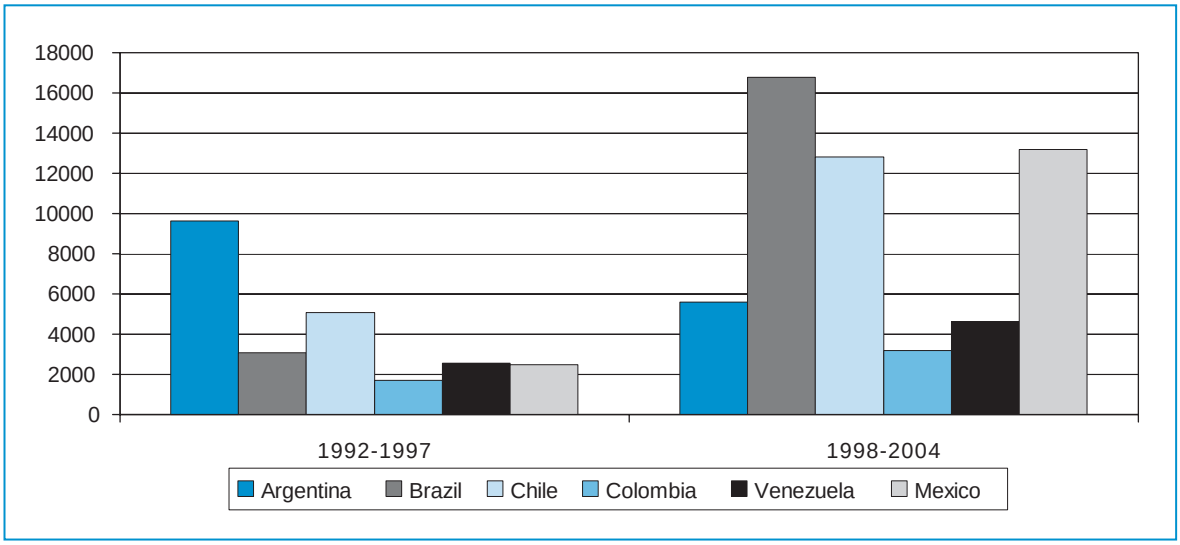
Figure 2. OFDI cumulative flows from Argentina and other large outward investors from Latin America, 1992-1997 and 1998-2004

(Millions of dollars)



Source: ECLAC.

(ii) most firms operated independently and with a small volume of ramifications and/or diversification in the local market; they were also in general not connected to the financial system;

(iii) companies were often national leaders in their respective markets, having developed under an import-substitution regime (that included protection, government credit and promotion mechanisms);

(iv) they developed their own technological capital by adapting existing product and process technologies to the characteristics of the local market; many also came to produce new and original products; and

(v) they often operated with a high degree of vertical integration, largely as a result of the insufficient degree of development of independent distribution networks.

By the late 1970s and early 1980s, crisis in the domestic market, factors inherent to the firms, and crisis and changes in target markets, led to the closing down of most of the Argentine operations abroad. It was only after the crisis of the 1980s and the beginning of the internationalization process with the adoption of new OFDI policies that they began to pick up again. A new wave of OFDI took place, against a background of overseas investment by Argentinean trade liberalization, deregulation, privatization and stabilization programmes. Investments in this period were undertaken mainly in neighbouring countries or in developed countries.

OFDI from Argentina took off in 1992 (figure 1). The country was the largest outward investor in Latin America and the Caribbean during the period 1992-1997 (figure 2). This upward trend was provoked by the restructuring of Argentine industry, which came as a response to the economic transformations during that decade (Kulfas 2001). OFDI flows peaked in 1997 and 1998, led by investments made by large enterprises including Arcor, Pérez Companc and Techint (table 1). Since 1998, OFDI flows from Argentina declined in each consecutive year, except in 2003. While OFDI flows recovered in 2003-2004 from the dramatic disinvestment in 2002, they remained under $1 billion.[10] Macroeconomic crisis and the acquisition of important Argentinean companies by foreign investors contributed to the OFDI decline in the early 2000s.

Geographical destination. The large acquisitions made by Argentine companies took place within the Latin American region, reflecting the influence of geographical proximity, business knowledge and cultural affinity. Investment opportunities created by the privatization process in the region were also a determinant. Between 1997 and 2000, 85 per cent of Argentine OFDI flows were directed at Latin American countries, of which 31 per cent in Brazil and 28 per cent in Venezuela (Kosacoff 1999). This geographical distribution was prevalent throughout the 1990s up until 2004. This is not to say that OFDI was limited to the region. Some enterprises

[10] Available data do not yet permit an interpretation of the beginning of a reversal of the previous trend.

Table 1. Largest acquisitions abroad by major economic groups in Argentina: the peak years of 1997-1998

Acquiring company	*Target company*	*Host country*	*Year*	*Value of transaction* (millions of dollars)
Arcor group	Koppol (packaging)	Brazil	1997	25
	Dos en Uno (food products)	Chile	1997	200
Clarín	Cable operators	Paraguay	1998	n/a
Macri Group	Isabela (food products)	Brazil	1997	n/a
	Zabet (biscuits)	Brazil	1997	38
	Chapecó (refrigeration)	Brazil	1998	135
Pérez Companc	Petroleum Commercial Supply (oil and gas)	United States	1997	1.8
	Exploration area La Concepción	Guatemala	1997	76.5
	Exploration area Colpa y Caranda	Bolivia	1997	5.9
	Exploration area Acema	Venezuela	1997	20.5
Soldati	Onado (oil and gas)	Venezuela	1997	5.1
Techint	Sidor (steel)	Venezuela	1997	192.3
	Tavsa (steel pipes)	Venezuela	1997	n/a

Source: ECLAC, based on Kulfas (2001) and Techint.

such as YPF have invested in the United States and also in Indonesia seeking access to natural resources; Impsa invested in Hong Kong (China), Malaysia and the Philippines; and Techint has operations in North America, Europe and Japan.

Sectoral distribution. Most of Argentina's OFDI flows in the 1990s were in non-financial activities. The country's participation in cross-border mergers and acquisitions concentrated in the oil and gas, iron and steel, and food sectors. From 1990 to 1996, the oil and gas industry accounted for 82 per cent of OFDI flows from Argentina, followed by the food industry. Since the late 1990s, Argentine oil companies that invested abroad, such as Pérez Companc and YPF, have sold their assets to other TNCs, the Brazilian Petrobras and Spanish Repsol respectively. Steel remains a leading industry for OFDI, a position reinforced by the recent acquisition of the Mexican company Hylsamex by Techint, which will be discussed below (box 1). Other industries investing abroad at the end of the 1990s, included food and beverages, engineering and construction, pharmaceuticals, petrochemicals, telecommunications, information services, banking and construction materials.

Characteristics of firms undertaking OFDI. Besides acquisitions, a number of SMEs, especially export-oriented ones, have been a significant agent of development. They have also been the subject of important government support policies in Argentina. OFDI by these companies has become an increasingly important issue as the number of exporting SMEs has risen significantly and their investment abroad is often strongly linked to, or preceded by, exports (CEP 2005). Data on overseas investments by SMEs from Argentina are scarce. However, positive results are visible in some industries such as software (box 2) and agricultural machinery (box 3).[11]

In general, Argentine OFDI has been market-seeking, either to intensify exports or to meet host country demand through local production. In some cases, they were related to taking advantage of incentives offered by the host countries.

OFDI by larger Argentine companies also provide SMEs in Argentina with important opportunities to market their products overseas through business linkages between them. Techint's investments abroad have had that effect in recent years (Techint 2004).

C. Drivers and motivations

The motivations of early internationalization by Argentina enterprises (1930s-1970s) include:

[11] Although some of the companies mentioned in the boxes below have grown beyond the official limit of medium-sized enterprises, they still maintain management characteristics that justify their inclusion in the category of SMEs.

Box 1. Overseas investments by selected large Argentinean enterprises

Pérez Companc. It was a family-based conglomerate in oil and gas, established in 1946. In 1989, it undertook its first major investment abroad. In partnership with YPF and Pluspetrol, it acquired an interest in Andina, a company that had originated in the process of capitalization of Bolivia's YPFB and that supplied gas to the Bolivia-Brazil pipeline. Between 1990 and 1994, the company expanded its domestic activities in the oil business and in a number of other industries through participation in the country's privatization programme. Since 1994, Pérez Companc made a series of overseas investments in oil and gas exploration, and production in neighbouring countries such as Brazil, Bolivia, Ecuador, Peru and Venezuela. In 1997, the company began investments in petrochemicals in Brazil, and in 1999 acquired two refineries in Bolivia in partnership with Petrobras. In 2000, as part of an asset swap with Repsol YPF, it gave up its share in Andina, along with other assets, receiving in return the Repsol-YPF share of the gas-bearing zones in southern Argentina. Before its acquisition by Petrobras, Pérez Companc invested in exploration and production of oil and gas and in pipelines in Ecuador (Pacheco 2001, ECLAC 2002). At the time of the acquisition, only 40 per cent of the company's oil reserves were in Argentina (Campodónico 2004).

Techint. The Techint group was established in Milan in 1945 and subsequently set up its base in Argentina. The company almost immediately started providing engineering and construction services in other Latin American countries and Europe, and was thus "born an international company". The scope of its activities and geographical presence expanded, reaching over 50 countries, especially in the pipeline industry and in the establishment of turnkey plants. The company's first construction projects outside Argentina were pipeline networks in Brazil. Techint gradually expanded its steel business. The first international investment in this sector was the construction of seamless steel tube plants in Mexico in the 1950s. Internationalization intensified in the 1990s. In 1993, Techint took control of the Mexican steel tube maker Tamsa. In 1996, the group acquired control of the Italian steel company Dalmine. Steel pipe manufacturing facilities were acquired or set up in Brazil, Venezuela, Japan, Canada, and recently Romania. Tube products are now consolidated under Tenaris. In 1997, Techint led the consortium that acquired control of Sidor, Venezuela's largest steel plant, producing flat and long products. In 2005, Techint reached an agreement with the Alfa group for the acquisition of the latter's stakes in the Mexican flat and long steel producer Hylsamex, including that company's shares in Sidor. Sidor and Hylsamex are, together with Siderar, Techint's Argentinean flat and long steel producers, now consolidated under Ternium. Techint is thus a consolidated world player in seamless pipes, and is steadily strengthening its regional presence in flat and long steels. Since the 1990s, the group has also taken part in other activities, which include, outside Argentina, health services and energy trading in Italy, oil and gas exploration in Bolivia, Ecuador, Mexico, Peru and Venezuela, and gas transmission in Peru, among others.

Arcor. Arcor was founded in 1951 and is now the world's largest producer of hard candy. It operates in four main areas: foodstuffs, confectionery, chocolates and biscuits, but has, over time, integrated vertically into packaging and other inputs of its core businesses. Arcor started exporting in the 1970s, and internationalization followed with investment in Arcorpar in Paraguay (1976) and in Uruguay (Van Dam) and Brazil (Nechar) in the early 1980s. A sales office was opened in the United States and a fruit processing plant was established in Chile in the 1980s. In the 1990s, Arcor intensified its regional presence through acquisitions and investments in Chile (Dos en Uno) and Brazil (development of a greenfield investment in the chocolate sector). In 1996, Arcor de Perú was established with a greenfield investment in Chancay. In April 2004, Arcor and Danone announced that they would merge their biscuits businesses in Argentina, Brazil and Chile. The resulting company (49 per cent owned by Danone and 51 per cent by Arcor) leads the biscuits market in Latin America. To support its export strategy, Arcor has established sales offices in Brazil, Chile, Canada, Colombia, Ecuador, Mexico, Paraguay, Peru, Spain, Uruguay and the United States (Kosacoff et al. 2002, Arcor 2005). The joint venture with Bimbo (Mexico) in 2005 expanded the presence of Arcor candy products in Mexico.

Source: Author, based on information from the respective company sources.

(i) exploration of natural resources, in the case of oil and gas companies and companies using minerals or agricultural products such as cocoa as material for industrial production; (ii) consolidation of trade flows between headquarters and affiliates which were established to execute certain stages of production more efficiently undertaken closer to consumer markets; and (iii) overcoming trade barriers in foreign

Box 2. International investment by small and medium enterprises in the software industry

Argentine software companies have started to invest abroad as a means of gaining proximity to clients and thus expanding sales. Three examples are presented: Idea-Factory, Cubika and Sistemas Estratégicos S.A.

Idea-Factory. Idea-Factory inaugurated a "Customer Proximity Center" in Madrid in 2004 to better exploit the Spanish market, one of the company's main consumer markets. This has been done essentially – and at an initial stage – through investment in the training and certification of local partners in Spain to help expand exports of the company's products from Argentina. This type of investment has been simple to manage and cost-effective for the current volume of sales. Although it is too early to make an assessment of the benefits gained from this investment, it is clear that the company has already benefited from the high standards of the Spanish market, which have been reflected in higher quality standards of the company's production in general. Idea-Factory found that the Spanish market was more demanding for a number of factors, such as customer support and product management (Proargentina 2005).

Cubika. Cubika, founded in 1999, has also focused on the Spanish market as its main export market because of its size, cultural and linguistic proximity, and a perceived unmet demand for software development services with J2EE technology, where the company has a competitive advantage. Cubika set up a subsidiary in Barcelona to manage overseas operations, including projects in France, Germany, Switzerland, Australia, Brazil, Chile, Cuba, Mexico, Venezuela and Costa Rica. In many cases, projects were developed with local partners. Support from the Argentine Government in the form of sponsored commercial missions to promote software exports was important in the company's internationalization process. The company found that, with the exception of a very small number of local companies, it was comparatively more advanced technologically than its competitors in Spain.

Sistemas Estratégicos. Sistemas Estratégicos was founded in 1992 and developed a strong position in the local market, especially in customer relationship and management products throughout the 1990s. It gradually expanded internationally through a system of partner distributors, which allowed it to rapidly establish its presence regionally. It has representation in Chile, Peru, Honduras and Mexico, and projects in Puerto Rico, Uruguay, Ecuador, Colombia, Venezuela, Bolivia and Brazil (Proargentina 2005).

Source: Author, based on company information and Proargentina (2005).

markets (Kosacoff 1999). As is the case for other Latin American countries, most OFDI from Argentina has been natural resource-seeking and, more recently, market-seeking.

- *Resource-seeking OFDI.* This constituted a large part of Argentine overseas investments in the 1990s and before that, particularly in the oil and gas sector, undertaken by large enterprises such as YPF and Pérez Companc (box 1). These investments were mostly aimed at complementing Argentine reserves and were motivated by diversification of supply sources.

- *Market-seeking OFDI.* In the beverage industry, this has been undertaken both independently (Quilmes' investments in the beer industry in the Southern Cone) and in the context of associations with TNCs (the cases of Baesa in Chile, Brazil, and Uruguay; and of Quilmes in Paraguay and Uruguay). In the case of food products, Arcor stands out (box 1). Its outward investment was both a natural step in its gradual growth process (Kosacoff et al., 2002), and a means to gain exposure to international quality standards and to acquire both scale and scope to defend and strengthen the company's position domestically. OFDI by the Macri group, for example, has been motivated by market-seeking factors. Most OFDI in the food sector took place in Brazil or in other Latin American countries and served as regional platforms for distribution and export of dairy, meat and flour-based products. Techint, on the other hand, has expanded far beyond the region and holds a prominent position in the global seamless pipes market, while more recently becoming an important regional player in flat

Box 3. SME international investment in the agricultural machinery industry

Agricultural machinery is another area in which Argentinean SMEs have stood out, investing in productive operations in neighbouring Brazil. Two cases are reviewed below:

Plá. Plá produces several types of agricultural machinery in Argentina. It established a plant in Porto Alegre, Brazil, to produce self-propelled pulverizers. With an initial investment of $1.5 million, the plant currently employs 30 people. What attracted Plá to Brazil was the potential of the host country's market. An additional reason for establishing a plant in the host country, versus exporting from Argentina, is that the company's products qualify for subsidized credit offered to local buyers through the finance programme provided by the Brazilian development bank (*La Capital 2004, 2005*).

Metalfor. Metalfor, based in Marco Juaréz, Córdoba, established a subsidiary in Brazil to produce agricultural pulverizers. The plant, situated in the southern state of Paraná, employs 100 people. Investments have been made to relocate and expand the plant in a nearby site. Metalfor also has facilities in the State of Mato Grosso, from where machinery is sold and spare parts are stocked for distribution. There are plans for the construction of an assembly plant and a plastic compounds operation in Mato Grosso (Metalfor do Brasil 2005).

Source: Author, based on company information and *La Capital* (2004, 2005).

and long steel. The company's acquisitions and investments abroad have supported its exports through distribution networks (Catalano 2004). The company's OFDI is increasingly complementing domestic production with sites situated close to consumer markets. Other Argentinean companies entered new markets through FDI. For example, Impsa has used its bases in Malaysia and the Philippines as export platforms for the rest of Asia in the provision of engineering services in infrastructure projects – especially electricity – and related capital goods. Impsa's experience in Argentina gave it an advantage in operating in similar market environment in other developing countries. The company's international operations has enabled it to maintain sufficient scale to survive in an industry that has been increasingly restricted at home. Impsa also explored the market for new services – such as GPS monitoring and environmental services – in Latin American markets, where it took advantage of language and other similarities.

D. OFDI and implications for enterprise competitiveness

The effects of OFDI – particularly in the 1990s – on competitiveness can be grouped into four broad categories.

- *Expand markets*. OFDI has been a means to expand sales, both by allowing companies better distribution channels for their exports and/or by placing productive operations closer to consumer markets. As an example, and as far as exports go, from 1990 to 1999, before crisis hit, the world market share of the Argentine sugar confectionery industry (excluding chocolates), rose from 1.09 per cent to 2.16 per cent. Argentina's share in the world market for chocolates went from 0.05 per cent in 1990 to 1.43 per cent in 1999 (TradeCAN 2004). Arcor's large contribution to the increased presence in the international markets is undisputed. The company's exports rose by a multiple of almost seven during this period.

- *Improve efficiency*. Companies have been able to defend their positions on the domestic market: enhanced capacity and larger scale. In Arcor's case, internationalization upgraded the quality of the company's products. Striving towards approximation to international standards was in fact one of the main reasons for the company's internationalization strategy. OFDI also allowed for the expansion of the scope and scale of operations. Both these factors helped strengthen the company's presence in Argentina at a time of intense competition with foreign players. For Techint, scale acquired through internationalization generated greater efficiency in obtaining supplies, machines and other

inputs through greater bargaining power. The nature of Impsa's core business, which involves high-tech services and capital goods for large-scale projects, required a larger minimum efficient scale than was compatible with the Argentine market, and its international operations thus became essential for the continuity of the development of high-tech solutions and productive operations.

- *Improve risk management.* Arcor's international presence shielded the company, to a certain extent, from the impact of the 2001 crisis. Although other companies reached out to the international market in response to the crisis, Arcor had an invaluable advantage in that it had pursued a long-term and systematic strategy to develop clients and markets abroad. By 2002, it exported to over 100 countries and enjoyed the confidence of retail channels in Europe (Kosacoff et al. 2002). International operations were a solution for other companies that saw their markets in Argentina contract severely, especially from the second half of the 1990s onwards.

- *Improve management skills.* Technology, knowledge and skills transfer between companies' international units, the application of best practices developed in other units, the results of human resource mobility within groups, and the capacity to manage larger and more sophisticated projects are among the benefits identified in this respect by a survey conducted by ECLAC in 2005 (ECLAC 2006). Companies interviewed for this survey perceived a positive externality of OFDI, which is the enhancement of the country's managerial pool, with national executives having been exposed to the international business environment.

SMEs that have internationalized have benefited from similar factors, at a smaller scale. In addition, SMEs from Argentina stand to benefit from the internationalization of larger companies, which provides opportunities to expand as suppliers.

E. OFDI policies

Current legislation on capital outflows allows residents (both companies and natural persons) outside the financial sector to have access to the Mercado Único y Libre de Cambios (official foreign exchange market) to acquire foreign currency for the purpose of undertaking direct investment abroad, subject to a monthly limit (Banco Central 2005). The current limit is $2 million, but can be increased according to export duties paid by the company and taxes paid on movements in the company's current account. The Government has recently instituted a system whereby OFDI must be declared to the Central Bank annually. Declaration is mandatory for values of over $1 million.

Government-subsidized financing programmes such as those executed by the Banco de Inversión y Comercio Exterior (BICE) seem to focus on investment made domestically and on support to SMEs. The latter may have a positive effect, in the long run, on OFDI by these companies to the extent that the programme supports the development of exporting SMEs, and, more generally, the growth and competitiveness of local companies.

F. Conclusion

One of the main obstacles to OFDI from Argentina has been the limited availability of funding at internationally competitive rates (Kosacoff 1999), aggravated in some cases by higher debt-equity ratios than foreign competitors (ECLAC 2002). In the past few years, economic crisis significantly weakened Argentine firms, causing a number of them to be bought by foreign firms. For companies that remained under Argentine ownership, the crisis had led to restricted investment capacity and often a need to divest. Other obstacles to outward investment include access to personnel qualified in international business operations or in management of overseas investment activities. The current legislation on capital outflows limits the amount of foreign exchange that residents (both companies and natural persons) can acquire. This issue is not, however, in itself generally considered a major obstacle to OFDI.

The prospect for OFDI flows from Argentina is caught between the positive trend of companies, such as Techint, Arcor and a selected group of SMEs that have pursued aggressive internationalization strategies in the post-crisis environment, and a process of denationalization where important Argentine firms that could lead a trend towards OFDI are being acquired by foreign firms. A number of upcoming smaller firms in software and agriculture machinery industries may be an important factor in the growth of OFDI from Argentina in the next few years.

Support policies for OFDI from Argentina could be thought out in terms of weighing, on the one hand, the potential of this kind of investment for generating social benefits in the form of development of local industrial production, productivity, employment, innovation capacity and other potential benefits and,

on the other hand, the opportunity cost of this support. To the extent that the difference between perceived social and private benefits of OFDI outweighs the cost of measures to support it, such policies may be justified, in the context of broader industrial development strategies.

An immediate challenge is to build institutional capacity for evaluating the potential benefits of OFDI and the specific difficulties that can realistically be addressed through policy action. The Centro de Estudios de la Producción, institutionally situated under the Ministry of Economics and Production, in the past maintained an important database on OFDI, but no longer does so. The importance of such a database in supporting policy analysis is crucial. Another challenge is to develop mechanisms that ensure that social benefits of government-supported internationalization are not eroded by foreign takeovers.

There is also opportunity for government action in the provision of market intelligence and legal investment information in target host countries and reducing the transaction costs of OFDI, which is especially important for SMEs.

More broadly, support to the general business environment could lead to greater amounts of OFDI and could contribute to a virtuous cycle towards competitiveness. Greater public-private sector dialogue could be established to exchange experiences, information and policy feedback on internationalization and competitiveness of Argentine firms.

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CHAPTER III

OUTWARD FOREIGN DIRECT INVESTMENT BY ENTERPRISES FROM BRAZIL*

A. Introduction

This paper analyses the evolution of Brazilian OFDI from 1997 to 2005. It shows how OFDI development in Brazil goes in parallel with the pattern identified in other emerging economies (UNCTAD 2005). It examines the drivers and motivation of Brazilian firms investing abroad. Examples of Brazilian companies' strategies involving their recent moves to gain international competitiveness are reviewed. Lastly, the impact of internationalization on the firms' competitiveness is analyzed, as well as the regulatory environment and policy options.

B. OFDI from Brazil: Trends and development

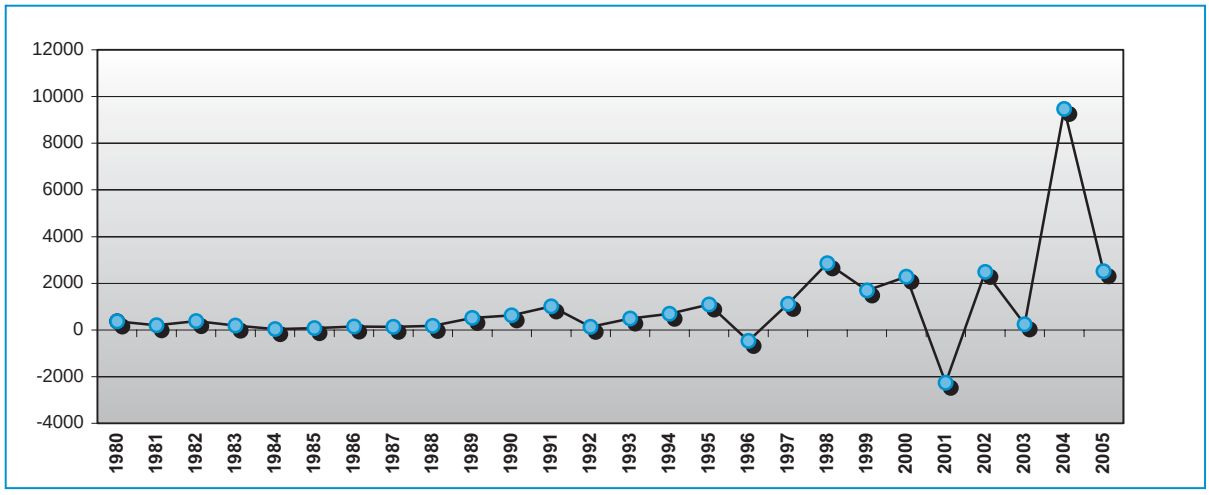
Brazilian OFDI[12] has increased significantly since 1999, with exception of a slowdown in 2001 and 2003 (figure 1).

* This paper was prepared by André Almeida, Erika Penido Barcellos, Álvaro Bruno Cyrino, Sherban Leonardo Cretoiu, Ana Vitória Alkmim de Souza Lima and Caio César Radicchi at Fundação Dom Cabral.

[12] Banco Central do Brasil uses the criteria of the 10 per cent invested in the company by Brazilian shareholders investment to distinguish shareholding related to direct investments from portfolio investments. Participations less than this percentage are registered under portfolio.

Figure 1. Brazilian OFDI flows, 1980-2005

(Millions of dollars)



Source: Banco Central do Brasil, Balance of Payments 2005.

Political and macroeconomic factors, exceptional events in 2004 caused by the market valuation of Brazilian companies abroad, the large volume of intra-company loans and the $4.9 billion exchange of assets between Ambev and Interbrew in 2004 have influenced the magnitude of OFDI flows.

In 2004, Brazilian OFDI accounted for over 86 per cent of the total OFDI flows from Latin America and the Caribbean, and more than 11 per cent from emerging economies (UNCTAD 2005).

According to data released by the Central Bank,[13] OFDI stock reached $70 billion in 2005. However, only a small proportion of Brazil's OFDI stock can be attributed to international production by Brazilian TNCs, with 68 per cent of the stock located in tax haven economies. More than half of this total is in "financial intermediation", a typical activity for this type of investment.[14]

It is also worth noting that between 2004 and 2005[15] the stock of FDI remained basically unchanged as a share of total Brazilian assets abroad. Most companies investing in foreign markets during the 1990s, as late-movers into the internationalization arena, had to progress in their learning curves, concentrating their attention on overcoming the liability of foreignness, or the need to adapt to a different business culture.

Therefore, they focused their efforts on stabilizing and restructuring their international operations (mostly through cross-border acquisitions), fine-tuning relations with their clients, suppliers, the business community, government and unions, understanding and addressing local competitive issues, as well as on improving on productivity and management. Also, during this initial stage, Brazilian companies invested heavily in the transfer of technical know-how from headquarters to affiliates, mostly through expatriates in permanent or temporary assignments (table 1).

Some of the companies have also progressively tried to transfer softer management issues, like company values and best human resources practices. At the dawn of the new century, Brazilian TNCs are facing new challenges, as a result of their international expansion. After one decade of diversifying their international activities and managing their international portfolio in a stand-alone basis, Brazilian TNCs will need to focus on consolidating and integrating their operations, while at the same time taking advantage of the local resource endowments. In short, after the stage of internationalizing their value chain, they will have to coordinate and integrate them on a global basis.

Geographical and sectoral distribution. According to Banco Central do Brazil, OFDI totalled over $4 billion in 2005. Table 2 breaks down the investments by destination. The Netherlands is surprisingly the main destination, followed by Italy, Venezuela, the Virgin Islands and Uruguay. Between 2004 and 2005, Saudi Arabia dropped from first to sixth place, Venezuela moved up from the seventh to the third and the Virgin Islands stood out by leaping from 23rd place in 2004 to fourth in 2005.

When this study was carried out, information on the destinations and activities of the stockholders of Brazilian capital in 2005 had not yet been made available by Banco Central do Brasil. According the previous year's trend, the majority of these investments were related to the tertiary (service) sector, representing nearly 93 per cent of the total. Data show an increase of nearly 20 per cent of investment in services, mainly financial services and wholesale trading.

There was also an increase of 210 per cent in investments in extraction of crude oil and correlated services activities (Petrobrás). Denmark stood out among the top recipients of Brazilian direct investment in 2004, as it moved up from 10th to third place. Tax havens – the Cayman Islands, the Bahamas and the Virgin Islands – remain among the largest recipients, followed by Luxembourg, while the United States dropped to seventh place. As to inter-company loans, the so-called tax havens once again stood out, as did the United States, Argentina, Panama and the Netherlands. According to Banco Central, Brazilian businesses choose tax havens as their operational base abroad for three main reasons. First, the tax regime is attractive because of tax exemptions on income and capital repatriation. Second, there are issues linked to the company operations such as the absence of foreign exchange controls, the lack of registrations and less red tape. Finally, offshore investment allows greater mobility to capital and other resources.

As tax havens have come under greater scrutiny by the international community because of alleged irregularities, other countries have become the favoured destinations of Brazilian investments (table 2). For example, although the Netherlands, Spain and Uruguay are not classified as tax havens, they offer a sound operational framework for business and competitive tax regimes.

[13] Central Bank of Brazil – Departamento de Capitais Estrangeiros e Câmbio: "Capitais Brasileiros no Exterior", Results for 2001, 2002 and 2003.

[14] Most likely much or most of it is reinvested in Brazil, as suggested by the considerable amount of FDI stock in Brazil from tax havens.

[15] Amounts recorded for the year 2005 as of September 2005 on the date this paper was prepared.

Table 1. Internationalization of Brazilian companies

Period:	*1960s-1970s the Brazilian "miracle"*	*1970s-1980s external debt crisis*	*1980s-1990s the lost decade*	*1990-1994 economic liberalization*	*1995-2005 international competitive insertion*
Selected macroeconomic policies	Imports substitution	Exports intensive	External debt default Currency exchange adjustments	Sharp reduction in imports barriers	International expansion
	• Brazilian Industry Protection: Restrictions for internally produced goods	• Tax credit for exporters • Subsidizing exports • Financial incentives	• Hyperinflation and Economic Stabilizations Plans • Stagnation with inflation	• Privatization of State-owned companies • Real/plan successfully fights hyperinflation	• Economic stabilization • Competi-tiveness adjustments of Brazilian firms to international levels • Growing amount of OFDI • Slowdown of economic growth
Implications for international competitiveness of Brazilian firms	• Regulated competition • Focus on international market • Competitive-ness of firms lagging behind • State price controls	• Government-driven tax incentives credits as main source of rents • Focus of companies on domestic market	• Stop and go economic growth • Inflation rates and indexation policies favour financial short term capital over long term investments • Weak market institutions	• New international entrants in Brazilian market due to liberalization and privatization • Stronger domestic competition between existing players	• Denational-ization of some industries • Defensive strategic movements by established firms • Quest for new opportunities in interna-tional markets

Source: Authors.

C. Drivers and motivations

In the early 1990s, most Brazilian companies have shifted from a pure export-oriented to a more comprehensive internationalization strategy through OFDI. This change was a response to increased globalization, to changes in the Brazilian macroeconomic and institutional environment, and corporate strategies in order to increase their competitiveness to international levels and sustain their growth.

Changes in the domestic macroeconomic and regulatory framework have stimulated a more open and competitive environment for Brazilian companies. This favoured the upgrading of domestic competitiveness to international benchmarks. At the same time, the non-inflationary environment which followed the successful implementation in 1994 of the *real* economic stabilization plan, helped to reinvigorate market institutions and the price systems in the Brazilian economy. The macroeconomic and institutional drivers that explain the levels of Bra-

Table 2. Host countries receiving OFDI flows from Brazil, 2003-2004

*(Millions of dollars)**

Country	*Ranking*	*2003*	*Ranking*	*2004*	*Ranking*	*2005*
Total		1 986		10 757		4 032
Netherlands	18	7	2	2 740	1	1 394
Italy	26	1	3	883	2	1 078
Venezuela	28	1	7	193	3	314
Virgin Islands	33	0	23	8	4	207
Uruguay	9	79	4	744	5	207
Saudi Arabia	39	-	1	4 930	6	191
Costa Rica	45	-	11	44	7	176
Puerto Rico	39	-	9	152	8	86
Aruba	40	-	16	17	9	77
Dominican Republic	31	-	20	11	10	52

Source: Banco Central do Brasil.

*Totals for each year do not take into account direct net investment (credit-debit), but only capital outflow.

zilian OFDI from 1997 include the growing attractiveness of international markets, the valuation of the Brazilian currency, the simplification of exchange procedures and the elimination of red tape regarding outward investment operations. At the corporate level, their motivations are much more varied, including following the main customers, consolidation of global positions and expansion plans in existing markets, access to cheaper resources (including capital), development of new resources and competences, and geographic diversification to reduce country risk. These motivations are analyzed below:

- ***Tapping fast-growing markets.*** Since the 1990s, with the exception of 1993 and 1994, Brazilian economic growth lagged behind world economic growth. In addition, the countries' total real annual product growth has been below the developing countries' average growth. At the same time, Brazilian TNCs reached the limits of growth in domestic markets, beyond which, besides decreasing returns, there were also risks of incurring in monopolist practices that risked legal action. As a result, opportunities offered by growing international markets became an attractive alternative compared to expanding share in a slow–growing and saturated market. This explains why the largest Brazilian TNCs increasingly targeted North American and Asian markets, instead of looking for neighbouring markets (table 3). Three Brazilian companies were among the largest TNCs from emerging economies in 2004 (UNCTAD 2005 and table 4). Most of them were already local market leaders and successful exporters before investing abroad. However, recently a new breed of middle-sized companies is also turning to internationalization strategies.

Petrobras is the leader among Brazilian TNCs, eighth among TNCs from emerging economies. It has 13 branch offices and more than 5,800 employees abroad. Companhia Vale do Rio Doce (CVRD) is ranked second and has 16 foreign branches. Metalúrgica Gerdau is third, with another 53 foreign branch offices and more than 5,300 employees abroad. It is interesting to note that, among the three companies ranked by UNCTAD, Gerdau is the one that has the largest percentage of equity abroad (43 per cent, compared to 27.5 per cent for CVRD and 14.5 per cent for Petrobras). Petrobras, a former monopolist in the upstream and downstream oil business, has increased investments in international markets (box 1).

- ***Consolidation of global positions.*** Brazilian TNCs that have already developed international outposts in most economic regions are now searching to consolidate their international strategies by complementing their assets, developing a more integrated global strategy, and entering new regions. This has been the case of WEG (electric motors) and Embraco (now an affiliate of Whirpool), which are relocating some of their activities in order to

Table 3. OFDI destinations of selected Brazilian transnationals

Company	*Industry*	*Markets*
Weg Motores	Electric engines	Argentina, Mexico, Portugal and China
Metalúrgica Gerdau S.A.	Steel	United States of America, Canada, Chile, Argentina, Uruguay and Colombia
Embraer – Empresa Brasileira de Aeronáutica	Regional aircraft	China and United States of America
Odebrecht S.A.	Engineering	Argentina, Peru, Bolivia, Ecuador, Venezuela, Dominican Republic, Angola, Portugal, Kuwait, United States of America and Djibouti
Petróleo Brasileiro S.A. – Petrobrás	Petroleum and Energy	Angola, Argentina, Bolivia, Colombia, United States of America, Nigeria, Venezuela, Mexico, Ecuador, Peru, Uruguay, United Republic of Tanzania, Islamic Republic of Iran, Libyan Arab Jamahiriya and China
CSN – Companhia Siderúrgica Nacional	Steel	United States of America and Portugal
Votorantim Cimentos	Cement	United States of America and Canada
Marcopolo S.A.	Bus maker	Argentina, Colombia, Mexico, Portugal and South Africa
Companhia Vale do Rio Doce	Mining	China, Japan, Mongolia, South Africa, Mozambique, Gabon, Angola, Venezuela, Chile, Peru, Argentina, Belgium, France, Norway, United States of America, Australia and Bahrain
Natura S.A.	Cosmetics	Chile, Argentina, Peru, France and Mexico
Sabó Autopeças	Autoparts	Germany, Austria, Hungary and Argentina

Source: GRINBAUM, 2005 and company web sites.

Table 4. Brazilian companies in the ranking of the largest TNCs from developing countries, 2004

(Millions of dollars)

Company	Ranking	Industry	Equity *(US$ million)*		Sales *(US$ million)*		Jobs		Affiliates	
			Abroad	Total	Abroad	Total	Abroad	Total	Abroad	Total
Petróleo Brasileiro S.A. - Petrobras	8	Petroleum and Energy	7 827	53 612	8 655	42 690	5 810	48 798	13	79
Companhia Vale do Rio Doce	23	Mining	3 155	11 434	6 513	7 001	224	29 362	16	55
Metalurgica Gerdau S.A.	31	Steel	2 056	4 770	2 096	4 531	5 334	19 597	19	53

Source: UNCTAD, *World Investment Report 2005.*

better respond to their global clients' needs and to growing global competition. Embraco has relocated some of its international platforms from its Italian affiliate to the Slovakian plant. Wegl, a Brazilian company with production affiliates in four countries (Argentina, Mexico, Portugal and China), intends to grow revenues from foreign production up to 20 per cent of total revenues in the next five years. Therefore, it plans to invest $34 million in its foreign plants, mainly those in Mexico and China. China has been one of the internationalization

Box 1. The international expansion of Petrobas

The Brazilian energy company Petrobras has invested $8.8 billion in foreign activities in the past 10 years. In 2005, international activities accounted for around 8 per cent of its net operating revenues, totalling $56.3 billion, 10.1 per cent of its total asset, amounting to $78.6 billion, and 11.4 per cent of its 54,600 employees. In the early 1970s, when the first oil crash took place, Brazilian production was small and did not meet consumption needs. In that scenario, the Brazilian Government, Petrobras' main shareholder, felt the need to access foreign petroleum reserves to guarantee domestic supplies, since there was no expectation that new petroleum reserves would be found in the country. Towards this goal, Braspetro was established to manage the company's international businesses. The targets for the international expansion were the Middle East, North Africa and Colombia, for their great oil exploration and production (E&P) potentials. During the 1970s the foreign operations were centred on the E&P segment, and in 1976 Braspetro discovered huge oil reserves in Iraq, but it withdraw after nationalization. At the end of the 1970s, when the first reserves of the Brazilian Campos Basin were discovered, Petrobras' investments concentrated into domestic oil reserves. In the mid 1980s, the giant deepwater pools in the Campos Basin - Marlim and Albacor - were developed, while the international activities under Braspetro's responsibility were refocused on trading. Almost all resources were invested in Brazil. Due to the small size of the businesses, Braspetro's results worsened and in the beginning of the 1990s international activities further reduced. However, with the end of the domestic monopoly Petrobras revived its internationalization process. The company intended to become the regional leader in Latin America, as an integrated oil company, while searching for new of oil sources in other regions. Three regions were selected for its expansion: the West Coast of Africa, the Gulf of Mexico and Latin America. In Africa and the Gulf of Mexico, Petrobras planned to apply its technological capabilities for deep-water petroleum exploration. In the Gulf of Mexico Petrobras intended to generate strong currency cash flows in a low-risk political environment, contributing to the reduction of its cost – a main constraint in Brazilian financial markets. In Latin America, the advantage against other competitors was the knowledge of the region, the economic integration with the southern countries (Mercosur) to grow as an integrated energy company, in upstream and downstream gas and energy activities. To strengthen international expansion, Petrobras created in 2000 an International Business Area. With this new structure, Petrobras then promoted its restructuring and new FDI. In the United States of America, for instance, the small swallow water investments was sold and substituted by new deep-water wells. Aiming for fast growth, the company expanded through acquisitions. In 2001, Petrobras and Repsol concluded an assets swap, where Petrobras obtained 99.5 per cent of EG3 (company with refinery processing capacity of 30.5 million barrels/day and around 700 service stations). It marked the expansion into the refinery and distribution segments. The acquisition of Petrolera Santa Fé and Perez Companc (PECOM), which, at the time, was in financial difficulties, increased its petroleum and gas production capacity from 20,000 barrels of oil equivalent (BOE)/day to 120,000 BOE/day. With an investment of around $2.5 billion, Petrobras incorporated diverse operations, including energy generation and high-tension transmission. However, there were also setbacks. In early 2006, Petrobras announced it was suspending its investments in Bolivia (including the plans to expand a gas pipeline between Brazil and Bolivia) after the nationalization of energy resources announced by the Bolivian Government. Besides growth, portfolio diversification, and development of human resources, Petrobras' benefits from the internationalization included a significant capital cost reduction. In 2005, the company reached Moody's Investor Service's investment grade level for its debt in foreign currency — four levels above the Brazilian sovereign risk classification.

Source: Company's web site and the authors.

targets of Brazilian companies, mainly due to its vast consumer market, cheap labour and strategic location as an exporting base in Asia .

- ***The evaluation of Brazilian currency.*** The strengthened domestic currency has increased pressure on Brazilian enterprise internationalization. The appreciated Brazilian currency reduced the cost of investing overseas and of acquiring foreign assets. The strengthened currency also affected the cost of production denominated in reais (e.g. raw materials, labour and other locally-incurred costs). Thus, while the strengthened real reduced the profitability of pure exporting strategies for companies that depend

heavily on local inputs, like the agribusiness sector and the meat and poultry segments, it also stimulated business initiatives into foreign markets, promoting resource-seeking investment to regions that offered cost advantages. Recent acquisitions by Brazilian firms in Argentina took advantage of devaluated foreign assets. Camargo Correia, a large diversified Brazilian group expanded its cement business to Argentina in 2005, acquiring Loma Negra, a leading local cement company. Friboi, a Brazilian meat processor, also expanded to Argentina in the same period. Friboi acquired 65.3 per cent of the Argentinean Swift Armour S.A. in September 2005. This was the first OFDI financed by resources from BNDES (the national bank for economic development), and it was estimated at $200 million – with resources from the bank amounting to $80 million. Friboi expected to increase exports by over 70 per cent because of easier access to the United States market due to the sanitary standards certification of the Argentinean plants.

- ***Efficiency-seeking investment.*** In the manufacturing and services sector, the recent offshoring and outsourcing of operations in Asia aimed at reducing labour costs. Earlier, the relocation of activities for cost reasons had been negligible since as an emerging country, Brazil has traditionally developed comparative advantages, and competed with Asian countries as a low-cost investment location. Nonetheless, the evaluation of the *real* has forced some companies to revaluate their cost structure. This has been the case in the footwear and textile and garments industry, which has been challenged by cheaper Asian imports. Footwear manufacturer Azaléia, which had lost international competitiveness, transferred part of its production to China (box 2).

The company closed a plant in Brazil and it outsourced part of its production to China to export it to the United States of America and Europe under its own brands. The transfer of production to China was also motivated by stiff competition from Chinese companies. The increased competition on prices has also affected the agribusiness sector in Brazil. Bungi Alimentos, a soybean oil and meal producer, no longer exports these products; it currently sells bulk soybean processed in two production plants set up in China in 2004. Bunge also relocated some of its soybeans oil processing plants from Brazil to Argentina to overcome infrastructure constraints and take advantage of lower production costs there.

Box 2. Calçados Azaléia S.A.

Calçados Azaléia S.A ("Azaleia"), founded in 1958, is today the largest shoe manufacturer in Brazil, and one of the largest in the world, with total revenues of 1 billion *reais* in 2005 (US$ 469 million), production of 160,000 pairs of shoes per day, and more than 17,000 employees. Headquartered in the Brazilian Southern Region, Azaleia has production units in the states of Rio Grande do Sul, Bahia and Sergipe, and sales representatives all over Brazil, as well as in Latin America, the United States and Europe. The company also has its own offices in the United States, Chile, Colombia and Peru. Azaleia exports about 20 per cent of its production to more than 70 countries, and has established more than 15,000 stores in Brazil and a further 3,000 shops spread in the five continents. Azaleia's first exports date from 1975, but only in the 1990s did the company start to invest abroad to compete in international markets. The strategic decision to internationalize derived from the need to expand into new markets, given the saturation of the Brazilian market. The locations were defined based on a commercial strategy. Accordingly, foreign units were established in Chile, Colombia, Peru and the United States, with the objectives to distribute its products and promote the brand. Under a project to internationalize its brands, it inaugurated an Olympikus' store in the largest shopping centre in the Czech Republic. With the same philosophy of exclusive stores, the company owns a showroom at 6th Avenue in New York. In 2005, the company decided to outsource part of its production to China, while maintaining the design and product development activities in Brazil. Given the strong competition with low-cost Chinese manufacturing, and unable to reduce its costs in Brazil, Azaleia rented plants in Dongguan. Outsourcing part of its production was a strategy for Azaleia to maintain cost competitiveness to supply its main foreign markets.

Source: Cunha, L. (2005) Azaléia vai à China. Revista Isto é Dinheiro. Gomes, Cavalcanti, Pinheiro, Barroso (2003) Management Control in the Internationalized Brazilian Firm: The Case of Calçados Azaléia S.A.

- **Following the leaders of productive chains.** Some of the Brazilian large and medium sized companies have chosen to internationalize to follow their main clients in the international markets. In the automotive sector, the globalization of first rank suppliers has been a traditional business practice (box 3).

For the Brazilian companies, it has also been an opportunity to tie strong links with suppliers and to develop new capabilities and resources abroad, including brands, technological and marketing capabilities, while learning how to operate in international settings.

- **Resources-seeking investments.** In some industries, the resource seeking activities are the main drivers for internationalization. This has been the case of the oil and mining industries and some areas of the agribusiness. In Brazil, investments by CVRD (mining) and Petrobras (oil) illustrate the first trend. The search for new sources of natural resources has pushed Petrobras to Africa, Argentina, North America and the Middle East (box 1). CVRD extended its operations to Africa, and is planning to invest in Argentina to identify and assess mineral deposits in the province of Neuquen.

- **Reducing the risk of overdependence from domestic markets.** Most of the large Brazilian companies that have developed good corporate governance practices and are already listed in stock exchanges of developed countries need to reduce the risk perception by international investors (Mork and Yeung 1991). Brazilian companies used OFDI to reduce such perceived risks associated with a dominant exposure to the Brazilian market. While this is not usually the main drive, risk reduction helps a company to access funds in more favourable conditions. Gerdau is an example of obtaining better investment grades than companies that operate solely in the Brazilian market (box 4).

- **The acquisition of complementary assets.** Most Brazilian TNCs are generally leaders in their domestic markets; however, some of their assets are difficult to transfer internationally. This has been the case with brands, marketing skills and technological capabilities that do not meet international requirements. Therefore, in addition to focusing on exploiting and adapting their assets and competencies developed in their home base, companies are increasingly using their international operations to tap (Doz, Williamson and Santos 2001). Learning assets are not only consequences of the internationalization process, but a drive by itself (Bartlett and Ghoshal 2002). Natura, a leading Brazilian company in the cosmetic industry, is an example of the use of internationalization for learning purposes. In establishing an affiliate in Paris, it plans to gain access to up-to-date fashion and market trends, while taking advantage of the proximity to the Paris region's luxury goods cluster (box 5).

Box 3. Sabó Autopeças- getting closer to the customer

Sabo has served important foreign clients, such as Ford, for which it manufactured car mirrors and assembled wheel oil seals for trucks. It has 100 per cent Brazilian ownership. It developed as a supplier of large automobile companies, and decided to internationalize its operations to serve large TNCs as a global supplier. In 1992, it acquired two oil seals plants in Argentina. In the next year, it acquired the ownership control of Kaco, the second largest manufacturer of oil seals in Germany, with three plants, including the headquarters, and another plant in Austria. This expansion was derived from a careful analysis of the global automobile industry. Germany is considered the technological centre for plastics and rubbers. By taking over Kaco, which had a well-known technology asset, Sabo acquired the Kaco's brand. The increasing presence of Sabo in Europe led to the construction of a production plant in Hungary. With this new unit, Sabo duplicated, in two years, its production capacity to serve the European market. After expanding to Germany, Austria, Hungary and Argentina, Sabo plans to establish a new plant in the United States. According to the company's General Director, Antonio Carlos Bento de Souza, the decision to build an oil seal plant in the United States was driven by the demand for Sabo products in the country. "It is the largest automobile market in the world, and they know our brand in the U.S. There, among many automobile companies, we supply General Motors that produces 8 million cars per year. Being close to the customers is an important differential in market competition", stated the company's director.

Source: Sabó, uma admirável história de liderança. www.nitriflex.com.br/template.asp?pag=nitrinews_06_02 .

Box 4. Gerdau S.A.

Gerdau developed its activities in Brazil benefiting from the country's comparative advantages in steel production, including the wealth of energy resources and low labour costs. Gerdau operates mini-mill and integrated-steel facilities in Brazil, Argentina, Chile, Colombia, Uruguay, the United States, Canada and Spain. With a crude steel production capacity of 18.7 million tons in 2006 and a gross revenue of 25.5 billion reais ($11.1 billion)[a] in 2005, the company holds in Brazil a 48 per cent market share in the long steel segment and a 22 per cent share in the crude steel market. In the early 1980s, with the saturation and low growth rates of the domestic market, Gerdau started investing abroad. The main motivation to expand within the region was the regional economic integration of Mercosur and the Chilean markets strength. In North America, where the annual demand of steel products is more than 150 million tons, investment was market seeking. However, it also took into consideration the high capital costs in Brazil – a disadvantage in relation to other industry's global players. Investment in the United States gave Gerdau the access to capital of lower cost to raise funds in developed financial markets without paying the premium associated with the Brazilian risks. The company pursued the same strategy developed in Brazil: a decentralized production of long-steel products in mini mills, using scrap iron or steel as raw material for the production process. It expanded through acquisitions - a rather rational consideration in an industry plagued with overcapacity. In 2002, Gerdau and Co-Steel merged forming Gerdau AmeriSteel Corporation in North America. In the same year, Gerdau's entered the flat steel market, with a 50 per cent acquisition in the joint venture Gallatin Steel based in the United States. New important acquisitions followed in 2004, including North Star Steel, and Gate City, RJ Rebar and Potter Form & Tie which had reinforcing steel facilities. The acquisition of North Star Steel for $308 million consolidated sales into the Midwest. The company also expanded in South America, with the acquisition of 59.8 per cent of the assets of the Colombian Grupo Diaco. In 2005, Gerdau signed an agreement to acquire 40 per cent of the capital stock of Corporación Sidenor S.A., the largest long specialty steel producer, forged parts and foundry in Spain and one of the major producers of stamped forged.

Source: Interviews by the authors.

[a] At a foreign exchange rate of R$2.287 per dollar on 23 May 2006.

D. OFDI and implications for enterprise competitiveness

The effects of enterprise internalization on the competitiveness of the 1,000 largest Brazilian companies have been acknowledged in a survey conducted by Fundação Dom Cabral in 2001 (Cyrino and Oliveira Junior 2003). When asked to evaluate which dimensions of economic performance have been most affected by their internationalization (including exports), these companies ranked, in order of importance, the positive effects on scale and scope economies, reduction of overdependence of country risks, overall improvement on bottom-line performance, learning effects and, with a lesser emphasis, increasing the company's market value (this result was probably influenced by the fact that there are few listed companies among the 1,000 Brazilian firms).

From the contribution to growth, it seems clear that Brazilian TNCs, which are among the largest in their markets, have profited from their investment abroad. As markets outside Brazil present higher growth rates, companies that are well placed in rapid growth markets tend to present better performance than those companies that rely exclusively on the domestic market.

As for the learning effects, international exposure has had an important effect on the competitiveness in the domestic market. Having to deal with more demanding customers in different institutional and cultural settings, these companies have been stimulated to search for new approaches and solutions that can be later on be incorporated in the whole network, included at headquarters. However, reliable quantitative data on international performance of Brazilian TNCs are scarce, which makes the effect of OFDI difficult to assess.

Some of the positive effects of OFDI on internationalized Brazilian firms as explained in the earlier company cases include expansion of markets (Azeleia, Sabo, Natura, Petrobas), maintain cost competitiveness (Azeleia), access to technology (Sabo), brand awareness (Natura), better control of value chain (Petrobas) and access to natural resources (Petrobas).

Box 5. Natura: the Brazilian perfume in Saint-Germain-des-Prés

In 2005 Natura opened its first "Maison" in Paris. It has plans to expand its brand in Europe, from its base in France. France is a strategic country for the company's international learning process because it is the most sophisticated cosmetics and perfumery market in the world and because of the intense rivalry among competitors in the market. All of the large global players of the industry are present in France. According to Natura's CEO, Alessandro Carlucci, the store, located in Saint-Germain-des-Près, in Paris' commercial city centre, was conceived not only to sell products, but also to present to the customers Natura's values and concepts. He explained that "We sell in our store well-being associated with our brand". This model adopted in Europe, which includes the objective of developing a global brand, also has the effect of strengthening Natura's brand in Brazil. On one hand, the company's Brazilian consumers who enjoy the opportunity to know the glamorous French store, place higher value on the company and its products after the experience. On the other hand, when selling Natura's products, its consultants can say that they are appreciated and sold in Paris, which is very appealing to new customers.

Source: Natura planeja expansão da marca na França. DCI – SP, Comércio, A-14
http://www.abevd.org.br/htdocs/index.php?secao=noticias&noticia_id=786, accessed on 30 March 2006.

E. OFDI policies

The lack of policy support and measures, including other constraints faced by Brazilian firms, had limited OFDI from Brazil (box 6). However, a number of policy efforts had been undertaken by the Government, which had contributed to improving the environment for OFDI. A positive and noteworthy recent effort made by Banco Central do Brasil (Brazilian Central Bank – or BC) to simplify the formal procedures and controls of foreign investments and debts is a case in point. In March 2005, BC issued a policy that facilitated outward investment by companies located in Brazil. Regulations dealing with foreign currency exchange and foreign currency inflows and outflows were simplified while, at the same time, the limits of investments transactions were removed. Excessive red tape was eliminated as well as the need for previous authorizations for investments.

Foreign exchange regulations. An exchange-rate operation is needed for a direct investment abroad. Companies investing abroad had many restrictions which have been progressively removed.

- Prior to 2000, the Free Exchange Rate Market (MCTL), also known as commercial market, was part of the foreign exchange market charged with exchange transactions related to foreign investments and international loans. This was the least flexible part of the exchange market. The chief feature of this market was the need for previous approval from the Brazilian Central Bank. Such approval was valid for specific operations only. Circular Nr. 1.280 (18 January 1988) demanded that foreign-currency remittances for Brazilian investment abroad be previously authorized by the Brazilian Central Bank through sale of a gold amount equivalent to the intended investment.

- In the year 2000, the legislation reformed the process. It made the OFDI regulation on the Free Exchange Rate Market (MCTL) more flexible. Brazilian companies were henceforth authorized to freely carry out these investments, up to a $5 million limit, for a 12-month time period. Prior authorization from Brazil's Central Bank would be needed only if the investment exceeded such amount or surpassed this time period. Yet, despite all this, the defined mechanism remained complex and dependant on submitting several documents for the investment exchange-rate operation to be performed. It is important to point out that all the demands and procedures would apply only to investments not surpassing the $5 million top limit and not remaining abroad for longer than 12 months. For investment plans outside these targets, the situation was even more complicated, inasmuch as the investment hinged on previous approval from the Brazilian Central Bank.

- In March 2005, a resolution from the National Monetary Council (CMN) unifying the Brazilian foreign exchange market encompassed all exchange operations, regardless of amount or purpose. The new resolution suppressed the Brazilian Central Bank's rigid controls on exchange-rate operations and on trade transactions related to it. Brazil's Central Bank intended to minimize

Box 6. Brazil: Some constraints on OFDI

A number of constraints had limited Brazilian firms from venturing abroad. These include the absence of government policies and support for companies that want to expand abroad, the stickiness of some of the Brazilian TNCs competitive advantages and management ethnocentrism.

- ***Lack of policies measures to support OFDI.*** In spite of the Government's declared intentions of creating 10 Brazilian TNCs, this has not been translated into concrete government policies and programmes that support the internationalization effort involving OFDI. While this laissez-faire position may not have a great influence in larger companies, it becomes an obstacle for SMEs, which lack the resources to expand their activities abroad and to compete successfully in international markets. Modernization of the legal framework, in order to adapt to the new reality imposed by globalization is fundamental for Brazilian companies' competitiveness in the international market. Even though recent changes have considerably reduced the red tape faced by companies expanding their international activities, the legislation restricts the consolidation of results generated abroad. Furthermore, changes to modernize legislation must be comprehensive. Often this is neglected and ad-hoc reforms in one area do not canvass effects in other fields.
- ***The stickiness of the competitive advantages of Brazilian TNCs.*** Larger Brazilian TNCs built their advantages in the domestic market becoming leaders in their industries. By internationalizing, they try to exploit their competitive advantages and distinctive assets and capabilities that they have long developed in the Brazilian market. To be effective in international markets, however, these capabilities must be transferable. In the Brazilian case, where, with some exceptions, most of the competitive advantages are linked to process technology, access to raw materials and low labour cost. Process technologies are in general "sticky" – deeply ingrained in the routines and tacit know-how of managers and qualified workers. While there are ways to manage tacit knowledge for competitive advantaga[a], it needs a conscious effort in order to organize information into best practices, develop mobility and invest in support systems to transfer knowledge. Low cost labour and raw materials are comparative advantages – and, as such, location-specific. In order to overcome market failures and institutional voids, Brazilian TNCs have in the past relied on internalized activities and transactions creating strong vertical integrated companies – an advantage difficult to transfer to new settings without incurring in huge investments and risks – surely a shortcoming for Brazilian companies. The main challenge for Brazilian TNCs is to adapt and reconfigure their business model abroad, and to organize their knowledge and transfer mechanisms in order to add value to the foreign operations. This has been the case of Gerdau (box 4). Before investing abroad, Gerdau has focused on the upgrading of their process technology and operations management to upgrade them to international best practices.
- ***Managerial Ethnocentrism.*** Most boards and top management do not have experience in managing cultural diversity. Being predominantly composed of Brazilian natives lacking a robust international experience, top management tends to be biased towards an ethnocentric approach. Because of that, domestic issues – that for most companies still represent the most representative part of their business – are favoured over international issues. Usually, the international ventures are segregated in an international department, which acts as an interface between the affiliates and the headquarters. Usually, they are perceived as simple implementers of operating policies – not as business units, with the need and autonomy to adapt to local circumstances and even contributing to global solutions. Most of these companies are still controlled by second and third generation family, and their exposure to international financial markets is limited. Most of the Brazilian TNCs rely, for the implementation of their international strategies, on expatriates with international experience, a scarce resource that limits international expansion. International capabilities (including language knowledge) are still scarce in most companies. Companies are overcoming this obstacle by recruiting new managerial talent with international skills and experience, and learning to work with local talent in the countries in which they operate.

Source: Authors.

[a] Cemex, the Mexican company in the cement industry, has been a successful case of transferring their best practices to their cross-border acquisitions. Strongly backed by information technology, they were able to organize the accumulated tacit knowledge and, with the development of teams, manage to integrate it in their network of subsidiaries. For more details, see: Marchand, D., Kettinger, W. and Chung, R. (2005). The Cemex way: the right balance between local business flexibility and global standardization. IMD - International Institute of Management Development Case, Lausanne, Switzerland. IMD-3-1341.Ghemawat, P. (2002). "The Globalization of CEMEX", by Pankaj Ghemawat. Harvard Business School Case. 9.701.017.

its interference on the exchange market. Instead of a long list of documents demanded for each type of operation, the principle of mutual trust applies. Hence, in contracting an exchange-rate operation, the financial institution is responsible for requesting the documents to review the transaction's economic foundation as well as for financial coverage. Current rules also removed the US$5 million limit and the 12-month constraint. Regardless of amount and time frame, any and all Brazilian investments abroad may now be carried out without previous authorization.

Fiscal regime. Brazilian legislation has lightened the burden of Brazilian companies. However, concerning direct investments made by Brazilian corporations abroad, the tax regime remains cumbersome. On corporate income, Brazil's national legislation used to adopt the territoriality principle - that is, Brazilian taxation was levied only on income produced in the Brazilian territory. However, as Brazilian OFDI increased and in order to fight tax evasion, in 1995 Law Nr. 9.249/95 abolished the principle of territoriality for Corporate Income Tax and introduced the principle of universality (worldwide income taxation). Thus, profits by affiliates (branch offices, controlled and associate companies abroad) became part of the actual profit, in its totality in the case of branch offices and, for controlled and associate companies, proportionately to the share of corporations resident or domiciled in the Country as of 1996. It ought to be pointed out that this reform became effective in the year 2000. Profits from abroad can be by affiliate and no results consolidation is allowed prior to taxation in Brazil. The sole exception applies to affiliates domiciled in a same country, under the control of the same Brazilian company. In such a situation, Brazilian fiscal legislation allows a company to select an affiliate for the consolidation of results in that country, for purposes of later consolidation in Brazil. For losses incurred abroad, legislation precludes compensation with corporate profits in Brazil. A positive aspect of the new legislation is its attempt to eliminate double-taxation. Tax legislation allows Brazilian corporations to use fiscal credits of Income Tax paid in the country of domicile of the foreign affiliates to be compensated by the tax due in Brazil on these same profits, regardless of any international treaty with the pertinent country, to avoid double-taxation. Only the difference between the national tax bracket and the bracket effectively levied in the country of the investment will be charged.

F. Conclusion

Since the early 1990s, large Brazilian companies have entered a new stage in their internationalization efforts, driven by the country's economic and institutional changes. In response to liberalization, privatization and economic stabilization efforts of the early 1990s, large firms in Brazil have adjusted their strategies and started to internationalize. Their early activities, mainly based on exports, have shifted to different forms of foreign investments with a reconfiguration of their value chain to meet increasing domestic and global competition. As a result, outward foreign direct investment (OFDI) by Brazilian transnational corporations (TNCs) reached new heights and it introduced new managerial challenges for companies that have traditionally developed their business models and practices in a protected and strongly regulated environment.

In spite of the higher levels reached by Brazilian OFDI, there have been several obstacles to the increase of outward investment flows. Some of these are linked to the general competitiveness of the Brazilian economy as a whole, and the exports in particular, such as the deterioration of the infrastructure (mainly the road system and port facilities) due to the lack of investment capacity by the Federal and by State Government, the high interest rates, the complexity of the tax regime and the high tax rates, bureaucracy and red tape. However, while these constraints affect the competitiveness of the Brazilian TNCs at home, it should not necessarily be seen as a hindrance to the capacity of increasing the investments abroad by Brazilian TNCs.

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CHAPTER IV

OUTWARD FOREIGN DIRECT INVESTMENT BY ENTERPRISES FROM CHILE*

A. Introduction

Chile began to open up its economy to outside competition in the 1970s. Economic reforms included trade and financial liberalization, deregulation, privatization, and the lessening of the size and role of the State. The country integrated rapidly into the international market by signing numerous free trade and bilateral investment agreements with countries in Latin America, North America, Europe and Asia. It became a large recipient of FDI and expanded its trade links with other countries. Pushed by growing external competition and domestic market saturation, some Chilean enterprises began to invest abroad. Between 1985 and 2004, the stock of Chilean OFDI grew from $100 million to $14.5 billion (UNCTAD 2005).

This paper examines the trends, drivers and cases of FDI by Chilean enterprises. It discusses the implications of Chilean enterprise internationalization on competitiveness and analyses the policies adopted to support OFDI.

B. OFDI from Chile: Trends and development

In the early 1990s, a group of Chilean enterprises, having grown in a competitive home market shaped by early liberalization and privatization, stood out for their competitive assets including their financial strengths and quality of the management. This group of firms included large enterprises in telecommunications, energy, retail, pension funds and selected manufacturing industries. Saturated local markets and investment opportunities in other Latin American countries encouraged Chilean firms to invest abroad.[16] With their efficient management practices and early experience operating in open and deregulated markets, some large Chilean enterprises saw opportunities to invest in the neighbouring countries that were starting a similar market opening process.

The local capital market provided access to funds that supported the expansion of leading companies in Chile. The strong performance of enterprises in finance and manufacturing sectors and the promising prospects of the Chilean economy offered new possibilities to raise external financing.[17] In particular, Chilean companies started looking abroad to raise funds provided by institutional investors. Listing of stock in foreign markets, especially through American Depository Receipts (ADR) and bonds, provided new resources for companies to undertake expansion abroad. Chile became a sort of "recycling centre" for international funds (Calderón and Griffith-Jones 1995). Along with improved access to finance, the Chilean authorities relaxed foreign exchange regulations, making investments abroad easier. Chilean OFDI grew rapidly in the 1990s, more than in any other Latin American country (ECLAC 1998, p.142; figure 1).

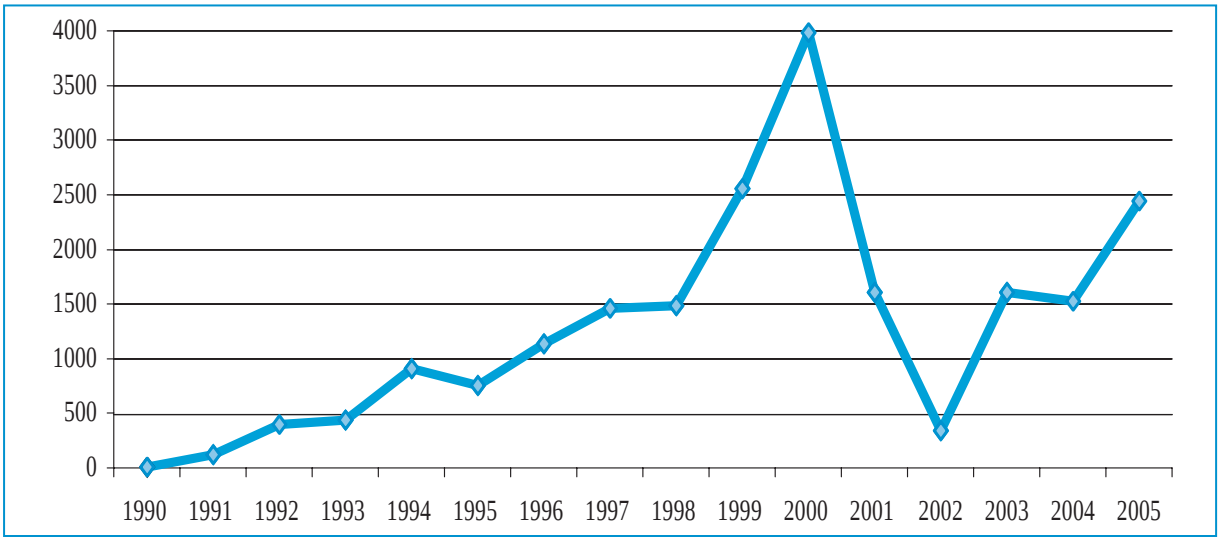
* This paper was prepared by Álvaro Calderón, Economic Commission for Latin America and the Caribbean (ECLAC), Santiago, Chile.

[16] OFDI opportunities in the neighbouring countries emerged because of the return of stability, market reforms, regional integration (especially Mercosur) and privatization in the host countries.

[17] With average GDP growth rates of 7 per cent between 1990 and 1998.

Figure 1. Chile: OFDI flows, 1990-2005

(Millions of dollars)



Source: Central Bank of Chile.

Geographical distribution. Chilean OFDI concentrated in the neighbouring countries because of the geo-cultural proximity and affinity. Large Chilean enterprises have significant investment in Latin America (table 1). Argentina accounts for the largest share of Chilean OFDI because of Chilean-purchased privatized assets (figure 2), particularly in the energy sector (figure 3). Enersis and Gener were the main players. Their acquisition of a stake in the privatized Servicios del Gran Buenos Aires (SEGBA) was the largest among Chilean acquisitions.[18] Recently, some companies started to invest beyond the neighbouring countries and ventured in Colombia, Central America and Mexico, others have invested in developed countries (in the United States, especially in real estate) and a few have gone to Asia (e.g. ENAP). These investments provide Chilean companies with diversification and a protection against regional risks.

Sectoral distribution. Chilean OFDI is concentrated in natural resources and related businesses and service industries. However, over time, Chile has diversified into other industries, particularly in services (Cencosud, Falabella, Ripley and a number of pension fund administrators (AFPs)) and other manufacturing industries (Madeco, Molymet). In manufacturing, internationalization only occurred when Chilean enterprises developed clear comparative advantages. In most cases, activities abroad have been associated with natural resources and market seeking investment, in food, soft drinks, beer, pulp and paper, and mineral manufactures (table 1). Chilean investments in these industries were mainly in Peru, Colombia and Brazil. Most of the market-seeking investments took the form of acquisitions.

Chilean companies that invested abroad grew rapidly. They established an important regional presence. For instance, *Enersis* became a major electricity conglomerate in Latin America before it was subsequently taken over by Endesa (Spain) (ECLAC 2000, p.158).

In services, OFDI by pension funds is notable. In the early 1980s, the Chilean authorities undertook a far-reaching reform of the pension system, moving from an unfunded system to one of individual accounts managed by private companies.[19] The Chilean AFPs built up a wealth of experience in the local market, which they then applied abroad when similar economic reforms took place in other Latin American countries. As with the electricity sector, the regional networks created by AFPs became valuable

[18] SEGBA was divided into four companies, three of which were acquired by Chilean firms. In March 1992, 60 per cent of the share capital of the Puerto power station were acquired by Chilean companies Gener (49.5 per cent) and Chilquinta (10.5 per cent) for $92 million. In May 1992, 60 per cent equity shares of Costanera power station were acquired by a consortium led by Endesa (30 per cent), Enersis (9 per cent) and Chilectra (9 per cent) for $90 million. In July 1992, 51 per cent of the equity shares of the distribution company EDESUR were sold for $511 million to the consortium that took over the Costanera power station.

[19] In May 1981, the individually funded pensions system began to operate with 12 pension fund administrators (AFPs). After a consolidation process involving numerous mergers, there are now six: Summa Bansander, Cuprum, Habitat, PlanVital, BBVA Provida and Santa María.

Table 1. OFDI destinations of selected Chilean enterprises, 2005

(Millions of dollars, percentages)

Company	Sector	Host countries	Sales	
			Total	Percentage abroad
Empresa Nacional del Petróleo (ENAP)	Petroleum	Argentina, Peru, other Latin American countries	6.653	…
Enersis	Electricity	Argentina, Peru, Brazil, other Latin American countries	6.255	…
Cencosud	Retail	Argentina	4.898	32
Falabella	Retail	Argentina, Peru, other Latin American countries	3.841	22
Lan Airlines	Air Transport	Argentina, Peru, Brazil, Mexico, other Latin American countries, European Union	2.499	…
Celulosa Arauco y Constitución (ARAUCO)	Pulp and paper	Argentina, Brazil, other Latin American countries	2.366	…
Compañía Manufacturera de Papeles y Cartones (CMPC)	Pulp and paper	Argentina, Peru, Mexico, other Latin American countries	2.123	11
Molymet	Metallurgy	Mexico, other Latin American countries	2.083	…
Compañía General de Electricidad (CGE)	Electricity	Argentina	1.658	10
ENTEL	Telecoms	Peru, other Latin American countries, European Union	1.491	16
Ripley Corp.	Retail	Peru	1.470	25
Farmacias Ahumadas (FASA)	Retail	Peru, Brazil, Mexico	1.226	60
Compañía Cervecerías Unidas (CCU)	Beverage	Argentina	957	10
Embotelladora Andina	Beverage	Argentina, Brazil	931	52
AES Gener [a]	Electricity	Argentina, Peru, other Latin American countries	896	…
Masisa [a]	Pulp and paper	Argentina, Brazil, Mexico	742	73
Manufacturas de Cobre (Madeco)	Metallurgy	Argentina, Peru, Brazil	711	39

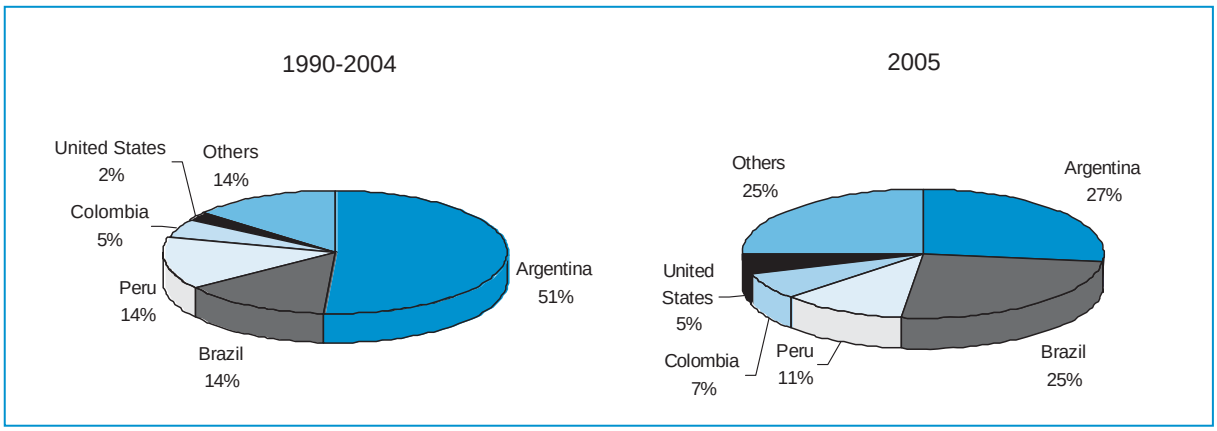
Source: Compiled by the author based on company information and *Capital*, "Top 100, las mayores compañía por ventas", Santiago, Chile, 22 April 2006.

[a] Chilean company bought by a TNC.

assets for other international operators that aspired to quickly establish a strong presence in Latin America. In the late 1990s and the early part of this decade, some of the largest Chilean companies with strong regional presence were taken over by foreign TNCs. At the same time, in an environment of economic uncertainty, the strategy adopted by Chilean firms was to consolidate their position in the local market, postponing plans to invest abroad.[20] These developments held back Chilean OFDI. However,

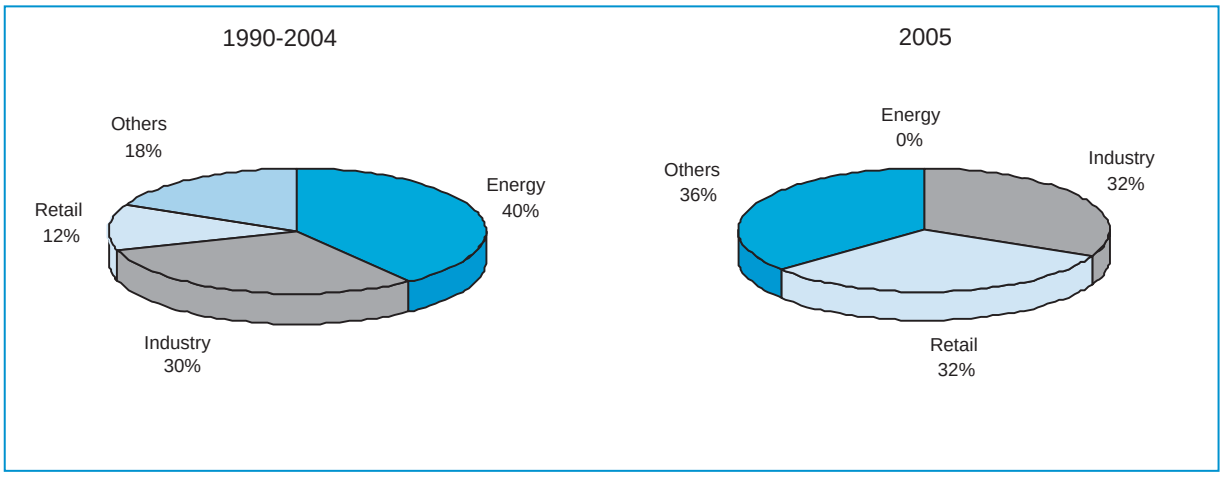
[20] It has been estimated that Chilean companies lost about $10 billion because of their high exposure to Argentina and Peru (interview with Guillermo Tagle of Santander Inversiones on the Radio Duna programme "Hablemos en Off", Santiago, Chile, 26 September 2005).

Figure 2. Chile: OFDI flows, by country, 1990-2004 (accumulated flows) and 2005



Source: Compiled by the author based on data from the Santiago Chamber of Commerce.

Figure 3. Chile OFDI flow, by economic activity, 1990-2004 (accumulated) and 2005



Source: Compiled by the author based on data from the Santiago Chamber of Commerce.

in 2005, Chilean firms re-established their overseas expansion plan, favoured by good economic prospects both in Chile and neighbouring countries.

In general, Chilean enterprises have internationalized cautiously. Many have encountered difficulties in their overseas expansion (Falabella, Cencosud, Ripley, and Madeco) and others were taken over by foreign TNCs when they extended over their capacity or built up regional networks that turned them into very attractive targets for acquisition (Enersis, Gener, Masisa, and pension funds).

C. Drivers and motivations

The internationalization of Chilean enterprises through investment can be explained by "push" and "pull" factors. The *push factors* can be grouped into four categories.

- Saturated market and growing competition at home (ENAP, Lan, Arauco, CMPC, Madeco and Farmacias Ahumada).
- The possession of competitive advantages by companies in telecommunications, energy, re-

tail, pension funds, pulp, paper and minerals, which pushed some Chilean enterprises to internationalize at an early stage.

- The need to develop new and consolidate existing export markets to increase scale (Cencosud, FASA, Ripley, and Falabella) and to obtain international financing (Enersis, Gener, Cencosud, Madeco, Embotelladora Andina and CCU).

- Other push factors include the early shifts in government policy towards liberalization, which gave Chilean enterprises a considerable advantage over their neighbours and other TNCs with less experience operating in Latin America, particularly in an environment of deregulation and privatization. Some Chilean companies have also developed new forms of businesses that have allowed them to grow strong in the local market and later pursue a strategy of internationalization (Falabella and Cencosud).

The main *pull factors* were:

- *Host country location advantages.* Chilean firms looked for the location advantages of host countries for growth and access to new markets, particularly in Argentina, Brazil, Colombia and Peru. Improved policy environment of the neighbouring countries through deregulation and privatization and improved logistics and distribution systems in host countries (ENAP and Masisa) also played a role.

- *Regional branding.* For some enterprises, the main target was to turn national into regional brands (CMPC, Masisa, Lan Airlines, Farmacias Ahumada, Falabella, Cencosud, and Ripley).

- *Strategic partnership.* Forming strategic alliances and partnerships with foreign TNCs in host countries (ENAP, CCU, and Embotelladora Andina).

D. OFDI and implications for enterprise competitiveness

There are three groups of activities, which dominate enterprise internationalization by Chilean companies. They are:

- A first group of firms that engaged in primary activities, producing natural-resource based manufactures and supplying basic inputs to the industrial sector. The growth of these enterprises has generally been strongly influenced by the State. They have invested abroad, mainly in Latin America in search of natural resources and markets, and are mainly involved in hydrocarbons, mining and metal processing, and pulp and paper activities.

- A second group includes manufacturing activities such as beverages and beer. These enterprises generally operate in alliances with global operators or industry leaders.

- A third group comprises public utilities that were transferred over to the private sector as part of the reforms in the 1990s.

Some Chilean enterprises have demonstrated that they have benefited from operating abroad (e.g. ENAP), while some had negative experiences (Falabella, Cencosud). In many cases, the success in internationalization of Chilean firms, particularly in establishing a strong regional presence, has resulted in takeovers by foreign TNCs because of the strong regional assets they had created. Some of the general positive implications include:

- *Resource-seeking.* Enterprises such as ENAP have increased their competitiveness and production capacity as a result of operating close to the natural resource supplies and expanded their markets' reach.

- *Market-seeking.* Other companies such as Arauco and CMPC have strengthened their value chain through vertical integration and supported their trade channels, developing overseas distribution networks.

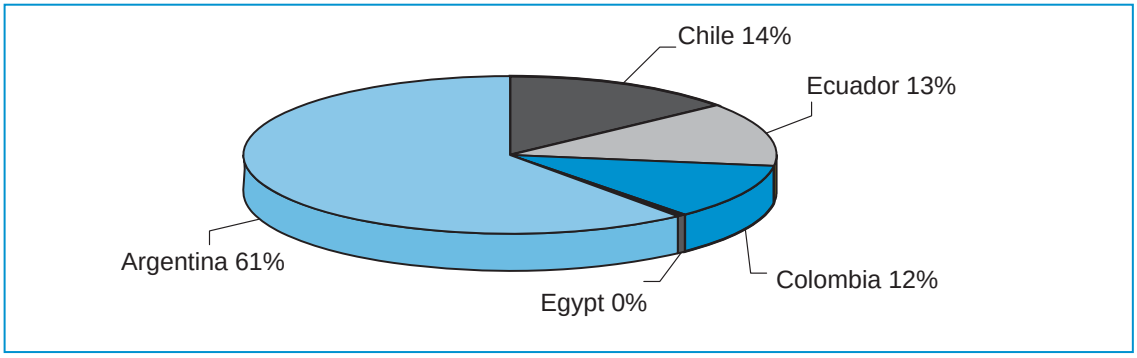
- *Acquisition of strategic assets.* Through acquisitions of strategic assets in the neighbouring countries, some Chilean firms strengthened their market position and increased the market share for their products (Madeco, Masisa, Andina and CCU).

Some of the specific implications for enterprise competitiveness can be assessed by examining cases of OFDI in selected industries.

(a) Hydrocarbons: resource-seeking and control of value chain

- ***Access to natural resources.*** The importance of reliable access to oil reserves has led many oil companies to geographically diversify their reserves and to form joint ventures with other companies. For instance, the State-owned *Empresa Nacional del Petróleo (ENAP*) began its international expansion by seeking out reserves that were scarce at home. Since 1990, ENAP participated in various overseas exploration and production projects to increase its own oil

Figure 4. ENAP: crude oil production, by country, 2004



Source: Compiled by the author based on data from the Empresa Nacional del Petróleo (ENAP).

supply. At an early stage, the company acquired shares in exploration in connection with the Argentine privatization programme. ENAP also formed partnerships with different international firms (Bridas, Repsol-YPF, Pluspetrol, Santa Fé Energy, Total) and in most cases holding minority stakes. This overseas experience was crucial to acquire knowledge of the Latin American market and to later increase regional presence, particularly in Colombia, Ecuador and Venezuela. The internationalization drive of ENAP intensified in the 2000s. In May 2000, ENAP signed a cooperation agreement with Repsol-YPF to undertake new joint projects in Chile, Argentina Peru and Ecuador.[21] ENAP also established a cooperation agreement with the Colombian State-owned company ECOPETROL to exploit, produce and refine hydrocarbons in Colombia. In 2001, it acquired a 100 per cent interest in of the oil exploration rights of the Pampa del Castillo-La Guitarra block in the Gulf of San Jorge (Argentina) for $105 million from Pérez Companc (Argentina). ENAP had also expanded its upstream operations to Colombia, Ecuador, Egypt and Yemen. Over time, ENAP gradually expanded its overseas investment to more distant locations such as Egypt and Yemen. Its exploration experience in the south of Chile and Argentina enabled it to develop significant competitive advantages in offshore operations, which it used to develop new projects abroad. In 2004 and 2005, it took an important step in diversifying its internationalization strategy by incorporating the advantages gained in the domestic refining market through acquiring Royal Dutch/Shell assets (networks of service stations and distribution businesses) of Royal Dutch/Shell in Peru and Ecuador. With these operations, ENAP established a leading position in refining, logistics and marketing in the Pacific coast of South America. These new locations are also major export destinations for the refined products produced in Chile**.**

- ***Increased production.*** The overseas operations increased the importance of ENAP's oil production outside Chile significantly. In 2004, 86 per cent of ENAP's production was obtained from its overseas operations (figure 4).

(b) Pulp and paper: resource- and market-seeking

Chile's forestry sector has major natural competitive advantages (climate, soil, geographical location of the forests and proximity to transport infrastructure). In the 1970s, the Government promoted forestry activities by offering large tax incentives to companies. Leading companies developed investment plans to increase their forestry base and to expand, modernize and diversify their productive capacity — mainly for exports — and to move into products of greater value added (pulp, paper, sawn timber and panels). Two companies, *Celulosa Arauco y Constitución (Arauco)* and *Compañía Manufacturera de Papeles y Cartones (CMPC)*, part of the two main traditional conglomerates in the country (Angelini and Matte groups) became significant global players (box 1).

The main implications for competitiveness were:

- ***Benefits of diversification.*** To complement their growth in the domestic market, CMPC and Arauco embarked on market expansion, initially through exports then through direct investment in neighbouring countries. International expansion was seen as a way to expand and diversify product ranges, in order to lessen vulnerability to commodity business cycles (Feller-Rate 2004, p. 3; BCI 2004, p. 5).

[21] In this context, ENAP signed over its participation in the Quiamare block in Venezuela while the Spanish company conceded the franchise to exploit sources in Argentina.

Box 1. Strengthening market position: Arauco, CMPC and Masisa

Arauco. In 1996, Arauco bought the plantations and production facilities of Alto Paraná in Argentina. It became the main producer and only exporter of pulp in that country. It also bought two sawmills and two wood processing plants, making Arauco the third-largest pulp enterprise in the world and the main producer of sawn wood in Latin America and in the southern hemisphere. In 2004, Arauco acquired the forestry assets of Pérez Companc. It entered the panel fabrication business to take advantage of a growing supply of timber from its own plantations, manufacture more products with higher value added and complement its main activity of pulp-manufacturing. In 1997, it began producing in Chile and subsequently acquired the facilities of Trupán S.A. and Maderas Prensadas Cholguán S.A., thus expanding the production of plywood, MDF and hardboard. In 2001, Arauco built an MDF plant in Misiones, Argentina, adjacent to the sawmill it owned there. In 2005, it invested in Brazil and built up its interests in Argentina by acquiring the assets of the French company Louis Dreyfus in both countries for $300 million. With an annual production capacity of over one million cubic metres of panels, Arauco has grown into one of largest panel manufacturers and the largest plywood producer in Latin America.

CPMC. CMPC expanded its plantations business through international expansion in paper manufacturing, mainly tissue-paper products. Today CMPC leads the tissue-paper markets in Chile, Argentina and Uruguay, and ranks second in Peru. In 2006, CMPC acquired a tissue-paper factory in Mexico and planned to expand in North and Central America.

Masisa. Starting from a much smaller base, Masisa expanded its forestry business in the region, mainly in timber boards. In 1994, Masisa opened the first particleboard plant and another facility to manufacture medium density fiberboard (MDF) in Argentina. The company then later entered Chile, Brazil and Mexico. Through its internationalization activities, Masisa had significantly increased its production capacity to become one of the lowest-cost producers in the world and the leading board producer in Latin America. Masisa has worked to complement its manufacturing business by strengthening distribution channels, as the main pillar of its commercial policy. It has developed an extensive distribution network for its products in all the countries where it owns operations and in another where it has trade offices. In 1992, Masisa opened the first of its specialized stores, known as Placacentros, in Chile. By the end of 2004, it had 215 Placacentros stores in 12 Latin American countries, mainly in Chile, Mexico and Brazil, and it is expected to have 290 such stores by 2005.

Source: Author, based on information from the respective companies' reports.

- ***Integration of the value chain.*** At the beginning of the 1990s, Chilean enterprises in forestry activities began to expand abroad, mainly in Argentina and, to a lesser extent, in Uruguay and Brazil because of the growing shortage of land for new plantations and stricter requirements in Chile on environmental matters and indigenous communities' rights. Investments abroad were integrated vertically, facilitating the supply of inputs between the different business areas (sawmills, cellulose, paper and panels) and obtaining better terms with suppliers and clients.

(c) Beverage and beer: Strategic alliances with global operators

The production of soft drinks, mineral water and beers has undergone important transformations both regionally and worldwide. In the beer market, a strong process of consolidation and concentration through mergers and acquisitions has taken place (box 2).

(d) Building on local privatizations

The privatization of public companies in the 1980s and the development of the local capital market provided opportunities for Chilean enterprises to enter in sectors being privatized such as electricity, telecommunications and air transportation. It helped the creation of a new group of large private Chilean enterprises that consolidated their position in the local market and could exploit opportunities to grow by internationalizing their operations. By participating in privatization, they gained market access and developed regional networks.

- ***Market access.*** Compañía General de Electricidad S.A. (CGE) stands out among the energy companies that have internationalized. It focused

Box 2. Internationalization through strategic alliances: Andina and CCU

In the 1990s, the brewery *Compañía Cervecerías Unidas (CCU)* and the bottling company *Embotelladora Andina* accelerated the expansion and diversification of their activities. A new generation of economic conglomerates (Luksic group and Said group) had, through forming partnership with foreign investors, taken control of both the companies. These two Chilean companies have based their growth strategy on a product mix including their own products and licensed global products. Licensing global products – Coca-Cola in the case of Andina and Budweiser and Heineken in the case of CCU – facilitated the expansion.

Andina. Between 1992 and 1996, *Andina* bought several bottling companies of Coca-Cola products in Argentina and acquired participation in other supplier companies to support its operations in the neighbouring country. In 1994, Andina entered the Brazilian market by acquiring Rio de Janeiro Refrescos Ltda. Later on it incorporated new licenses to bottle Coca-Cola products in Rio de Janeiro with the purchase of Nitvitgov Refrigerantes S.A.

CCU. With a similar strategy, CCU took over the control of two Argentine regional brewers. Taking advantage of the new productive capacity, CCU formed a joint venture with the American company Anheuser-Busch to produce and sell beer under the Budweiser brand name in Argentina. Andina and CCU strengthened their positions in the host countries, and gained dominant market position in Chile, Brazil and Argentina, for the products in which it has license. CCU has 90 per cent and 15 per cent of the beer markets in Chile and Argentina, respectively.

Source: Author.

its international expansion on the northwest of Argentina, in the distribution of electricity and natural liquefied gas. In 1992, GASCO — a Chilean gas producing and distributing company in which CGE owns 57 per cent — acquired the concession for natural gas supply in the provinces of Salta, Tucumán, Jujuy and Santiago del Estero.

In 1995, CGE participated in the consortium purchased by EDET, an electrical energy distribution company in the Province of Tucumán. CGE formed another consortium with EDET to control Empresa Jujeña de Energía S.A. (EJESA) and the Empresa Jujeña de Sistemas Energéticos Dispersos S.A. (EJSEDSA) in the province of Jujuy. The acquisition of Empresa Eléctrica Emec S.A. (EMEC) in 1999 gave CGE control of Aguas Negras, the controlling company of Energía San Juan, a distributing company of electrical energy in the province of San Juan. CGE distributes electrical energy to 640,000 clients, covering the provinces of Tucumán, Jujuy and San Juan, with a market share of 4 per cent in terms of energy and 5 per cent in terms of clients (CGE 2005, p. 48).

- ***Regional networks.*** With the intent to establish a new corporate identity and a brand that is not limited to the Chilean market, LAN Airlines expanded its networks in the region by creating a network of affiliates in different Latin American countries. For instance, it had constituted LAN Peru, LAN Ecuador, LAN Dominicana and LAN Argentina to operate domestic routes and some international destinations.

It is the main passenger airline in the international and domestic routes in Chile, Peru and Ecuador. LAN has become the main regional operator in the cargo segment. It has expanded its range of operations by acquiring shares in airlines in Brazil, MasAir in Mexico and Florida West in the United States and by establishing an operation-centre in Miami.

(e) Retailers: the largest regional expansion

The retail industry in Chile is one of the most competitive and dynamic economic sectors. It consolidated different retail segments: supermarkets, specialized chains (pharmacies, home improvement and construction) and department stores. The pioneers in the international expansion have been Falabella and Cencosud (box 3).

The Chilean retail companies have managed to develop competitive advantages based on a business model of strengthening the sales of a variety of products and granting credit to clients. The successful combination of investing different business areas has created important functional and commercial

Box 3. Market-seeking strategy: Falabella and Cencosud

Falabella. Falabella moved into Argentina in 1993. It opened its first store in the border city of Mendoza, which was perceived as a lower risk operation (Bianchi 2002, p.6). Falabella was one of the early Chilean department store chains to operate in Argentina (Falabella 2004, p.37). In spite of this privileged position, the results were not as successful as expected. Falabella faced complex surroundings, with legal norms, consumer preferences and habits, and import procedures and facilities that were very different than in Chile. The company continued its expansion in Argentina, opening two new stores to generate economies of scale. The lacklustre performance in Argentina led Falabella to change its strategy in new markets. In 1995, it entered the Peruvian market by acquiring an existing department store, operated under the name Falabella SAGA, conserving the local administration and incorporating slowly the processes and best practices developed in Chile. Its operations in Peru produced good results. Like in Argentina, the introduction of inter-related businesses such as the CMR credit card, travel agency and supply of insurances services proved very successful. These positive results encouraged Ripley, one of the main competitors in Chile, to invest in Peru.

Box table 3.1. Number of stores abroad of retailers, by type and country, 1998, 2000, 2005

	Falabella			Cencosud			Ripley		
	1998	*2000*	*2005*	*1998*	*2000*	*2005*	*1998*	*2000*	*2005*
Department stores									
• Chile	26	29	33	-	-	21	14	23	31
• Argentina	4	5	6	-			-	-	-
• Peru	4	4	10	-			1	4	8
Home renovation									
• Chile	2	5	54	2	3	16	-	-	-
• Argentina	-	-	-	8	14	26	-	-	-
• Peru	-	-	2	-	-	-	-	-	-
• Colombia	-	-	9	-	-	-	-	-	-
Supermarkets									
• Chile	-	-	11	3	4	119	-	-	-
• Argentina	-	-	-	8	10	248	-	-	-
• Peru	-	-	3	-	-	-	-	-	-

Source: Compiled by the author based on data from Falabella, Cencosud and Ripley.

Cencosud. Cencosud inaugurated two shopping centres with “Jumbo” supermarkets in Buenos Aires in the 1980s. Unicenter is the biggest shopping centre in Argentina. Cencosud invested in real estate development (construction and operation of shopping centres) and retail trade. It later added home renovation stores. Under the Easy brand name. It introduced this new line of home business simultaneously in Chile and Argentina, creating synergies with other product lines. It also developed the real estate business with shopping centres in smaller cities in Argentina. In 2002, it purchased the four premises that the American chain Home Depot owned in Argentina for $105 million. The company became the largest retailer and leader in home renovation and construction. After the Argentinean economic crisis, it further expanded its market share. In 2004, Cencosud acquired 85 per cent of the assets of the country’s second largest supermarket chain, Disco S.A. from Dutch operator Koninklijke Ahold for $315 million, becoming the second largest operator in the Argentina.

Source: Author, based on information from companies’ reports.

synergies. In their international expansion, these companies have emulated the central elements of their strategies carried out in Chile. However, they also developed some adaptations in order to obtain a good acceptance, and to gather knowledge of the idiosyncrasies and the necessities of the local consumers.

The main adaptation included the search for local partners and the establishment of long-term relations with local suppliers and the employment of local staff. These changes have been implemented during crisis periods in the host countries, and the restructuring process has been difficult. However, the recovery of the Chilean economy, the increased competition at home and improvement in the expectations of the neighbouring countries' economies revived the interest of Chilean retail companies to extend their presence abroad.

There were also negative implications for Chilean enterprises as a result of investing abroad. These include the following instances:

- *Threat of acquisition.* During the first cycle of Chilean investments abroad, many of the more successful companies were acquired by other TNCs. This is still a threat, since global markets are undergoing consolidation and the size of these companies makes it difficult for them to resist hostile takeovers by global leaders.

- *Inexperienced management*. In the initial few years of internationalization, Chilean entrepreneurs behaved in manners that were qualified as unpopular and arrogant. Companies named young and inexperienced managers to take charge of the new investments outside the country. In many cases, there were few local managers. In the neighbouring countries, the presence of some companies sparked nationalistic reactions.

- *Lack of managerial talents.* Many of the experiences in internationalization have met the challenge of finding qualified human resources, both in Chile and in the target countries. Expatriate Chilean employees created difficulties for their headquarters and at the same time it has been difficult to recruit new qualified personnel with international business management skills. Many companies have started investing in training of their executive personnel by sending them to academic institutions in Europe and the United States, and by opening small offices in more complex markets such as in Asian countries.

- *Host country factors.* One of the main challenges for Chilean investments abroad has been the political and economic instability in target host countries in the region. Excessive bureaucracy and poorly developed business environments have made the operation of Chilean firms more difficult. In many cases, these companies faced highly competitive environments with high degrees of informality, where they were at a disadvantage in regard to local players which were more at ease operating with high taxes and operational costs linked to complex bureaucratic and tax structures. This has been especially true in the case of Brazil where the federal structure implies a plethora of national, federal, state and municipal laws and taxes. The crisis in Argentina in 2001 affected the regulatory environment, which became a problem for Chilean enterprises operating in that country, especially in services.

E. OFDI policies

In the past years, the Chilean administration has undertaken an ambitious strategy to improve the country's international insertion. It signed free trade agreements and investment protection agreements with its principal trading partners and other strategic countries with promising growth prospects. The establishment of these free trade agreements and the promotion of Chilean OFDI however have not been an important driving factor of Chilean investment abroad. The main policy measure influencing the firms' decisions to invest abroad was the lifting of exchange controls.

In addition, Chile did not have explicit policies in promoting OFDI or in creating national champions or regional leaders. The experience of the late 1990s and the beginning of this decade brought about important lessons when Chilean companies made significant lost in overseas activities. In 2005 the two main business associations in the country, Confederación de la Producción y el Comercio (CPC) and Sociedad de Fomento Fabril (SOFOFA) expressed their interest in a new strategy that would enable them to do business outside Chile with greater safety. The business associations proposed the possibility of opening up capital ownership of Chilean enterprises abroad to institutional investors such as pension funds in the target markets, the listing of these enterprises in the stock markets of host countries and improved conditions for joint ventures with local partners. These measures would reduce mistrust, provide greater security and better the legal framework for Chilean investment abroad.

OFDI is a strategic necessity for many Chilean enterprises given the small size of the local market. Therefore, there is a need for Chile to have a clearer policy supporting outward investment and to consider

the proposals made by the private sector, while cautious of the potential costs of OFDI.

F. Conclusion

Chilean enterprises have used trade channels to access markets abroad. The exporting experience has provided valuable knowledge on new markets, their characteristics and the idiosyncrasies of consumers. This export know-how has favoured the expansion in these markets through OFDI. The stability and favourable economic conditions in Chile have created a strong base to pursue new businesses outside the country's borders. Early reforms, the privatization of State enterprises and the acquired experience of doing business in an open, competitive economy, together with geographical and cultural proximity, gave Chilean enterprises an important competitive edge to expand internationally and take advantage of investment opportunities arising in neighbouring countries, particularly at a time when Chile had access to external financing that it could redirect into foreign investments (Calderón and Griffith Jones 1995).

Chilean enterprises were especially dynamic in their internationalization during the second half of the 1990s. They are fairly small and have only limited international spread, and they are often regionally concentrated. Their initial internationalization drive was due in large part to possession of competitive advantages. As their competitors in the region and elsewhere gained experience and access to the same markets, their initial advantages eroded.

In many cases, the success of Chilean firms in establishing strong regional presence made them attractive targets for acquisitions by foreign TNCs (Enersis, Gener, Masisa and pension funds). However, there are examples of Chilean companies that have defended their own market against dominant TNCs (Cencosud, Ripley, Falabella), even through the acquisition of TNC assets in Chile (ENTEL, Falabella) and abroad (Cencosud). Chilean companies that have learned from experience and became more competitive, both locally and in neighbouring countries, have gradually consolidated their internationalization. Chilean investments abroad are concentrated in natural resource extraction activities or natural resource-based manufactures, in which the country has clear competitive advantages. The lack of critical assets has inhibited investments in knowledge intensive industries or in the establishment of manufacturing productive capacity abroad. The prospect for further enterprise internationalization from Chile is promising against the background of positive expectations of the Chilean economy and the desire of Chilean firms to internationalize to increase competitiveness.

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CHAPTER V

OUTWARD FOREIGN DIRECT INVESTMENT BY ENTERPRISES FROM CHINA*

A. Introduction

Over the last decade, China has become a noteworthy outward investor and the stock of Chinese OFDI now exceeds that from the Republic of Korea, whose TNCs are already formidable international competitors.[22] While the scale of the two economies is different, what is of incontrovertible interest is that sizeable numbers of Chinese companies have begun to invest overseas at a very early stage in the country's development. This has implications for the drivers and motives behind the OFDI, which will be discussed in this paper. The paper will also examine the trends, broad dimensions and characteristics of Chinese OFDI, including the legal and regulatory framework, and offers some policy suggestions.

B. OFDI from China: Trends and development

Chinese enterprises have been investing abroad prior to the open door policy of 1979. However, such early enterprise internationalization was limited, partly because of the result of very specific aims permitted by the State. After 1979, OFDI has accelerated and increasingly it is possible to talk of genuine Chinese TNCs. Chinese OFDI has grown considerably since the early 1990s, both in terms of total annual FDI outflows – from $367 million in 1991 to over $2 billion in 2003 – and size of each investment (table 1). In the early 1990s, the average size of each investment was as low as $0.3 million, whereas by 2003 the average investment was $4.1 million; and some investments were larger.

Geographical distribution. The geographic spread of Chinese OFDI has changed. In the early 1990s, the bulk of the FDI was in North America, but in recent years the predominant share of Chinese OFDI has been received by Asian countries. There has also been dispersal of flows, with Latin America, Africa, Europe and Oceania all receiving sizeable amounts. This represents a move from market-entry type of sales subsidiaries to a more complex pattern of TNC expansion, reflecting China's growing need for raw materials, other resources (including labour) and diversified markets.[23] Five host countries represent over 50 per cent of the total approved Chinese OFDI and the 10 largest recipients about a two-thirds share (table 2). Hong Kong (China) alone (a special case, since it is a "special autonomous region" of China[24]) receives about a third of total Chinese approved OFDI. There are some idiosyncrasies – for example, Denmark is the fifth largest because of a single project, but in most cases the larger recipients represent target countries because of possible reasons such as market size (United States), proximity (Hong Kong (China), Macau (China), Republic of Korea, Thailand), resources (Canada, Peru, Indonesia) or – conceivably – other opportunities such as past ties, undervalued assets, access to technology.[25] A very wide distribution

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[22] UNCTAD (2004), World Investment Report 2004: The Shift towards Services, New York and Geneva, table 1.11.

[23] UNCTAD (2006), World Investment Report 2006: FDI from Developing and Transition Economies – Implications for Development; Yang Yao and Ying He (2005), Chinese Outward Investing Firms (a study for FIAS/IFC/MIGA), China Centre for Economic Research, Peking University (mimeo).

[24] It is likely that quite a lot of FDI in Hong Kong is a stepping stone to investments further afield – and some in China itself, i.e. an example of "round-tripping".

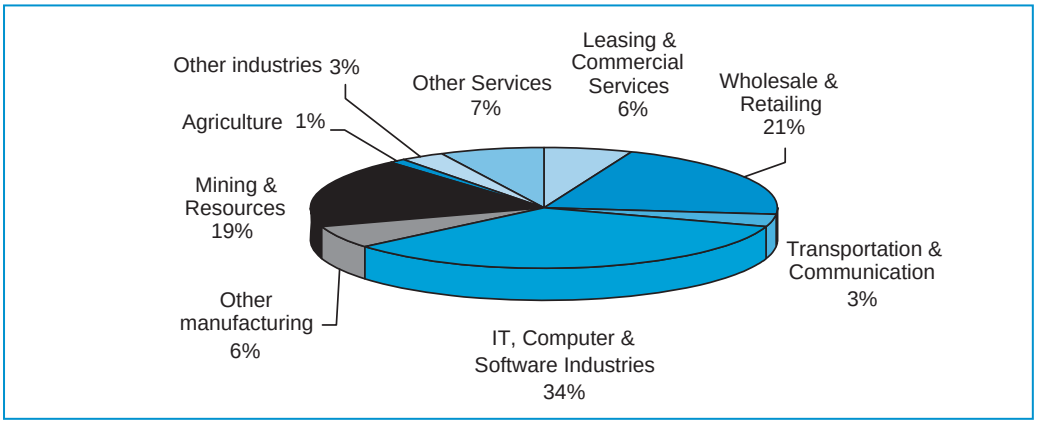
[25] OFDI patterns are seldom established during a country's early period of internationalization and can change remarkably from year to year because each new investment can potentially be a sizeable proportion of the total OFDI stock.

of recipient territories, especially in poorer African, Asian and Latin American countries, also suggests other motives, especially securing political ties and relationships.

Industrial distribution. Chinese OFDI concentrated in the "information technology, computer and software" (ITCS), "wholesaling and retailing" and "mining and resources" industries (figure 1).[26] The latter two sectors relate to market-entry and resource-securing actions. The scale of ITCS reflects the primacy or relative competitiveness of this manufacturing cluster of companies and industries in China's economy. The motives underlying the expansion of companies in these industries relate to a complex amalgam of market, efficiency and resource-seeking reasons. Various service sectors are increasingly important in Chinese OFDI (figure 2). For instance, leasing, commercial services, communication and other services accounted for 15 per cent of total OFDI in 2003. The share of "wholesaling and retailing" and manufacturing OFDI flows in 2003 was far lower than in stock, while "mining and resources" share was a striking 48 per cent. Allowing for the fact that China's OFDI

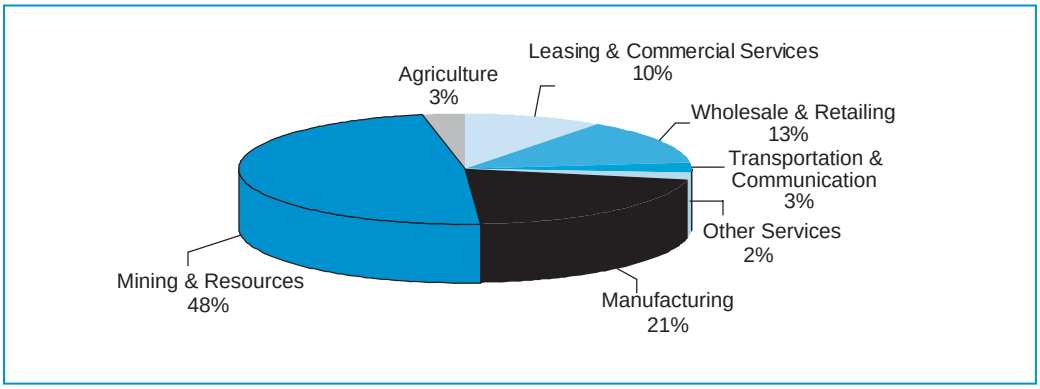
[26] Banking and most financial services are not captured by MOFCOM data.

Figure 1. Chinese OFDI stock, by sector and industry, 2003



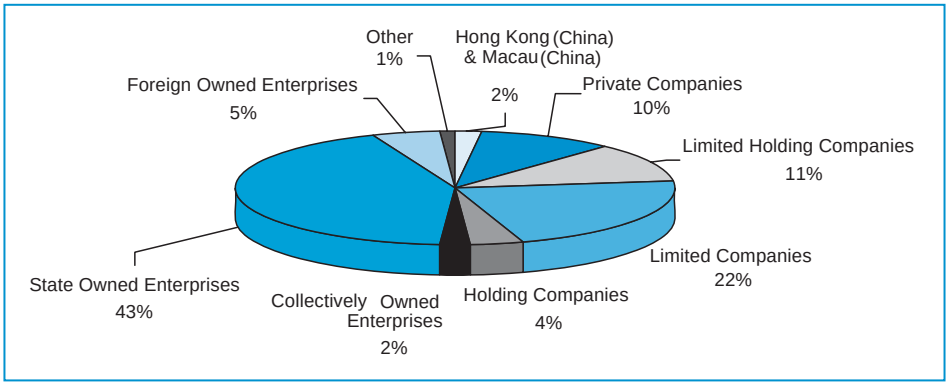
Source: China, Ministry of Commerce.

Figure 2. Chinese OFDI flows, by sector and industry, 2003



Source: China, Ministry of Commerce.

Figure 3. Top 20 Chinese Overseas Investors, by FDI stock, 2003



Source: China, Ministry of Commerce.

is at an early stage, and that too much should not be made of short-term trends, these figures suggest that securing raw materials and other resources is a very major part of the FDI effort by its enterprises.

Types of enterprises. Between 1979 and 1985, Chinese OFDI approvals were tightly controlled and largely undertaken by state-owned enterprises (SOEs), including provincial and municipal corporations. Trade relations and expanding China's influence were the guiding principles behind this early investment. After 1985, non-state-owned firms were allowed to apply for approval to invest overseas, especially for manufacturing and to access foreign markets. Between 1992 and 1998 there was a rapid increase in OFDI by SOEs, including provincial and municipal corporations, both in and via Hong Kong (China). This led to a tightening-up of approval procedures in order to better manage the process. Since 1998, however, the authorities have actively encouraged OFDI, both to secure key resources (including raw materials and technology) and establish "global" Chinese TNCs as part of a strategy of creating national champions in the face of formidable competition from existing non-Chinese TNCs, within and without China. Though this latest phase is relatively new – and all OFDI is subject to government approval – some commentators regard the post 1998 period as an "acceleration stage" in Chinese OFDI.[27] The data suggest some merit to this view (box 1).[28]

Characteristics of China's Transnational Enterprises. Some 43 per cent of all Chinese outward foreign investors in 2003 were state-owned enterprises and, leaving aside "Hong Kong (China) and Macau (China)" and "Foreign Owned Enterprises"[29], the remaining investors are a mixed bag of private, limited, holding and collectively owned companies (figure 3). Most are large companies, working closely with the state and, therefore, likely to pursue OFDI in accordance with at least some of the priorities of the Government. As mentioned earlier, smaller, private companies are unlikely to be captured by either MOFCOM or SAFE data.

Looking at specific companies, tables 3 to 5 provide insight on the nature of the largest Chinese TNCs. Although there is a slight variation in terms of which TNCs appear in these tables (since these relate to the ranking of companies in FDI stock, revenues and assets overseas), the vast majority are state-owned enterprises. In consequence, the largest sectors or industries represented by these large TNCs are resource/raw materials orientated companies (e.g. China Petroleum & Natural Gas, China Ocean Petroleum, China Resources and China MinMetal Corporation; it is likely that some of the holding companies are parents to similar companies), transport and communication to handle imports and exports (e.g. China Airline, China Shipping and China Foreign Trade Shipping Corporation), Heavy Industry (e.g. China Construction Engineering Corporation and China Bao Steel) and the Information Technology and Electrical/Electronic industry (e.g. China Mobile, China Telecom and China Electric). It is only in this last sector that a few private companies (e.g. Huawei

[27] John Child and Suzana B. Rodrigues 2005, "The Internationalization of Chinese Firms: A Case for Theoretical Extension?", Management and Organization Review, Vol. 1, No 3; and Douglas H. Brooks and Hafiz Mirza (2005), "Outward FDI from Developing Asia", paper presented at the Asian Development Bank seminar, "Outward Foreign Direct Investment from Asian Developing Countries", Bangkok, 28-29 November.

[28] For further discussion, including various nuances of Government policy towards OFDI, see John Wong and Sarah Chan (2003), "China's Outward Direct Investment: Expanding Worldwide", *China: An International Journal*, Vol 1, No 2; Dexin Yang (2003), *Foreign Direct Investment from Developing Countries: A Case Study of China's Outward Investment*, Centre for Strategic Economic Studies, University of Melbourne, unpublished thesis; UNCTAD (2004), "China: An Emerging FDI Outward Investor", e-brief, United Nations, New York and Geneva.

[29] Presumably establishing grandchildren subsidiaries in third countries.

Box 1. Chinese OFDI: Data limitation

There are two official sources of data on Chinese OFDI: the Ministry of Commerce (MOFCOM), which approves OFDI by non-financial Chinese firms, and the State Administration of Foreign Exchange (SAFE), which – in addition – includes data on non-Financial OFDI.

Furthermore, the data disseminated by MOFCOM is based on approvals, while the SAFE data relates to capital movements, which might include movements of capital over and above the approved levels (although, as is generally recognized, approved investments do not necessarily materialize or occur at a later date). Neither MOFCOM nor SAFE collect data on reinvestments and various other components of FDI flows; nor (in most cases) do they include information on OFDI by private, small and medium-sized enterprises. As an example of the scale of the difference arising from using data from different sources, the stock of Chinese OFDI in 2003 was $11.4 billion (table 2) according to MOFCOM, whereas the SAFE-based figure is around $37 billion[a] (and OFDI through informal channels would boost the latter figure even further).

Although the MOFCOM figure is probably a significant understatement of the scale of Chinese OFDI, there are concerns that "round-tripping" inflates the SAFE data.[b] Given the fragility of the data, this paper opts to use the more conservative MOFCOM approved dataset, which has the additional merit of providing a useful breakdown of the information by destination countries/regions and industry. It should be recognized, however, that the full scale of Chinese OFDI is likely to be somewhat larger.

Source: Authors.

[a] From table Annex B.4 in UNCTAD (2004), World Investment Report 2004: The Shift Towards Services, United Nations, New York and Geneva.

[b] See Geng Xiao (2004), People's Republic of China's Round-Tripping FDI: Scale, Causes and Implications, ADB Institute Discussion Paper No 7, Asian Development Bank, Manila.

Technology and China Great Wall Computer Corp.) appear in table 4 – i.e. revenues overseas, which are not necessarily achieved through FDI, although the companies mentioned do have sizeable levels of FDI abroad.

The continuing importance of the state-owned sector in OFDI results from such firms receiving privileged access to capital and technology. In consequence, according to the Economist, China's "best" companies are state-owned TNCs: "…the most impressive are the resources groups. For example, three big oil companies, PetroChina, Sinopec and CNOOC, are aggressively buying overseas and building pipelines across central Asia to satisfy China's fuel demands. They are in more than a dozen countries: CNOOC, for example, is Indonesia's largest offshore oil producer".[30] In contrast, because China opened its economy to foreign companies at a relatively early stage in its development – relying on them for export-orientated industrial development – the competitive strength of major global TNCs has dampened the emergence of home-grown private sector TNCs. The few significant ones are mostly in electronic/electrical industries (e.g. Haier, Huawei, Lenovo, TCL, Gome and Bird), although there are some private sector Chinese TNCs in cars, clothing and food & beverages.[31]

C. Drivers and motivations

Unlike other established developing countries, China is a relatively new investor and very little research has been conducted on the main motives underlying Chinese OFDI. The discussion below, therefore, mostly relies on a few existing surveys, reports in business journals and a careful scrutiny of the nuances of the OFDI in terms of factors such as the main industries of investment and the nature of the companies involved. A survey by Roland Berger on FDI strategies by the "top 50 Chinese TNCs"[32] highlighted three broad categories of motives: seeking

[30] The *Economist* (2005), "The Struggle of the Champions", March 10th.

[31] *Business Week* (2004), "China's Power Brands", November 8th.

[32] Eugene von Keller and Wei Zhou (2005), *From Middle Kingdom to Global Market*, Roland Berger Strategy Consultants, Shanghai.

Table 1. China: Approved OFDI flows, by region, 1991-2003

(Millions of dollars)

YEAR	TOTAL			ASIA			AFRICA			EUROPE			NORTH AMERICA			LATIN AMERICA			OCEANIA		
	Number of Enterprises	Chinese Investment	Average Investment	Number of Enterprises	Chinese Investment	Average Investment	Number of Enterprises	Chinese Investment	Average	Number of Enterprises	Chinese Investment	Average	Number of Enterprises	Chinese Investment	Average	Number of Enterprises	Chinese Investment	Average	Number of Enterprises	Chinese Investment	Average
1991	207	367.0	1.8	55	13.7	0.2	7	15	0.2	80	24.2	0.3	34	313.9	9.2	16	4.1	0.3	15	9.6	0.6
1992	355	195.3	0.5	106	57.5	0.5	23	7.7	0.3	131	53.7	0.4	46	171.2	0.4	26	13.0	0.5	23	46.3	2.0
1993	293	95.9	0.3	107	31.4	0.3	28	14.4	0.5	58	11.7	0.2	48	166.8	0.4	20	9.9	0.5	32	11.8	0.4
1994	106	70.6	0.7	49	25.7	0.5	12	28.0	0.2	14	5.8	0.4	17	73.9	0.4	6	0.8	0.1	8	2.9	0.4
1995	119	106.4	0.9	61	50.4	0.8	26	17.7	0.7	7	2.0	0.3	12	21.5	1.8	10	4.9	0.5	3	9.9	0.3
1996	102	293.8	2.9	53	109.3	2.1	23	56.2	0.2	8	2.7	0.3	10	4.9	0.5	4	119.8	30.0	4	0.9	0.2
1997	128	169.3	1.3	55	27.5	0.5	41	81.8	2.0	22	12.9	0.6	1	0.9	0.9	4	27.3	6.8	5	18.7	0.4
1998	266	259.0	1.0	85	68.1	0.8	40	88.3	2.2	78	33.4	0.4	21	30.5	1.4	32	24.2	0.8	10	14.5	14
1999	220	590.6	2.7	86	171.4	2.0	54	95.2	1.8	34	33.4	1.0	22	81.2	3.7	21	207.6	9.9	3	1.7	0.6
2000	243	551.0	2.3	102	159.6	1.6	52	214.3	4.1	32	47.7	1.5	23	54.8	2.4	19	60.7	3.2	15	13.8	0.9
2001	232	707.5	3.1	106	460.0	4.3	45	72.3	1.6	32	60.1	1.9	23	57.2	2.5	17	40.0	2.3	9	17.9	2.0
2002	350	982.6	2.8	141	605.9	4.3	36	62.4	1.7	63	74.9	1.2	45	15.3	3.4	46	37.0	0.8	19	49.5	2.6
2003	510	2 086.9	4.1	279	1 139.6	4.1	53	107.4	2.0	47	42.1	11.1	94	120.9	1.3	25	164.2	6.6	12	34.1	2.8

Source: China, Ministry of Commerce.

Table 2. China: Approved OFDI flows, top 30 destination countries, 1979-2003
(Number; Millions of dollars)

Rank	Economy	1999		2000		2001		2002		2003		1979-2003	
		Number of projects	Value	Number of projects	Value	Number of projects	Value	Number of projects	Value	Number of projects	Value	Number of projects	Value
	Total	220	590.6	243	551.0	232	707.5	350	982.7	510	2086.9	7470	11427.2
1.	Hong Kong, China	24	24.5	15	17.5	26	200.7	40	355.6	73	266.4	2098	4340.7
2.	United States	21	81.1	15	23.1	19	53.7	41	151.5	83	113.1	786	947.6
3.	Russian Federation	12	3.8	14	13.9	12	12.4	27	35.5	41	339.3	523	546.2
4.	Australia	3	1.7	13	10.2	6	10.1	15	48.6	10	33.5	225	464.4
5.	Denmark	..	..	..	..	..	..	..	..	1	459.3	3	459.7
6.	Canada	1	0.1	8	31.7	4	3.5	4	1.2	11	7.9	155	443.8
7.	Republic of Korea	1	0.1	5	4.2	2	0.8	7	83.4	10	194.7	72	302.5
8.	Thailand	3	2.0	6	3.3	9	121.3	5	3.9	11	49.1	245	263.8
9.	Macao, China	3	0.2	4	0.5	6	2.4	2	2.0	9	30.6	238	214.2
10.	Peru	1	75.7	1	0.0	2	3.1	..	..	3	0.9	23	75.7
11.	Indonesia	..	19.0	1	8.0	2	0.6	6	3.7	6	103.1	165	168.1
12.	Mexico	2	97.0	1	19.8	1	0.2	1	2.0	2	0.0	47	167.4
13.	Cambodia	13	32.8	7	17.2	7	34.9	3	5.1	4	33.4	65	158.4
14.	Bermuda	2	1.1	..	..	1	0.02	..	..	1	135.0	11	148.4
15.	Zambia	4	6.7	3	11.6	3	4.3	1	0.3	..	..	18	134.4
16.	Brazil	1	0.5	3	21.1	4	31.8	8	9.3	6	9.3	73	129.0
17.	South Africa	14	12.8	17	31.5	2	12.4	3	1.7	10	7.3	108	126.5
18.	Singapore	6	2.9	6	1.0	3	0.4	6	2.1	16	26.2	188	97.9
19.	Viet Nam	2	6.6	17	17.6	12	26.8	20	27.2	17	8.2	90	93.1
20.	Japan	1	0.5	2	0.3	6	1.7	11	18.2	14	7.5	250	89.6
21.	Germany	1	0.3	1	1.6	3	3.5	6	2.8	17	24.0	167	75.6
22.	Mongolia	15	40.3	12	5.4	7	4.5	7	3.4	9	17.3	78	73.9
23.	Myanmar	1	6.6	7	32.9	3	1.8	5	15.8	..	..	38	66.1
24.	Mali	1	1.2	1	28.7	..	..	..	..	..	..	5	58.1
25.	Egypt	5	3.8	3	9.7	2	1.4	3	16.3	5	7.8	32	56.3
26.	Nigeria	2	1.6	2	2.6	8	6.4	9	11.4	13	11.7	62	56.0
27.	United Arab Emirates	2	6.19	3	3.2	3	0.8	..	..	8	2.9	78	50.1
28.	New Zealand	..	..	..	..	2	0.9	2	0.9	2	0.6	28	49.4
29.	Papua New Guinea	..	..	1	0.9	..	..	..	..	..	..	20	44.7
30.	Kazakhstan	7	17.2	5	7.7	1	0.3	3	26.9	8	3.5	59	43.1

Source: China, Ministry of Commerce.

Table 3. Top 20 Chinese overseas investors, by OFDI stock, 2003

Rank	*Company name*	*Rank*	*Company name*
1	China Mobile	11	China Shipping
2	China Petroleum & Natural Gas	12	China Electric
3	China Resources	13	China Minmetals Corporation
4	China Telecom	14	China National Petroleum Corporation
5	China International Trust & Investment Co.	15	China Merchants Group
6	China Ocean Petroleum	16	China National Chemicals Import and Export Group
7	Guangdong Macau-Hong Kong Investment Holding Co. Ltd	17	Jing Oriental Science and Technology Corporation (Holding Co. Ltd.)
8	China Airline	18	China Hua Yuan Corporation
9	Shanghai Enterprises Ltd.	19	China Foreign Trade Shipping Corporation
10	China Foreign Trade Shipping Corporation	20	China National Cereals, Oils & Foodstuffs Import and Export Corp.

Source: China, Ministry of Commerce.

Table 4. Top 20 Chinese overseas investors, by revenues abroad, 2003

Rank	*Company name*	*Rank*	*Company name*
1	China Mobile	11	China Minmetals Corporation
2	China National Chemicals Import and Export Group	12	China Construction Engineering Corporation
3	China Petroleum Chemical Industry	13	Shanghai Bao Steel
4	China Resources	14	Air China Petroleum & Materials
5	China Petroleum & Natural Gas	15	Hong Kong China Tourism (Corporation) Ltd.
6	China Ocean Petroleum	16	Shanghai Enterprise (Corporation) Ltd.
7	China Shipping	17	Guangdong Macau-Hong Kong Investment Holding Co. Ltd
8	China National Cereals, Oils & Foodstuffs Import and Export Corp.	18	Huawei Technology Company Ltd.
9	Zhuhai Zheng Rong Co.	19	China Great Wall Computer Corp.
10	Jing Oriental Science and Technology Corporation (Holding Co. Ltd.)	20	China Electric

Source: China, Ministry of Commerce.

Table 5. Top 20 Chinese overseas investors, by overseas corporate assets, 2003

Rank	Company name	Rank	Company name
1	China Mobile	11	China Merchants Group
2	China Petroleum Chemical Industry	12	China Construction Engineering Corporation
3	China Joint Communications Co.	13	China International Trust & Investment Co.
4	China Shipping	14	Hong Kong China Tourism (Corporation) Ltd.
5	China Ocean Petroleum	15	China National Chemicals Import and Export Group
6	China Petroleum & Natural Gas	16	China Petroleum Chemical Industry
7	Guangdong Macau-Hong Kong Investment Holding Co. Ltd	17	Jing Oriental Science and Technology Corporation (Holding Co. Ltd.)
8	Shanghai Enterprise (Corporation) Ltd.	18	China Electric
9	China National Cereals, Oils & Foodstuffs Import and Export Corp.	19	China Marine Shipping (Group) Co.
10	Guang Zhou Yue Xiue Corp.	20	China Minmetals Corporation

Source: China, Ministry of Commerce.

new markets (including sales expansion and jumping trade barriers), securing natural resources and obtaining advanced technology and brand activity.[33] A survey conducted on behalf of the Foreign Investment Advisory Service (FIAS) of the World Bank confirms these motives and their rank order of importance.[34] In addition, other motives, especially efficiency-seeking are mentioned; but interestingly efficiency-seeking is far less a reason for FDI by Chinese TNCs than other Asian TNCs, for whom this motive is often the primary one. Apart from this, the motives of Chinese TNCs are broadly similar to other developing country TNCs.[35]

Nearly half of the respondents in the Roland Berger report indicated a preference for greenfield investments overseas, followed by strategic alliances. Few indicated acquisitions as their preferred mode for foreign market entry strategy. This is again confirmed by the FIAS study, where M&As represented only 15 per cent of all affiliates established by the responding companies. M&A activity by developing country TNCs is volatile, but the Chinese proportion is certainly proportionally smaller than M&A activity by some other developing economies, e.g. Hong Kong (China), Singapore and Dubai.[36]

About 70 per cent of all Chinese M&As made during 1995-2003 were concentrated in five economies (the United States, Australia, Hong Kong (China), Indonesia and Singapore) (table 6). This represents both opportunity and the nature of the companies acquired. The biggest concentrations of acquisitions during the same period were in oil and gas-related, manufacturing activity, electronic/electrical products, trade and communication, various business services and financial services (table 7). In even sharper relief, 11 of the largest acquisitions by Chinese TNCs were in petroleum, petrochemicals and related products, five were in electronics/electrical products and three were in communications (table 8). While these data probably underplay the extent of OFDI in other industries, possibly with a different profile of motives, nevertheless they do confirm the importance of the three sets of motives mentioned earlier: finding new markets, securing resources, and accessing technology, brands and other assets.

[33] 8 per cent of companies gave other reasons, but these are not detailed in the report.

[34] Yang and Yin, op. cit.

[35] UNCTAD 2006, op. cit.

[36] UNCTAD 2006, op. cit.

Table 6. Geographical distribution of cross–border M&A purchases by Chinese companies, 1995-2003

(Number of Deals)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*1995-2003*
World	7	10	25	20	11	20	15	25	26	159
Developed countries and territories	6	3	8	6	1	2	5	10	10	51
Europe	–	2	3	–	–	–	2	3	1	11
North America	4	1	2	2	–	2	3	5	7	26
Other developed countries	2	–	3	4	1	–	–	2	2	14
Developing countries and territories	1	7	16	14	10	18	10	14	14	104
Africa	–	–	1	–	1	–	1	–	–	3
Latin America and the Caribbean	–	–	–	1	–	1	1	–	1	4
Asia and Oceania	1	7	15	13	9	17	8	14	13	97
Transition economies	–	–	1	–	–	–	–	1	2	4

Source: UNCTAD M&A database.

Table 7. Industry distribution of cross-border M&A purchases by Chinese companies, 1995-2003

(Number of Deals)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*1995-2003*
Total	7	10	25	20	11	20	15	25	26	159
Primary sector	–	–	–	–	1	–	1	1	–	3
Secondary sector, of which:	6	2	10	6	4	4	6	16	15	69
Oil and gas; petroleum refining	1	1	2	1	1	1	1	4	6	18
Electrical and electronic equipment	2	–	2	2	1	–	3	3	4	17
Tertiary sector, of which:	1	8	15	14	6	16	8	8	11	87
Trade	–	1	3	–	–	2	–	1	2	9
Transport, storage and communications	–	3	3	2	–	2	–	1	–	11
Finance	–	1	5	4	4	5	3	4	4	30
Investment & commodity firms, dealers, exchanges	–	1	2	2	2	3	1	2	4	17
Business activities	1	1	1	4	1	7	2	2	3	22
Business services	–	1	–	1	–	6	2	2	–	12

Source: UNCTAD M&A database.

However, as the earlier discussion indicated, these motives vary in degree between different types of Chinese TNCs. Resource-seeking OFDI is almost entirely initiated by state-owned TNCs, whereas market and asset-seeking investments are conducted by both state-owned and private-owned TNCs.

D. Expansion and performance of selected international Chinese enterprises

There are two main types of Chinese TNCs, two types of "champion". The first set of champions are defenders of the Chinese miracle, motivated by the need to maintain and secure energy and other raw materials increasingly demanded by a burgeoning economy – resources that China is no longer in a position to entirely provide for itself. Most of these champions are state-owned enterprises. This type of champion, engendered because of concerns about over-reliance on existing energy/raw material TNCs, is not new; many companies from other countries have trod a similar path. An obvious parallel is the government-sanctioned role of Japan's Sogo Shosha (general trading companies) in securing resources to fuel the Japanese economic miracle during and after the oil crises of the 1970s. As the Chinese economy evolves, the relative importance of energy and other resources will diminish and, in consequence, so will the significance of such TNCs.

The second group of champions is, as yet, relatively few in number – and competitively weak – compared to their international competitors both within and outside China. The very policies that have propelled China's rapid development in recent years are one of the main reasons for their weakness; the mass entry of foreign TNCs into China has simultaneously strengthened the country's export industries and, through their presence, created a formidable competitive quandary for the nation's home-grown firms and entrepreneurs. Nevertheless, these local companies represent a part of the future of China in terms of advanced industries and services, typified by the information technology, electronics and electrical cluster of industries/companies. Most, but not all of these "champions", are quite recently established private companies. In order to prosper they are trying to secure local and global markets and, to do this, they are seeking to bolster both their productivity (hence access to technology) and their market position (hence entry into new markets and promotion of brand credibility).

The Haier Group is a good example of a Chinese company in this second group which has become a major TNC through carefully planned international market and asset seeking FDI. Established (in its current form) in 1984, the company spent a number of years boosting the quality of its products (initially refrigerators), followed by product line diversification. Its first overseas venture was to the United States (in 1994) where it currently maintains an industrial park in South Carolina. Local design has boosted the quality and brand recognition of its products – and improved the company's technology and productivity because competition is extremely fierce. It competes against the likes of Whirlpool, Frigidaire and GE; nevertheless its sales of white goods in the United States have grown by more than 24 per cent a year and its refrigerators are regularly among the top five best selling models in the country. Interestingly, by proving itself in the United States, Haier found itself able to break into European markets (e.g. for markets and technology acquisition in the United Kingdom and Italy) and markets such as Pakistan, India and the Middle East. It uses its position in the United States to improve its brand and standing in developing markets; and in consequence it has production subsidiaries in all these countries and regions. It now has 10 manufacturing complexes outside of China (the one in Jordan opened in 2005), which comprise some 30 factories. As Liu and Li (2002) remark, the Haier approach has been to crack the most lucrative developed market in the world (through FDI), learn in the process – and thereby ease its entry into both developing and developed economies.[37] [38]

Other such champions include the likes of Midea, Huawei, TCL, and Lenovo. Midea is a home appliance manufacturer like Huawei, but has taken a contrasting approach to internationalization by maintaining the vast bulk of its manufacturing activities in China. Nevertheless, it has established overseas ventures in Europe, Japan and the United States in order to access markets, raise capital and secure technology.[39] Huawei produces telecom products and has established overseas labs in Britain, India, Sweden, and the United States in order to tailor products and serve 90 telecom companies in over 30 countries while maintaining a Chinese manufacturing base.[40] TCL is in electronic appliance and is largely owned by the Huizhou municipality, with Philips and Toshiba as strategic investors. It aims to expand into high-end products such as plasma televisions and LDC displays and to this end has acquired Thomson's

[37] Hong Liu and Kequan Li (2002), "Strategic Implications of Emerging Chinese Multinationals: The Haier Case Study, *European Management Journal*, Vol 20, No 6.

[38] *Business 2.0* (2003), "When your customer says jump…", October.

[39] Ping Deng (2004), "Outward Investment by Chinese MNCs: Motivations and Implications", Business Horizons, May-June.

[40] *Business Week* (2004), "Huawei: More than a local hero", October 11.

Table 8. Top 20 International M&As involving Chinese companies, by value, 1996-2003

(Millions of dollars)

Years	*Value*	*Target nation*	*Target company*	*Target industry*	*Acquiring company*	*Acquired Industry*
2002	591.9	Indonesia	Repsol YPF SA	Crude petroleum and natural gas	CNOOC Ltd	Crude petroleum and natural gas
2003	380.0	Korea, Republic of	Hydis	Electronic components, nec	BOE	Electronic capacitors
2001	364.7	Hong Kong, China	Industrial & Coml Bk CH-HK	Banks, non-US chartered	ICBC (China)	Banks, non-US chartered
1997	325.0	Kazakhstan	Aktyubinskmunaygaz (Kazakhstan)	Crude petroleum and natural gas	China National Petroleum Corp	Crude petroleum and natural gas
1998	292.0	Australia	Aluminium Smelters of Victoria	Primary production of aluminium	Investor Group	Investors, nec
2003	275.0	Indonesia	Tangguh LNG Project, Indonesia	Crude petroleum and natural gas	CNOOC Ltd	Crude petroleum and natural gas
2002	262.0	Indonesia	Devon Energy-Indonesian Oil	Crude petroleum and natural gas	PetroChina Co Ltd	Crude petroleum and natural gas
1996	254.7	Hong Kong, China	Dragonair	Air transportation, scheduled	CNAC (Civil Aviation Admin/CH)	Air transportation, scheduled
1998	240.7	Venezuela	Venezuela-Caracoles Oil Field	Crude petroleum and natural gas	China National Petroleum Corp	Crude petroleum and natural gas
2000	231.0	Hong Kong, China	Union Bank of Hong Kong Ltd	Banks, non-US chartered	ICBC	Banks, non-US chartered
2004	227.0	Australia	OzGen	Electric services	Huaneng Power Intl Inc	Electric services
2003	200.0	Kazakhstan	N Buzachi Oilfield, Kazakhstan	Crude petroleum and natural gas	CNPC	Crude petroleum and natural gas
2004	200.0	Peru	PlusPetrol Norte	Crude petroleum and natural gas	CNPC	Crude petroleum and natural gas
1996	181.1	Hong Kong, China	Asia Satellite Telecommun Hldg	Communications services, nec	Investors	Investors, nec
1997	165.7	Hong Kong, China	Nam Pei Hong (Holdings) Ltd	Pharmaceutical preparations	Investor	Investors, nec
2003	164.0	Indonesia	Amerada Hess Indonesia Hldg	Crude petroleum and natural gas	Investor Group	Investors, nec
2003	134.7	Hong Kong, China	TPV Technology Ltd	Computer terminals	BOE	Electronic capacitors
2003	104.0	Norway	Atlantis (Petroleum Geo-Svc)	Oil and gas field exploration services	Sinochem	Plastics materials and basic forms and shapes
1997	102.1	Hong Kong, China	Asia Satellite Telecommun Hldg	Communications services, nec	CITIC (China)	National government agency
2003	100.0	Ecuador	Ecuador Block 16	Crude petroleum and natural gas	Sinochem	Plastics materials and basic forms and shapes

Source: UNCTAD M&A database.

TV business, as well as German electronics firm Schneider and United States DVD firm GoVideo.[41] These acquisitions are aimed at both augmenting its technological capabilities and expanding its market share in both developed and developing countries (e.g. acquisition of Thomson's TV business gives it access to production facilities and distribution channels in South-East Asia, as well as China).[42] Finally, Lenovo gained considerable press coverage recently (in itself a valuable marketing ploy) through its acquisition of IBM's PC business division.[43] This was a "global" M&A aimed to secure technology and brand recognition at a world level, especially because the acquired division has operations in many international locations.[44] Table 9 provides details of these and other major Chinese companies, not all of which are yet fully-fledged TNCs. However, it is clear from their strategies – at home and abroad – that their market- and asset-seeking international operations are most frequently driven by intense competition in their domestic market – and the aim to achieve "global reach".

Although there are variations, the consequent strategies of this group of companies are a mix of a push to improve their productive/competitive/technological base (including by acquiring strategic assets) and a thrust towards securing/widening/deepening their international and domestic markets (including a branding strategy, promoted through host-country marketing efforts, the purchase of brands and alliances with non-Chinese TNCs). However, a notable number of Chinese companies are seeking to turn their international thrust, caused by underlying competitive weaknesses, into a formula for becoming global players. A recent article by Business Week (table 9) analyses the international branding strategies of 10 Chinese TNCs in products ranging from appliances to beverages and clothing.[45] Though branding strategies vary, depending on circumstances and contingencies, all the surveyed companies are seeking to challenge global leaders. For example, Geely, a car maker, is trying to promote a mid-market image which it hopes will secure customers in China and abroad (especially because it has a lower cost-structure than state-owned automakers.

Such a champion represents the next stage in the evolution of the Chinese economy. It is important for the country to nurture such companies and promote them as models for the next generation of companies. Having said this, their international success cannot be taken for granted. Although it is too early to paint a definitive picture, it seems that most Chinese TNCs are satisfied (or very satisfied) with the current operations of their international operations.[46] However, there are nuances in performance. In particular, an analysis of three types of Chinese investments by the Boston Consulting Group showed a divergence in performance (value creation). In general, 100 per cent M&As requiring a high deal of integration between the acquired company and the new parent performed least well because Chinese TNCs still do not have a high-level of M&A capability. Investments in which the seller maintained limited involvement (perhaps for a specific time) performed better, while the highest performance was in investments where the Chinese had a minority stake. Analysing the investments differently, strategic investments with a focus on stand-alone assets and resources (including raw materials) performed far better in terms of value creation than investments where parent-affiliate integration was essential.[47]

Internationalized Chinese SMEs

As mentioned earlier, neither MOFCOM nor SAFE data capture Chinese OFDI undertaken through "informal" means, much of which is in South-East Asia. Various writers have tried to estimate the possible value, but the estimates vary too widely to be reliable. Informal OFDI is undertaken by both large and – probably – small Chinese TNCs, mostly private, and what data there are imply that investments by SME TNCs are likely to be opportunistic. For example, Frost (2004) records some 1,000 Chinese subsidiaries or projects across South-East Asia,[48] in the entire gamut of industries ranging from computers and electronics through food processing and garments to resource procurement and tourism. However, on closer inspection, most of these investments are by larger companies which, because they are relatively unknown, are incorrectly assumed to be SME TNCs. Having said this, in some host countries, such as Thailand, the Lao People's Democratic Republic and

[41] *Business week* (2003), "Bursting out of China", November 17.

[42] Ping Deng (2006), "Investing for Strategic Resources and its Rationale: The Case of Outward FDI from Chinese Companies", Business Horizons, November-December.

[43] With a continuing IBM interest in the acquired business.

[44] *Business Week* (2005), "East Meets West, Big Time", May 9.

[45] *Business week (2004)*, "China's Power Brands". 8 November.

[46] Asia-Pacific Foundation of Canada (2005), China Goes Global, Vancouver.

[47] The Boston Consulting Group (2006), China's Global Challengers: The Strategic Implications of Chinese Outbound FDI, Boston.

[48] He uses various sources, including local Boards of Investment, newspapers etc. to collect the data; and there is no reason to assume that the data are accurate – nevertheless they do establish activity and a picture of sorts. Stephen Frost (2004), "Chinese Outward Investment in Southeast Asia: How Much and What Are the Regional Implications?", *Southeast Asia Research Centre Working Paper 67*, City University of Hong Kong.

Table 9. Some of China's Major Manufacturing TNCs and their Principal Strategies

GEELY Cars	**BIRD** Mobile Phones	**TSINGTAO** Beer	**LI-NING** Clothing, Shoes	**YOUNGHE KING** Fast Food	**HAIER** Appliances, TVs	**LENOVO** Computer	**TCL** TVs, Mobile Phones	**WAHAHA** Beverages	**GOME** Electronic sales
2003 Revenue $484 Million	**2003 Revenue** $1.3 Billion	**2003 Revenue** $907 Million	**2003 Revenue** $121 Million	**2003 Revenue** $36 Million	**2003 Revenue** $9.75 Billion	**2003 Revenue** $3 Billion	**2003 Revenue** $3.4 Billion	**2003 Revenue** $1.23 Billion	**2003 Revenue** $2.15 Billion
2003 Profits $58 Million	**2003 Profits** $42.3 Million	**2003 Profits** $31 Million	**2003 Profits** $11 Million	**2003 Profits** $386 000	**2003 Profits** $193 Million	**2003 Profits** $128 Million	**2003 Profits** $163 Million	**2003 Profits** $196 Million	**2003 Profits** $151 Million
SLOGAN "A happy life comes with Geely"	**SLOGAN** "The fighter plane of mobile phones"	**SLOGAN** "Enthusiasm everywhere"	**SLOGAN** "Anything is possible"	**SLOGAN** "Delicious food, new concept"	**SLOGAN** "Honest and trustworthy"	**SLOGAN** "Innovation and excellence"	**SLOGAN** "Technology that caters to you"	**SLOGAN** "Youth knows no failure"	**SLOGAN** "Wherever we're needed, we're there"
)) **BRAND STRATEGY** Move upmarket while maintain low sticker prices. Overcome low-quality image first to China, then abroad.	))**BRAND STRATEGY** Facing growing competition at home, Bird plans to expand in markets including France, Italy and India.	))**BRAND STRATEGY** Leverage its German heritage and reputation as China's oldest beer to build up image overseas.	))**BRAND STRATEGY** Use its spon-sorships of up-and-coming young Chinese athletes to grow its brand on the mainland.	)) **BRAND STRATEGY** Will boost service, restaurant atmosphere and food quality following a $26.5 million investment by the Philippines Jollibee.	)) **BRAND STRATEGY** Break away from its low-end niche with a push out of small refrigerators and into higher-end products with juicier margins.	)) **BRAND STRATEGY** After unveiling a new corporate name last year, Lenovo hopes its sponsorship of the 2008 Olympics will boost its profile worldwide.	)) **BRAND STRATEGY** Linked up with France's Thomson, owner of RCA. Will sell as Thomson in Europe, RCA in the United States and TCL in developing markets.	)) **BRAND STRATEGY** Plans to use its name to expand beyond beverages and into fast growing markets such as children's clothing.	)) **BRAND STRATEGY** Plans to add new stores across China and possibly overseas following the opening late last year of its first Hong Kong store.
)) **KEY CHALLENGE** Has no joint ventures with foreigners, so it lacks overseas distribution networks.	)) **KEY CHALLENGE** Focused solely on mobile phones, Bird is vulnerable to a telecom slowdown.	)) **KEY CHALLENGE** Growing competition at home, sales abroad largely limited to Chinese eateries.	)) K**EY CHALLENGE** Faces competition from the likes of Nike, Adidas and Reebok on its home turf.	)) **KEY CHALLENGE** Fast food in China dominated by McDonald's and KFC.	)) **KEY CHALLENGE** Convince overseas retailers and consumers that it can make quality appliances.	)) **KEY CHALLENGE** Facing stiff competition at home from Dell, HP and IBM.	)) **KEY CHALLENGE** Protectionism: the United States levies 21.25% tariffs on its televisions.	)) **KEY CHALLENGE** Rivals Coke and Pepsi fast expanding beyond coastal China and into the interior.	)) **KEY CHALLENGE** WTO commitments means China will open fully to foreign retailers by year end.
)) **KEY STRENGTH** Low cost structure compared with major state-owned automakers.	)) **KEY STRENTH** Leads in smaller Chinese cities, where the market will grow most rapidly.	)) **KEY STRENTH** Close ties with Enthuse-Busch will help it build reputation overseas.	)) **KEY STRENGTH** Profile is high due to founder Li Ning, an Olympic medallist.	)) **KEY STRENGTH** Now partnering with Jollibee, which has beaten multinationals at home.	)) **KEY STRENGTH** Already sells at the likes of Wal-Mart, Sears and Best Buy.	)) **KEY STRENGTH** The market leader in China and strong in most other countries in Asia.	)) **KEY STRENGTH** Strong ties with established brands and network of overseas factories.	)) **KEY STRENGTH** Has unparalleled penetration into China's smaller cities and rural markets.	)) **KEY STRENGTH** Has nationwide network of stores and enjoys close ties with electronics-makers.

Source: Business Week (2004), 'China's Power Brands', 8 November.

Cambodia, there seems to be some definite evidence of Chinese SME-TNC OFDI in sectors such as garments and electrical/electronic goods, often underwritten by close links between individuals in China and the host country (usually people of Chinese ethnic origin).

At present, the scale of OFDI by Chinese SMEs is an imponderable. Though there may be large numbers of SME TNC investments overseas, it is also quite possible that quite a few of these are "mis-sightings" because of general unfamiliarity with Chinese state and private TNCs; after all, they have only recently emerged into the global limelight. In other words, considerable research is required to establish the scale and nature of Chinese SME TNCs, including their characteristics and motives. The Chinese Government certainly cannot ignore this sector at home or abroad, and it is essential that better data are collected by state authorities. As in all countries, although "champions" play a vital function – for example in securing "strategic" industries or acting as role models – the mainstay of economic vitality is underscored by SMEs, although this may not yet fully be the case for China. Knowledge about Chinese SME TNCs is also important for host countries; for example, it is likely that – as for FDI from other emerging economies, such as the Republic of Korea, Taiwan Province of China and Thailand – Chinese SME FDI is likely to be regionally focused, as opposed to the global intentions of larger players.

E. OFDI policy measures and support facilities

Since 1979, the Chinese Government has enacted a series of policies and legislation on outward foreign direct investment. The overall framework will be discussed in terms of four aspects: basic principles, rules and regulations, control measures and promotion policies.

Basic principles

China's direct investment in foreign countries follows the principles of "equality and mutual benefit, stress on efficiency, diversified forms and mutual development". "Equality and mutual benefit" refers to the fact that all the operation activities of China's TNCs should comply with the laws of the host country; both parties of the cooperation have equal rights to negotiation, operation strategy and management, and share the risks and benefits according to the proportion of investment. "Stress on efficiency" means that Chinese domestic enterprises are required to consider the practical needs and conditions choose their priority sectors to develop, adopt proper investment scale and yield quick returns from investment. "Diversified forms" refers to various means of investment, investment proportion and operation methods. "Mutual development" means that through joint investment and operation, both parties of the cooperation will make profits.

Rules and regulations

No specific laws on direct investment in foreign countries have been promulgated by the Chinese Government. Relative policies are included in the rules and regulations issued by ministries or commissions of the State Council. They include: *Notice on Rights and Principles of Examination and Approval of Non-trade Joint Ventures Enterprises Abroad and in Hong Kong and Macao Regions*, issued by former Ministry of Foreign Economic Relations and Trade in May 1984; *Examination and Approval Procedures and Control Measures on Establishing Non-trade Joint Ventures Enterprises Abroad*, issued by former Ministry of Foreign Economic Relations and Trade in July 1985; *Foreign Exchange Control Measures on Overseas Investment*, issued by State Administration of Foreign Exchange in March 1989; *Specific Rules of Foreign Exchange Control Measures on Overseas Investment*, issued by State Administration of Foreign Exchange in June 1990; *Notice on Transmitting the Suggestion of Encouraging Enterprises to Develop Overseas Processing and Assembling Enacted by Ministry of Foreign Trade and Economic Cooperation, National Economic and Trade Commission and Ministry of Finance*, issued by General Office of the State Council in February 1999; *Notice on Application Procedures and Relative Principles of Overseas Processing and Assembling Projects*, issued by former Ministry of Foreign Trade and Economic Cooperation and former National Economic and Trade Commission in May 1999; and *Notice on Simplifying the Examination and Approval Procedures of Overseas Processing Trade and Transferring the Authority to Local Departments*, issued by Ministry of Commerce and State Administration of Foreign Exchange in June 2003.

China has signed with many foreign countries and regions bilateral trade and economic cooperation agreements, investment protection agreements and double taxation relief agreements. By the end of 2002, China has signed trade agreements or protocols and economic cooperation agreements with 147 countries and regions, bilateral investment protection agreements with 109 countries and regions, and double taxation relief agreements with 81 countries and regions. To some extent, they provide necessary institutional guarantee for domestic enterprises to invest overseas.

Control measures

There is a surprising system of "hierarchical control, plural examination and approval" for OFDI and foreign exchange controls. However, the whole mechanism has been streamlined over time.

Project Approval

At present, project examination and approval is the main way for the Chinese Government to control direct investment in foreign countries. A supervising system of "hierarchical control, plural examination and approval" is carried out. Before the reform of the State Council organs in 2003, domestic enterprises must submit their project applications, depending on the amount of investment, to State Development Planning Commission (SDPC), Ministry of Foreign Trade and Economic Cooperation (MOFTEC), National Economic and Trade Commission (NETC), or relative local departments subordinated to the above-mentioned three ministries and commissions. In details, when the amount of investment is from $1 million (inclusive) to $30 million (exclusive), the project should be examined and approved by MOFTEC and SDPC; when the amount of investment is more than $30 million (inclusive), the project is firstly examined by MOFTEC and SDPC, and then submitted to the State Council for approval; when the amount of investment is less than $1 million, the project is reported by foreign trade and economic cooperation departments of provincial governments or ministries to MOFTEC for approval. As for overseas processing trade, the project is first examined by NETC, and then MOFTEC makes the final approval.

In 2003, the State Council's organs and functions were adjusted. The newly established Ministry of Commerce (MOFCOM), which is responsible for the general domestic and foreign trade, and State Administration of Foreign Exchange (SAFE), together issued Notice on Simplifying the Examination and Approval Procedures of Overseas Processing Trade and Transferring the Authority to Local Departments. The functions of departments for examination and approval have been adjusted as well. When the amount of investment for a project of overseas processing trade is less than $3 million (inclusive), the local foreign trade and economic cooperation department is responsible for the examination and approval; when the amount of investment is more than $3 million, the project is submitted to MOFCOM for approval through the local foreign trade and economic cooperation department.

Foreign Exchange Control

The SAFE and its branches are responsible for censoring the risk and source of foreign exchange used in OFDI. They also supervise and manage the remittance and reclamation of investment, profits and other returns on foreign exchange. There are two regulations for them to guide the work: one is Methods of Foreign Exchange Control of Overseas Investment, and the other is Detailed Regulations on Implementing the Methods of Foreign Exchange Control of Overseas Investment. In December 1993, Announcement of Further Reforming the System of Foreign Exchange Control by People's Bank of China was issued, which stipulated that the control of the portion, submission and quota of foreign exchange would be cancelled from 1994, and relative parts of the two above-mentioned documents were abolished.

The specific regulations include: first, domestic enterprises that plan to invest overseas with foreign exchange should submit necessary data and evidence; second, domestic enterprises that plan to invest overseas in the form of equipment, raw materials, industrial property right, etc. should submit the price information and the property right register of stated-owned assets of the equipment, raw materials and industrial property rights, etc. used in investment; third, after the approval of remitting the foreign exchange as investment, domestic enterprises should deposit 5 per cent of the total remittance as deposit to a designated bank account; fourth, domestic enterprises should remit back the OFDI profits and other foreign exchange profits within six months after the end of the local fiscal year, and settle with the foreign exchange balance; fifth, if domestic enterprises are closed or disbanded, the remaining foreign exchange should not be diverted for any other purposes or be deposited overseas.

For those overseas processing trade projects that require the purchase and remittance of foreign exchange, before domestic enterprises submit projects to local foreign trade and economic cooperation department, they should have the source of their foreign exchange censored by foreign exchange control authorities according to Notice of SAFE on Simplifying the Source Censorship of Foreign Exchange Used in Overseas Investment. If the amount of the investment is less than $300 million (inclusive), the source of foreign exchange should be censored by local foreign exchange control authorities; if the amount is more than $300 million, the source of foreign exchange should be censored first by local foreign exchange control authorities and then submitted to SAFE.

In addition, since 1 October 2002, China has launched pilot programmes in a few provinces with the purpose of reforming the foreign exchange control of OFDI. These provinces include: Zhejiang, Shanghai, Jiangsu, Guangdong, Shandong, Fujian, Beijing, Tianjin, Heilongjiang, Sichuan and Chongqing. In these provinces, a series of policies and measures have been adopted, which are as follows: the total quota of the purchase of foreign exchange within the pilot period of one year is up to $1.75 billion; qualified domestic enterprises are granted the right to choose the source of foreign exchange from its own foreign exchange reserve, domestic loans on foreign exchange or purchasing foreign exchange in market. Domestic enterprises are no longer required to remit profit back according to their financial situation; domestic enterprises no longer need to be approved before they use profit or other returns to increase their capital of investment or reinvestment.

Promotion policies

Countries all over the world provide preferential policies to direct investment in foreign countries. To encourage domestic enterprises to invest overseas, the Chinese Government has some limited promotion policies in respect of finance and taxation.

Finance

(1) Banks will provide mid and long-term RMB loans to all qualified domestic enterprises for OFDI. (2) Banks will provide export credit to finance the export of equipment, accessories and raw materials being promoted by overseas processing trade. (3) Domestic enterprises aiming at overseas processing trade can apply for trade development funds and the Export-Import Bank of China evaluates the projects, provides with loans and retrieves loans. (4) Domestic enterprises aiming at overseas processing trade can apply for preferential loans under aid programmes and aid project funds if the host country is an aid-receiving country.

Taxation

(1) Domestic enterprises are allowed to retain all the foreign exchange they earn within five years since their establishment with a purpose of assuring enough capital to expand production. After five years, they should pay income tax and submit 20 per cent of their foreign exchange quota as required. (2) If products from resources-exploiting projects sold back to China are included in the importing plan of the Government, these products will be treated the same tariff as that of the import from other countries. (3) Fish products caught by the Chinese side in offshore fishing are exempted from import tariffs in the long term. (4) The exported equipment, raw materials and semi-product, led by the Chinese side investment, are exempted from export tariffs.

F. Conclusion

Chinese TNCs have emerged in significant numbers in recent years, especially since the early 1990s, and this has been paralleled by sizeable levels of OFDI, widely dispersed across the globe. Initially industrialized countries were the main focus of Chinese OFDI (because of specific drivers, such as the need for raw materials and technological assets), but increasingly developing countries are receiving sizeable investments. Since about 1998 OFDI has been actively encouraged by the Chinese authorities, with two broad, overlapping aims: to secure resources (e.g. raw materials, technology, and brands) and establish national champions, though these policies are not yet fully coherently or consistently applied. Most Chinese TNCs are SOEs, e.g. PetroChina, Sinopec and CNOOC; but private companies such as Huawei, Haier and Lenovo are increasingly to the fore and will most likely become the more important and common players in the mid to long run.

The authorities' two aims mirror corporate drivers and motives, which in essence are: seek new markets, secure natural resources and access/acquire advanced technology, brands and other assets. These aims and motives are a mix of the "normal" and the "unusual". The first aspect, that is Chinese OFDI to secure raw materials and markets (e.g. through greenfield and acquired subsidiaries), is normal in the sense that other countries have manifested similar characteristics in their early OFDI. For example, raw materials-orientated FDI was common in the case of Japan and the Republic of Korea at a similar stage in their OFDI development because, as with China, both countries are characterized by raw materials scarcity (relative to their needs). Similarly, TNCS from these countries – along with many others – invested considerable amounts in sales subsidiaries (greenfield and acquired) in industrialized countries at an early stage in their development because this is where the markets (mostly) are. For these earlier TNCs, it was only later that motives and drivers such as acquisition/development of brands, technology from advanced countries or utilization of cheap labour in developing countries for production became more common. China is unusual in that these latter drivers are very significant in the country's OFDI "life-cycle"; and the chief reason for this appears to be that by allowing TNCs large-scale entry to its economy at such an early stage in its development (this is in marked contrast to Japan, the Republic of Korea, Taiwan Province of China, Russia, India – and even Brazil and Mexico) it has forced its companies to face

a formidable competitive threat in their heartlands – they must find the resources to compete in order to survive. Since many resources needed (technologies, purchasing or honing brands, even cheap-skilled labour resources) are found overseas, this has resulted in a rapid internationalization of Chinese companies. The relatively early internationalization by Chinese companies may also, partly, explain the possibly low levels of OFDI by SME TNCs, which are less likely to have built up the assets for internationalization at an early stage in a country's development.

These aims, drivers and motives in consequence explain the main industries in which Chinese TNCs are investing. The investments in petroleum, gas and minerals follow from the need to secure raw materials for the Chinese economy; the concentration of manufacturing FDI in computer, IT and software (electronic) industries are a little more unexpected – save for the fact that these are among the industries in which foreign TNCs have made the most inroads and therefore represent the greatest competitive threat to Chinese companies. Having said this, these industries in China are in essence the result of FDI by foreign TNCs in China, thereby establishing the conditions for Chinese companies to respond/develop; indeed, many Chinese TNCs affected entry into electronic/electrical in alliance, partnership or linkage with foreign TNCs in China itself (again in some, but not complete, contrast to Japan, the Republic of Korea, India and the Russian Federation). The major expansion of Chinese TNCs into the world economy has occurred at a time when alliances and partnerships are common. Moreover, inasmuch as Chinese TNCs are already working with foreign companies in China itself, they are already familiar, to a degree, with international partnerships, which they have taken further through M&As. Of course, this familiarity with international alliances and partnerships, allied to a considerable use of them in the international domain does not ensure their effective use (though examples mentioned earlier, such as Haier, do indicate some level of success); and certainly research is needed to determine the situation and recommend options and policies.

A number of policy implications can be highlighted. First, there is a pressing need to improve data gathering, analysis and reporting on OFDI; without timely and suitable data it will not be possible to pursue appropriate policies or offer support to companies. Secondly, the data gathering instruments must urgently include SMEs within their framework; as discussed earlier there is a dearth of knowledge on Chinese SME TNCs and their OFDI. Thirdly, there is a need for a more coherent policy approach to Chinese OFDI, a better reflection of this in the country's legislation and, perhaps, some support for OFDI activities (especially for SMEs). Fourthly, although this requires a fuller assessment of the issues, there may be a case for a Chinese OFDI promotion agency, especially because of the diverse nature of Chinese TNCs, their differential needs and the need to orchestrate the activities of a wide range of national, provincial and municipal authorities and their policies.

Finally, because Chinese OFDI and TNCs have only recently emerged onto the global scene, very little is known about them (apart from some case studies), whether their modus operandi are similar or different from other TNCs, indeed whether there is such a thing as "typical" Chinese TNCs, etc. Given the importance of the Chinese economy, the rising scale of Chinese OFDI and the lessons that these companies might hold for TNCs from other emerging economies, it is urgent that a research agenda be established and implemented.

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CHAPTER VI

OUTWARD FOREIGN DIRECT INVESTMENT BY SMALL MEDIUM-SIZED ENTERPRISES FROM INDIA*

A. Introduction

This paper examines the OFDI behaviour of Indian small and medium enterprises SMEs.[49] The pattern of enterprise internationalization is interesting because India is a developing country that has pursued a long-term policy of protecting and promoting SMEs development. Therefore, the Indian SMEs internationalization experience could be highly relevant for understanding the behaviour and characteristics of OFDI by developing country SMEs. The paper analyses the trends in OFDI by Indian SMEs, the drivers, implications on enterprise competitiveness and finally it reviews OFDI policies.

B. OFDI from India: Trends and development

Indian enterprises have been investing abroad for a long time, but it is only in recent years that Indian OFDI has become sizable. The evolution of OFDI flows from India is captured by the "two waves" trend. The first wave of Indian OFDI is different from the second wave in terms of investment size, growth, geographical spread, sectoral characteristics, pattern of ownership and motivations (figure 1). This "two waves" classification reflects the liberalization of OFDI policy, and changes in the quantum of OFDI flows including the character and motivations of Indian investment abroad.

The second wave is a distinct break from the first in terms of the number of Indian enterprises undertaking overseas production and the size of investment. It was a period of dramatic expansion of Indian OFDI. As at December 1983, there were only 228 approved OFDI projects, compared with 4,533 approved projects during 1997-2004 (table 1). This significant rise in the number of OFDI projects contributed to a 177 times increase in Indian OFDI stock, from $0.037 billion in 1976 to $6.6 billion in 2004 (figure 2).

Indian OFDI has undergone significant changes in sectoral and geographical distribution, types of FDI, structure of ownership participation and financing arrangement in the two different periods.

Geographical distribution. Most of the approved OFDI in the second wave went to the developed countries, which contrasted with the destinations in the first wave (table 2).

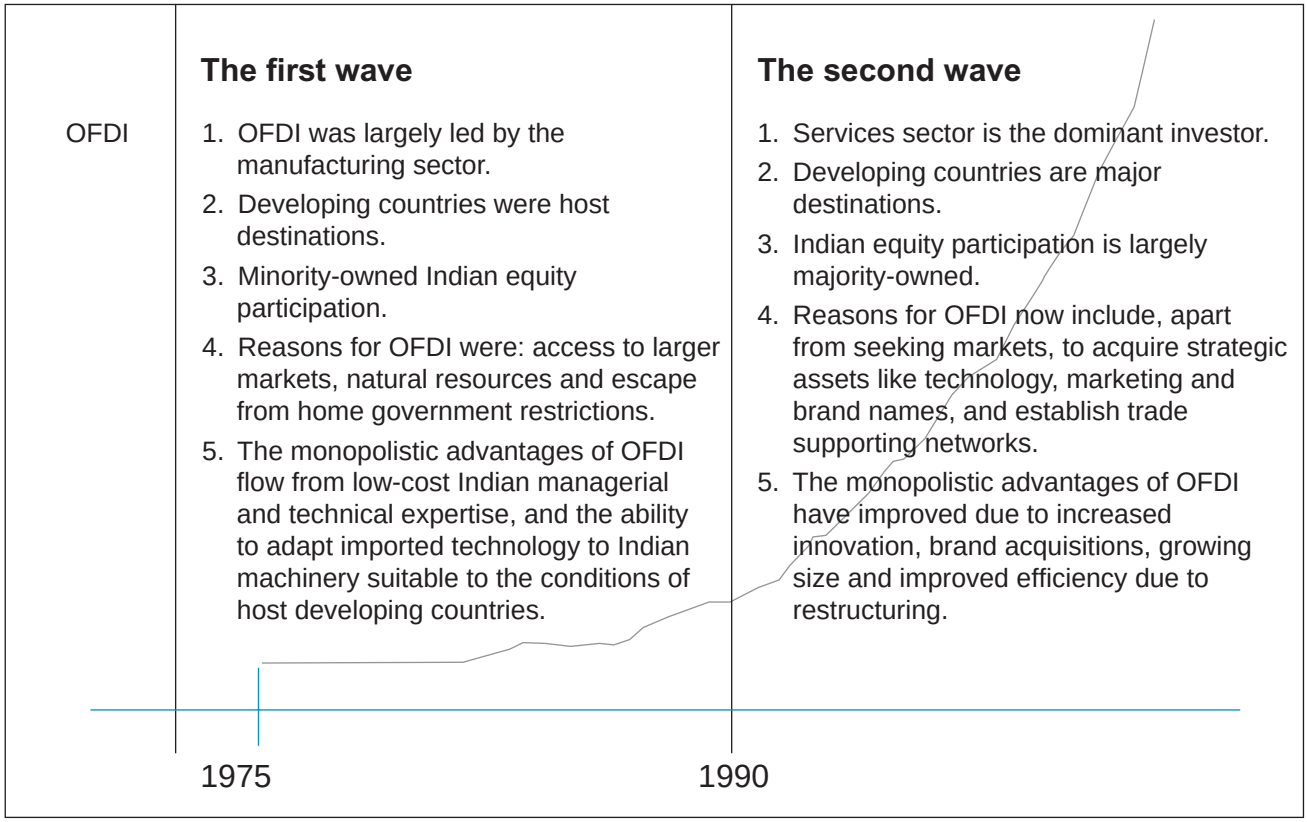
- In the first wave, developing South-East and East Asia were the largest host regions, followed by Africa, West Asia, Central Asia and South Asia in that order (figure 4).

- During the second wave, Western Europe and North America emerged as the major host regions, accounting respectively for 34 and 24 per cent of total Indian OFDI equity. Among the developing regions, South East Asia witnessed the largest decline in share, from 36 down to 9 per cent. Two developed countries, namely, the United Kingdom (27 per cent) and United States (24 per cent) were the major destinations for Indian OFDI in the second wave.

* This paper was prepared by Jaya Prakash Pradhan, Gujarat Institute of Development Research and Manoj Kumar Sahoo, Centre for Economic Studies and Planning, Jawaharlal Nehru University, India.

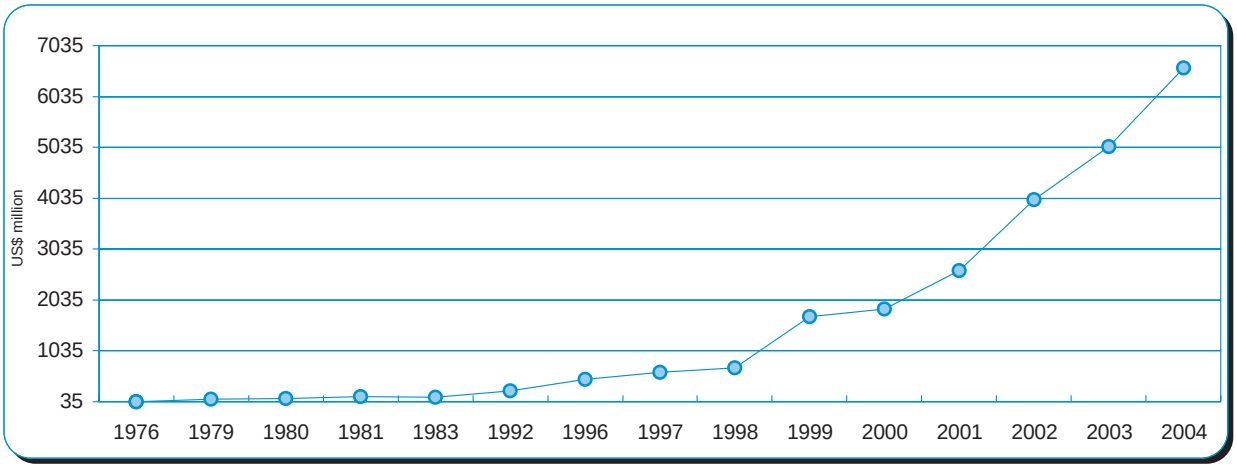
[49] For the purpose of this paper, firms are classified into small, medium-sized and large firms according to the following rule: for an industry (defined as the 3-digit level of International Standard Industrial Classification Revision 3), firms with sales up to the 25th percentile are taken as small, those having sales greater than the 25th percentile and up to the 75th percentile are classified as medium-sized and those with sales greater than the 75th percentile are designated as large enterprises.

Figure 1. The evolution of Indian OFDI from "first wave" to second wave"



Source: Pradhan (2005).

Figure 2. OFDI stock of India, 1976-2004
(Millions of dollars)



Source: Based on table 1.

Table 1. India: OFDI stock, 1976-2004

(Millions of dollars; number)

Period	Direct investment abroad	Equity capital and reinvested earnings	Claims on affiliated enterprises	Other capital	No. of OFDI projects
Jan. 1976	37	37	..	7	133*
Jan. 1979	86	86	..	..	..
Jan. 1980	101	101	..	..	192*
Dec. 1981	135	135	..	..	204*
Dec.1983	120	120	..	..	228*
March 1992	247	247	..	..	..
March 1996	481	481	..	..	..
March 1997	617	617	617	..	..
March 1998	706	706	706	..	..
March 1999	1 707	1 707	1 707	..	..
March 2000	1 859	1 858	1 858	..	..
March 2001	2 615	2 541	2 541	74	..
March 2002	4 005	3 810	3 810	195	..
March 2003	5 054	4 753	4 753	301	..
March 2004	6 592	6 211	6 211	381	4 533

Source: RBI releases International Investment Position (InIP) as on March 2003, Press Release: 2003-04/441; RBI releases International Investment Position (InIP) at India as at end March 2004, Press Release: 2004-2005/359; Reserve Bank of India Bulletin (2000) census of India's Foreign Liabilities and Assets as on March 31, 1997, pp. 1018-1021; Commerce Ministry as reported in R. B. Lall (1986), *Multinationals from the Third World*, table 2.1, p. 14, OUP, Delhi.

Notes: Figures for 1976-1983 include only equity capital; *indicates the stock of OFDI project accumulated over the past whereas @ indicates the cumulative number of approved OFDI projects from 1997 to 2004. The number of year-wise OFDI approvals has been obtained from Finance Ministry at http://finmin.nic.in/the_ministry/dept_eco_affairs/investment_div/idi_05Jan2004.*htm*.

.. means data not available for the corresponding year indicated in the table.

Table 2. Cumulative OFDI approvals by Indian enterprises, 1975-2000

(Millions of dollars; number; percentages)

Period	Total		Sectoral distribution						Regional distribution			
			Extractive		Manuf.		Services		Developing countries		Developed countries	
	No.	Equity	No.	Equity	No.	Equity	No.	Equity	No.	Equity	No.	Equity
1975-90 (First wave)	230	222.45	3	4.04	128	145.22	99	73.22	165	191.52	64	30.89
	(100)	(100)	(1.3)	(1.8)	(55.7)	(65.3)	(43.0)	(32.9)	(72.0)	(86.1)	(27.9)	(13.9)
1991-2000 (Second wave)	2 561	4 262.23	7	61.14	1 236	1 678.92	1 318	2 522.17	1 176	1 719.82	1 386	2 542.6
	(100)	(100)	(0.3)	(1.4)	(48.3)	(39.4)	(51.5)	(59.2)	(45.9)	(40.3)	(54.1)	(59.6)
1975-2000	2 791	4 484.68	10	65.18	1 364	1 824.14	1 417	2 595.39	1 341	1 911.34	1 450	2 573.49
	(100)	(100)	(0.4)	(1.4)	(48.9)	(40.7)	(50.8)	(57.9)	(48.0)	(42.6)	(51.9)	(57.8)

Source: UNCTAD's estimates based on RIS OFDI database (2002).

Notes: In parentheses are percentage shares of the total.

The Research and Information System for the Non-Aligned and Other Developing Countries (RIS) had made an attempt to compile firm-level information on Indian OFDI from unpublished information of the Ministry of Commerce and published reports from the Indian Investment Centre. The compiled information covers a long period from 1975 to March 2001 in the evolution of Indian OFDI. This dataset takes account of only the approved equity capital for projects in production and under implementation, not actual, and does not cover reinvested earnings and other capital.

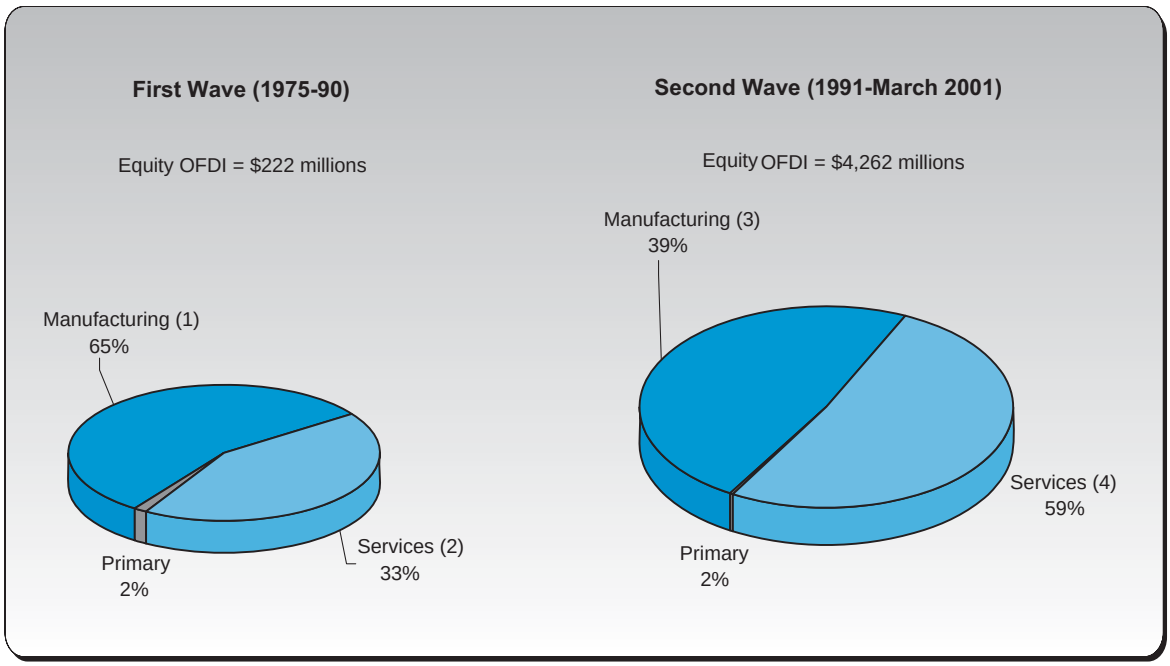
Sectoral distribution. In the first wave, Indian manufacturing enterprises were the largest investors abroad and in most cases firms invested in other developing countries with similar or lower level of economic development than India. The manufacturing industry accounted for the lion's share of Indian OFDI approvals (table 2). The services industry accounted for about 33 per cent of the approvals in terms of equity value, while the extractive sector accounted for less than 2 per cent.

Low- and middle-ranking technology manufacturing industries such as fertilizer and pesticides (18 per cent), leather (9 per cent), iron and steel (7 per cent), and wood and paper (5 per cent) were the main industries investing abroad in the first wave. The three leading service industries in that period were financial services and leasing (12 per cent), hotels and tourism (11 per cent), and trading and marketing (6 per cent) (figure 3).

- In the second wave, approved OFDI equity value of service industries rose to 60 per cent and it constituted 52 per cent of OFDI approvals (table 2). The Indian information and telecommunication (IT) industry emerged as the largest source of Indian services OFDI, accounting for 32 per cent of total flows, followed by media, broadcasting and publishing (17 per cent). The leading manufacturing OFDI sources were fertilizers and pesticides and pharmaceuticals. Recent years saw a significant increase in natural resources OFDI from India, contributed by acquisitions made by such companies as ONGC-Videsh.

Types of OFDI. Another significant feature of the second wave is the emergence of M&As as an important mode of internationalization by Indian enterprises. The late 1990s saw a surge in overseas acquisitions by Indian enterprises. As many as 119 overseas acquisitions were made by Indian enterprises

Figure 3. India: OFDI flows, by industrial distribution, 1975-1990 (first wave) and 1991-March 2001 (second wave)



Source: Research and Information System for the Non-Aligned and Other Developing Countries (RIS) OFDI database.

Notes:

(1) Three industries accounted for the lion's share fo the manufacturing OFDI. They were fertilizers, pesticides and seeds accounted for 18%; leather, shoes and carpets (9%) and iron and steel (7%) of equity OFDI.

(2) Three industries accounted for the majofr share of services OFDI. They were financial services (12%); hotels, restaurants, tourism (11%) and trade and marketing (6%) of total equity OFDI.

(3) Three industries accounted for the bulk of the manufacturing OFDI during this period. They were: Fertilizers, pesticiides and seeds (8%); drugs and phamaceuticals (6%); and textiles and garments (3%)

(4) Two industries accounted for the major part of services OFDI. They were: IT, communication and software (32%) and media broadcasting and publishing (17%).

Table 3. Overseas M&As by Indian enterprises, 2000-2003

(Number; percentage)

Sectoral composition			Regional composition		
Sector	No.	Per cent	Region	No.	Per cent
Primary	9	7.6	Developed countries	93	78.2
Mining, petroleum and gas	9	7.6	United Kingdom	16	13.4
Industry	34	28.6	United States	53	44.5
Pharmaceuticals	12	10.1	Australia	8	6.7
Paints	4	3.4	Developing countries	20	16.8
Plastic & products	4	3.4	Africa	5	4.2
Services	76	63.9	Latin America and the Caribbean	3	2.5
Software	67	56.3	Asia and the Pacific	12	10.1
All sectors	119	100	All regions	119	100

Source: Based on Pradhan and Abraham (2005).

in 2002-2003. The key characteristics of Indian M&As in the second wave include:

- Most of the acquisitions were in the software industry, followed by pharmaceutical and mining activities (table 3).
- The lion's share of the M&A purchases was in developed countries, dominated by the United States and the United Kingdom.
- Indian enterprises are increasingly using M&As to venture abroad to access market, technology, strategic assets and benefits from operational synergies.

Ownership participation. The structure of Indian ownership participation has also undergone a complete shift in the second wave as compared with the previous pattern. While the share of minority ownership[50] OFDI projects declined from 64 per cent to only 24 per cent, the share of majority ownership[51] increased from 13 to 57 per cent (table 4). The removal of policy restrictions on ownership participation during the second period and the desire of Indian companies to have full ownership explain this phenomenon.

Financing arrangements. The unprecedented growth of OFDI during the second wave is accompanied by significant changes in the financing patterns of OFDI. Earlier, OFDI operations were financed largely through equity investment from the home country. Following the liberalization of OFDI policy, Indian companies expanded their foreign production activities, which were financed through reinvestment earnings. The share of re-invested earnings emerged as the most important component of OFDI flows, accounting for about 45-50 per cent of the total flows during the fiscal years 2000-2001 and 2002-2003 (table 5). It also implies that Indian firms are increasingly more confident with internationalization.

C. OFDI by Indian SMEs

Indian SMEs are not far behind the large enterprises in OFDI activities. For instance, OFDI approvals by SMEs accounted for 26 per cent of cases of manufacturing activities and 41 per cent of cases in the software industry. Software SMEs contributed significantly to OFDI stock (47 per cent), however manufacturing OFDI by SMEs was small (table 6). SMEs in the software industry are largely more internationalized than SMEs in manufacturing activities. This reflects the competitiveness of Indian SMEs in software activities. The fact that the software industry is a skill-intensive industry and it is largely dependent upon foreign markets encouraged Indian SMEs to operate abroad.

[50] Less than 50 per cent of equity ownership.

[51] Greater than 80 per cent of equity ownership.

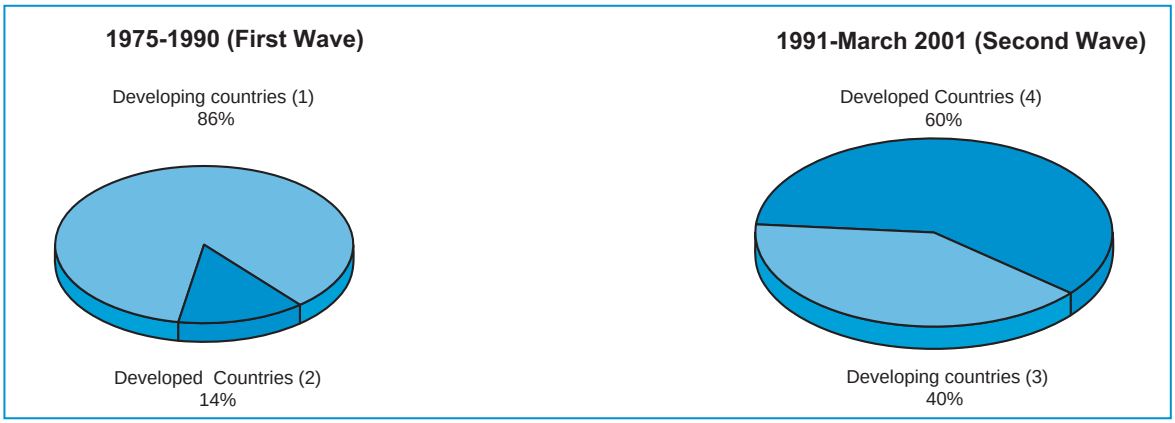
Table 4. The second wave and changing ownership structure of Indian OFDI

(Number; percentage)

Equity range (%)	First Wave (1975-90)			Second Wave (1991 - March 2001)		
	No of OFDI Approval	Per cent	Cumulative per cent	No. of OFDI Approval	Per cent	Cumulative per cent
0 to 20%	51	22.9	22.9	41	3.7	3.7
20 to 50%	91	40.8	63.7	230	20.6	24.2
50 to 80%	53	23.8	87.4	211	18.9	43.1
80 to 100%	28	12.6	100	637	56.9	100
Total	223	100		1119	100	

Source: UNCTAD's estimates based on RIS OFDI database (2002).

Figure 4. India: OFDI flows, by geographical distribution, 1975-1990 (first wave) and 1991-March 2001 (second wave)



Source: Research and Information System for the Non-Aligned and Other Developing Countries (RIS) OFDI database.

Notes: The dataset was compiled at RIS from published reports of the Indian Investment Centre and unpublished data from the Ministry of Commerce.

(1) Three subregions accounted for the bulk of first wave OFDI. They were Southeast and East Asia (36%), Africa (17%) and Central Asia (10%).

(2) Western Europe (8%) and North America (6%) were the two main developed countries destination for first wave Indian OFDI.

(3) Africa subregion accounted for 12%, Southeast and East Asia (9%) and Central Asia (9%) of the second wave OFDI.

(4) OFDI to developed countries surged during the second wave. Western Europe accounted for some 34% share and North America (24%).

Table 5. Distribution of Indian OFDI flows by components, fiscal year 2000-2003

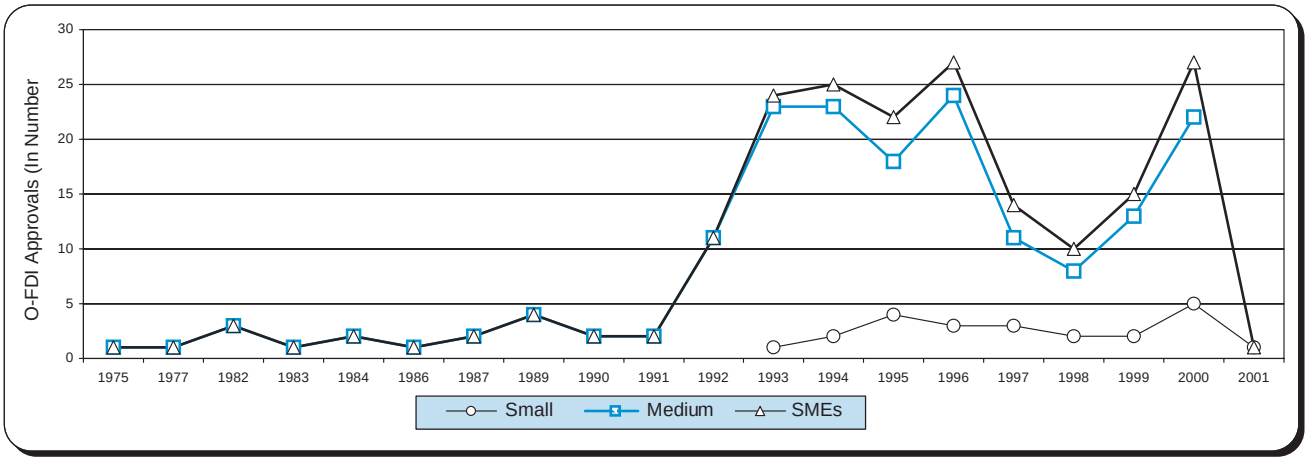
(Percentage)

	FY 2000/2001	*FY 2001/2002*	*FY 2002/2003*
Total OFDI	100	100	100
(i) Equity	45	41	40
(ii) Reinvested earnings	45	50	49
(iii) "Other capital"	10	9	10

Source: Revised Data on Foreign Direct Investment, press release of the Ministry of Commerce and Industry, 30 June 2003.

Figure 5. OFDI approvals by Indian manufacturing SMEs, 1975 - March 2001

(Number)



Source: ibid.

Table 6. OFDI stock, by firm sizes, as at 31 March 2001

(Millions of dollars; number; percentage)

Sector[a]		Firm size				
		Small	Medium	SMEs	Large	Total
Manufacturing	No.	23	172	195	551	746
		(3.08)	(23.06)	(26.14)	(73.86)	(100)
	Value	5	99	104	1450	1554
		(0.32)	(6.37)	(6.69)	(93.31)	(100)
Software	No.	16	105	121	173	294
		(5.44)	(35.71)	(41.16)	(58.84)	(100)
	Value	10	396	405	454	859
		(1.16)	(46.10)	(47.15)	(52.85)	(100)

Source: UNCTAD's estimates based on RIS OFDI database (2002).

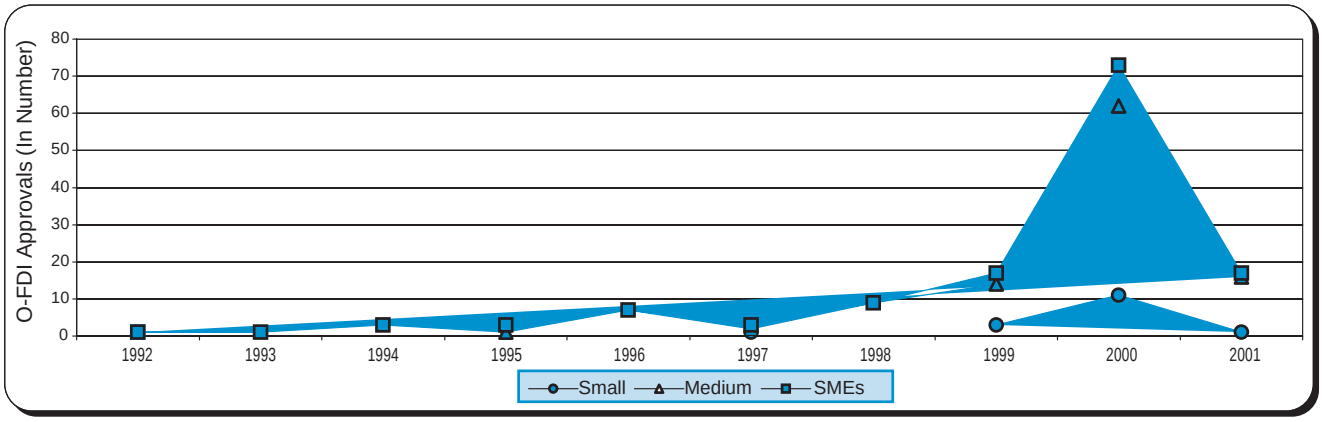
Note: Percentages are in parentheses. [a] Owing to the lack of data on OFDI by SMEs, the authors constructed a database which classified OFDI by firm size by merging firm names from the Prowess database of the Centre for Monitoring the Indian Economy with information from government sources and the dataset from the Research and Information System for the Non-Aligned and Other Developing Countries (RIS). The merging was done at firm level to ensure that recent changes in firm's names and their abbreviations are correctly incorporated when classifying OFDI by firm sizes. Manufacturing and software were selected because they are the two largest investors from the Indian economy.

Indian manufacturing SMEs investment abroad can be traced back to two different time periods. The OFDI process for medium-sized enterprises started when Indian Hume Pipe Company Ltd. commissioned a joint venture in Sri Lanka to manufacture hume pipes in 1975. However, the earliest case of OFDI by small enterprises was a joint venture between Roto Pumps & Hydraulics (P) Ltd. and Sterling Ltd. (United Kingdom) to manufacture pumps in 1993. OFDI by manufacturing SMEs became notable since 1991 when 177 overseas projects by SMEs were approved within a period of 10 years (figure 5). The approved projects cover such industries as light engineering, auto pumps and spares, electrical equipment, textiles and garments, and pharmaceuticals. OFDI by software SMEs, similar to manufacturing SMEs, became prominent since the 1990s, which coincided with the second wave of Indian OFDI (figure 6).

There are several reasons for the difference between SMEs' OFDI behaviour and that of large enterprises. SMEs have insufficient resources to meet the costs of information collection (e.g. foreign markets, government regulations, consumer preference) and are less able to withstand the uncertainty and risk associated with OFDI activities. Because of these disadvantages, SMEs investments are invariably small in quantity as compared with

Figure 6. OFDI approvals by Indian software SMEs, 1992 - March 2001

(Number)



Source: ibid.

OFDI by larger enterprises. Further, the quality and quantity of firm-specific assets owned are also different between SMEs and larger enterprises. SMEs are less likely to be motivated to undertake OFDI for reasons of exploiting its competitive advantages. On the contrary, OFDI is more likely to be undertaken for the purpose of accessing foreign technologies or building trade-supporting infrastructures overseas. As OFDI by Indian SMEs is a relatively recent phenomenon, they might not have a well-planned strategy vis-à-vis the global market, compared with TNCs.

Indian manufacturing SMEs are relatively younger, are less able to undertake R&D and import foreign technologies, are less oriented towards selling activities and have lower profit margins than larger enterprises. In the software sector, SMEs are relatively younger and have a higher R&D intensity but lower technology import intensity, compared with the larger enterprises. While SMEs in the software sector are less export-oriented in their OFDI activities, compared with larger ones, they are relatively more export-oriented in the manufacturing sector. The geographical and sectoral distribution is as follows:

Geographical distribution. Indian manufacturing SMEs invest in both developed and developing economies. Within the developing region, South-East and East Asian countries were the most favoured locations. They accounted for 17 per cent and 24 per cent respectively of OFDI approvals and stock. The Western European countries emerged as the principal destination among the developed countries followed by North America. For software SMEs, the developed countries were the most favoured destinations. Within developing countries, South-East and East Asia were popular locations. North America emerged as the most important investment destination among the developed countries. The United States and United Kingdom were the two largest destinations for OFDI by both Indian TNCs and SMEs. This suggests that Indian SMEs are not shying away from investing in developed countries even though they possess lower levels of technological, brand and skill advantages vis-à-vis Indian TNCs and developed country enterprises. In fact, the lack of these specific advantages was a key reason driving these Indian SMEs to invest in developed countries to augment the advantages.

Industry distribution. Indian OFDI by SMEs is similar to that by large Indian TNCs and covers a broad spectrum of manufacturing industries. SMEs are visible in low-technology-intensive industries (food products, textiles and paper) and in high-technology-intensive industries (pharmaceuticals, office machinery and communications). OFDI by SMEs is prominent in such industries as textiles, leather, footwear, machinery and equipment and motor vehicles. Indian SMEs, namely A C E Laboratories Ltd. (pharmaceutical) and R E P L Engineering Ltd. (electrical engineering), have emerged as top Indian manufacturing SMEs with more OFDI proposals than others.

Cross-border M&As. Overseas M&As by Indian SMEs have been small, particularly in the manufacturing industry. A number of overseas acquisitions by Indian SMEs were in the software industries including SMEs such as Aftek Infosys Ltd., Datamatics Technosoft Ltd., KLG Systel Ltd., Leading Edge Infotech Ltd. and Moschip Semiconductor Technology Ltd.

D. Drivers and motivations

During the first wave, Indian OFDI was mostly driven by the desire to escape the restrictive investment environment at home. The sluggish growth in domestic demand and restrictive government regulations encouraged many Indian enterprises to seek OFDI as an alternative route for growth (Lall 1983). Attractive growth prospects in overseas markets motivated Indian OFDI during this period, as did the need to secure natural resources. The motivations of OFDI changed radically during the second wave. Along with the traditional objective of exploiting overseas markets and securing natural resources, the drivers of OFDI expanded to include:

- accessing/acquiring firm-specific intangibles such as technology, skills and marketing expertise,
- establishing trade-supporting infrastructure, and
- circumventing emerging regional trading arrangements (Pradhan and Abraham 2005).

The relaxation of exchange controls and the significant liberalization of OFDI policies in the 1990s played an important role in encouraging Indian enterprises to invest abroad. More recently, the encouragement provided by the Government has also played a key role. Increasing global competition and the need to establish a firm global position have encouraged Indian enterprises to invest abroad to acquire brand names and production facilities.

E. OFDI and implications for enterprise competitiveness

This section highlights implication for competitiveness, with a focus on SMEs. Whether OFDI for an individual firm is largely beneficial depends upon firm-specific strategies pursued. SME that diversify into too many business activities or product lines and spread its limited financial skill and manpower resources too thin, such as the case of REPL Engineering Ltd., which entered into various joint venture arrangements with other foreign companies abroad, is more likely to face critical survival issues. Without a sound growth strategy pursued in the domestic market, moving abroad would expose an SME to more risk than it can manage. Over-exposure to OFDI activities could lead to inefficiency and decline in competitiveness. Notwithstanding obstacles faced by Indian firms, there was anecdotal evidence indicating that enterprise internationalization has helped some Indian SMEs to become more competitive. For instance, OFDI has helped develop the export competitiveness of Indian manufacturing SMEs and their R&D intensity[52] as compared with those SMEs that did not invest abroad, although profitability did not seem to change through the internationalization process (table 7). Indian manufacturing SMEs are undertaking, in most cases, trade-supporting OFDI activities by establishing distribution and marketing centres in overseas market, enhancing their capability to ensure better sales and after-sales services. In this way, the foreign affiliates of Indian manufacturing SMEs appear to have played a significant role in enhancing export performance.

- **Market access.** The case studies of seven Indian SMEs reveal interesting insights into the nature and impact of their OFDI operations.[53] OFDI undertaken by Indian SMEs has been primarily aimed at strengthening their export performance. Indian SMEs, unlike their TNC counterparts, do not possess the necessary firm-specific competitive advantages to exploit value-adding activities abroad. SMEs such as ACE Laboratories Ltd., Roto Pumps Ltd. and CGVAK Software & Exports Ltd. indicated that they are using OFDI as a strategy to enhance marketing and trade-supporting networks overseas. Roto Pumps Ltd, in particular, used OFDI strategy to build marketing and warehouses overseas. Liberty Shoes Ltd., an affiliate of an Indian TNC, used OFDI to establish retail outlets overseas. In this regard, OFDI has helped expand the market scope and access to new markets overseas for these SMEs.

- **R&D.** Superhouse Ltd. demonstrated that Indian SMEs are also internationalizing their innovation activities, creating new assets. This confirms that internationalization of R&D is not only a strategy of developed country enterprises: less technologically advanced firms from developing countries may also adopt it and gain benefits from well-developed research infrastructures and availability of skilled manpower in overseas markets. In the software industry, Aftek Infosys showed that Indian SMEs are first movers in adopting overseas acquisition strategy. Aftek Infosys

[52] Measured as in-house R&D expenses as a percentage of sales to represent a firms indigenous technological activities.

[53] These cases are ACE Laboratories, REPL Engineering, Liberty Shoes, Roto Pumps, Superhouse, Aftek Infosys and CGVAK Software & Exports reported in an earlier version of the paper (TD/B/COM.3/EM.26/2/Add2) prepared for the UNCTAD Expert Meeting on "Enhancing the Productive Capacity of Developing Country Firms through Internationalization", Geneva, 5-7 December 2005.

Table 7. Export intensity, profitability and R&D intensity of Indian manufacturing SMEs, 1991-2001

Year	Outward investing				Non-outward investing			
	No. of Firms	Export Intensity (%)	Profitability (%)	R&D Intensity (%)	No. of Firms	Export Intensity (%)	Profitability (%)	R&D Intensity (%)
1991	44	7.950	4.753	0.344	966	2.997	4.473	0.013
1992	51	11.264	4.225	0.025	1143	3.670	1.945	0.049
1993	73	14.060	3.974	0.029	1439	4.224	1.947	0.102
1994	102	20.920	6.366	0.254	1931	5.243	4.517	0.115
1995	106	20.812	7.066	0.411	2385	6.380	7.136	0.192
1996	110	21.718	4.914	0.433	2509	6.922	4.450	0.235
1997	101	18.404	2.394	0.184	2555	6.985	3.343	0.227
1998	96	20.388	-2.809	0.326	2550	7.663	2.271	0.251
1999	103	22.204	0.129	0.294	2554	7.343	1.600	0.205
2000	104	21.333	0.485	0.136	2551	6.940	3.467	0.162
2001	83	21.978	5.090	0.461	1938	8.710	6.420	0.186

Source: Computation based on Prowess Database (2002) and RIS OFDI Dataset.

used M&As strategy to access the European market and technology overseas to improve its competitiveness.

Lesson learned. A number of strategic lessons could be considered by enterprises that explore internationalization strategies through OFDI:

Enterprises constrained by size and resources should not diversify production activities into a variety of products internationally. Specializing in a niche product is a good strategy for incremental internationalization rather than spreading the limited resources too thinly on many products and to many places.

Enterprises operating in a particular product category could come together, collaborate and pool their resources for creating their own respective niche market segment. The need for an interactive platform that enables enterprises, particularly SMEs to share information, learning and jointly developed differentiated products can go a long way in overcoming their size limitations.

Indian enterprises could consciously invest in new technologies, particularly ICT. This is most critical as it enables them to access information on global markets, regulations and finding business partners abroad.

Indian enterprises could improve their capabilities and internationalization capacity by upgrading their technology, product differentiation and management skills in collaboration with business schools and management institutions.

Indian enterprises with easy access to finance or in a strong financial position could consider internationalization through using M&As. Indian enterprises could also observe good corporate governance and contribute to the host country's national development.

F. OFDI policies

India's OFDI policy regime, 1978-2004[54]**.** India's policy regime for OFDI has been changing since 1978 when the concrete guidelines for Indian joint ventures (IJVs) and wholly owned affiliates abroad were issued. Although overseas investment was permitted before 1978, the Indian policy regime was yet to be shaped.

Two distinct phases in the evolution of Indian OFDI policy can be distinguished: the period between 1978 and 1992, when the 1978 guidelines stayed in place throughout, with minor revisions; and the period

[54] This discussion draws heavily on Pradhan (2005).

following 1992, when new guidelines for OFDI were brought in. While the first phase was characterized by a restrictive attitude towards OFDI, the second phase was marked by large-scale policy liberalization (box 1).

Indian OFDI in the 1990s grew dramatically after the implementation of the economic liberalization policy in 1991, which resulted in intense competition for survival and growth among firms. Indian firms, including SMEs, also faced competition from abroad as a result of globalization. The Government subsequently relaxed restrictions on Indian OFDI. The increasing competitive pressure at home and abroad, and the liberalization of OFDI, played an important role in driving Indian OFDI.

- ***The first phase.*** During the first phase of its evolution, the government policy towards OFDI had been motivated by two main objectives:

(i) using OFDI as a strategy for fulfilling India's commitment to South-South cooperation; and

(ii) promoting Indian exports through OFDI at minimum possible foreign exchange cost.

OFDI was regarded as a vehicle to share India's development experience, technology and skills with other developing countries. The early OFDI policy explicitly required that Indian equity participation comply with the rules and regulations of the host country. The early policy also sought to promote OFDI only in the form of joint ventures with minority Indian ownership participation. The promotion of joint ventures ensured that local capital also participated with Indian capital in the development process of host countries. In addition, there were concerns of minimizing foreign exchange costs. To further minimize these costs, the policy required that Indian ownership participation be in the form of capitalization of exports or financed by Indian-made plant, machinery and know-how. The motivation for minimizing foreign exchange costs also found its practical form in not permitting cash remittances for OFDI, except for deserving cases.

Box 1. Salient features of different phases of OFDI policy

	Phase I: 1978-1992	Phase II: 1992 onwards
Policy objectives	• Promoting Indian OFDI as a tool of South-South cooperation • Maximizing economic gains (mainly exporting of machinery and know-how) from OFDI at minimum foreign exchange costs	• Promoting OFDI as a tool of global competitiveness • Maximizing exporting from India, acquiring overseas technology, gaining insider status in emerging trading blocs, etc.
Strategies	• Permission only for minority-owned joint ventures (JVs)	• Removal of ownership restrictions in overseas ventures
	• Equity participation should be through exports of Indian-made capital equipment and technology • Capitalization of export of second-hand or reconditioned machinery against foreign equity is prohibited • Cash remittances, except in deserving cases, are normally not permitted	• Foreign equity participation normally is allowed through cash transfer along with the usual way of capitalization of exports of plant, machinery and know-how. • Equity participation through export of second-hand or reconditioned machinery is permitted • Equity participation through the ADR/GDR route is allowed
	• Overseas JVs must be in the same line of business activity	• OFDI can be in any bona fide business activity
	• OFDI is permitted only through the normal route [a]	• Automatic route under Reserve Bank of India (RBI) is instituted for OFDI approval along the normal route.

Source: Authors.

[a] There are two different routes for OFDI: the automatic and the normal. For a speedy and transparent approval system, the automatic clearance route was put in place for a specified investment limit. Under this route no prior approval from the regulatory authority such as the RBI or Government of India is required for setting up a joint ventures or a wholly owned affiliate abroad.

- ***The second phase.*** After pursuing a restrictive policy regime during the 1970s and 1980s, India shifted to a new, transparent and liberal OFDI policy regime during the 1990s. By the 1990s India had attained a higher level of development with strong competencies in knowledge-based industries such as pharmaceuticals, software and automobiles. It had accumulated significant levels of technological expertise and knowledge, entrepreneurial development, management skill and infrastructure.

The guidelines for joint ventures and wholly owned enterprises were issued in October 1992 with the objective of making OFDI policy regime more transparent and commensurate with current global developments and Indian business realities. It is now motivated to use OFDI in promoting exports, acquiring technology abroad, building trade-supporting networks and gaining insider status in emerging trading blocs with the strategic objective of global competitiveness. The 1992 policy removed the restriction on ownership participation and the Indian entity is free to decide on the exact level of ownership it wants to hold in overseas ventures. For a speedy and transparent approval system, the automatic clearance route under RBI was put in place for a specified investment limit. Under this route no prior approval from the regulatory authority such as the RBI or Government of India is required for investing abroad.

The amount of direct investment under automatic approval was raised continuously from $2 million in 1992, $15 million in 1995, $100 million in 1999 and any amount up to 200 per cent of their net worth in 2005. Indian firms operating in the Special Economic Zone are allowed to make overseas investments with no limit on the amount invested under the automatic route. Investments under the automatic route have also been allowed in unrelated business from the investing firm and in new sectors such as agricultural activities.

OFDI policy regime and SMEs. As the existing Indian OFDI policy permits only those corporate entities and partnership firms that are registered under the Indian Factories Act, 1956, and the Indian Partnership Act, 1932, it prevents the largest chunk of SMEs operating in the unorganized segment of overall Indian manufacturing industry from undertaking OFDI operations. However, SMEs, which are classified under organized manufacturing, are legally eligible to undertake investment abroad.

During much of the first phase of policy evolution, SMEs faced policy constraints on their OFDI as equity participation has to be in terms of exporting indigenous machinery, equipment and technical know-how. SMEs during that phase were not original equipment manufacturers and did not possess the required technological capabilities to undertake OFDI. During the second phase, however, the previous restrictions that supported SMEs internationalization through OFDI were relaxed. However, many of the liberalized provisions such as liberal access to overseas financial markets and international securities markets did not help SMEs to engage in OFDI, as many of them did not have the capability to do so. Resource-constrained SMEs also did not benefit much from the increase in the cap on investment limit.

G. Conclusion

Indian OFDI activities have emerged as distinguishing features of the Indian economy since the 1990s. The number of OFDI approvals, as well as the size of OFDI flows, has increased significantly in the past decade. This new wave of OFDI, termed the second wave, was accompanied by significant changes in the structure, characteristics and motivations which differ from those of OFDI in the pre-1990s.

OFDI from India has not been entirely led by large enterprises. Indian SMEs have also played a significant role. Indian OFDI by SMEs has been growing since the 1990s, a trend that is relevant in both the manufacturing and software industries. OFDI by Indian manufacturing SMEs is visible in both the low- and high-technology intensive industries. Indian SMEs invest in both developed and developing countries, but the software OFDI is more inclined to favour the developed region. There is also a growing tendency for Indian SMEs, as for TNCs, to pursue overseas acquisitions to expand markets and access to technology, including other strategic assets.

The liberalization of OFDI policy alone is not enough to encourage more SMEs to go abroad to participate in internationalization and benefit from it. OFDI activities by Indian SMEs are conditional upon both government policy initiatives and firm-specific endeavours.

A number of measures, fiscal and non-fiscal, which directly impinge upon the technological capabilities of SMEs are crucial for helping them fully exploit their OFDI potential. Low levels of technological capabilities of SMEs due to resource constraints, lack of technical and trained manpower and lack of access to facilities of public-funded research institutions discourage SMEs' overseas expansion. Given that SMEs suffer from low levels of skills and have limited capability to create their own brand names, support in skills upgrading (training, management development programmes), assistance in receiving certification from international

quality testing agencies and steps towards quality improvement can be helpful. Measures that will enhance SMEs' access to finance are crucial for their growth at home as well as in the global market, and should be considered.

- The provision of market information and investment opportunities in host countries is another area where the Government can support SMEs in realizing their full potential for OFDI. As government policies and the business environment may differ sharply between the home and the host country, SMEs need assistance from home and host Governments in dealing with legal matters, collecting information on overseas business opportunities and foreign market characteristics. Government policy framework supportive of international M&A could further help facilitate OFDI as a means to enhance enterprise competitiveness.

- A major constraint hindering research on internationalization of SMEs is the lack of accurate and reliable data. Hence, development of a readily available database on SMEs undertaking OFDI is an important precondition for assessing and examining comprehensively the issues faced by Indian SMEs in internationalization through OFDI.

- Certain policy measures are needed to help Indian SMEs overcome the barriers to internationalizing through OFDI, including access to finance. Facilitative measures such as institutional support and incentives could be considered. The OFDI promotion programme is another area where both the public and the private sector can work together in strengthening India's position as an emerging outward investor, with the Indian SMEs featuring prominently in the process. The need for capacity building and strengthening Indian technological capability deserves closer attention by the Government, the private sector and research institutions.

On the whole, the significant liberalization of policies by the Government and the growing competitiveness of Indian enterprises in such industries as software and pharmaceuticals have played a significant role in supporting the rapid growth of Indian OFDI in recent years. The need to secure natural resources abroad, such as oil, gas and minerals, to support the rapid growth of industrial development at home has led the Government to actively encourage both public and private enterprises to venture abroad. Against this background, the prospect for Indian OFDI, including by Indian SMEs, is promising.

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CHAPTER VII

OUTWARD FOREIGN DIRECT INVESTMENT BY ENTERPRISES FROM MALAYSIA*

A. Introduction

This paper examines Malaysian investment abroad with emphasis on SMEs. It assesses the drivers, motivations, obstacles, and the regulatory framework relating to the internationalization of Malaysian enterprises through OFDI. It also highlights how OFDI has helped increase the competitiveness of selected Malaysian enterprises.

B. OFDI from Malaysia: Trends and development

Malaysia is a growing source of FDI for other developing countries. Its OFDI stock rose from $2.7 billion in 1990 to $29.7 billion in 2003 (table 1). The country's annual average OFDI flows increased steadily in 1980-1989, 1990-1994 and 1995-1999. However, annual average OFDI flows dropped to $1.4 billion in 2000-2003 due to the impact of the 1997 Asian financial crisis, the slower pace of economic growth in Malaysia and corporate consolidation. OFDI stock as a percentage of Gross Domestic Product rose from 6.1 in 1990 to 28.8 per cent in 2003, indicating the increased internationalization of Malaysian economy. Large Malaysian enterprises such as Kulim, Kumpulan Guthrie, Sime Darby, UEM, Amsteel Corporation, Genting, Hume Industries, Telekom Malaysia, Malaysian Airline and Malaysian International Shipping Corporation have significant presence overseas (Annex table 1). They were among UNCTAD's top 50 TNCs from developing countries and most of them were government linked companies (GLCs) (UNCTAD 1999, 2001, 2004). Examples of Malaysian SMEs investing abroad include Top Glove, Ingress Corporation and Munchy Food Industries.

Geographical distribution. The largest share of Malaysian OFDI flows goes to other developing

Table 1. Malaysia: OFDI flows and stock, 1980-2003

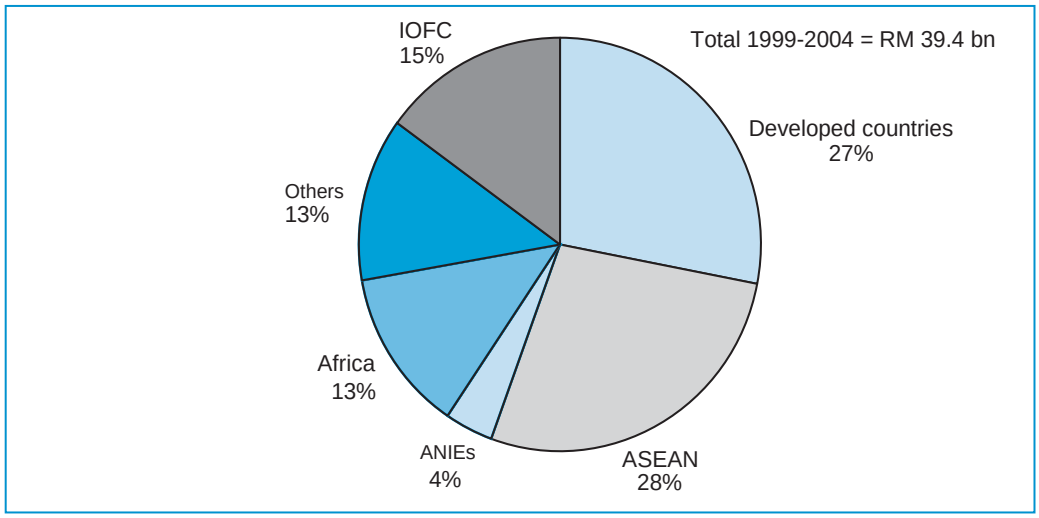
OFDI Stock (US$ billion)				
1980	1990	1995	2000	2003
0.2	2.7	11.0	21.3	29.7
OFDI flows (annual average) (US$ billion)				
1980-1989	1990-1994	1995-1999	2000-2003	
0.2	0.8	2.2	1.4	–
OFDI stock as a percentage of gross domestic product				
0.8	6.1	n.a.	23.6	28.8

Source: UNCTAD, *World Investment Report 2004.*

* This paper was prepared by Zainal Aznam Yusof, Working Group, National Economic Action Council (NEAC), Malaysia.

Figure 1. Malaysia: Gross OFDI flows, by destination, 1999-2004

(Billions of Ringgit Malaysia)



Source: Bank Negara Malaysia.

Note: RM 3.80 = US $1.
The total figure excludes RM5 billion to the Labuan Offshore Financial Centre in Malaysia.
IOFC: International Offshore Financial Centres

countries (figure 1). The international offshore financial centres (IOFC) accounted for 15 per cent of the total OFDI, suggesting the channelling of funds to tax haven locations for financial motives and other corporate reasons (e.g. holding company purpose, trans-shipped FDI).

The geographical destinations of Malaysian investment abroad have diversified in this decade, compared to the 1980s and 1990s. However, most of the overseas investments still concentrated in Asia, particularly in the ASEAN countries. Singapore was the largest recipient of Malaysian investments followed by the United States in 1999-2004. More than a quarter of Malaysian FDI abroad went to ASEAN. The amount of Malaysian investment in ASEAN was as large as flows into developed countries. Malaysian OFDI to African countries started from a low base but grew rapidly in recent years. Malaysian companies have significant business interests in Ghana, Namibia, South Africa, the United Republic of Tanzania and Zimbabwe. Companies such as Petronas are present in Angola, Ethiopia, Nigeria, South Africa and Sudan; and Telecom Malaysia in Malawi.[55] Malaysian OFDI to China rose from $40 million in 1999 to $62 million in 2004, suggesting increased investment relationship and production linkages between the two countries.

Sectoral distribution. There are two sets of data: investment by public enterprises and by all other firms, named "resident controlled**".** Overall, Malaysian overseas investments concentrated in a few industries, especially in oil and gas for government linked companies, and in finance (mainly in commercial banking), utilities, construction and in plantation.

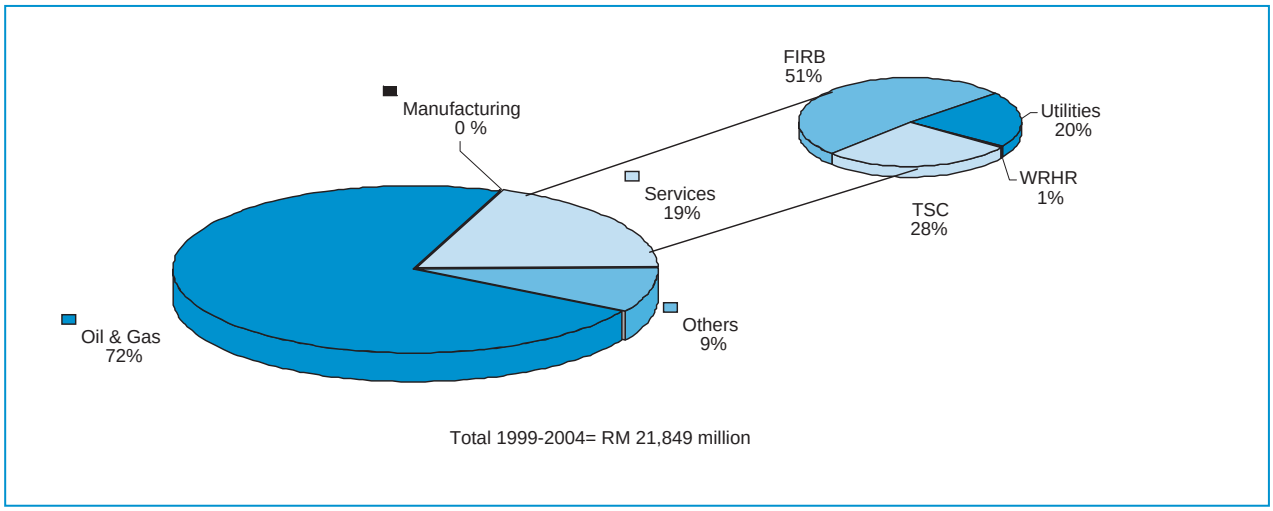
- ***Public enterprises.*** A sizable amount of Malaysian OFDI in 1999-2004 came from non-financial public enterprises (NFPEs) or government linked companies (49 per cent). The bulk of the overseas investments by NFPEs were in oil and gas (figure 2). NFPEs OFDI in services declined from 34 in 1999 to 5.6 per cent in 2004. The significant overseas investment by Petronas contributed to the country's oil and gas OFDI (box 1). Malaysian overseas investments in agriculture activities have grown from a 3.6 per cent share in 1999 to 8.6 per cent in 2004, mainly in plantation activities (e.g. rubber and palm oil) in neighbouring countries such as Indonesia.

- ***Resident controlled enterprises.*** About two thirds of Resident Controlled Companies (RCCs) OFDI were in services in 1999-2004 (figure 3). RCCs services investments were mainly in finance, insurance, real estates and business services. Overseas investment by the Malayan Banking and Public Bank contributed to the dominance of the services investment. OFDI in utilities have also been growing rapidly as well as wholesale, retail trade, hotels and restaurants. Manufacturing OFDI has grown by

[55] See "Petronas: International operations» (http://www.petronas.com.my/internet/corp/centralrep2.nsf/frameset_corp?OpenFrameset) and "About TM overseas investment" (http://www.tm.com.my/about_TM/oversea_invest/TMI.htm)

Figure 2. Gross OFDI flows, by NFPEs, 1999-2004

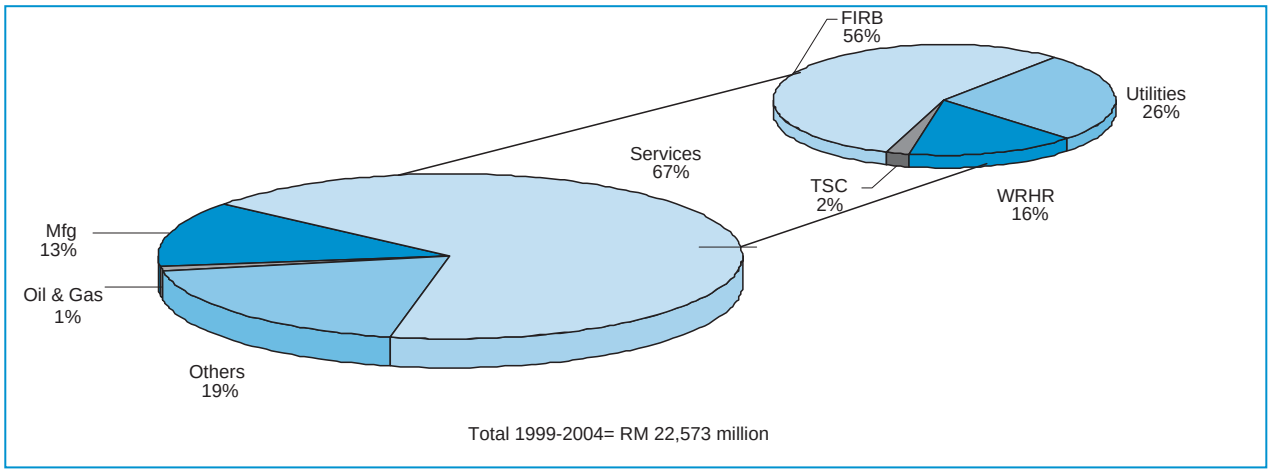
(Millions of Ringgit Malaysia and percentage)



Source: Bank Negara Malaysia.

Figure 3. Gross OFDI flows, by resident-controlled enterprises, 1999-2004

(Millions of Ringgit Malaysia and percentage)



Source: Bank Negara Malaysia.

Note: RM 3.80 = US $1. Data include Malaysian OFDI to Labuan Offshore Financial Centre.
Abbreviations: WRHR: Wholesale and retail trade, hotels and restaurants; TSC: Transport, storage and communications; FIRB: Finance, insurance, real estate and business services.

more than threefold but has not been as sizable as flows from the services industries.

Malaysian manufacturing companies abroad are involved in a wide range of products and services. These range from the manufacture of plastic injection moulding, construction bricks, food, fibreboard, garment, apparel, plywood, flour, paints, electronic products and filter. In services they provide banking services, engineering services, software, restaurants, toll operator services, retailing and airport hotel services, including service apartment.

C. Drivers and motivations

The motivations of Malaysian investment abroad can be categorized into the following areas:

- market-seeking (e.g. Opus International, Telekom Malaysia, Royal Selangor, CIMB, Top Glove, Road Builders, Malayan Banking, Hong Leong);
- resource-seeking (e.g. Petronas, Kumpulan Guthrie, Sime Darby, Melewar Industrial Group); and
- efficiency-seeking (e.g. Press Metal, Globetronics).

Box 1. Petronas

Petronas is a leading Malaysian oil corporation. Its corporate vision is to become a leading oil and gas multinational. Petronas expanded its activities overseas since the early 1990s. It now has over 100 affiliates and associated companies with interests in more than 30 countries. It is involved in a wide range of petroleum activities, which range from upstream exploration and production of oil and gas, to downstream oil refining, marketing and distribution of petroleum products, trading, gas processing and liquefaction, gas transmission pipeline operations, marketing of liquefied natural gas, petrochemical manufacturing and marketing, shipping, automotive engineering and property investment. Its first overseas operation was in Viet Nam in 1991. Overseas operations now cover countries not only in Asia but also in Africa, Latin America and the Middle East. Petronas international operations cover both upstream and downstream activities and in some countries (e.g. Egypt, Cameroon, Indonesia, Sudan and Vietnam) it has both upstream and downstream operations.

Petronas international operations are motivated by the need to enhance and sustain Malaysia's oil and gas reserves through exploration and production. The location of its overseas investment is determined by geology, i.e. the likely supply and existence of petroleum resources including resource-rich countries in Africa. The growing size of the markets in Africa, especially in sub-Sahara Africa and the Indian Ocean rim are additional determinants of its international investment activities. Its overseas operations have made Petronas more competitive through access to oil and gas reserves abroad, strengthen its business profile, gain sizable foreign currency cash flows which strengthens the balance sheet. Investing overseas, therefore, had added to the company's total oil reserves.

Source: Petronas.

Firm-specific factors (e.g. history, contacts, vision of the company's founder or CEOs and investment opportunities) play a role in influencing Malaysian companies to venture overseas. Government support such as investment missions, incentives and institutional facilities have facilitated Malaysian companies to invest abroad.

- **Market-seeking.** Seeking new markets and growth opportunities abroad are key factors encouraging Malaysian OFDI (e.g. Opus International and CIMB). The slowdown in the domestic construction activities, for example, has encouraged Malaysian firms to seek growth and business opportunities overseas (e.g. Industrial Concrete Products). Investments by some GLCs have been motivated by the need to forge close links with some countries, and to exploit growth opportunities and markets overseas (Khazanah National, Petronas and Sime Darby). Many of the GLCs, especially in construction, have been constrained by the reduction in public investment in domestic construction and have been forced to look abroad for growth. Regional developments have also exerted influences on Malaysia's OFDI, particularly in ASEAN. The ASEAN Free Trade Area (AFTA) and ASEAN Investment Area (AIA) have raised the level of integration of ASEAN members and have contributed to intra-ASEAN investment flows (ASEAN Secretariat 2001). Some Malaysian companies have significant investments in ASEAN. They include Petronas, Sime Darby, Guthrie, Golden Hope Plantations, CIMB, Globetronics Technology, Cosmopoint, Delcom, Malaya Glass, Sapura, TRI-Cellular and YTL Corp. Malaysian companies are also buying assets in the neighbouring countries and further afield to ensure quick access to markets, production facilities and natural resources. For instance, Malayan Banking acquired a bank in the Philippines, Batu Kawan acquired a 12.5 per cent stake in Chemical Industries Far East (Singapore), Top Glove acquired a 70 per cent stake in Great Glove (Thailand), Petronas acquired a 10.9 per cent stake in Yetagun Oil (Myanmar), YTL Corp bought a 35 per cent stake in Jawa Power (Indonesia), Amsteel Corp acquired a 50 per cent stake in Parkson Venture (Singapore) and DRB-HICOM acquired PT Bina Mitra Serasi Haluan (Indonesia).
- **Resource-seeking.** Investment in the agriculture and mining/petroleum sectors has been motivated by the need to exploit petroleum (Petronas) and other resources in the countries that have such natural resources, including agricultural land and workers (Sime Darby and Guthrie).
- **Efficiency-seeking.** Competition and pressures on costs from competitors play a role motivating

Box 2. Telekom Malaysia

Telekom Malaysia Bhd has been expanding overseas. Through TM International, Telekom has acquired interests in Bangladesh, Cambodia, India, Indonesia, Pakistan, Singapore, Sri Lanka and Thailand. Telekom overseas investments contributed an operational profit after tax of $110 million in 2004 compared to $105 million in 2003. Its overseas investments have boosted its total assets. Its market capitalization increased in August 2005 when Dialog Telekom Ltd. was listed on the Colombo Stock Exchange, the largest initial public offering (IPO) in Sri Lanka, which accounted for about 15 per cent of the stock exchange's total market capitalization. Dialog Telekom holds about 60 per cent of the market share. Dialog Telekom has 500 base operations serving 1.5 million subscribers and it has invested $20 million to replicate critical network elements and Third Generation (3G) commercial trials are also under way.

Source: Telekom Malaysia (www.tm.com.my).

Malaysian firms to go abroad (e.g. Royal Selangor and Press Metal). The rise of China has been instrumental in pushing Malaysian OFDI. China's huge market and ample low cost labour have attracted many Malaysian firms. Other low cost neighbouring countries such as Viet Nam have also pressured Malaysian firms to venture abroad to improve competitiveness as well as taking advantage of investment opportunities provided by these countries.

D. OFDI and implications for enterprise competitiveness

There is no systematic documentation of information on the performance of OFDI by Malaysian firms. This hampers reliable assessment on the competitiveness of Malaysian firms abroad and the extent in which investing overseas had contributed to the overall competitiveness of Malaysian firms. However, available information indicates that there have been some mixed performances. Some firms have reported that they have increased production and are expanding, implying that their overseas operations are competitive; and have increased their corporate image as international firms. Top Glove and Ingress, which were once small firms, have reached a critical size thanks to the overseas operations. Some businesses overseas have failed. The main implications on competitiveness are examined below:

- **Market expansion.** Many Malaysian firms have expanded and are making plans to expand their capacities overseas. These firms are optimistic in increasing their market shares abroad. Plantation companies such as Guthrie, Golden Hope Plantations and IOI have made significant investments overseas. Their long experience in plantation activities in Malaysia and the exploitation of these advantages contributed to developing their operations abroad. Royal Selangor - a company that has remained competitive in its specialized line of products - has diversified overseas, focusing on modernizing its products lines through new designs, raising quality and products range. Globetronics Technology and Press Metal invested in China to increase competitiveness and to gain access to the Chinese market. Given the saturated market and increased competition at home, investing abroad has helped Malaysian companies increase their market reach and in diversifying their markets. Companies involved in infrastructure and construction activities have expanded overseas such as Road Builders and YTL Power. According to a study by JP Morgan, Malaysian contractors have increased their order books thanks to overseas contracts and operations. Jobs secured overseas, mainly in India, West Asia and increasingly in Indonesia, totalled $1.86 billion compared to $1.21 billion for domestic projects.

- **Revenues and profits.** Investing abroad has been profitable for some Malaysian companies, which experience an increase in their share of overseas revenues and profits to total revenues and profits. For instance, Wah Seong Corporation earns the largest part of its revenues overseas.[56] One of the main reasons for the increase in Malaysian OFDI in 2004 was the significant rise of reinvested earnings in the non-banking sector as a result of higher profits earned by Malaysian companies abroad (Department of Statistics 2005). Companies successful in bidding for overseas projects have increased their profitability, including their market valuation. For instance, IJM Corporation took part in a Malaysian consortium comprising five member firms bidding to build a highway valued at more than RM1 billion in Islamabad,

[56] See "Wah Seong: Corporate Profile» (http://www.wahseong.com/nonflashsite/aboutWahSeong/corporateProfile.asp)

Pakistan. Its overseas projects have constituted more than 50 per cent of its projects by end-2005. It has a current order book valued at RM3 billion for projects in India and West Asia, which accounts for 40 per cent of the total value of jobs. Its success in international ventures has led IJM to emerge as a strong contender in the international arena in the construction and construction-related industries.[57] Solutions Engineering Holdings, a manufacturer of teaching equipment for engineering educations, have reported plans to increase its overseas revenues by expanding its operations to China and Pakistan, anticipating an increase of its revenue to at least 30 per cent by 2010. It plans also to expand operations into Southeast Asia and West Asia to increase efficiency and profitability. Specialized requirements for food products have provided a competitive edge to some Malaysian manufacturers. The halal-based food products for the Muslim market/clientele have provided such a competitive edge and some companies have expanded their operations overseas to tap new markets. The EuroGroup of Companies, based in London, which is Malaysian controlled set up a halal hub in Swindon.[58]

In services, some Malaysian services companies have increased their total revenues and profits as a result of OFDI. For instance, Telekom Malaysia's overseas investments have increased its total assets, expanded its markets and strengthened its position as a leading telecommunications company in the Asian region (box 2).[59] Dialog Telekom Ltd. where Telecom Malaysia International (the Telekom's investment holding arm) owns a 87.7 per cent equity interest was recently listed on the Colombo Stock Exchange. Telecom overseas investments have contributed to its overall performance – operational profit after tax of $110 million in 2004, compared with $105 million in 2003. In financial services, Public Bank has expanded to Cambodia, Lao PDR, Sri Lanka and Viet Nam. In insurance, Equator Life Science Ltd. has strengthened its presence in Europe by forging an alliance with the Netherlands-based RH Van Leeuwen Beheer BV and owned a 70 per cent equity stake in a joint venture company, Equator Europe BV. The Gadang Holdings group, an infrastructure development company, has expanded its business overseas.[60] It won a bid for a water treatment and distribution concession project in Indonesia, which is expected to contribute sales of RM3 million per year to the group. PECD Bhd., a construction and engineering group, won a contract to supply gas engine generators and auxiliary equipment in East Java, Indonesia. The company also built and installed liquefied petroleum gas (LPG) storage facilities for PT Bakti's LPG Terminal Facility, in West Java. However, some Malaysian companies have also experience losses and found it difficult to operate in different regulatory frameworks and cultural environment. The Telekom Malaysia investment in Ghana is an illustration of these constraints.

- **Corporate image.** Sithru (Malaysia) with its joint venture partners was successful in its bid for a low-cost housing project in Ghana valued at $1.5 billion.[61] Going abroad has not only helped secure contracts and markets but has also help increased the international image of some Malaysian companies. However, not all Malaysian enterprises that have invested abroad have been successful. Some had expressed difficulties operating overseas and others had ceased operations in host countries because of unsustainable losses and projects failure. As seen above, Telekom Malaysia had divested its interest in some countries in Africa – among others- because of changing corporate international strategy focusing on geographic regions closer to home (box 3).[62] The lack of detailed planning for internationalization, including appreciating the extent of the risks associated with operating in different business culture, social environment and labour practices were some common factors (see for example the case of Ramatex Textiles factory closed down in Namibia). Other reasons include unanticipated level of competition and inadequate investment feasibility assessment.

E. OFDI policy measures and support facilities

Generally, economic policies, laws and regulations in Malaysia support Malaysian enterprises investing abroad. The Government encourages Malaysian firms to venture overseas and to develop world class Malaysian owned companies (MITI 1996). The planners and policy makers have at an early stage raised the issue of growing competition for Malaysian manufacturing industries and the competitiveness threats to exports of Malaysian

[57] "IJM Corporation Berhad Core Business: International Ventures" (http://www.ijm.com/) .

[58] See "Euro Group to set halal hub in Swindon", Business Times, 8 August 2005 (http://www.halaljournal.com/artman/publish/article_331.shtml) and http://www.mida.gov.my/beta/news/view_news.php?id=2030.

[59] See http://www.tm.com.my.

[60] See http://www.gadang.com.my.

[61] See "Sithru bags RM331m Ghana deal", MIDA Industry News, 31 October, 2005 (http://www.mida.gov.my/beta/news/view_news.php?id=2260).

[62] "Telekom Malaysia quitting Africa", African Advanced Level Telecommunication Institute (http://www.afralti.org/tech2.html).

Box 3. Telekom Malaysia's investment in Ghana

Telekom Malaysia (TM) invested in Ghana Telecom (GT) in 1997 when the company launched the first privatization. TM took a 30 per cent stake in GT through G-Com Ltd., in which it had a majority interest. Under the investment scheme, TM was awarded a technical assistance and management contract. It had significant board representation and controlled the management of GT. Under the arrangement, TM was expected to improve the host country's telephone services and install some 40,000 landlines by 2002. TM invested heavily in GT after it was privatized and tripled the number of telephone lines in Ghana. After a good start, it faced operation difficulties due to deteriorated domestic economic conditions and the lack of clear sectoral regulations and delays in establishing the Telecommunications Board. The earlier technical and consultancy services agreement between GT and TM was not renewed after its expiration in February 2002. TM faced substantial losses ($100 million) as it bought expensive equipment in US dollars but earned revenues in depreciated Ghanaian cedis, because of the devaluation and the industry wide downturn. Investment dispute between TM and the Government of Ghana rose when TM lost its management control of GT. TM paid $50 million in 2000 as down payment to purchase a further 15 per cent stake of GT that did not materialize. The down payment was not returned to TM. In July 2002, the Ghana Government terminated the employment of the Malaysian managing director and appointed an Interim Management Committee to oversee and manage GT. In March 2004, the Ghanaian Government admitted that it would soon have to pay $50 million to TM as compensation. In 2004, TM filed an international arbitration proceeding against the Ghana Government in the Hague to recover the value of its share in GT, and allegation on dispossession and loss of control of its investment to an amount of $174 million. The investment dispute was settled amicably in May 2005. Telekom Malaysia announced that upon full payment of the settlement sum, it would transfer its stake of 30 per cent in GT to the Ghanaian Government.

Sources: "Telekom Malaysia wants it's $50 mil back", *GhanaHomePage Business News*, 24 May 2002 (http://www.ghanaweb.com/ghanahomepage/economy/artikel.php?id=24345); "Ghana battles with Telekom Malaysia", *BBC News (World edition)*, 6 January 2003. (http://news.bbc.co.uk/2/hi/business/2632509.stm); "Telekom Malaysia to seek international arbitration", *GhanaHomePage General News*, 1 November 2002 (http://www.ghanaweb.com/ghanahomepage/economy/artikel.php?id=28975); "Update on Telekom Malaysia's investment in Ghana: Government of Ghana admits US $50m liability to Telekom Malaysia, *TM News Release*, 31 March 2004 (http://www.tm.com.my/about_tm/newsroom/2004/040331_2.htm); "Govt wants to pay $50 million for GT, but…", *GhanaHomePage Business News*, 1 April 2004 (http://www.ghanaweb.com/ghanahomepage/economy/artikel.php?id=55064); "Telekom Malaysia, Ghana Govt Settle Dispute Over Ghana Telecom", AFX News Limited, 9 May 2005 **(**http://www.forbes.com/technology/feeds/afx/2005/05/09/afx2012175.html**);** "Ghana-Telekom Malaysia dispute settled", *GhanaHomePage Business News*, 9 May 2005 (http://www.ghanaweb.com/ghanahomepage/economy/artikel.php?id=81010); "*Asian Foreign Direct Investment in Africa: Towards a New Era of Cooperation among Developing Countries*", UNCTAD (forthcoming).

manufactured products. Therefore, the policy position on OFDI has been shaped by the manufacturing sector's need to sustain the growth of manufacturing industries. Initially, policy makers were concerned that a too liberal approach to OFDI would lead to sizable capital outflows. The increasing global competition on products and markets has influenced the Government's shift to supporting OFDI. Policy makers have in recent years been much concerned with seeking out new sources of growth for the economy and enterprise internationalization has been welcome.

Aside from a liberal OFDI policy environment, the Malaysian Government is also supporting OFDI through various institutional support facilities and fiscal incentives. To support Malaysian SMEs that invest abroad, the Government has launched a one billion RM fund.[63] Some private sector organizations such as the Malaysian South-South Association and Malaysian South-South Corporation Berhad (MASSCORP) have also played a role in facilitating and contributing to Malaysian investments overseas. The main regulations concerning FDI are reviewed below:

Prudential regulations. The Central Bank issues main regulations that have a direct bearing on Malaysian OFDI. They include: the Central Bank of Malaysia Act 1958 (Revised 1994), Banking and Financial Institutions Act 1989 (BAFIA) and

[63] "RM1 billion Fund to Assist SMEs Venture Overseas" 17 May 2006, New Straits Times.

the Exchange Control Act, 1953. The Central Bank does not restrict OFDI but investors have to comply with prudential regulations which come under the Exchange Central Act, 1953. Over the period September 1998 – July 2005, Malaysian OFDI was governed by a regime of capital controls, where the local currency was pegged to RM3.80 to a US dollar.[64] The focus of the capital controls were on short-term capital flows. Of special interest to Malaysian OFDI are the regulations that cover export proceeds and investment abroad by residents. Prior to de-pegging the currency, the Central Bank liberalized further its control on overseas investment by easing further regulations. Unit trust funds, insurance companies and individuals are now permitted to use a sizable amount of their financial resources for overseas investment. Liberal foreign exchange control has also encouraged Malaysian OFDI.

Institutional support. A number of institutions provide support and assistance to OFDI. These support measures include information provision, outward investment missions, facilitating meetings and interaction, private sector networking and financial facilities. Some of the institutions and their support programmes are summarized below.

- *Export-Import (EXIM) Bank of Malaysia* supports Malaysian companies investing overseas. It provides financial facilities, investment information and advisory services. Its overseas project financing facility supports Malaysian investors undertaking projects overseas in manufacturing, infrastructure and other developmental projects.
- *Malaysian Export Credit Insurance Berhad (MECIB)* provides export credit insurance services to Malaysian exporters of goods and services, Malaysian corporations for outbound investments as well as Malaysian companies, mainly SMEs involved in exporting. It provides various facilities and services to cater for both SMEs and large corporations that plan to internationalize. Its overseas investment insurance scheme offers insurance facilities to Malaysian companies to protect their overseas investment and profits against transfer restriction, expropriation, war and civil disturbance, and breach of contract.
- *Malaysia South-South Association through its investment arm, the Malaysian South-South Corporation Berhad (MASSCORP)* plays an important role in supporting the internationalization of Malaysian companies. It promotes bilateral trade and investment ties with South-South countries by serving as a platform and link between Malaysian businesses and South countries. MASSCORP is a consortium comprising 85 Malaysian (companies) shareholders from various industries.
- *Ministry of International Trade and Industry (MITI)* encourages Malaysian investments in both domestic and international businesses. MITI is responsible for the planning and formulation of industrial and investment policies, both promoting and safeguarding Malaysian industrial interests at home and abroad. The Ministry also monitors policies relating to enhancing the competitiveness of the manufacturing and services related sectors and creating conducive business and investment environment. MITI organizes trade and investment missions to explore business and investment opportunities in selected countries, and maintains offices overseas to assist Malaysian investors in host countries.
- *Malaysian Trade Development Corporation* provides market intelligence information, databases and organizes training programmes to improve Malaysian international marketing skills while enhancing and protecting Malaysia's international trade and investments abroad. It offers financial assistance, including grants.
- *Small and Medium Industries Development Corporation* promotes the development of small and medium industries (SMIs) in the manufacturing sector through the provision of such services as advisory, fiscal and financial assistance. It provides financial assistance and development programmes to SMIs on accessing new markets, financing, technological capabilities, information and communications technologies, and skills training.
- *Malaysian Industrial Development Authority* also extends services and facilities supporting Malaysian cross-border investment. Some of the facilities include enterprise connect, which helps Malaysian firms seek investment opportunities abroad and support business linkages between Malaysian firms and foreign investors in the country. The Malaysia-Singapore Third Country Business Development Fund[65] supports Malaysian and Singapore enterprises to cooperate and to jointly identify investment and business opportunities in "third countries".
- *Inland Revenue Board (IRB)* offers such incentives as Double Deduction for Promotion

[64] The ringgit was depegged from the US dollar on 21 July 2005.

[65] See http://www.mida.gov.my/beta/news/print_news.php?id=979

of Malaysian Brands and Incentives to Acquire a Foreign Company. One of the most important supports for OFDI is that income remitted to Malaysia by resident companies, non-resident companies and non-resident individuals (other than companies in the banking, insurance, air and sea transportation sector)is exempted from tax. IRB does not enforce any kind of outward remittance tax. This greatly simplifies the process of operating and controlling international subsidiaries, relative to countries which have some form of remittance tax system. Under the agreements for the Avoidance of Double Taxation, income such as business profits, dividends, interest and royalties that are derived in one country and remitted to another country is taxed in one country only. Malaysia has double taxation agreements with 55 countries.

F. Conclusion

Malaysia is a growing source of FDI to many developing countries, particularly in Asia and Africa. The prospects for further increase in OFDI is promising in light of industrial development and structural changes in Malaysia's economy, including growing competition from inside and outside the country that will push more Malaysian firms to invest abroad. As Malaysian firms in the manufacturing industries move up the value chain and become more skill and technology-intensive, firms in the labour intensive and lower end of the production value chain will increasingly find the need to establish productive capacities in low cost location to improve or maintain competitiveness. For these firms, investing abroad is crucial for their survival. The support of the Government and the institutional facilities provided by the various specialized agencies will give the added impetus for enterprise internationalization. Greater economic integration within ASEAN will encourage Malaysian enterprise to regionalize as will the establishments of the various free-trade area arrangements with partner countries. The improved policy environment and the increase capacity and capability of Malaysian firms to internationalize will play a significant role in this regard.

Relatively few Malaysian SMEs invest overseas because of constraints including the lack of managerial capacity, higher risks and access to finance. In particular, they often lack the knowledge on overseas markets, legislations and policies on FDI in the host countries. They also lack capacity and understanding on international business activities and risks associated with FDI. Their limited financial resources also restrict their ability to venture abroad. Most SMEs need fiscal incentives and other assistances to venture abroad, including advice and coaching. Larger firms on the other hand are relatively less constrained by finance. They have the advantage of the backing and support of the Government in their overseas ventures, particularly the GLCs.

While there are success stories of Malaysian enterprise internationalization through OFDI there are also stories of failures. The success stories of Malaysian SMEs such as Top Glove, Ingress and Munchy Food Industries that grew from small entities to large enterprises has shown that OFDI can increase competitiveness.

The lack of capacity, information and appropriate approaches in managing risks of internationalization, including "impulse drive" to go abroad had contributed to internationalization failures by Malaysian enterprises. It is important that these limitations be addressed to facilitate and ensure more successes of Malaysian enterprise internationalization. The Government could consider adopting measures to increase the pool of efficient and competitive SMEs capable of producing goods and services demanded internationally and in supporting business linkages at home. Through institutional support and capacity building, these homegrown competitive Malaysian SMEs should then be encouraged to internationalize through OFDI.

While policies can influence the nature and scope of Malaysian OFDI, a clear distinction should be made between State-owned and private firms. A number of distinct policy issues need to be considered and assessed. For private firms, the attractiveness of different policies can differ. Interviews conducted by the author suggest that for some private firms, fiscal/tax incentives for OFDI are not important and the benefits are often applicable only in the short-term. Some companies are of the view that grants and soft loans are move attractive than other incentives to facilitate investing overseas. Apparel manufacturers and enterprises in the wood products industry expressed the view that both soft loans and incentives can assist their internationalization. A few consumer electronics companies with trading offices in China, Hong Kong (China) and Thailand, indicated that grants would be very important to assist them set up overseas operations, especially for building brands.

Government assistance in the form of fostering government-to-government relationship was considered important for investors in the automotive components and parts industry. Companies in the rubber products and packaging industries consider that government-to-government negotiations for favourable investment policies and trade agreements

would be beneficial to OFDI. Companies in the palm oil products industry were of the view that policies on relaxing capital and exchange controls are relevant for their operations.

As for the State-owned firms, they are undergoing structural re-organization to strengthen corporate governance, and to improve the evaluation of corporate performance. This is a necessary undertaking to increase their competitiveness both at home and abroad. In the short to medium-term, OFDI by GLCs in infrastructure and construction activities will grow. As the Government continues with its downsizing in the economy, it will reduce its investment in domestic infrastructure. GLCs that have been dependent on the infrastructure projects at home will have to find overseas markets to use their excess capacity. In this regard, support programmes, including training and other capacity building to facilitate the GLCs participation to international bidding would be useful.

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Annex Table 1. Selected Malaysian Companies with Investments Abroad

Company	*Industries*	*Selected destination*	*Website*
Aman Resorts	Hotel and Leisure	Cambodia	
Bernas	Paddy	Guinea	
CIMB	Banking and Finance	Singapore, Indonesia	(http://www.cimb.com.my)
Cosmpoint	Education	Indonesia	
Delcom Bhd	Mining	Cambodia	
Genting	Hotel, leisure, casino, plantation, property, power generation, manufacturing	Isle of Man, Hong Kong (China), Luxembourg, Singapore, Australia, Philippines, United Kingdom, Indonesia, South Africa	(www.genting.com.my)
Globetronics Technology	Consumer Electronics	China	(http://www.globetronics.com my/)
Golden Hope Plantations	Plantations	Viet Nam, Germany, China, Netherlands	
Holiday Villa	Hotel	China	
Hong Leong Malaysia	Conglomerate (significant interest in finance, property and manufacturing). Its subsidiaries such as Hume Industries and OYL have interests overseas.	Philippines, Indonesia, ASEAN, China	
Hume Industries	Concrete products, furniture, board and panels	Philippines, Indonesia	
IJM	Construction	India	
Industrial Concrete Products	Concrete Piles	China	(www.icpb.com)
Kumpulan Guthrie	Plantation	Indonesia	(http://www.guthrie.com.my/)
Lion Group	Conglomerate. Has interest in such industries as steel, tyre, computer, property, services, retailing. Amsteel is one of its subsidiaries.	Indonesia, Singapore, United States, China, Mexico	
Malaya Glass Bhd	Manufacturing	Viet Nam	
Malaysian International Shipping Corporation	Transportation and warehousing. A subsidiary of Petronas	Australia, Bermuda, United Kingdom, Japan, Netherlands, Singapore, Thailand	(www.misc.com.my)
MRCB	Broadcasting (TV3)	Ghana	
MRCB	Financial services	Croatia	
Opus International	Asset Development and Asset Management	New Zealand, United Kingdom, South Africa	(http://www.opusplc.com/)
OYL	Manufacturing	China, Indonesia, Philippines	
Petronas	Petroleum Exploration and Distribution	Pakistan, Sudan, South Africa, Australia, Argentina, United Kingdom, China, Philippines, Iran, Somalia, India, Cambodia, Myanmar, Thailand, Viet Nam and Turkmenistan	(http://www.petronas.com.my/)

Company	*Industries*	*Selected destination*	*Website*
Press Metal	Aluminium angles, ceiling tees	China	(http://www.pressmetal.com)
Putera Capital Berhad/ International Commercial Bank SA	Financial services	Czech Republic, Hungary, Bosnia and Herzegovina, Albania, Ghana, United Republic of Tanzania and Mozambique	
Renong	Hotel, Leisure	Viet Nam	
Renong	Cement	India	
Renong	Financial and educational services; oil and gas exploration	Uzbekistan	
Royal Selangor	Pewter	Australia, United Kingdom, Canada, United States	(http://www.royalselangor.com)
Sapura	Telecommunication	Viet Nam	
Samling Group	Logging	Cambodia	
Sime-Darby	Plantation	Indonesia, Viet Nam	(http://www.simenet.com/)
Sime-Darby	Palm oil refinery	Egypt, United Republic of Tanzania, China and Tunisia	(http://www.simenet.com/) (http://www.simenet.com.hk/)
Technology Resources Industries Bhd (TRI)/ Malaysian Helicopter Services	Transportation	Cambodia	
Telekom Malaysia	Telecommunication	Guinea	(http://www.tm.com.my)
TRI-Cellular	Telecommunication	Cambodia	
Wah Seong Corp.	Oil and Gas	Australia	(http://www.wahseong.com/)
YTL Corp. Bhd.	Power	Indonesia	(www.ytl.com.my)
YTL Corp. Bhd	Tourism development zone	Cambodia	(www.ytl.com.my)
YTL e-Solutions	Narrowcast advertising	United Kingdom	

Sources: Company's websites and various Malaysian newspapers.

CHAPTER VIII

OUTWARD FOREIGN DIRECT INVESTMENT BY ENTERPRISES FROM THE REPUBLIC OF KOREA*

A. Introduction

Export has been the growth engine for the Korean economy. It has contributed to the country's economic success. However, export was a development strategy appropriate at the initial stage of the country's economic development. As the economy enters into a more developed stage, while continue exporting, it has to actively promote OFDI to maintain and enhance the competitiveness of its indigenous firms. Korean firms have to go abroad to compensate for labour cost disadvantage, to support trade channels, to access to natural resources and to acquire strategic assets such as technology.

This paper explains the key drivers and motivations of Korean OFDI and their impact on firms' competitiveness. It highlights the government policies relating to OFDI as they evolved over time and it proposes policy options for strengthening the internationalization of Korean enterprises through outward investment.

B. OFDI from the Republic of Korea: Trends and development

The Republic of Korea is an established outward investor among the Asian Newly Industrialized Economies. Its first OFDI took place as early as 1959 when a Korean company acquired real estate in New York, United States.[66] Up until the mid-1980s, Korean OFDI has been negligible and limited to mining, forestry and trading businesses primarily in natural resources. Strict foreign exchange controls that existed at that time were a key deterrent. Since the mid-1980s, the Government liberalized regulations relating to OFDI, pushed by high domestic wages and land prices. The appreciation of the Korean currency, following the 1985 Plaza Accord, encouraged Korean companies to invest abroad to regain competitiveness. Most Korean OFDI during this period went to Southeast Asia, which offered market expansion opportunities and lower labour costs. Korean OFDI in the region since then has continuously increased except during the 1997-1998 Asian financial crisis.

The Republic of Korea is among the top 10 emerging market investors. Its OFDI stock rose from $2.3 billion in 1990 to $34.5 billion in 2003 (figure 1). Korean OFDI, in terms of number of projects, increased dramatically from 614 in 1998 to 3,772 in 2004.[67] OFDI flows increased from $3,634 million in 2002 to $5,884 million in 2004, contributing to an increased total OFDI stock.

Geographical distribution. The geographical distribution of Korean OFDI has changed over time. The North America region was the most preferred destination in the early 1990s. The attention was later refocused on Asia (figure 2). Investment in Asia, particularly to China, peaked to $3,324 million in 2004. Most of the labour intensive OFDI were in textile, clothing, shoes and toys. These industries relocated to China and the Southeast Asian countries because of the availability of low cost labour - the key pull factor. Most of the capital intensive OFDI such as in steel, automobile and electronics industries concentrated in Europe and North America.

Sectoral distribution. Korean OFDI concentrated in manufacturing activities, which accounted for 56 per cent of total flows in 2004. About 64 per

* This paper was prepared by Hwy-Chang Moon, Professor of International Business, Graduate School of International Studies, Seoul National University, Republic of Korea.

[66] Korean OFDI in non-real estate activities began in 1968 when the Korea Southern Area Development Company invested in a project on development of Indonesia's forestry.

[67] See Korean Overseas Information Service (www.korea.net) .

Figure 1. Korean OFDI: flows and stocks

(Number and millions of dollars)

Figure 1-1. OFDI projects, 1981-2004

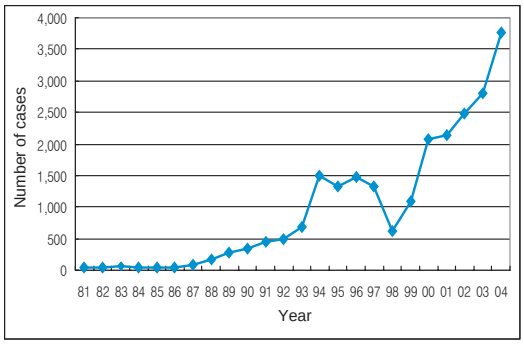


Figure 1-2. OFDI flows, 1981-2004

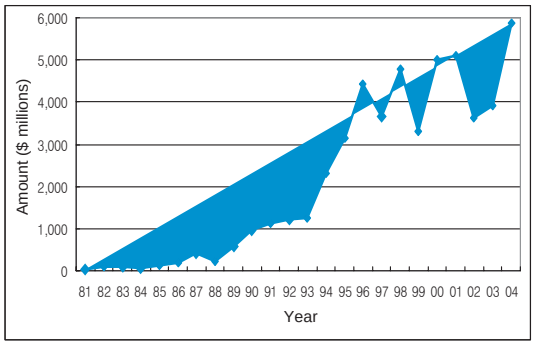


Figure 1-3. Average value of OFDI per project, 1981-2004

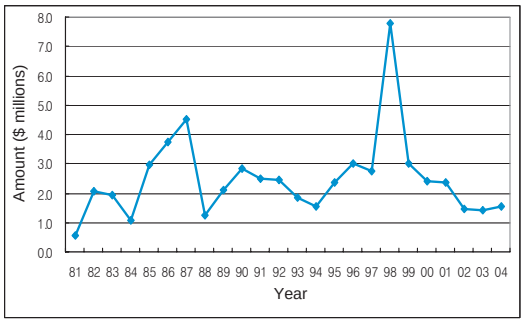
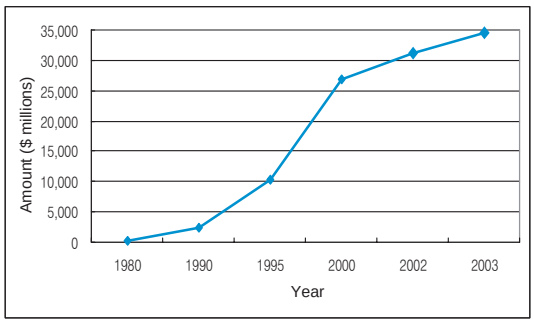


Figure 1-4. OFDI stock, 1980-2003



Sources: Figure 1-1, 1-2, and 1-3 complied from the Export-Import Bank of Korea (www.koreaexim.go.kr) and Figure 1-4 from UNCTAD (2004).

cent of 21,911 Korean overseas subsidiaries were in manufacturing activities (2004a).[68] Until the early 1990s, labour intensive industries such as textile and clothing accounted for the largest share of the Korean manufacturing OFDI. More recently, however, Korean OFDI covers a wider range of manufacturing industries including high-tech electronics. While OFDI to the service and wholesale/retail industries have been increasing, they remained at low level.

Size of enterprises. About 80 per cent of Korean OFDI value in the mid-1990s came from large transnational corporations (TNCs). These Korean TNCs that have actively invested abroad include Daewoo Corporation, Hyundai Engineering & Construction, SK Corporation, POSCO, LG Electronics, Samsung Electronics, Samsung Corporation and Hyundai Motor.

The recent years have, however, witnessed a gradual increase in OFDI by Korean small- and medium-sized enterprises (SMEs).[69] OFDI by SMEs started as early as in the 1980s, with investment in labour intensive manufacturing activities (e.g. sewing, wigs, bags, and toys) in Indonesia and the Philippines. Since the formalization of diplomatic ties with China in 1992, manufacturing OFDI by Korean SMEs to China, has been increasing. There are more than 2,500 Korean SMEs in Quingdao and Tianjin area and more than 1,000 Korean SMEs are in Darian, China.[70] Korean SMEs accounted for 37 per cent of the OFDI in 2004, while the large firms accounted for 54 per cent and the remaining 9 per cent by individual investors. Investment abroad by individuals increased rapidly and focused on real estate (KCCI 2005).[71] OFDI by SMEs had increased at a faster pace than by large firms. OFDI by SMEs accounted for the largest share of manufacturing activities, while large Korean

[68] Newly established Korean overseas subsidiaries in manufacturing activities grew annually by 19.2 per cent, while those in all industries grew by 7.8 per cent.

[69] The firm is classified as SME if it has employment of less than 300 or asset of less than $8 million in the manufacturing industry. The criteria for classification vary slightly across industries (Korea Federation of Small and Medium Business).

[70] According to a report by KOTRA Shanghai Branch Office (Donga Newspaper, 15 September 2003).

[71] The rise was due to the increase of the investment ceiling for individual investors (www.mofe.go.kr) .

Figure 2. Korean OFDI flows, by region, industry and firm size, 1981-2004

Figure 2-1. Amount by region ($ millions)

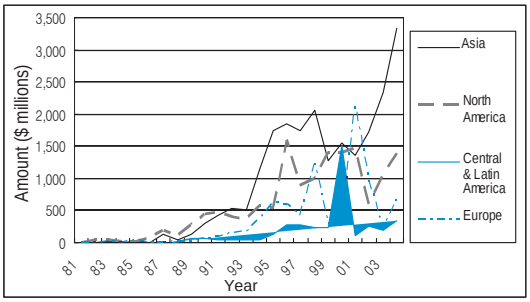


Figure 2-2. Amount by Industry ($ million)

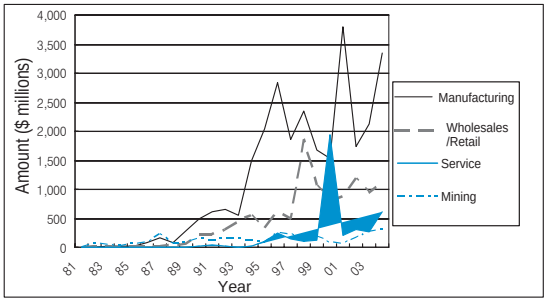


Figure 2-3. Amount by firm size ($million)

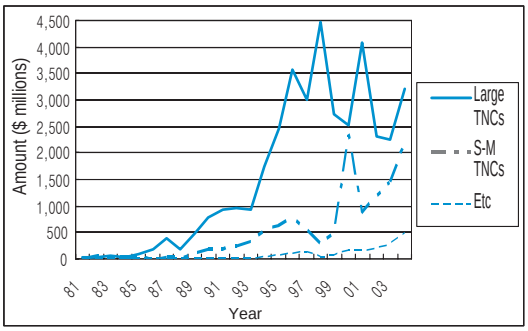
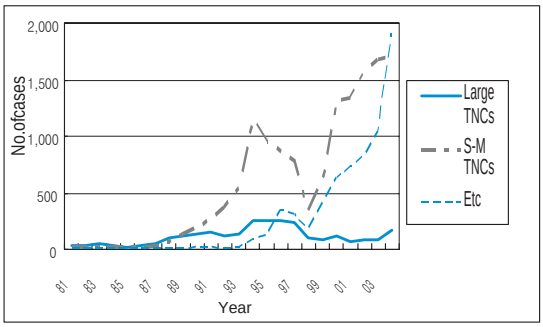


Figure 2-4. No. of projects by firm size



Sources: Figure 1-1, 1-2, and 1-3 complied from the Export-Import Bank of Korea (www.koreaexim.go.kr) and Figure 1-4 from UNCTAD (2004).

firms invested more in services, wholesale/retail and mining activities (figure 3). About 40 per cent of the Korean SMEs have specific plans for OFDI in the near future as compared with only 15 per cent for large Korean firms (table 1).

Cross-border merger and acquisition (M&A) is not a major market entry mode in the internationalization activities of Korean firms. There are, however, some prominent cases of M&A purchases made by Korean firms and most relate to access to natural resources and technology. For instance, Korea's leading Internet company, Daum Communication Corp., bought Lycos Inc. (United States) for $100 million in 2004 to access its technology.[72]

C. Drivers and motivations

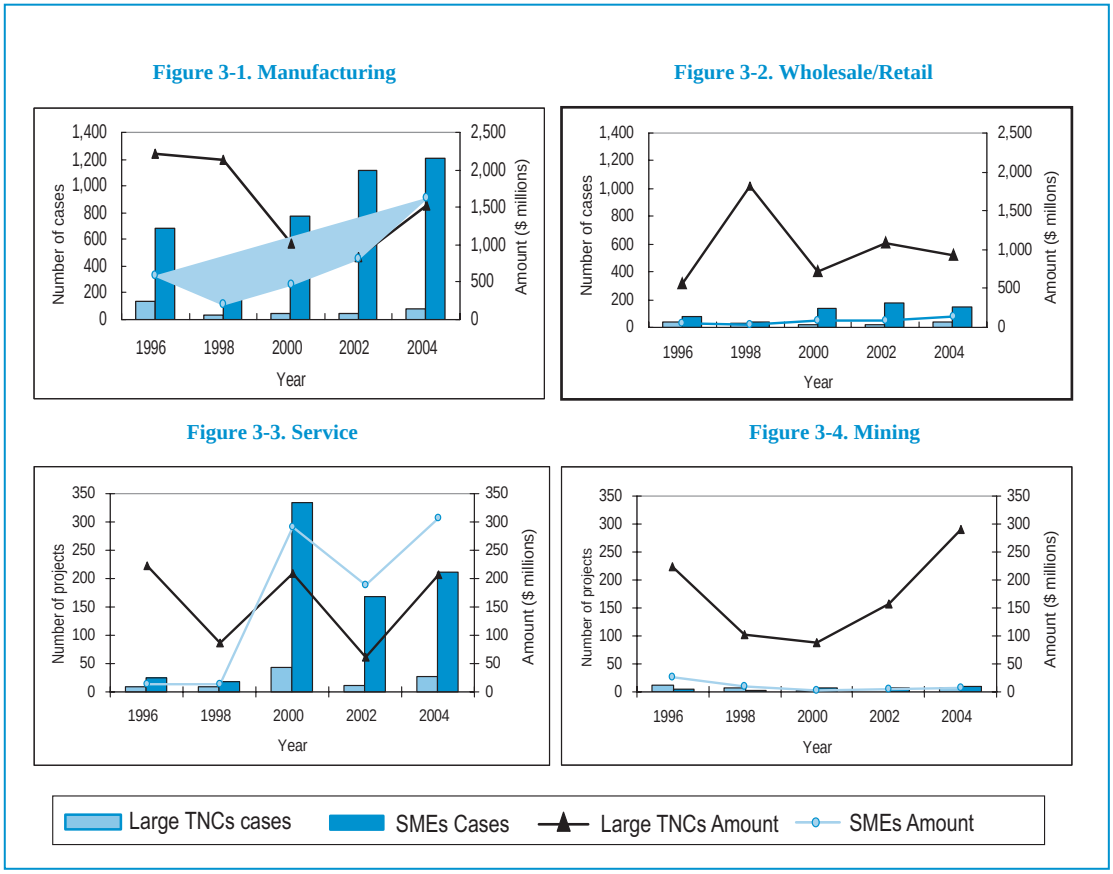
General Trend. Export promotion and cheap labour factors were major motivations for Korean OFDI (figure 4). Saturated market at home, cost disadvantage and competition were among the key drivers. Korean firms also invested abroad to access to natural resources (POSCO, Samsung Corporation), markets (Woori Bank) and strategic assets through M&As (LG Electronics, Hyundai Electronics, Samsung Electronics).[73] OFDI motivations in terms of region and firm size vary (figure 5). Korean firms that invest in Asia tend to seek low cost labour to reduce production cost (MOCIE 2002). Korean OFDI to North America and Europe were generally either market-seeking, which includes supporting trade channels, overcoming trade barriers and strategic assets-seeking, such as technology and R&D. There are interesting differences in investment behaviour and motivations between large firms and SMEs. The latter are more concerned with reducing production costs to maintain competitiveness while the former are more market-seeking (figure 5-2). This difference can be explained by the fact that most of the large firms have already invested abroad to reduce production costs and the recent trend is to seek new markets to sell their products.

[72] Hankyoreh Newspaper, 30 August 2004.

[73] Samsung Electronics Co. (http://www.sec.co.kr); LG Electronics (http://www.lge.com); POSCO (http://www.posco.com); Samsung Corporation (http://www.sams.com).

Figure 3. Korean OFDI: four major industries and firm size, 1996-2004

(Number and millions of dollars)



Source: Export-Import Bank of Korea (www.koreaexim.go.kr).

Table 1. Korean OFDI activities: current status and plan

(Percentage)

Overseas operation	*Firm size*	
	Large TNCs	*Small TNCs*
Already owns	68.1	37.3
Plans to transfer	14.9	39.2
No plan	17.0	23.5
Total	100.0	100.0

Source: KCCI (2002).

A framework for analysis. The motivations of OFDI by Korean firms can be illustrated based on the extended diamond model (figure 6).[74] This extension incorporates the TNCs activities (Moon, Rugman and Verbeke 1998) and unconventional OFDI explanation (Moon and Roehl 2001). It includes factor conditions, demand conditions and strategy, structure and rivalry, and related and support sectors.

[74] Porter (1990) introduced the diamond model, which consists of four attributes of analysis: (1) factor conditions, (2) demand conditions, (3) related and supporting sectors and (4) strategy, structure and rivalry. However, Porter's original model dealt mainly with domestic contexts and so was extended by Moon, Rugman, and Verbeke (1998) to incorporate international dimensions.

Figure 4. Motivations of Korean OFDI, 1998-2004

Figure 4-1. Number of cases

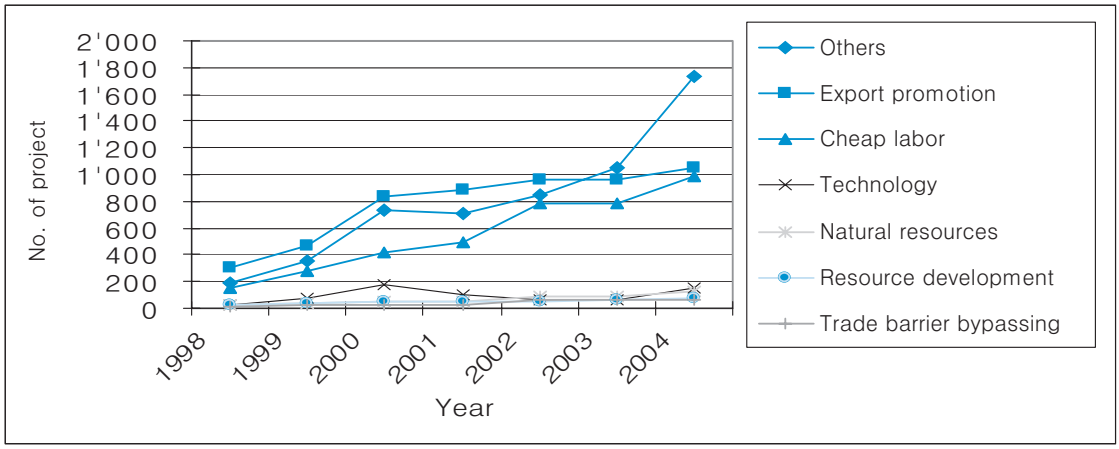
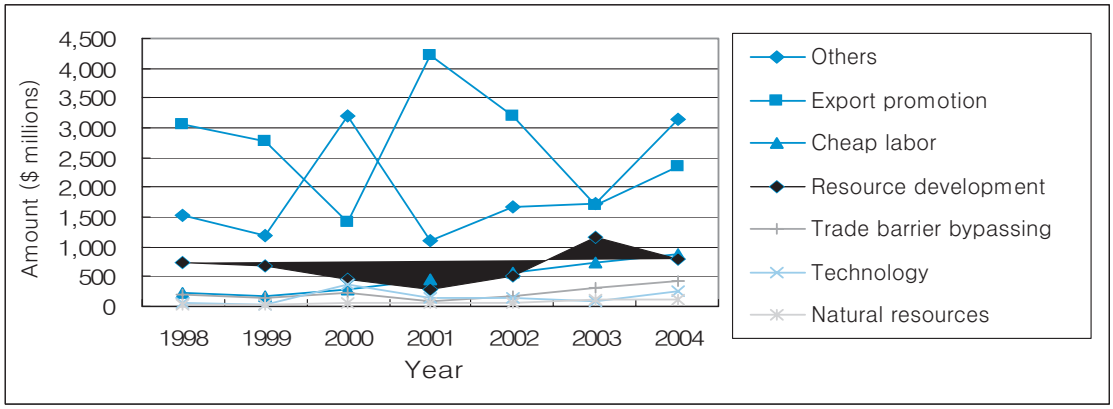


Figure 4-2. Amount ($ millions)



Source: Export-Import Bank of Korea (2001 and 2004).

1. Factor conditions

1-1 Cost reduction

China is the primary location for Korean OFDI because of its low labour cost, which is about one-tenth that in the Republic of Korea. Examples of firms investing abroad for cost reasons include:

- LG Electronics established more than ten production sites in China since mid-1990s and has significantly reduced its production costs. About 98 per cent of the company's employees in China are local workers and more than 80 per cent of resources and components are sourced locally. Given the company's success in China, it has further expanded its production in China into high-value products.
- Shinwon, a medium-sized clothing manufacturing company, has factories in Viet Nam, Indonesia, Guatemala and China since the 1990s. It invested in these countries to reduce cost.
- Korea Toptone, a medium-sized company that manufactures speakers and related parts, invested in China to access low cost labour.

1-2. Natural resources

Volatile commodity market and price fluctuation encouraged Korean companies to go overseas to secure natural resources. Resource-seeking OFDI includes oil, gas and mining of natural resources. Examples of firms motivated by resource-seeking reasons include:

- POSCO, a leading Korean TNC and the fifth largest steel producer in the world, established a joint venture Poschrome with Samancor in South Africa to secure a stable supply of ferrochromium, which is a major resource

Figure 5. Korean OFDI motivations, by region and firm size, 2002

Figure 5-1. Motivation by region (percentage)

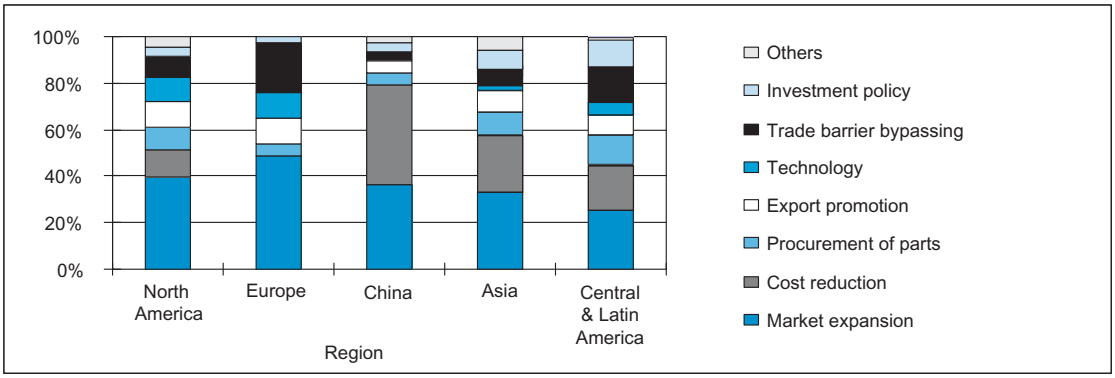
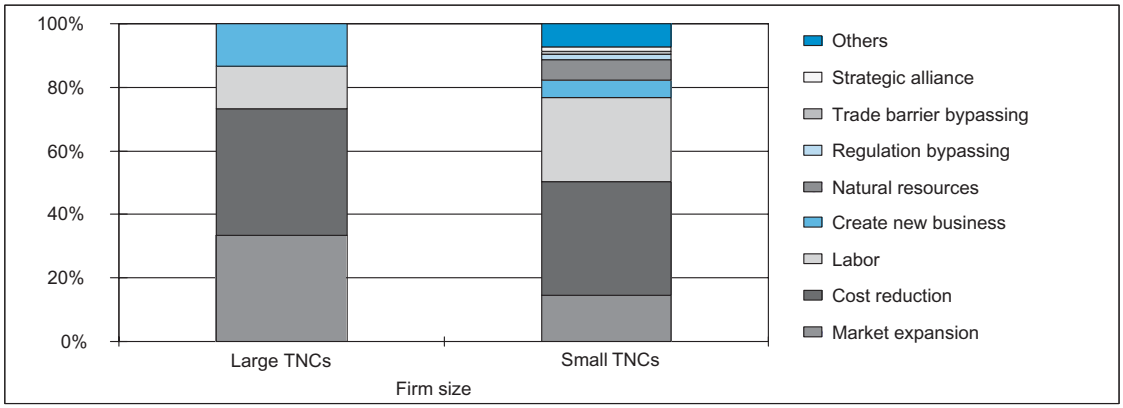


Figure 5-2. Motivation by firm size (percentage)



Sources: Figure 5-1 from MOCIE (2002) and Figure 5-2 from KCCI (2002).

for production of stainless steel. It has been importing this raw material from South Africa, India, Finland and other countries. It also acquired a 14.9 per cent stake in CAML Resources Group (Australia) for $13.3 million.[75] POSCO has also signed a $12 billion investment deal in June 2005 for mining activities and to establish steel plants and mills in India.

- Samsung Corporation acquisition of Otel Inox (Romania) in 1997 for $37 million to assure long-term resource supplies of iron and steel.[76]

- Korea National Oil Corporation (KNOC) and SK invested $62 million and $51 million respectively in Peru for crude oil and natural gas development.[77]

1-3. Technology learning

A number of Korean firms had invested abroad to learn or access foreign technologies. Even though some of these investments did not yield satisfactory profits abroad, the main goal was to gain access to more advanced technologies and to establish a global brand name. They include:

- LG Electronics purchased a 5 per cent share of Zenith (United States) in 1991. The main purpose of the investment was to learn the flat screen TV technology and to acquire brand name. LG Electronics subsequently increased its stake in the company to 57.7 per cent in 1995 and eventually took over the company in 1999.

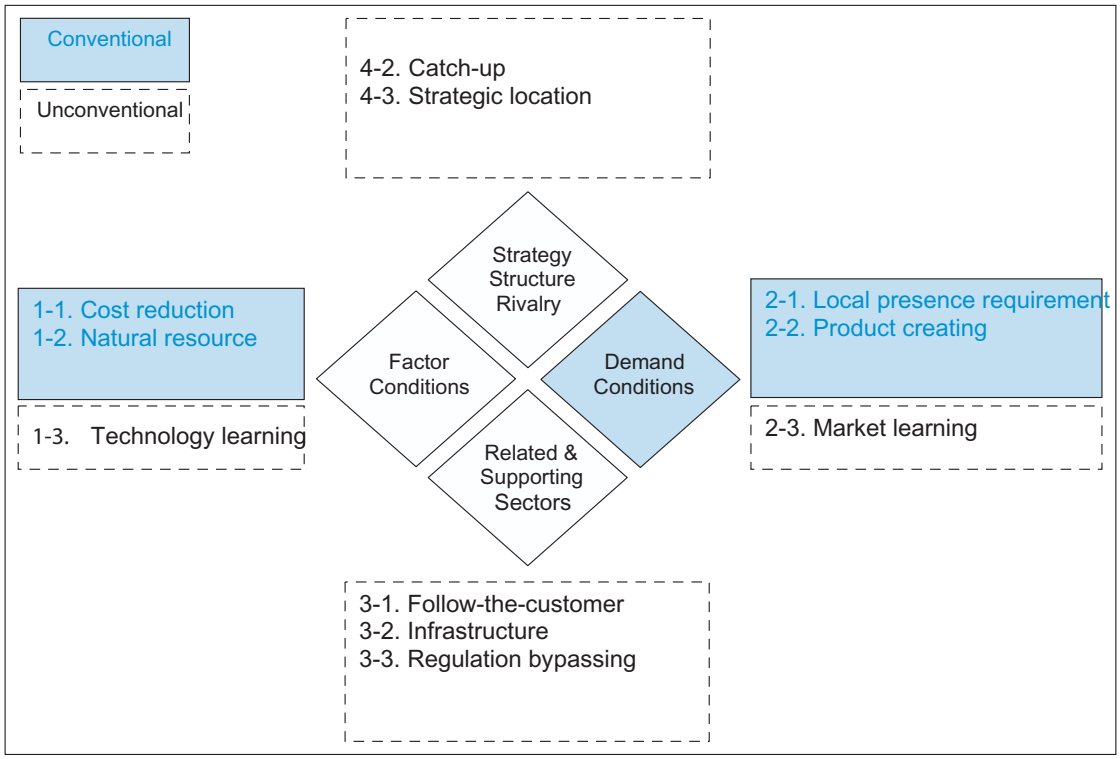
- Hyundai Electronics acquired a 37 per cent interest of Maxtor (United States) in 1993 to access to Maxtor's technology of hard disc drive production for computers.

[75] Korea Metal Journal, 15 September 2004.

[76] Samsung Corporation acquired 51 per cent of the equity in 1997 and 75 per cent at present.

[77] SK Corporation (www.skcorp.com).

Figure 6. Typology of OFDI motivations



Source: Adapted from Moon, Rugman and Verbeke (1998) and Moon and Roehl (2001).

- Samsung Electronics in 1995 bought a 40 per cent interest in AST Research Inc. (United States).

2. Demand conditions

2-1. Local presence requirement

FDI may be preferred to exporting when transaction costs are high in the external market. This includes requirements set by the host Government for foreign firms to access to the domestic market. An example of this is:

- Samsung Electronics invested in Viet Nam to produce television sets, monitors and other home appliances to service the local market because Viet Nam requires foreign companies to establish production facilities in Viet Nam in order to sell their products to the Vietnamese market (KITA 2003).

2-2. Product creation

Firms may need to modify their products or improve qualities to access new markets. Examples include:

- LG Electronics introduced new products such as three-directional air-conditioners and stainless-steel refrigerators in Taiwan Province of China.
- Hyundai Motor introduced a new car, Santro, to the Indian market. It is a compact car (999cc) but equipped with high-tech and differentiated features. Hyundai Motor understood the unique characteristics of the Indian consumers and met their needs.

2-3. Market learning

Operating near to overseas customers can be important to respond quickly to consumer tastes and to access to design facilities. Such examples include:

- Samsung Electronics established a design centre in Italy to learn the advanced Italian design mechanism. Samsung has already built design centres in Los Angeles, San Francisco, Tokyo, London and Shanghai.
- Amorepacific, the largest Korean cosmetics company, expanded its operations into France to sell its products and more importantly, to learn the sophisticated French cosmetics market.

3. Related and supporting sectors

3-1. Follow-the-customer

Firms may follow their customers abroad to keep customs. Examples include:

- 49 part suppliers to Hyundai Motor followed the latter in investing abroad.[78] These overseas Korean suppliers account for about 10 per cent of the total supplies to Hyundai Motor operations outside of the Republic of Korea. About two-thirds of these supplies are imported from Korea and the remaining one-third is produced in host countries. This type of follow-the-customer FDI strategy can also be found in other manufacturing industries such as electronics, textiles and machinery, and in services.
- In finance, Woori Bank acquired Panasia Bank (United States) for $35 million in 2003 to better serve Korean customers in the United States.[79]

3-2. Infrastructure

Host country location advantages such as provision of conducive business environment and excellent infrastructure can play a role in encouraging OFDI. A number of examples in this area include:

- Samsung chose Malaysia for its Samsung Electronics Complex because of the quality of labour, stable political environment and more advanced business infrastructure of the host country as compared to other countries in the region.
- Hyundai Motor plans to set up sales and marketing centre in Offenbach, Germany by 2006 to boost its European sales. The centre will operate as the headquarters for sales and marketing of Hyundai and Kia automobiles in Europe. Offenbach offered high quality workers, network of automobile part supply and other favourable infrastructures related to automobile industry. For similar reasons, Hyundai Motor established a research and design centre in Russelsheim in 2003.
- Choong Ang Plastic Engineering, an SME that manufactures polyester tarpaulin bag for cement products, established manufacturing facilities in Guangdong Province of China because of the province's transportation and financial infrastructure and as a trading hub.

3-3. Regulation bypassing

Some Korean firms go abroad to avoid existing restrictions such as foreign exchange controls, while others invested abroad to take advantage of trade quota privileges of the host countries. Examples include:

- Pulmu One, a Korean food-processing company, built its business in the United States to avoid various regulations enforced by the Korean Government on food-processing industry (Moon 2002).[80]
- Nam Yang International has a factory in Guatemala and Saipan, and SeA International also has a factory in Guatemala motivated by the need to overcome quota restrictions.[81]

4. Strategy, structure and rivalry

4-1. Labour management relations

Concern over labour issues at home has led many Korean firms to invest abroad. The tension between labour and management in the Republic of Korea, particularly in labour-intensive industries such as textiles is an example.

- Korea High Pressure Gas Container Ltd. moved its manufacturing facilities to China in the mid-1980s when the labour problem was at its peak in the Republic of Korea. Labour disputes in this company delayed the production schedule and weakened its competitiveness. By moving its production to China, the company regained its international competitiveness.
- Taekwang Corp of Korea, a supplier to Nike, established production facilities in Viet Nam and hired more than 10,000 Vietnamese workers where labour issues are easier to manage.

4-2. Catch-up

Korean firms invest abroad to imitate or offset the advantage of its competitors in going abroad. An example of this includes:

- Samsung Electronics and LG Electronics are two major competitors in the Korean electronics industry, but Samsung has more advanced technology in some areas such as in semi-conductors than LG. According to the traditional OFDI theories, Samsung should be more active because it has more advanced technology or ownership advantage than LG.

[78] Korea International Trade Association (www.kita.net).

[79] Money Today Newspaper, 7 April 2005.

[80] Korea Ministry of Legislation (www.klaw.go.kr).

[81] Chosun Newspaper, 6 January 2004.

Table 2. Cost reduction effects of OFDI

(Percentage)

		Large TNCs	Small TNCs
Cost reduction	Below 20%	25.0	24.2
	20~40%	37.5	42.0
	40~60%	34.4	30.6
	60~80%	3.1	3.2
Total		100.0	100.0

Source: KCCI (2002).

However, LG invested more than Samsung in recent years. A reason for LG OFDI behaviour can be explained by LG's attempt to catch up with Samsung.

4-3. Strategic location

Korean firms may invest in a strategic location because of the need to be well positioned in key markets, especially in the automotive industry. For example:

- Hyundai Motor invested in key locations in North America, Europe and Asia. The company invested abroad to bypass trade barriers and aspires to become a top five global automakers by 2010.[82] To do so, the company has to survive and grow in the most competitive markets in the America, Europe and Asia regions, and operate close to local customers. The company has established R&D centres and production facilities in major strategic foreign locations.
- Samsung Electronics established its first overseas semiconductor plant in Austin, Texas in 1998. In the following year, it generated $700 million in sales and $160 million in income which was acknowledged as a very successful OFDI case.

D. OFDI and implications for enterprise competitiveness

Despite the lack of information, impact on competitiveness can be seen in a number of areas.

- ***Exploiting ownership advantage.*** OFDI has provided Korean construction firms the opportunities to exploit their ownership advantages, expand their scope of business, thereby increase their overall competitiveness. With their advanced technology and skilled labour, Korean construction firms were very successful in the Middle East market in the 1970s. In 1976, Hyundai Engineering and Construction Company constructed a harbour in Al Jubayl (Saudi Arabia).[83]
- ***Employment effect.*** While OFDI can have negative impacts on domestic production and employment, there are evidences supporting that OFDI could also lead to an increase in domestic production and employment through interactions between foreign and domestic operations. A study by the Ministry of Commerce, Industry and Energy in 2003 indicated that OFDI and intra-firm trade generated $6.8 billion of trade surplus. Such intra-firm trade promoted export and production by domestic firms which led to a chain effect in increasing employment and production in related industries (MOCIE 2004b). According to the study, production increased by $19 billion and generated 88,000 additional employments. Among these new jobs created, 71,000 were in manufacturing industries.
- ***Cost competitiveness.*** In a study by KCCI, it was revealed that of the 166 Korean TNCs surveyed, 75 per cent of them managed to reduce their production costs by more than 20 per cent through OFDI (table 2). In a survey of 2,026 Korean manufacturing companies with more than 50 employees and overseas activities, 85.5 per cent of the companies indicated that they continued their domestic operations and only 12.3 per cent had closed down their factories at home (MOCIE 2003). Another study indicated that OFDI promotes export and improves the balance of trade

[82] Hyundai Motor Company (www.hyundai-motor.com).

[83] Hyundai Engineering & Construction Company (www.hdec.co.kr).

Box 1. Korean OFDI policy development

Korean OFDI policies in general can be classified into 4 specific stages:

Stage 1: Introduction (1968 – 1974)

In 1968, the Republic of Korea's Government introduced four articles on foreign investment law under the foreign exchange regulation (Rhim 1975). Article 131 refers to the approval of foreign investment. It states the establishment of overseas subsidiary as an exception. To acquire foreign stock, real estate or bond, approval of the Minister of Ministry of Finance is required. The investor must submit required documents, including contract paper, permission by the host Government, business plan, acknowledgement, and other required documents.

Stage 2: Growth (1975 – 1979)

Due to an increase in OFDI activities, the Republic of Korea's Government revised the laws on OFDI in 1975 and 1978. In 1975, the Ministry of Finance enacted foreign investment approval and post management guide and in 1978 the Bank of Korea established the by-laws on foreign investment approval operations. The approval requirement was needed. Investing companies had to get prior approval of their business plans by the president of the Bank of Korea before concluding a joint contract or acquiring the warrant by the host Government. The attempt of the Government to control capital flight from the country pushed the introduction of controls.

Stage 3: Encouragement (1980 – 1985)

During this period, the Government liberalized the law relating to OFDI. Revisions were made in 1981, 1982 and 1983. Many restrictive conditions for OFDI were relaxed. In July 1981, the requirement of three years business experience, host country condition were relaxed and streamlined, and pre-approval process on OFDI plan was abolished. In July 1982, the rate of investment was relaxed and in December 1983, restriction on the credit limit of profit reservation was also relaxed.

Stage 4: Openness (1986 – 2004)

Since 1986, the Korean economy has recorded trade surpluses and thus OFDI was more actively encouraged. Increasing wage costs and deterioration of labour-management relations also drove firms to go abroad. The Korean Government has relaxed most of the OFDI-related regulations including the investment ceiling for venture capitalists. In 2003, a new enforcement ordinance in foreign trade law was established, which included support for OFDI by Korean firms by solving obstacles faced by Korean firms operating abroad. Some important changes in laws and policies are illustrated in Box 2.

Source: Author.

through intra-firm trade (Ha 2003). These studies supported that OFDI created a positive impact on enterprise competitiveness through lower production cost, increase export and access to new markets. In addition, the case of LG Electronics India Ltd (LGEIL) revealed that its annual sales increased by 36 per cent in 2003, compared to 2002 due to gains in India[84] where the firm exploited business opportunities in the host country growing IT industries.[85]

E. OFDI policies

The OFDI policy of the Republic of Korea has evolved over the years (box 1). The Government has also recently introduced new measures supporting Korean firms to invest abroad (box 2). There are four

[84] The net profit came to $45 million, with the annual sales of $1 billion.

[85] E-week Newspaper, 24 May 2004.

Box 2. Republic of Korea: Recent OFDI policies and promotion measures

The Ministry of Finance and Economy has recently released an OFDI promotion plan which consists of six main parts. These are:

Amelioration of foreign direct investment regulation

- Before 2005, a Korean businessman could invest within $1 million or equivalent to 30 per cent of its total sales. That limit has been extended to $10 million and shall be completely lifted soon to bolster business operations overseas by individual investors.

Reinforcement of support through co-financing with Multilateral Development Banks

- The Government plans to construct an integrated system that will provide information on projects participated by Multilateral Development Banks for domestic companies. The World Bank plans to open an information network channel, Private Sector Liaison Office (PSLO), which will act as a bridge between the Korean private enterprise and the host country.

Expansion of financial support through EXIM Bank

- In case of investment for technology transfer, EXIM Bank will increase the limit of loan up to 90 per cent and extend the period. Credit lending will be expanded to SMEs that invest along with large TNCs.

Expansion of financial network

- The Government will support the establishment of financial organization subsidiaries especially in China and Viet Nam, which are the most popular investment destinations for the Korean firms.

Consolidation of the function of overseas investment insurance

- Expansion of the export insurance fund will be promoted so as to increase payment ability in the long-run. Payment ability, the amount of fund over the amount of valid amount, of Korea (0.053) falls behind Japan (0.07), Belgium (0.11) and Australia (0.25). A new insurance policy for foreign investment will be developed to induce diversification of risks for overseas Korean firms.

Innovation of information system

- A foreign investment synthetic support centre is established in KOTRA and it will act as a one-stop service centre for foreign investment. A synthesized portal website will be created in the KOTRA website to supply user friendly information. Other related websites will be organically linked with KOTRA website so as to simplify information search. Updated information will be provided simultaneously through KOTRA website and e-mail.

Republic of Korea: OFDI measures

Type	*Classification*	*Description*
Finance	The Export-Import Bank of Korea	To reduce financial burdens of an investing company, the bank provides a loan plan which can cover up to 80% of estimated total overseas investment (90% for the SMEs).
	Economic Development Cooperation Fund (EDCF)	EDCF supports investment in developing countries especially for business involving a long-term resource development and business that takes a long retrieval period. The loan condition is repayment in 15 years with a 5 year grace period at an annual interest of 5–6%.
	Agreement between Governments on Investment Security	As a means to protect overseas Korean investors from war, expropriation, restriction on remittance etc., Korea has established investment security agreement with 62 countries.

Type	Classification	Description
Finance	Foreign direct investment post management system (Foreign exchange regulation- Clause 7~9 Article 9)	The aim of this regulation is to induce fair management overseas, prevent possible problems caused in overseas subsidiary, and avert the flight of invested capital. The report organization, designated foreign exchange banks and overseas legation, should practice post management for a case of foreign direct investment.
Taxation	Exemption on Overseas Paid Tax (Corporate Tax Law- Article 57)	If an investor has paid corporate tax to the host country, then the amount of tax paid will be exempted within the limits of tax deduction in that business year. A domestic firm is also subject to a tax credit for dividends received from its subsidiary.
	Exemption on Deemed Overseas Paid Tax (Corporate Tax Law –Clause 3 Article 57)	If a country that has concluded a taxation treaty with the Republic of Korea in order to prevent double taxation decides to exempt tax for Korean firms, then the same amount of tax will be also exempted for these firms in the Republic of Korea. The Korean Government will acknowledge the exempted tax as tax paid overseas so firms do not have to repay the tax in the Republic of Korea.
	Exemption of Corporate Tax on the Dividends from the Overseas Investment (Qualified Beneficial Tax Law-Article 22)	If a country possessing a certain resource exempts tax for dividend income generated from overseas resource development investment by Korean firms, then the same amount of tax will be also exempted in the Republic of Korea. This is to promote overseas resource development.
	Double Taxation Avoidance Agreement	The Republic of Korea has established this agreement with 57 countries so as to avoid imposing double tax on overseas investing firms.
Overseas Investment Insurance	Korea Export Insurance Company	It helps Korean firms that experienced a loss in capital, dividends and interest, due to expropriation, war, breach of contract, and risk of remittance.
Administration	Korea Overseas Company Assistance Center	This centre collects information, provides administrative help, and solves issues concerning Korean firms abroad. The centre also supports overseas business on behalf of the Government.
	FDI Information Network	In order to provide precise information for companies willing to invest abroad, the Ministry of Finance and Economy runs a separate website related to OFDI information network (www.mofe.go.kr/odi).
	Korea Overseas Company Information System (MOFE)	The overseas direct investment information network page (www.mofe.go.kr/odi) also has a website of "Korea overseas company information system" (www.kocis.go.kr) which provides information on overseas companies via the Internet.

Sources: Ministry of Finance and Economy (www.mofe.go.kr), MOFE 2005 and MOCIE 2006.

types of OFDI measures provided by the Korean Government. They include:

- financial support,
- taxation,
- overseas investment services, and
- institutional services (administration and information).

A number of institutions in the Republic of Korea played an active role facilitating or supporting Korean OFDI. Among them, there are the Ministry of Finance and Economy, Bank of Korea, Export-Import Bank of Korea, Korea Federation of Banks, Ministry of Commerce, Industry and Energy, Korea Trade-Investment Promotion Agency, Small Business Corporation, Korea Chamber of Commerce and Industry, Korea International Trade Association, Small and Medium Business Administration and Korea Institute for Industrial Economics & Trade.

Their functions with respect to OFDI include the following:

- *EXIM Bank.* The EXIM bank provides loans for investing companies and it provides loans of up to 90 per cent of the capital invested abroad for SMEs. Tax support includes avoidance of double taxation. The Korea Export Insurance Corporation, a state-owned corporation established under the Ministry of Commerce, Industry and Energy, provides export credit insurance to Korean exporters against non-payment risks by buyers, and guarantees banks that provide export financing and issue bonds for exporters. It also covers war/civil disturbance, expropriation, inconvertibility and breach of contract risks connected with new investment overseas (MOFE 2004).
- *Overseas investment services.* There are many OFDI supporting organizations in the Republic of Korea that promote investment overseas. For instance, the Ministry of Finance and Economy runs an overseas direct investment information network website, which provides information on foreign direct investment procedures, investing country, statistics and information on the Korean overseas companies. The EXIM bank also provides similar information through the Internet and publication, and provides substantial support for Korean OFDI. The International Management Institute was institutionalized on 31 October 2005 to provide consultation to SMEs investing abroad. The role of this institution is to provide consultation to Korean SMEs on the environment of host country, joint venture and business opportunities abroad.

F. Conclusion

Outward investment is as important as inward investment for enhancing the competitiveness of both the country and the firm. As labour costs and attitudes deteriorate in some industrial sectors, it is critical for Korean firms to maintain and enhance their competitiveness through OFDI. The Korean Government played an important role in enterprise internationalization through providing strong institutional support and specific OFDI promotion programmes. However, more can be done to internationalize Korean enterprises, in particular Korean SMEs, as a means to increase competitiveness.

Korean OFDI has increased notably in the past two decades and it is expected to increase further because of an improving regulatory environment supporting OFDI. Nonetheless, there are some key challenges. First, Korean OFDI is concentrated in China and it needs to diversify to other regions and countries. Second, the industrial distribution is mainly in manufacturing industries where competition is fierce and there is also a need to diversify into other sectors such as services. Thus, upgrading OFDI to high-tech areas is important. Third, Korean firms should consider using an appropriate market entry strategy, which could vary depending on OFDI motivations. Fourth, the Government could further strengthen institutional support to help SMEs, which may have more difficulties than large firms in investing abroad.

Korean SMEs, in general, encounter more difficulties than large firms in investing abroad. The challenges and obstacles that Korean SMEs face include difficulties such as access to finance, lack of managerial expertise in handling different cultural issues and business practices, inadequate feasibility study and business plan, and lack of comprehensive and prompt information on overseas investment opportunities. Due to their limited scope of business, competition is often very severe among Korean enterprises in getting access to quality labour and raw materials overseas.[86] Some Korean firms invest abroad based on speculative thinking and some were easily satisfied with their operations at home rather than expanding their business overseas to improve competitiveness (www.kotra.or.kr, Choi 2001).

OFDI may be a win-win game for both home and host countries. While there may be a concern about hollowing-out effects, the benefits associated with OFDI could be greater than the costs, which would be good for the investing firms and the home country. In improving the competitiveness of Korean SMEs, through internationalization, a number of policy options could be considered. They include:

- Streamlining of OFDI regulation and strengthening encouragement, including providing specific support facilities (e.g. consultation, OFDI advisory service and facilities of overseas industrial estates). At the enterprise level, Korean enterprises need to strengthen their capacity in understanding the risks and opportunities of internationalization, including the need for careful planning and assessment of the investment opportunities and the choice of market entry strategies to cushion risks of operating in unfamiliar business and cultural environment.
- International cooperation could promote investment flows between countries, encouraging South-South relations. Investment promotion agencies of different countries could cooperate in facilitating investment, including in providing information on investment environment of host countries.

[86] For example, latecomers scout workers from existing Korean firms by providing higher wages and thus escalate labour costs.

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CHAPTER IX

OUTWARD FOREIGN DIRECT INVESTMENT BY ENTERPRISES FROM THE RUSSIAN FEDERATION*

A. Introduction

This paper provides an overview of the trends and motivations in overseas investments by Russian enterprises. Selected cases of Russian enterprises and their overseas investment activities are discussed. The paper also examines the OFDI policy framework and how investing overseas has increased the competitiveness of some Russian enterprises. It concludes by discussing policy options to strengthen the internationalization of Russian enterprises, for both large companies and SMEs, through OFDI.

B. OFDI from Russia: Trends and development

OFDI from the Russian Federation has increased significantly in recent years, contributing to the growth of OFDI stock that rose from $20 billion in 2000 to $72 billion in 2003 (table 1). OFDI flows in 2004 exceeded $9 billion. The significant increase in OFDI stock was partly attributed to a recently improved State's data registering system and significant increase in outflows. The Russian Federation is the fifth largest emerging economies' direct investor after Hong Kong (China), Singapore, Taiwan Province of China and the British Virgin Islands (UNCTAD 2005). Although there is widespread debate concerning the total amount of Russian OFDI and capital abroad, it is widely acknowledged that the actual figures are considerably higher than suggested by the official data (European Commission 2004; Buiter and Szegvari 2002; Loungani and Mauro 2000; Grigoryev and Kosarev 2000).[87]

Geographical distribution. Russian investment abroad is mainly in the neighbouring areas such as the Commonwealth of Independent States (CIS)[88], European Union, and Central and Eastern Europe (CEE). OFDI to other locations such as Australia, Africa and the United States is increasingly visible. About half of Russian OFDI stock is in the European Union, while the CIS and the United States each accounted for about a one-fifth share (Kalotáy 2003).[89] For many Russian enterprises, the CIS is the first region to invest in when internationalizing (Pchounetlev 2000). Russian enterprises are dominant market players in CIS countries (Zashev 2004; Heinrich 2003; Pelto et al. 2003; Liuhto 2001 and 2002), but they have smaller market shares in developed countries, and leverage on their product and corporate strengths (Vahtra and Lorentz 2004).

Industrial distribution. Russian enterprises investing in natural resources have a strong presence in the CIS markets and are increasingly investing beyond the neighbouring region. Oil and gas industries accounted for nearly 60 per cent of the value of OFDI by Russian enterprises. The ferrous and non-ferrous metals industries accounted for about a quarter of shares. The Russian manufacturing and

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[87] Various estimates are provided on additional capital flight from the Russian Federation. The non-recorded capital flight from Russia totalled $245 billion in 1992-2002 (European Commission 2004).

[88] Includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Republic of Moldova, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.

[89] Russian OFDI to the United States could be considerably larger than what has been reported in various other studies, particularly in view of a few large-scale investment projects by the Russian firms in that host country. The actual amount of Russian investments in the CIS could be considerably higher if round-tripping and transhipped FDI are taken into account (Kalotáy 2003).

Table 1. Russian Federation: OFDI stock, by financing components, 2000-2003

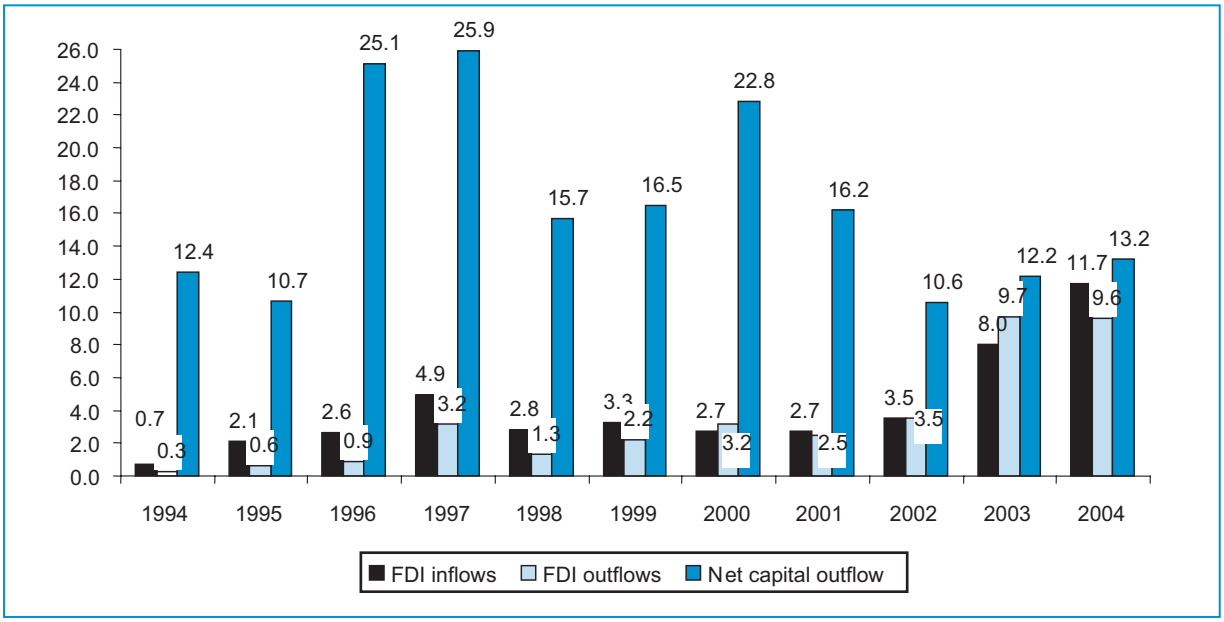
(Millions of dollars)

	2000	2001	2002	2003
Direct investments abroad	20 141	32 437	54 608	72 273
Equity capital and reinvested earnings	18 470	30 384	50 616	67 931
Other capital	1 671	2 053	3 992	4 341

Source: Bank of Russia (http://www.cbr.ru/eng/statistics/credit_statistics/).

Figure 1. Russian Federation: FDI inflows and net capital outflows, 1994-2004

(Billions of dollars)



Sources: Bank of Russia (http://www.cbr.ru/eng/statistics/credit_statistics/);
UNCTAD (http://stats.unctad.org/fdi).

telecom enterprises are also investing significantly in the neighbouring countries. In general, Russian OFDI in the CIS countries is strategic in nature, in such industries as energy and infrastructure. Russian finance enterprises are also active in investing abroad, particularly through M&As (table 2).

Russian TNCs possess considerable assets abroad. OFDI from the Russian Federation is driven by large industrial conglomerates (Gazprom, Lukoil, Russian Aluminium, Norilsk Nickel, Alrosa, Rosneft), particularly in natural-resource-based industries as oil, gas and metal. Some of these TNCs are State-owned enterprises (e.g. Gazprom, Rosneft, RAO UES and Alrosa). Among the leading Russian investors abroad, measured by foreign assets, three are non-natural resource-based enterprises in transportation (Novoship, Primorsk Shipping Corporation, Far Eastern Shipping) (UNCTAD 2005). Russian banks such as Vneshtorgbank, Alfa-Bank, Evrotrast and Gazprombank have also invested abroad (Liuhto and Jumpponen 2003).

Types of OFDI. Russian OFDI through M&As has been large recently. Over half of the Russian M&A purchases took place in the CIS region (table 3). M&A purchases in developed countries

Table 2. Russian Federation: Cross-border M&A purchases by Russian enterprises, by industry distribution, 1995-2004

(Number of deals)

Industry	1995-1999	2000-2004	1995-2004
Total industry	**32**	**111**	**143**
Primary	–	3	3
Agriculture, forestry, and fishing	–	1	1
Mining	–	2	2
Secondary	**18**	**49**	**67**
Food, beverages and tobacco	2	7	9
Oil and gas; petroleum refining	3	11	14
Chemicals and chemical products	3	7	10
Metal and metal products	2	13	15
Services	**14**	**59**	**73**
Electric, gas and water distribution	2	6	8
Trade and wholesale	1	8	9
Transport, storage and communications	1	10	11
Finance	7	25	32
Of which:			
Commercial banks, bank holding companies	6	14	20
Insurance	-	7	7

Source: UNCTAD, cross-border M&A database.

are increasing, especially in Lithuania, the Czech Republic and Latvia.[90] This indicated that Russian OFDI has become geographically more widespread. The majority of the M&As by Russian enterprises in 1995-2004 took place in the past five years, a fact that suggests a growing interest by Russian firms in internationalizing through OFDI and particularly through M&As. An important aspect of Russian OFDI is connected with the international activities of State-owned enterprises. By supporting the active expansion of State-owned energy giants (Gazprom, RAO UES), the Russian Federation strengthened its cooperation with countries in the CIS region and elsewhere.

OFDI by Russian SMEs. The internationalization of Russian SMEs has been limited. Their OFDI motivations differ from those of the larger enterprises. Operational characteristics, size and financial resources explain the differences. While Russian TNCs frequently use cross-border M&As to improve their global market positions, the Russian SMEs target niche markets in their internationalization process. Market-seeking investments dominate the international expansion of Russian SMEs. As a consequence, Russian SMEs tend to operate in familiar environments closer to home. A number of obstacles hinder OFDI by Russian SMEs. Owing to limited statistics, analysis of OFDI by Russian SMEs has been considerably constrained. Available information suggests that Russian SMEs seldom possess the capital and market knowledge needed for extensive foreign expansion (World Bank 2004).

Their relatively low internationalization experience and limited financial resources are among the main hindrances to OFDI. Russian SMEs also lack the experience associated with international business operations. The additional risks associated with operating abroad, in an unfamiliar environment, have also contributed to the limited OFDI. Domestic market size and growth potential are factors that encourage Russian SMEs to invest and operate at

[90] These countries are now members of the European Union.

Table 3. Russian Federation: Cross-border M&A purchases by Russian enterprises, by geographical distribution, 1995-2004

(Number of deals)

Economy	1995-1999	2000	2001	2002	2003	2004	2000-2004	1995-2004
Total world	**32**	**12**	**22**	**21**	**31**	**25**	**111**	**143**
Developed countries	**14**	**4**	**12**	**10**	**10**	**13**	**49**	**63**
Lithuania	–	2	–	3	2	2	9	9
United Kingdom	1	1	1	1	1	1	5	6
United States	–	–	1	1	1	3	6	6
Czech Republic	1	–	–	–	–	4	4	5
Germany	1	–	1	2	1	–	4	5
Latvia	2	–	1	–	1	–	2	4
Netherlands	1	–	2	–	–	1	3	4
Developing economies	–	–	–	**2**	**1**	**1**	**4**	**4**
Mongolia	–	–	–	2	–	–	2	2
Turkey	–	–	–	–	–	1	1	1
China[a]	–	–	–	–	1	–	1	1
Transition economies	**18**	**8**	**10**	**9**	**20**	**11**	**58**	**76**
Ukraine	3	7	2	6	3	4	22	25
Armenia	–	–	–	–	6	2	8	8
Belarus	2	1	3	–	–	1	5	7
Uzbekistan	–	–	1	1	3	2	7	7
Bulgaria	3	–	1	1	1	–	3	6
Georgia	3	–	1	–	–	–	1	4
Kazakhstan	1	–	1	–	–	2	3	4

Source: UNCTAD cross-border M&A database.

[a] Intensifying energy cooperation between the Russian Federation and China is likely to lead to increasing investment flows by Russian companies to this vast energy-consuming market, including infrastructure and downstrean projects.

home rather than abroad. The lack of international networks remains a discouraging factor for many Russian enterprises especially in the manufacturing sectors where business networks are traditionally build around large domestic conglomerates.

C. Drivers and motivations

At the initial stage of internationalization, Russian OFDI was closely related to export-supporting activities and access to natural resources (Bulatov 1998; McMillan 1987; Hamilton 1986). Russian OFDI was also traditionally driven by the motives to diversify risk through reducing exposure to the domestic business environment. At a later stage of enterprise internationalization, the motives for OFDI became more diverse and strategic (Vahtra and Liuhto 2004). Thus, Russian enterprises are now investing abroad for a diverse set of corporate strategic reasons rather than for limited motives as witnessed in the earlier internationalization period (Sokolov 1991).

OFDI motivations differ among Russian TNCs and by industries (table 4; box 1). Resource-seeking firms invest abroad to access natural resources, while telecommunication firms do so to expand market base. Russian enterprises are investing abroad for reasons ranging from strengthening market position, expanding global reach, accessing natural resources to strengthening control of value chains. Three key features of Russian OFDI need to be emphasized:

Table 4. Motivations of Russian OFDI

Motivations	Corporate examples
Efficiency-seeking motivations (e.g. compulsion to control the entire value chain)	Oil companies' acquisitions of retail assets, petrol stations in the CEE, United States and Baltic countries.
Strategic asset-seeking motivations (e.g. securing infrastructure functionality abroad)	Acquisitions by Yukos of Mazeikiu Nafta in Lithuania and Transpetrol in Slovakia; Severstal's acquisition of Rouge Industries in the United States.
Resource-seeking motivations (e.g. accessing natural resources)	Oil companies' upstream acquisitions in the Middle East, South America and the CIS. Acquisition by RusAl of Queensland Alumina (Australia) and Norilsk Nickel's acquisition of Gold Fields (South Africa).
Market-seeking motivations (market expansion in neighbouring countries and further afield)	Telecommunication companies' acquisitions of mobile operators in the CIS.

Source: UNCTAD.

(i) strong export revenues of large industrial resource-based enterprises have helped finance active OFDI activities;

(ii) acquiring of assets abroad by Russian enterprises is on the rise; and

(iii) investment opportunities and privatization in CIS countries encouraged Russian enterprises to acquire strategic assets in the neighbouring countries (Liuhto and Jumpponen 2003).

The main drivers include:

- **Strengthening value chains.** Russian oil enterprises invest abroad to exercise better control of value chain internationally. By acquiring refineries and sales outlets abroad, Russian enterprises achieved better control over foreign demand, processing oil in their own refineries and selling the products via their own petroleum stations. In the oil industry, the infrastructure assets are of vital importance and Russian oil enterprises have gained control of several strategic infrastructure assets in the CEE countries, including seaports and oil pipelines delivering crude oil and products to the European and the United States markets. Lukoil possesses a wide infrastructure network in the Baltic and several CEE countries. The acquisition of the second-largest petroleum retailer in Finland, Teboil, and its sister company Suomen Petrooli provided Lukoil with a strong foothold in the Scandinavian petroleum markets. Through these acquisitions, Lukoil is able to introduce its own petroleum products in the Finnish market. The acquisition of Lithuanian Mazeikiu Nafta and Slovak Transpetrol by Yukos is another example.

- **Securing natural resources.** Other resource-seeking Russian enterprises (metal and mining activities) such as Norilsk Nickel are extending their global reach in accessing natural resources. M&As were used to acquire strategic assets abroad. The recent acquisition of a 20 per cent stake in Queensland Alumina (Australia), the world's largest alumina refinery, by RusAl for $460 million in 2005 is an example. The acquisition increased RusAl's raw material stock and strengthened the company's position in the world aluminium markets. Russian enterprises such as Lukoil, Yukos and Gazprom also invested abroad to access natural resources (box 1).

- **Expanding market reach.** Russian enterprises are investing abroad to expand their markets and for long-term growth. Russian TNCs in transportation (Novoship, Primorsk Shipping Corporation, Far Eastern Shipping Co.) have a strong presence overseas, with a considerable share of their assets and revenues emanating from abroad (UNCTAD 2004, p. 317). In telecommunications, Russian enterprises invested abroad to expand markets (e.g. MTS, VimpelCom).

D. OFDI and implications for enterprise competitiveness

The company cases analyzed in this paper suggest that OFDI has helped increase the competitiveness of Russian enterprises, especially in increasing revenues, strengthening global networks, better control of value chain and access to natural resources. These effects are reviewed below:

Box 1. Selected cases of internationalized Russian enterprises

Gazprom is the largest and most transnationalized Russian corporation in terms of foreign assets, foreign sales and the spread of its international operations. It has extensive operations in the CIS region and 17 European countries, involving natural gas distribution and processing activities. Foreign acquisitions by Gazprom largely follow its natural gas export markets. It has invested abroad to strengthen its traditional export markets, exploit new market opportunities and enhance value chain of its business activities.

Lukoil is a leading private Russian TNC. It possesses large foreign assets abroad. The company has a strong presence in upstream production activities in resource-rich Middle East and the CIS region. Lukoil downstream assets are concentrated near its main export markets (i.e. the European Union and United States). It has an extensive network of petrol stations in the Baltic States, several of the CIS countries, new EU members and the United States. It also operates three oil refineries in Eastern Europe, which supply to key export markets such as the European Union.

Russian Aluminium (RusAl) is the country's largest non-ferrous metal manufacturer and the largest primary aluminium producer in the world. RusAl's OFDI is resource-seeking and market expansion oriented. It controls an extensive network of production outlets worldwide, from the neighbouring CIS countries to Australia and Africa. Owing to insufficient domestic raw material reserves, RusAl has expanded its raw material base by acquiring bauxite mines in Guinea and, more recently, a majority share in the world's largest alumina refinery in Australia.

Norilsk Nickel is the world's largest producer of strategic metals, including nickel and palladium. It has representative and sales offices in Europe and the United States. It expands internationally through acquisition of strategic assets abroad. The company recently acquired a majority stake in Stillwater Mining (United States), which is the world's fifth-largest producer of platinum group metals (PGM), and a 20 per cent stake in Gold Fields Ltd. (South Africa) for $1.2 billion.

Mobile TeleSystems (MTS) is the Russian Federation's largest mobile operator and has successfully entered the CIS markets with substantial investments. MTS adopts an aggressive market-seeking strategy by having operations in virtually all the countries in the CIS region. It owns the majority share in UMC (Ukraine) and controls the largest operator in Uzbekistan, Uzdunorbita. It has a substantial telecommunication infrastructure asset in the region. MTS invests in the CIS region because of investment opportunities, geographical proximity and historical ties. Several large corporate clients of MTS had entered the CIS markets and the need to follow them to these markets has become an important factor driving OFDI.

Alrosa is one of the world's leading diamond mining enterprises, responsible for over 25 per cent of the world's raw diamond output. It has a 33 per cent share in a diamond mining company in Angola. The company has production units overseas (e.g. CIS region) and plans to carry out further resource-seeking investments, targeting additional mining assets and projects in Africa. Most of the OFDI projects are to strengthen the company's global market position and access to the mining of diamonds.

OMZ is the largest heavy engineering corporation in the Russian Federation. It has a strong international presence through production, marketing and financial units overseas. The company controls a 25 per cent share of the world market for equipment for atomic power stations and has a strong international market position in highly specialized product segments. OMZ has affiliates and subsidiaries in the CIS countries, Western Europe and the United States. It acquired three units of Škoda Holding (Czech) (i.e. Škoda JS division, Škoda Steel consortium, and Hutè and Kovárny) in 2005 for $200 million. The acquisition provided the company's competitiveness with improved access to the Eastern European markets.

Source: Authors, information compiled from companies' sources.

Table 5. Russian Federation: Top 8 Russian TNCs,[a] ranked by foreign assets, 2003
(Millions of dollars and number of employees)

Companies	Industry	Assets		Percentage of foreign Assets	Sales		Percentage of foreign Sales	TN[b] (per cent)
		Foreign	Total		Foreign	Total		
Lukoil JSC	Petroleum and natural gas	7 247	26 574	27	16 260	22 118	74	36.7
Norilsk Nickel, OJSC MMC	Mining	1 518	5 916	26	1 518	11 253	13	13.6
Novoship Co.	Transportation	1 107	1 213	91	317	395	80	57.6
RusAl	Metals mining services	691	6 085	11	3 660	4 509	81	33.7
Primorsk Shipping Corporation	Transportation	382[c]	442	86	104[d]	134[e]	78	71.3
Mechel	Metal and metal products	121	1 835	7	1 048	2 050	51	24.2
Far Eastern Shipping Co.	Transportation	52[c]	160	32	57[d]	180	32	22.8
Alrosa	North-metallic mining	46	4 630	1	886	1 955	45	45.4

Source: UNCTAD, *World Investment Report 2005.*

[a] based on survey responses and annual reports.

[b] TN is calculated as the average of the following three ratios foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

[c] Foreign assets data are calculated applying the share of foreign assets in total assets of the previous year to total assets of 2003.

[d] Foreign sales data are calculated by applying the share of foreign sales in total sales of the previous year to total sales of 2003.

[e] 2002 data.

- **Increase revenues.** OFDI has contributed to the increase in sales and assets of Russian enterprises. For instance, more than 50 per cent of sales of Lukoil, Novoship, RusAl, Primorsk Shipping and Mechel in 2003 came from foreign sales (table 5). Other Russian TNCs such as Gazprom, Alrosa, Far Eastern Shipping Co., Severstal and Rosneft generated a significant proportion of their revenues abroad.
- **Strengthening global networks.** OFDI has helped increase the international presence of Russian enterprises in key industries such as in natural resources. For instance, such enterprise internationalization has helped Gazprom achieve a strong international presence, which has provided Gazprom with substantial leverage in key markets and in the CIS region. OFDI has enabled Gazprom to achieve market dominance in these countries and contributed to it being the largest Russian TNC in terms of foreign assets and foreign sales. Other Russian enterprises had strengthened their global market position, and accessed new markets and natural resources by acquiring strategic assets abroad. For example, OFDI has helped MTS increase its customer base and expanded its market abroad. Other examples include RusAl which rose to the largest primary aluminium producer in the world through OFDI. Internationalization through M&As have enabled other Russian enterprises such as Norilsk Nickel and MTS acquired strategic assets abroad that contributed to increasing their global market position, competitiveness and dominance in some host countries. Severstal's international expansion through strategic asset-seeking investments helped strengthen the company's position among the world's top steel producers. Acquisitions of assets in the United States and the European Union provided Severstal with opportunities to increase production capacities and gain market access through local production and distribution outlets in these regions.
- **Gaining control of value chains.** In 2004, Lukoil expanded its retail network in the United States by purchasing 795 petroleum stations

from ConocoPhillips for $266 million, which provided it with better control of value chain. In addition, the acquisition of the second-largest Finnish petroleum retail chain provided Lukoil with strategic accessed to the Finnish market with introduction of its own petroleum products.

- **Expanding access to natural resources.** RusAl has been able to improve its competitiveness by acquiring strategic companies abroad to access raw material. OFDI has helped Norilsk Nickel increase the company's competitiveness by strengthening its global access to natural resources in Australia and elsewhere, and increases its overall raw material stock. In the case of Lukoil, foreign ventures had extended the company's hydrocarbon resource base and contributed to cover the depletions of its domestic resources.

E. OFDI policies

The Russian Federation does not have a specific policy promoting OFDI. Despite the absence of a policy, Russian enterprises are active investors among emerging economies. The low level of real sector investments in the Russian economy and massive capital outflows are among the main challenges faced by the Russian Government. These factors partly explained the absence of specific policy supporting OFDI.

The new regulatory framework on capital exchange, enacted in 2003, is expected to ease OFDI by increasing transparency and legitimizing capital movements. This new regulation, known as the Currency Law, regulates cross-border currency and capital transactions, including direct investments (Ernst and Young 2005). Under this new regulation, capital exchange control is relaxed. While not directly targeting OFDI, the improved exchange control environment is expected to have a positive impact on Russian investment abroad in the future.

F. Conclusion

The Russian Federation is an emerging outward investor, with significant recent OFDI flows. While most of the OFDI is dominated by large Russian enterprises, particularly resource-based and transportation companies, OFDI by SMEs and manufacturing and telecommunication firms is increasingly visible. The cases of internationalizing Russian firms presented in this paper confirm that OFDI has helped increase enterprise competitiveness through strengthening their global market position, expand their natural resources base, gain better control over the value chain, increase global sales and the acquisition of strategic assets abroad.

The future prospects for OFDI from the Russian Federation are promising despite the lack of specific policies promoting it. The recent relaxation of exchange control is expected to contribute to this trend as will the increasing competition from within and outside the country.

OFDI by Russian enterprises is essential for both the individual enterprises and the Russian economy as a whole. It is imperative that Russian enterprises become more internationalized with a view to increasing their ability to compete in the global market. Competition at home through imports, inward FDI and non-equity forms of participation is likely to increase once the Russian Federation becomes a member of the World Trade Organization. To better integrate into the world economy, Russian enterprises should be encouraged to invest abroad.

The Government could consider improving the regulatory framework and offering institutional support to facilitate OFDI by Russian enterprises. A number of specific policy options could also be considered, if OFDI is deemed important and it is viewed as a way to strengthen the economy and enhance enterprise competitiveness. For example, any administrative OFDI requirement such as OFDI approval should be easy to comply with. Support measures such as outward investment missions to target host countries could include SMEs. Provision of information on markets and investment opportunities in target host countries by the Russian Government could also help.

Transparency for OFDI could also be encouraged through regularization and legalization of existing overseas investment activities and assets. Consideration could be given to the establishment of public-private sector forums to provide a platform for the exchange of views and experiences of Russian enterprises with regard to internationalization through OFDI. To the extent possible, the Government could consider providing investment guarantees and financing support. The latter is particularly important for SMEs, which often face limited access to finance and are more concerned about operating risks.

Due consideration should be given to improving the national statistical system to collect data on OFDI by Russian enterprises, particularly with respect to SMEs. Improvement and availability of comprehensive statistics will help increase the understanding of OFDI by SMEs, including how enterprises can benefit from investing abroad, and formulation of appropriate policies to further

strengthen the competitiveness of Russian SMEs, through internationalization.

The private sector could also take a number of measures. Russian enterprises, particularly the SMEs, could increase their knowledge and understanding of the challenges and risks associated with internationalization through OFDI. They could strengthen their capacities to associate in forums or industry club, sharing experiences with other SMEs that have invested abroad. To this end, the Russian business schools could assist in providing programmes to support capacity building and development of management skills in internationalization. Increasing expertise on managing cross-border transactions, cross-cultural issues and international laws are important aspects that deserve attention as well as the understanding on how to obtain and manage information to operate effectively abroad. Russian enterprises, including SMEs, should observe good corporate governance and while investing abroad should strive to contribute to the development of the host countries.

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CHAPTER X

OUTWARD FOREIGN DIRECT INVESTMENT BY ENTERPRISES FROM SINGAPORE*

A. Introduction

OFDI by Singaporean companies has a long history. Since the country attained nationhood in 1965, the Government has planned and implemented several national development strategies to create and sustain Singapore's competitiveness. By the early 1990s, Singapore had become a regional coordination centre capable of hosting significant R&D activities and management functions. To consolidate further its national competitiveness and to enable the expansion of domestic capital, the Government initiated a regionalization programme through which Singaporean companies were explicitly encouraged to venture abroad. In January 1993, Senior Minister Lee Kuan Yew announced the Government's new initiatives to generate a larger pool of local entrepreneurs and to build up the "external wing" of the Singapore economy. This national strategic thrust is known as Singapore's "Regionalization 2000". Since the 1997-1998 Asian economic crisis, the Government has further recognized the continuing importance of the globalization of Singaporean enterprises.

This paper describes the nature and trends of OFDI by Singaporean enterprises, the major reasons for, and impact of, OFDI and the policy framework that enhances Singapore's OFDI. The analysis relies extensively on primary data from a corporate survey, conducted in 1999, of 204 Singaporean companies that have overseas operations.[91] These Singapore companies are referred to as Singapore-based TNCs throughout this paper.[92]

B. OFDI from Singapore: Trends and development

The Department of Statistics (1991) estimated that OFDI stock from Singapore at the end of 1976 was S$1 billion. By 1991, Singapore OFDI stock had risen to S$ 15 billion, and S$ 150 billion by 2003 (table 1). Singapore is the second largest source of OFDI among the developing economies after Hong Kong (China) (UNCTAD 2004). A significant proportion of OFDI from Singapore, however, originates from Singapore-based affiliates of foreign TNCs. In 1996, foreign-controlled companies accounted for 46 per cent of Singapore's OFDI and, in 2002, the ratio decreased to 39 per cent.[93] OFDI flows grew marginally between 1976 and 1989 but have surged since 1990 except in

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[91] For a comprehensive analysis of these data, see Henry Wai-chung Yeung (2002).

[92] Interviews were conducted with executives from 204 parent companies headquartered in Singapore and 56 subsidiaries in Hong Kong (China) and China. At least 76 per cent of the respondents were chairmen, CEOs, managing directors, presidents and senior vice-presidents, executive directors and general managers. Secondary data on Singapore's OFDI and top 100 TNCs were obtained from the Department of Statistics, the Ministry of Trade and Industry, and International Enterprise Singapore, a statutory board of the Singapore Government that helps Singaporean companies to internationalize. Websites of major government institutions were consulted for key laws and regulations.

[93] It should be noted that the Department of Statistics defines foreign-controlled companies as either wholly owned (100 per cent) or majority-owned (at least 50 per cent of paid-up shares). This relatively high percentage required for control implies that many SINTNCs may be considered as local-controlled even if some 20-49 per cent of their shares are owned by a single foreign investor. Since 1996, the Department of Statistics data have included data on locally-owned companies for some variables (e.g. host countries and activity abroad).

1998 and 2002.[94] The improvement in the quality of data reported since 1989 and later again in 1994 partly explained the significant increase in OFDI flows.[95]

Geographical distribution. Singapore's OFDI has always been concentrated in the Asian region, although the degree of geographical concentration has decreased over time. More than 64 per cent of Singapore's OFDI was in Asia. Throughout the 1990s, Asia remained the most favoured host region, accounting for about 47-52 per cent of OFDI from Singapore. Within Asia, Malaysia had always been the single most important destination until 1997 when China emerged as the largest recipient of Singapore's OFDI. Singapore's OFDI to Malaysia declined from 60 per cent in 1981 to 17 per cent in 1996 and 8 per cent in 2003. The decline was associated with the Government's 1993 regionalization drive, emerging investment opportunities in China and other countries in the South East Asian region, including the Government's involvement in the development of large industrial estates and infrastructural projects in Indonesia and China (e.g. China-Singapore Suzhou Industrial Park). Singapore's OFDI to China and Indonesia grew significantly in 1993-2003. A large amount of Singapore's OFDI to China was also channelled through Hong Kong (China) (table 1).[96] Detailed data on locally controlled Singaporean TNCs in table 1 indicate that between 1996 and 2002 the proportion of locally controlled OFDI from Singapore to Asia decreased from about 62 per cent in 1996 to 52 per cent in 2002, indicating a gradual shift in the geographical focus of Singaporean firms from investing in Asia to developed regions such as Europe (58 per cent in 2002) and Australia (64 per cent in 2002). One key explanation for this geographical shift is the increasing number of mergers and acquisitions (M&As) conducted by large locally controlled TNCs affiliates (see below). The Caribbean and Latin American countries also emerged as an important host region for OFDI from Singapore. In 2003, the region hosted some 28 per cent of OFDI from Singapore. While some of this OFDI was in the natural resources sector, a substantial portion went to tax-free zones in the region.

Sectoral distribution. The financial sector spearheaded Singapore's OFDI. Some 47 per cent of OFDI in 1990 came from this sector. The sector's share of OFDI consistently increased in 1990-2003. By 2002, the financial sector accounted for a 62 per cent share of total OFDI, reflecting Singapore's competitiveness as an international financial centre.[97] Despite Singapore's competitive strengths in manufacturing, the sector accounted for only 20 per cent of OFDI in 1990, and declined further to 8.5 per cent in 2002 (table 2). This decline was a consequence of the decrease in the share of manufacturing activities in Singapore's GDP in the same period. In terms of activity abroad, the share of the manufacturing sector remained fairly consistent, hovering between 18 and 25 per cent in the same period. However, investors from Singapore may not be classified as manufacturing firms, even though they are investing in manufacturing activities abroad. Financial, transport and manufacturing firms were the three largest industries investing abroad from Singapore. They accounted for 86 per cent of Singapore's OFDI at year end 2002. Asia, in particular China and South East Asian countries, accounted for the overwhelming majority of manufacturing, commerce and real estate investments from Singapore in 1996 (figure 1). By 2002, however, only about 45 per cent of manufacturing OFDI went to Asia as compared with 93 per cent in 1996. Oceania received 20 per cent and Europe 16 per cent of Singapore OFDI stock in 2002. A large proportion of real estate OFDI went to Europe (about 60 per cent), contributed by major hotel and property investments made by leading Singaporean firms. In the financial sector, Europe (United Kingdom, Netherlands and Belgium) and other economies such as the Netherlands Antilles, Liberia and other tax haven locations emerged as the most important destinations for OFDI in 1996. The share of Asia in financial services OFDI rose to above 50 per cent in 2002, which reflected the recent waves of mergers and acquisitions made by Singaporean financial institutions in Indonesia, Hong Kong (China), the Philippines and Thailand.

The 1993 regionalization drive had an impact on Singapore's OFDI to China. Some 151 of the 204 sample TNCs have established 365 affiliates in China. On average, each TNC has more than two affiliates in China. At least half of these affiliates have established in China after 1992. Malaysia hosts the largest share of TNC affiliates: 119 of the 204 TNC established 273 affiliates there. On the other hand, these TNCs

[94] The Department of Statistics does not publish annual flow data on OFDI from Singapore. Instead, only stock data are published. All flow data are calculated from these stock data by subtracting the previous year from the current year.

[95] Since 1994 the OFDI data series has included loans granted to affiliates abroad.

[96] It is difficult to estimate the exact percentage of Singapore's OFDI into China that is channelled through Hong Kong (China). Through personal interviews with many subsidiaries of Singapore TNCs in Hong Kong (China), I found that some large banks and property developers from Singapore have invested in China out of their Hong Kong (China) operations. These large-scale investments may account for a significant portion of OFDI from Singapore to Hong Kong (China). The main reason for this pattern of channelling OFDI through Hong Kong (China) is to enable better control and management of these China-bound investments out of the Hong Kong (China) offices of Singaporean TNCs.

[97] In terms of activity abroad by Singaporean firms, the financial sector's share of OFDI hovered consistently in the range of 54 per cent-56 per cent in 1990-2003.

Table 1. Singapore: OFDI stock, by geographical distribution, 1981-2003

(Millions of Singapore dollars; percentage of local-controlled companies in parentheses)

Economy	1981	1985	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003[1]
Asian countries	1289.9	1721.4	7013.3	27101.2	31714.2(62)	37316.6(60)	42905.2(65)	46026.4(64)	57542.8(59)	68453.3(51)	70746.2(52)	72994.1
ASEAN	1078.5	1133.3	3567.1	16088.2	16874.2(59)	17924.8(54)	18264.8(58)	18548.2(57)	23568.8(53)	28548.1(48)	30512.5(49)	32621.6
Brunei	3.7	52.9	66.2	92.0	89.9(74)	73.9(74)	63.9(81)	81.4(57)	98.1(61)	56.8(79)	51.6(79)	52.8
Indonesia	39.5	65.0	224.8	4030.9	3914.3(35)	6519.0(21)	4484.7(34)	4516.9(33)	5461.8(36)	7599.9(40)	8592.9(46)	9828.4
Malaysia	1006.9	971.8	2790.1	9715.9	9591.1(69)	8908.0(72)	8610.0(70)	7939.8(67)	9754.0(66)	11303.0(57)	12141.4(56)	12758.9
Philippines	18.4	22.4	97.7	625.1	1003.8(63)	934.1(56)	1297.6(72)	1480.7(77)	2555.6(51)	2741.7(55)	2693.6(56)	2779.6
Thailand	10.0	21.2	388.4	1252.8	1573.0(39)	1219.0(39)	1986.4(48)	2685.7(55)	3494.4(39)	4506.0(32)	4617.7(34)	4404.0
Viet Nam*	-	-	-	371.3	702.1(86)	1001.9(84)	1050.9(53)	895.5(55)	1069.7(58)	1067.0(57)	1149.2(51)	1396.0
China	-	57.6	239.7	2968.2	6414.1(73)	10477.0(64)	12186.3(79)	12625.3(78)	15710.2(69)	17499.2(50)	17702.4(50)	17623.9
Hong Kong (China)	181.8	460.7	2266.2	6268.3	5973.6(64)	8113.0(54)	7668.0(67)	8399.4(67)	8508.0(70)	11564.1(64)	12042.3(62)	11529.0
Japan	0.3	5.0	51.8	465.8	454.9(13)	535.1(8)	865.5(51)	828.2(73)	993.8(59)	1468.1(64)	1548.1(70)	2051.5
Taiwan Province of China	12.9	32.9	494.8	573.2	570.7(51)	657.7(55)	1287.6(48)	1715.0(62)	3571.4(39)	3586.3(37)	3319.1(39)	3392.1
Republic of Korea	-	-	-	-	-	-	669.0(3)	1691.1(9)	2403.3(24)	2754.0(29)	2505.3(30)	2202.1
Others	16.2	31.9	393.7	737.4	1426.6(62)	1981.2(63)	1648.9(73)	1812.8(81)	1902.5(80)	2266.6(67)	2234.9(63)	2509.5
European countries	50.7	89.3	1095.4	5550.8	8754.0(30)	11391.4(30)	9581.1(40)	12901.3(33)	8934.9(75)	12692.4(55)	14003.0(58)	12379.2
Netherlands	0.8	12.0	656.3	1020.8	2422.6(31)	2254.0(29)	2113.6(11)	2217.3(17)	1188.0(35)	1295.9(34)	1154.0(27)	480.5
United Kingdom	49.7	45.9	300.4	3296.5	5021.5(27)	7678.0(29)	3275.8(87)	3338.6(88)	4903.4(89)	6843.3(56)	6884.8(54)	7183.4
Germany	-	-	-	-	-	-	-	-	-	156.3(79)	102.5(98)	102.3
Others	0.2	31.4	138.6	1233.4	1309.9(39)	1457.4(34)	642.0(94)	751.0(88)	1568.1(94)	1836.3(93)	2363.6(95)	2383.0
Australasia	62.6	176.9	1889.0	3566.7	3226.7(45)	3205.7(51)	2348.8(66)	2355.8(66)	3352.9(73)	3031.2(57)	3965.7(60)	5586.9
Australia	62.6	176.9	530.5	1448.3	1773.1(59)	1821.2(72)	1708.7(74)	1756.1(72)	2486.9(74)	2518.6(58)	3225.1(64)	4528.3
New Zealand	-	-	1358.5	2118.4	1453.6(28)	1384.5(23)	640.1(45)	599.7(47)	866.0(69)	512.6(50)	740.6(41)	1058.6
Canada	-	17.6	-	-	-	-	-	-	-	55.7(78)	26.4(79)	106.0
United States	31.8	66.1	689.7	2635.2	2628.9(93)	2905.0(91)	6063.9(49)	4285.1(97)	6187.5(94)	7336.0(93)	8144.3(95)	9188.0
Caribbean/Latin America	-	-	-	-	-	-	-	-	-	39982.3(72)	42154.5(76)	42569.0
Other countries n.e.c.	242.9	185.9	2934.3	7386.3	9212.7(43)	15764.2(36)	17719.4(37)	18650.0(41)	22273.0(39)	8132.7(22)	9396.3(32)	7054.8
Total	**1677.7**	**2257.2**	**13621.7**	**46240.2**	**55536.4(54)**	**70640.5(51)**	**75622.4(56)**	**84218.6(56)**	**98291.1(58)**	**139683.7(58)**	**148436.3(61)**	**149878.0**

Table 1 (cont'd). Singapore: OFDI stock, 1981-2003

(Millions of Singapore dollars; percentage of locally-controlled companies in parentheses)

Country	1981	1985	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003[1]
Ratio to GDP at current prices	5.7	5.8	20.4	38.9	42.7	49.9	55.1	60.2	61.6	90.8	93.7	93.1
Percentage of non-manufacturing	-	-	79.6	75.4	79.3	79.1	76.6	72.8	74.6	79.5	80.5	80.2
Total (foreign)	799.4	585.1	6674.0	21982.8	25362.8	34998.2	33042.2	37068.8	40872.0	58476.4	58649.9	NA
Percentage of foreign	47.6	25.9	49.0	47.5	45.7	49.5	43.7	44.0	41.6	41.9	39.5	NA
Percentage of local	52.4	74.1	51.0	52.5	54.3	50.5	56.3	56.0	58.4	58.1	60.5	NA
Wholly local owned	298.2	709.9	2538.9	11106.3	15869.9	19553.4	25425.3	27668.3	33374.1	50132.6	57321.1	NA
Majority local owned	580.1	962.2	4408.9	13151.2	14303.8	16088.8	17154.9	19481.5	24045.0	31074.8	32465.3	NA
Wholly foreign owned	292.9	384.2	5347.9	16290.0	19224.3	26633.0	21600.2	23623.6	26812.6	41104.1	41916.9	NA
Majority foreign owned	506.5	200.9	1326.1	5692.8	6138.5	8365.2	11442.0	13445.2	14059.4	17372.3	16733.0	NA
Exchange rate: S $ to one US dollar	2.0478	2.105	1.7445	1.4143	1.3998	1.6755	1.6605	1.666	1.7315	1.851	1.7365	1.7008

Source: Department of Statistics, Singapore, Singapore's Investment Abroad (various years).

Note: Data for 1981-1985 refer to direct investments abroad (D1), which are the amount of paid-up shares of overseas subsidiaries and associates held by companies in Singapore. Data for 1990-1995 refer to direct equity investments (D2), which are direct investment (D1) plus the reserves of the overseas subsidiaries and associates attributable to those companies. For overseas branches, the net amount due to the local parent companies is taken as an approximation of the magnitude of direct investment. Data for 1996-2002 refer to total direct investment abroad (D3), which are D2 plus loans granted to affiliates. From 1994 onwards, financial institutions such as banks, finance and insurance companies were included.

[1] Data for 2003 are preliminary.

Table 2. Singapore: OFDI stock, by industry and activity abroad, 1990, 1995, 2000, 2002, 1990–2002

(Millions of Singapore dollars; percentage)

	1990		1995		2000		2002		Percentage increase
Industrial sectors	**Value**	**%**	**Value**	**%**	**Value**	**%**	**Value**	**%**	**(1990-2002)**
Manufacturing	2 779.8	20.4	15 241.2	30.7	10 103.0	10.3	12 603.0	8.5	353.4
Construction	251.3	1.8	837.5	1.7	792.0	0.8	818.0	0.6	225.5
Commerce	993.5	7.3	4 746.5	9.6	10 179.0	10.4	10 258.0	6.9	932.5
Transport	825.1	6.1	2 435.9	4.9	7 334.0	7.5	23 953.0	16.1	2 803.0
Financial	6 362.9	46.7	20 546.1	41.4	59 770.0	60.8	91 777.0	61.8	1 342.4
Real estate	1 140.9	8.4	2 939.7	5.9	5 493.0	5.6	2 917.0	2.0	155.7
Business services	1 246.6	9.2	2 744.3	5.5	4 480.0	4.6	5 839.0	3.9	368.4
Others	21.7	0.2	79.7	0.2	140.0	0.1	272.0	0.2	1 153.5
Total	**13 621.8**	**100**	**49 570.9**	**100**	**98 291.0**	**100**	**148 437.0**	**100**	**989.7**
Activity abroad									
Manufacturing	2 395.0	17.6	12 418.9	25.1	24 969.0	25.4	28 925.0	19.5	1 107.7
Construction	69.5	0.5	597.7	1.2	780.0	0.8	638.0	0.4	818.0
Commerce	1 504.3	11.0	5 092.0	10.3	8 126.0	8.3	10 149.0	6.8	574.7
Transport	347.2	2.5	2 097.8	4.2	6 185.0	6.3	12 503.0	8.4	3 501.1
Financial	7 301.2	53.6	23 845.7	48.1	47 437.0	48.3	84 691.0	57.1	1 060.0
Real estate	1 213.1	8.9	3 610.4	7.3	7 019.0	7.1	7 282.0	4.9	500.3
Business services	511.6	3.8	1 359.4	2.7	2 251.0	2.3	2 529.0	1.7	394.3
Others	279.8	2.1	548.8	1.1	1 525.0	1.6	1 720.0	1.2	514.7
Total	**13 621.7**	**100**	**49 570.7**	**100**	**98 292.0**	**100**	**148 437.0**	**100**	**989.7**
Exchange rate: S $ = US $1	1.7445		1.4143		1.7315		1.7365		

Notes and source: As for table 1.

are not present in Europe and North America as in Asia. Less than 20 per cent of them invested in these regions and the number of affiliates is low – with little more than one affiliate per region. This geographical concentration of OFDI suggests that most of the TNCs in the sample focus on East and South East Asia as their centres of business operations.

Types of FDI. The extent of transnationalization by Singaporean companies can be examined from the information provided in a recent ranking of the top 100 Singapore international companies conducted by International Enterprise Singapore (IE Singapore 2005).[98] Out of these 100 TNCs, the top 12 are dominated by government-linked companies (GLCs) (table 3). All the top five TNCs are GLCs investing in strategic sectors, such as air transport, shipping, telecommunications, shipyard and shipbuilding, and property development. A number of these TNCs are also family-owned enterprises, e.g. Pacific International Lines (shipping), Hong Leong Asia (industrial) and City Developments Ltd (property development and hotels). The degree of transnationality varies among these 12 SINTNCs. For instance, Neptune Orient Lines, SingTel and Hong Leong Asia held a very high proportion of their sales and assets outside Singapore.

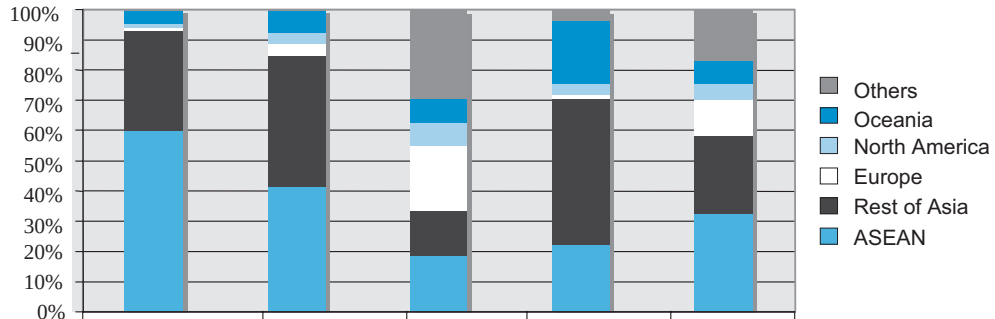
About two-thirds of the cross-border M&A purchases by Singaporean companies in 1995-2004 occurred in Asia. Of the total 883 deals in the period, 13 per cent were in Malaysia, 13 per cent in Hong Kong (China), 10 per cent each in China and Australia, and 8 per cent in the United States. Services accounted for

[98] In terms of overseas revenues and regional breakdown of these revenues. See *The Straits Times*, 3 February 2005, for details of the report by IE Singapore. The ranking is also available on the IE Singapore website, http://www.iesingapore.gov.sg, accessed on 23 March 2005.

Figure 1. Singapore: OFDI stock, by geographical distribution and industry, 1996 and 2002

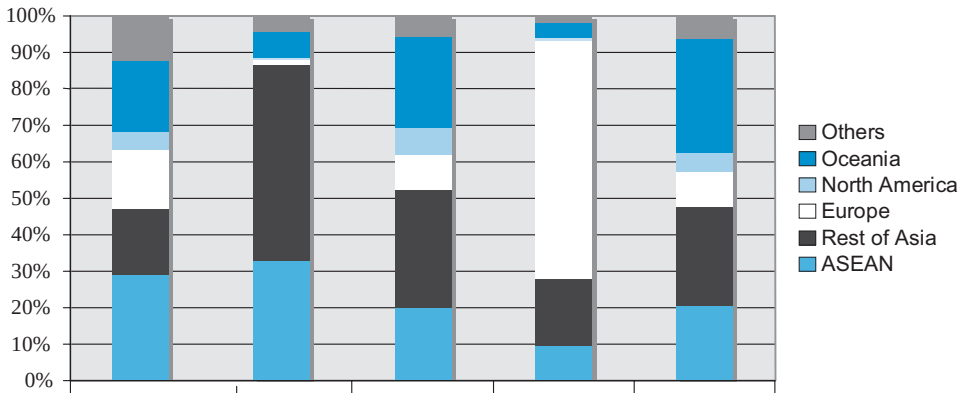
(Millions of Singapore dollars)

1996



	Manufacturing	Commerce	Financial	Real estate	Total
Others	54	35	8 150	142	9 415
Oceania	578	408	2 317	824	4 290
North America	175	219	2 149	146	2 841
Europe	161	213	5 862	39	6 741
Rest of Asia	4 448	2 496	4 187	1 919	1 4374
ASEAN	8 023	2 381	5 220	867	1 7995

2002



	Manufacturing	Commerce	Financial	Real Estate	Total
Others	1550.1	438.8	5196.7	58.7	9396.3
Oceania	2446	744.2	22965.6	116.5	46120.2
North America	619	52	6620.8	22.4	8170.7
Europe	2037.2	145.7	9047.3	1898.2	14003
Rest of Asia	2299.8	5508.3	29465.5	546.7	40233.7
ASEAN	3651	3369	18481.1	274.1	30512.5

Notes and source: As for table 1.

70 per cent of Singapore M&A purchases in the same period. Finance dominated followed by business activities such as real estate and business services. Of the top 15 M&A purchases between 1997 and 2004, most took place after 2001 in electrical and electronics, transportation and finance (table 4). The industrial concentration of cross-border M&A purchases reflects the competitiveness of Singaporean companies in selected industries and the increasing preference of Singapore companies for M&As as a mode of entry into internationalization. Some 21 per cent of TNCs established their overseas subsidiaries through an

Table 3. Singapore: Top 12 transnational corporations, 2004

(Millions of Singapore dollars; percentage; unit)

Rank	Name of company	Foreign assets	Total assets	Foreign assets as a % of total assets	Foreign sales	Total sales	Foreign sales as a % of Total sales
1	Singapore Airlines[a]	NA	19 990	NA	NA	9 762	NA
2	Neptune Orient Lines[b, c]	NA	4 064	NA	4 595	5 523	83
3	SingTel[a]	31 736	36 857	86.1	8 221	11 995	69
4	Keppel Corporation[d]	2 315	10 083	23.0	1 528	5 947	28
5	CapitaLand[d]	6 695	17 558	38.1	2 465	3 830	64
6	Pacific International Lines	NA	NA	n/a	2 396	2 495	96
7	Fraser & Neave[e]	2 765	7 374	37.5	2 242	3 446	65
8	SembCorp Industries[d]	NA	6 622	n/a	2 111	4 795	45
9	Olam International[f]	NA	1 242	n/a	NA	2 610	NA
10	Hong Leong Asia[d]	1 271	1 554	81.8	1 636	1 883	87
11	City Developments Ltd	NA	13 059	NA	1 419	2 326	61
12	DBS Group Holdings[d]	61 940	159 595	38.8	1 386	3 310	42

[a] Apr 01 2003 - Mar 31, 2004

[b] Jan 1 2003 - Dec 26 2003

[c] In US$ million

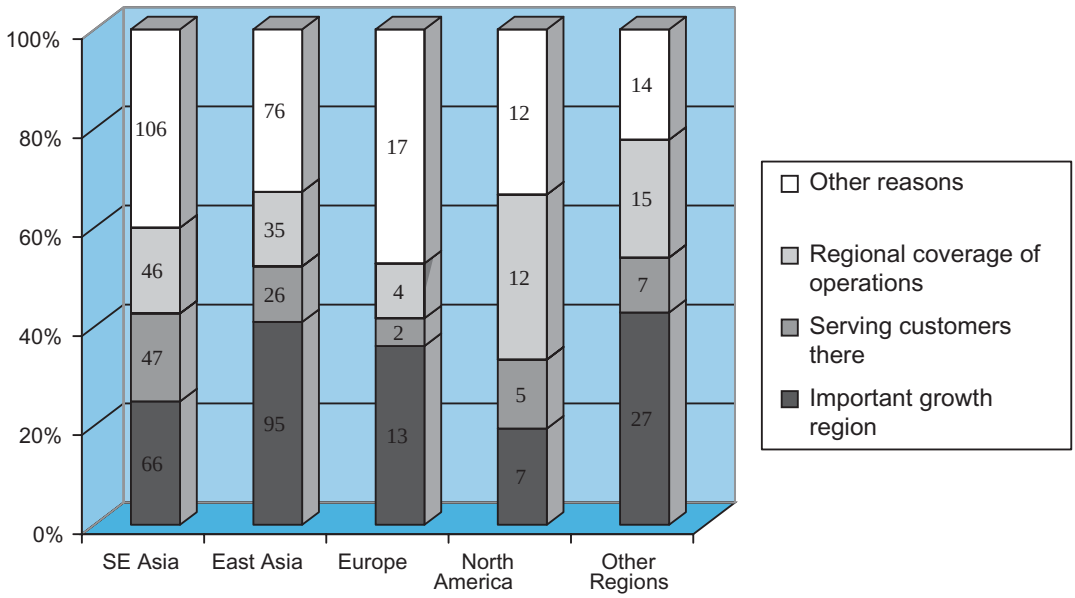
[d] Jan 1 2003 - Dec 31 2003

[e] Oct 1 2003 - Sept 30,2004

[f] July 1 2003 - June 30 2004

Source: Company annual reports.

Figure 2. Reasons for OFDI by TNCs from Singapore, by host regions



Source: Survey conducted by Henry Wai-chung Yeung (see footnote 92).

expansion of their existing operations or trading/sales relationships into a full-fledged manufacturing or services subsidiary in the host country (figure 3). These SINTNCs had prior experience and knowledge of the host countries through trading activities and developed close relationships with partners locally.

In contrast to the internationalization patterns of larger companies, Singaporean SMEs invested primarily in the neighbouring economies. Greenfield activities are preferred because of the financial position and the scale of overseas operations of SMEs, which are relatively smaller. These SMEs do not usually consider M&A for internationalization. They are thus mostly engaging in joint ventures with host country partners, establishing their own production and service facilities. The preference for joint ventures and greenfield investment has a great deal to do with the lack of firm-specific advantages among SMEs. Their locational preference is also explained by their relatively weaker intra-firm coordination and management systems.

C. Drivers and motivations

Figure 2 summarizes the drivers and rationales of OFDI from Singapore on the basis of the survey's responses of the 204 TNCs. TNCs venture into different host regions and countries for different reasons.[99] However, market presence is the single most important reason in explaining OFDI by TNCs. This market preference factor can be explained by the following specific motivations.

Market-seeking. Most TNCs venture abroad to reach growing markets in the region, particularly those in East Asia, to sell manufactured goods. Many TNCs invest in China because of its potential to become one of the fastest growing and largest markets in the world.

Proximity to customers. Some TNCs are prompted by their regional or global customers to have a presence in important host countries in order to provide them with quality and customized products or services. This motive is equally important for manufacturing and service TNCs. For firms in manufacturing industries, having a presence in host countries significantly increases their chances of securing contracts as preferred suppliers or strategic partners. Firms in service industries (e.g. producer services), have to follow their customers in order to cater to their needs. Other TNCs are also motivated to invest on the basis of personal relations with the local partners and customers. In some host countries (e.g. China and Malaysia), ethnicity and social connections

[99] This variation is explained by different strategies for FDI by different TNCs. See further theoretical arguments in John H. Dunning (1998) and Grazia Ietto-Gillies (2005).

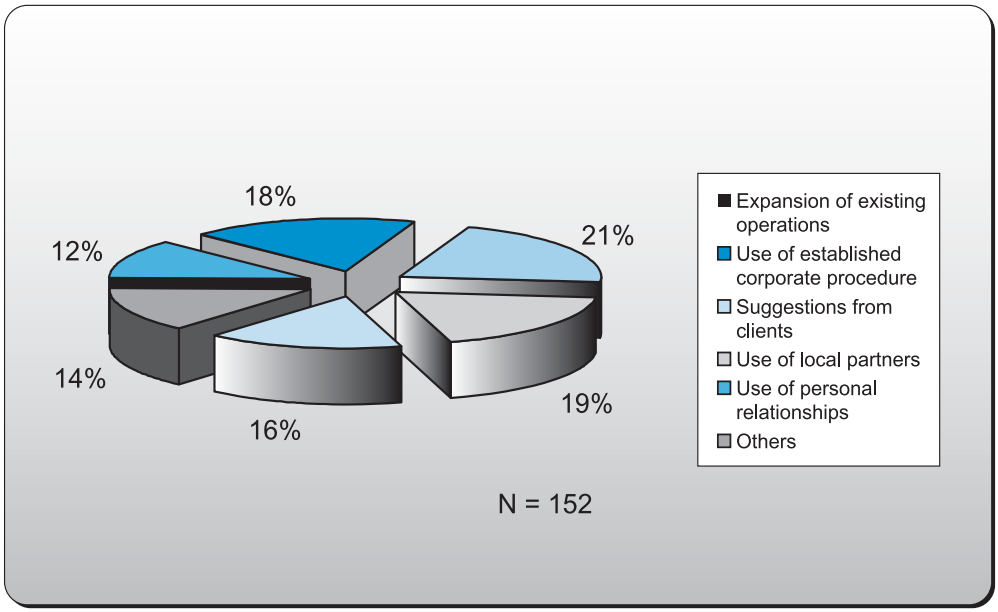
Table 4. Singapore: Top 15 cross-border M&A purchases, 1997-2004

(Millions of dollars)

Rank	Target company	Target industry	Target economy	Acquiring company	Acq ind	Value	Year
1	Cable & Wireless Optus Lt(C&W)	Telephone communications	Australia	SingTel(Singapore)	Radiotelephone communications	8 491.117	2001
2	Dao Heng Bank Group(Guoco)	Banks, non-US chartered	Hong Kong (China)	DBS Group Holdings Ltd	Banks, non-US chartered	5 679.702	2001
3	TXU Australia Ltd	Electric services	Australia	Singapore Power Pte Ltd	Electric services	3 720.000	2004
4	DII Group	Electronic components, nec	United States	Flextronics International Ltd	Printed circuit boards	2 591.000	2000
5	DBS Diamond Holdings Ltd	Investors, nec	Hong Kong (China)	DBS Bank	Banks, non-US chartered	1 964.93	2003
6	US Premium Office Properties	Operators of non-residential buildings	United States	Investor Group	Investors, nec	1 852.00	2004
7	ChipPAC Inc	Semiconductors and related devices	United States	ST Assembly Test Services Ltd	Instruments to measure electricity	1 458.68	2004
8	GPU PowerNet Pty Ltd	Combination utilities, nec	Australia	Singapore Power Pte Ltd	Electric services	1 264.00	2000
9	Virgin Atlantic Airways Ltd	Air transportation, scheduled	United Kingdom	Singapore Airlines Ltd	Air transportation, scheduled	884.00	2000
10	APL Ltd	Deep sea foreign transportation of freight	United States	Neptune Orient Lines Ltd	Transportation	878.50	1997
11	Gotaas-Larsen Shipping Corp	Deep sea foreign transportation of freight	Monaco	Osprey Maritime Ltd	Transportation	749.90	1997
12	Nortel-Mnfg Facilities (5)	Communications equipment, nec	Canada	Flextronics International Ltd	Printed circuit boards	725.00	2004
13	Indosat	Telephone communications	Indonesia	Singapore Technologies Telemed	Communications services, nec	635.06	2002
14	Telkomsel	Telephone communications	Indonesia	SingTel(Singapore)	Radiotelephone communications	627.00	2001
15	Hessenatie	Water transportation of freight, nec	Belgium	PSA Corp Ltd	Port services	605.48	2002

Source: UNCTAD, cross-border M&As database.

Figure 3. Mechanisms of overseas operations by TNCs from Singapore



Source: Survey conducted by Henry Wai-chung Yeung.

played a role in motivating Singaporean investments there.[100] This set of motivations (cost, personal relationships and ethnicity and social connections) is particularly important for SMEs. They may be less relevant for the larger Singapore companies. As a result, SMEs from Singapore tend to invest regionally in nearby host countries that are both cheaper in terms of production costs and culturally closer in terms of ethnic relations (e.g. China and Malaysia).

Expanding regional and/or global networks. TNCs venture abroad to establish a regional or even global coverage of their operations. This motive is more significant for large TNCs that aim at the global market and it is the most important motive for TNCs investing in North America. Singapore Airlines' acquisition of a strategic stake in Virgin Atlantic Ltd in December 1999 to broaden its share in the transatlantic air travel market is an example. A similar earlier effort by City Developments Ltd. to acquire UK-based Millennium & Copthorne Hotels Plc in 1995 also enabled the former to have a global presence in the hotel industry.

Access technology . High-tech manufacturing TNCs invest in Europe and North America in search of a conducive environment for R&D and specialized labour skills.

Efficiency-seeking. Whilst a significant reason, cost saving is not the most important factor in fostering OFDI from Singapore. Most TNCs in the sample are not labour-intensive. Rather, they are high-value-added manufacturers or service providers. Production or labour costs constitute only a relatively low proportion of their total operational costs.

D. OFDI and implications for enterprise competitiveness

OFDI has helped increase the competitiveness of Singaporean companies in several ways (table 5). Some two-thirds of TNCs confirmed that OFDI had increased their companies' competitive advantages. The foremost important competitive advantage was the increasing familiarity and experience in international business (exposure to foreign culture and business practices) that became a firm-specific asset.[101] This increase in familiarity and experience is particularly important for SMEs since they tend to have limited experience of different business cultures and practices.

Another gain from OFDI is reputation and brand image. Some 41 per cent of respondents cited "better reputation" as an outcome of increased competitiveness in relation to OFDI. Potential clients

[100] See a full analysis in Henry Wai-chung Yeung (2004).

[101] Athanassiou, Nicholas and Nigh, Douglas (2000), and Blomstermo, Anders and Sharma, D. Deo (eds.) (2002).

Table 5. Impact of OFDI on the competitive advantages of TNCs from Singapore

Competitive advantages after OFDI	*Total*	*Percentage*
Yes	123	65.8
No	64	34.2
Total	187	100.0
Greater familiarity and experience	67	54.5
Better reputation	50	40.7
Better managerial expertise	34	27.6
Better product quality and services	30	24.4
Better marketing expertise	24	19.5
Special contacts and connections	24	19.5
Possession of specialized materials and resources	19	15.5
Greater financial assets	17	13.8
Greater technological edge	14	11.4
Others	31	25.2
Total	123	100.0

Source: Survey conducted by Henry Wai-chung Yeung.

of Singaporean firms value the firm experience abroad and view foreign presence as an indication of the competitiveness of TNCs. One fifth of the respondents identified better managerial and marketing expertise as an outcome of their OFDI activities. While organizational capabilities are an important initial precondition for OFDI to occur, these capabilities can be further enhanced by managing foreign operations.[102]

OFDI also leads to better product/service quality and greater technological edge. This increased competitiveness in product and process is particularly linked to Singapore OFDI taking place in industrialized economies such as the United States and Western Europe. In the manufacturing industry, some leading technology-driven TNCs such as Creative Technology (PC sound cards), Aztech Systems (ADSL products), WBL (flexible printed circuit boards) and Singapore Technologies Engineering have benefited from having their operations in the United States.

They have gained access to cutting-edge technology and have been able to improve their product and process technologies by being nearer to their customers.

While the survey did not fully capture the profitability indicator, an increase in revenues as a result of OFDI activities for enterprises highlighted in table 3 deserves mentioning. Many of the leading Singaporean TNCs have a major stake in a single affiliate, due to some large-scale acquisitions conducted since the mid-1990s. For example, Neptune Orient Lines' (NOL) United States affiliate, American President Lines, contributed 61 per cent and 22 per cent of NOL's revenues in 2004, which were respectively generated from the Americas and Europe, making it the largest Singapore TNC in terms of revenue. SingTel, the largest local telecommunications group, reported a consolidated sale of S$ 12 billion in 2004, of which its Australian affiliates SingTel Optus (acquired in 2001) contributed some two thirds. City Developments Ltd (CDL) is another example. Its UK-based Millennium & Copthorne Hotels Plc., an acquisition completed in 1995, contributed much to its revenues from the Americas (S$ 510.8 million) and Europe (S$ 454 million) in 2004. These two markets alone accounted for 68 per cent of CDL's total foreign sales.

[102] See further ideas in Nohria, Nitin and Ghoshal, Sumantra (1997).

The wave of large-scale cross-border acquisitions by leading TNCs after 1995 marks a significant development in the internationalization of Singaporean firms (table 4). It demonstrates the serious commitment of Singaporean firms, particularly the leading TNCs, to globalize their operations, to tap into potential overseas markets and generate revenues from abroad. It also indicates the increasing preference of leading TNCs to grow through acquisitions to gain fast access to firm-specific competencies that often take time to develop in-house. The acquisitions reflect the growing competitiveness of Singaporean TNCs and their capabilities in managing complex financial arrangements in relation to these acquisitions.

In the service industry, this increased competitiveness comes from the significantly improved understanding of foreign markets and therefore the possibility of greater customization of products and services. This client-driven service is particularly important in North America and Western Europe. Even in Asia, there is a greater demand for customized services. OFDI allows many service TNCs to build stronger relationships with their existing customers and to develop new markets in the host countries.

E. OFDI policies

Although there are no specific laws or regulations on promoting OFDI, the Singapore Government has been relentlessly promoting OFDI by indigenous Singaporean firms since 1993 as a means to strengthen its export-oriented domestic economy. This promotion has been taking place through institutional support and specific policy measures for OFDI.

Main institutions dealing with OFDI. Three government agencies are strategically important in promoting OFDI from Singapore. They are:

- International Enterprise Singapore (IE Singapore);
- Economic Development Board (EDB);
- Standards, Productivity and Innovation Board (SPRING).

IE Singapore is the former Trade Development Board (TDB) that was in charge of promoting Singapore's external trade until its name change in 2002. IE Singapore now focuses on internationalizing Singapore-based enterprises. Its new mission is to help Singapore-based companies that are willing and able to grow and internationalize successfully.[103] Its vision is to be an expert agency in firm-level growth, market intelligence and internationalization strategies. It offers a wide range of services in Singapore and overseas to help local companies shorten their learning curve and make the right connections. In doing so, it provides market information, and assists enterprises in building up their business capabilities and finding overseas partners. With 36 overseas centres around the globe, IE Singapore is equipped to help companies succeed. It provides assistance to Singapore-based companies to build up their business through four key business groups: the Corporate Group, Enterprise Group, International Operations Group and Capability Development Group.

The EDB of Singapore was established in 1961 as a one-stop investment promotion agency to assist foreign firms in Singapore. Working closely with the Ministry of Trade and Industry, the EDB has since played a key role in shaping the Singapore economy through its efforts to solve the unemployment problems, promote investment, train manpower and develop the industrial sector.[104] The main concern of the EDB was and still is to attract foreign (preferably global) firms to invest in Singapore. Since 1993, the EDB has experienced major changes in its strategic orientation and business outlook. It no longer focuses exclusively on attracting world-class manufacturing firms to invest in Singapore; it has also formed a division specifically for promoting the regionalization of Singaporean firms (annex A).

Growing out of its previous existence as the Productivity and Standards Board (PSB), SPRING has as its mission the enhancement of the competitiveness of local enterprises. It nurtures a pro-business environment that encourages enterprise formation and growth, facilitates the growth of industries, enhances the productivity, innovation and capabilities of enterprises, and helps increase access to markets and business opportunities. Its ultimate aim is to nurture a host of dynamic and innovative Singapore enterprises that can serve the domestic market and invest in the regional and global marketplace.

In addition, the government-linked companies (GLCs) that were previously established as State-owned enterprises for specific developmental purposes, played a significant role in the internationalization. Since the late 1980s, many former large State-owned enterprises, through privatization, have been listed on the Stock Exchange of Singapore (e.g. Singapore Airlines, Keppel Corporation, Sembawang Holdings). These former State-owned

[103] http://www.iesingapore.gov.sg, accessed on 24 March 2005.

[104] See two book-length analysis of EDB: Linda Low, Toh Mun Heng, Soon Teck Wong, Tan Kong Yam and Helen Hughes (1993) and Chan Chin Bock (2002).

enterprises are known as GLCs because the State still retains significant influence over their management control primarily through such State-owned holding companies as Temasek Holdings. By the early to mid-1990s, the public sector and GLCs accounted for about 60 per cent of Singapore's GDP.[105]

Policy measures. The Government also provides various facilitative measures in promoting OFDI. These include the following:

- Regionalization of GLCs and companies,
- "Political entrepreneurship", by which the State opens up overseas business opportunities for private capitalists and negotiates the institutional framework, and
- Tax incentives and various capability building support mechanisms.

The State's involvement in regionalization through GLCs and other companies set up by statutory boards is run on a commercial basis. The State, however, never takes on a greater proportion of the risk than what the private sector investors of the project are prepared to take. GLCs and companies of statutory boards are prepared to take the lead only in large infrastructural projects. In most other projects, the private sector entrepreneurs are expected to bear the primary risks and take the majority stakes.

By 2005, there is a large variety of facilitative measures and specific types of incentives offered primarily by EDB, IE Singapore, and SPRING to promote OFDI. The Singapore Government has been working on establishing free trade agreements (FTA) to remove trade and investment barriers. The Ministry of Trade and Industry reckons that a network of FTAs can be designed to support the business community in moving up the value-added ladder and knowledge chain. In particular, clauses on Rules of Origin (ROO) are drawn in such ways as to favour high-value-added portions of the production process to be located in Singapore, whereas other less important value chain activities can be relocated to nearby low-costs countries. In this way, FTAs facilitate SMEs that take advantage of increasing cross-border outsourcing by their customers. It also encourages large Singaporean TNCs to fragment their value-chain activities to capitalize on different locational advantages in Southeast Asia. Singapore has also signed bilateral investment treaties and double taxation avoidance agreements with various countries.

Other support measures through various agencies include grants, loans, tax incentives and equity financing. Both EDB and IE offer various kinds of support to all local companies. For instance, in terms of equity financing, the Growth Financing Program from EDB provides equity financing for overseas expansion that matches S$ 1 for every S$ 2 raised from third party investors. The EDB's SEEDS also provides similar equity financing to encourage development of new/better products or processes that are innovative, scalable and have potential for global markets.

In terms of loans, the EDB has the Approved Foreign Loan Incentive (AFL) with a minimum of S$ 200,000 that helps companies improve ability to access offshore financing for investment. Its Local Industry Upgrading Program (LIUP) continues to support local suppliers to upgrade through collaborations with foreign firms. The Regionalization Finance Scheme (RFS) from IE Singapore also helps local SMEs (total assets less than S$ 30 million) to set up overseas operations. Other IE Singapore's programmes such as the Overseas Investment Incentive (OII) provides a three-year support encouraging local companies to make overseas investments that generate spin-offs to Singapore, for example the enhancement of operations in Singapore and the creation or acquisition of new markets overseas that increase production, export sales and services of companies from Singapore.

For tax incentives, the programmes administrated by IE Singapore such as Double Deduction for Overseas Investment Development Expenditure (DD) allow a double deduction of up to S$ 200,000 per approval against the income of approved expenditure incurred in initiating and developing investment outside Singapore. This encourages local companies to explore overseas investment opportunities that will enable them to enhance their competitiveness to expand and grow. Programmes of the EDB such as the Expansion Incentive for Partnerships (EIP) provide a tax exemption on 50 per cent of the qualifying overseas income above a predetermined base that helps Singapore companies establish competence and conduct a substantial amount of regional activities. Also, the Integrated Industrial Capital Allowance (IICA) allows companies to claim capital allowances for approved expenditure on plant and equipment used in overseas subsidiaries.

In general, SPRING targets SMEs as several of its assistance schemes (e.g. LEFS, V-Loan, LETAS) have a ceiling of fixed assets of no more than S$ 15 million and of fewer than 10 (service industry is up to 200). In addition, there are many programmes of IE, EDB and SPRING that target information or technology-oriented sectors (such as high-tech and bio-tech). There are no explicit restrictions on using those financial supports for overseas operation or

[105] See Ministry of Finance (1993) and Kulwant Singh and Ang Siah Hwee (1998).

market expansion, as long as the core and highest-value activities remain in Singapore. The EDB also has an investment arm that acts as the "visible hand" of the Government in promoting the productivity, innovation and competitiveness of companies in Singapore through different policy measures and incentives.

F. Conclusion

Singapore is an established outward investor among the developing economies. It is the second largest outward direct investor after Hong Kong (China). The geographical spread of Singapore OFDI extends to many regions and countries. While most of the major OFDI activities are associated with large Singaporean companies, more Singapore SMEs are also investing abroad for similar reasons. OFDI by Singapore SMEs is in most cases through greenfield and joint venture activities rather than cross-border M&A. Because of their financial positions and scale of their operations, SMEs from Singapore remain interested in regional markets rather than global markets, but the larger enterprises are investing as far afield as Europe, the Middle East and Africa.

There is clearly a growing awareness among Singapore enterprises of the importance of competing in the global economy through direct presence in host countries. The main motives for Singaporean firms' internationalization include:

- The country's limited domestic market is a very significant "push" factor in propelling Singapore enterprises to expand their markets abroad.
- Singapore's role as an international financial centre has contributed to the availability of capital for internationalization, and access to good information on foreign markets has proved crucial to successful OFDI.

The Singapore Government plays a significant role in promoting OFDI. The direct presence of several government agencies (e.g. EDB and IE Singapore) in key markets further offers assistance and guarantees to Singaporean investors. This institutional support is far more effective in facilitating OFDI than are incentives per se. Since 1993, OFDI from Singapore has helped increase the competitiveness of Singaporean firms and the Singapore economy. Through OFDI, Singapore companies have gained better access to competitive markets, and/or acquired sophisticated technological knowledge and managerial skills.

The analysis of selected cases of Singapore enterprises reveals that a significant proportion of their revenues and assets are related to OFDI activities. Two thirds of firms investing abroad surveyed confirmed that OFDI had increased their competitiveness. OFDI had contributed to increasing familiarity and experience with international business, which enhance firm-specific assets, including improving the reputation and brand image of Singaporean enterprises. This internationalization process has also helped strengthen managerial and marketing expertise and market access.

Like the large enterprises, SMEs from Singapore have benefited from the regionalization of their operations. SMEs are able to sustain their cost competitiveness through their manufacturing presence in nearby countries within the region. They have invested within the Asian region, focusing primarily on such low-cost destinations as China, Indonesia, Malaysia, Thailand and Viet Nam. OFDI has also played a critical role for Singapore SMEs to continue to support their main customers overseas, and allowed others to develop new markets in the host countries. As SMEs find it increasingly difficult to expand their markets in Singapore, they begin to look for more business opportunities in the Asian region. Their operations focus on producing for their large customers locally. However, over time, they have diversified into other business activities such as property development and trading. This unexpected diversification in business activities has provided Singaporean SMEs with a new avenue for business growth and development.

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Annex A. OFDI-facilitating programme by agencies of the Singapore Government, 2004

Programme	Nature of support	Agency	Specific to OFDI	Goal	Ownership of recipients	Special requirements
Growth Financing Program	S$1 million max	EDB	Yes, and highest value-added functions reside in SG	Equity financing for earnest overseas expansion activities; every S$ 2 raised from third party investors will be matched by S$1 from EDB	Incorporated in Singapore (SG) and core activities in SG	–
SPRING SEEDS	S$ 300,000 max	SPRING	Yes, and highest value-added functions reside in SG	Matching every dollar raised by a start-up from third party investor up to max. S$ 300,000;	Incorporated in SG and core activities in SG	–
Approved Foreign Loan Incentive (AFL)	Loan: min S$ 200,000	EDB	Yes	Improves company's ability to access offshore financing for investments	–	–
Expansion Incentive for Partnerships (EIP)	Tax incentives	EDB	Yes	Leads to establishment of a regional centre of competence;	At least 50% of equity stake be held by SG tax residents (accounting/law firms legally constituted as partnership)	–
Integrated Industrial Capital Allowance (IICA)	Tax incentives	EDB	Yes	Allows companies to claim K allowances for approved expenditure on plant & equipment used in overseas subsidiaries;	Plants or equipment must be owned by SG	–
Regionalization Finance Scheme (Indonesia) (RFS-I)	Fixed rate loans	EDB	Yes	Investment in manufacturing operations or set up/expand operations in Indonesia	All SG companies	–
Startup Enterprise Development Scheme (SEEDS)	Equity: matching funds for startups which have third party investors	EDB	Yes	Encourages entrepreneurship (scalability for the international market)	Innovative enterprises	–

Programme	Nature of support	Agency	Specific to OFDI	Goal	Ownership of recipients	Special requirements
Double Deduction for Overseas Investment Development Expenditure (DD)	S$ 200,000 max	IE	Yes	Encourages local enterprises to explore overseas investment opportunities	SG registered company/firm with operations in SG (30% SG citizens or permanent residents)	–
Overseas Investment Incentive	3 years from date of approval	IE	Yes	Encourages SG companies to make investments overseas that generate spin-offs to SG (e.g. enhance SG operations, productions, exports sales, etc.)	Min. 50% of paid-up capital beneficially owned by SG citizens or permanent residents	>10 employees; min S$5 million turnover; for new place or new product or new tech outside Singapore
Regionalization Finance Scheme (RFS)	S$ 10 million max	IE	Yes	Helps local enterprises to set up operations overseas (purchase of fixed assets, purchase or construction of factories or buildings)	SG-based or SG-listed company (min 51% SG local equity)	<200 in service sector and <$30 million in turnover
Double Tax Deduction for Market Development Scheme		STB	Yes	Encourages SG companies to expand overseas	SG registered companies or company having a permanent establishment in SG	–
EDBV Management Pte Ltd (EDBVM)	Manages the venture capital and private equity investments of EDB	EDB	Some (61% in SG by portfolio companies, 29% by # of funds)	Commercializes innovative and emerging technology, develops new business models and brings together new talents to create transformational opportunities that have a global impact/market	–	–
TIF Ventures Pte Ltd	Government-owned Fund-of-funds mgmt company	EDB	Some	Promotes high-growth tech-oriented companies in SG	–	–
Loan Insurance Scheme II (LIS II)		IE	Some	Offers SG-based companies an additional source of financing to fuel their entrepreneurial aspirations	SME: 30% local shareholding	<200 in service and <S$15 million in turnover

Programme	Nature of support	Agency	Specific to OFDI	Goal	Ownership of recipients	Special requirements
Loan Insurance Scheme II (LIS II)	1 year	IE	Some	Offers SG -based companies an additional source of financing to fuel their entrepreneurial aspirations	ISC: 30% local shareholding	200-500 in service; S$15-50 million in turnover
Enterprise Investment Incentive Scheme (EII)	S$3 million max	SPRING	Probably not, as start-up activities in SG	Mainly for start-up and unlisted in initial years of existence with a paid-up capital of at least S$ 10,000	–	–
Innovation Development Scheme (IDS)	Grants	EDB	Not sure	Supports innovation-based activities (expenditure)	All SG companies	–
Investment Allowance (IA)	Tax incentives	EDB	Not sure	Introduces new technology to the industry	–	–
Resource Productivity Scheme (RPS)	Fixed rate loans	EDB	Not sure	–	SG-based companies	–
Local Industry Upgrading Program (LIUP)	Grants	EDB	Maybe	Provides support for local suppliers to upgrade through collaborations with foreign firms	–	–
Local Enterprise Finance Scheme (LEFS)	S$15 million max.	SPRING	Maybe	Fixed interest rate financing programme	At least 30% local equity	< 200 in non-manufacturing and < S$15 million in turnover
Micro Loan Program	S$ 50,000	SPRING	Maybe	Fixed interest rate financing programme	At least 30% local equity	< 10, <200 in group employment in service and < S$15 million in turnover
Variable Interest Loan Scheme (V-Loan)	Same as LEFS and Micro loan	SPRING	Maybe	Complements the existing LEFS	At least 30% local equity	< 10, <200 in group employment in service and < S$15 million in turnover
Bio*One Capital	Manages funds investments in biotech, pharmaceutical & medical technology	EDB	Maybe	Enhances the level of biomedical industrial activities in SG	–	–
Loan Insurance Scheme (LIS)	–	SPRING	–	Same as LIS II from IE	–	–
Local Enterprise Technical Assistance Scheme (LETAS)	–	SPRING	–	–	at least 30% local equity	< 10, <200 in group employment in service and < S$15 million in turnover

Sources: Websites of various government agencies.

CHAPTER XI

OUTWARD FOREIGN DIRECT INVESTMENT BY ENTERPRISES FROM SOUTH AFRICA*

A. Introduction

South Africa is an emerging outward investor. The main pull factors for investment abroad were the desire of South African companies to internationalize to access markets, natural resources and technologies, diversify, support trade channels, control value chains. Among the push factors were market liberalization and relaxation of exchange controls. This paper analyses the trends and distribution of OFDI from South Africa. It examines the drivers, motivations and reasons why South African OFDI is largely concentrated in a few host economies. It explores the implications for the competitiveness of South African companies and the characteristics of OFDI by SMEs. It also reviews the policy environment and support measures to encourage OFDI by South African enterprises.

B. OFDI from South Africa: Trends and development

South African OFDI started in the 1980s, but the push to invest abroad occurred after 1990, largely owing to the relaxation of restrictions and OFDI liberalization. The pressure for South African companies to diversify their operations internationally became stronger after 1990. Until 1990, exchange controls in South Africa encouraged domestic vertical integration.[106] Thereafter, corporate strategies based on conglomeration evolved into "focusing on core businesses." South Africa is the largest source of FDI in Africa. Its OFDI flows increased since the 1990s, and OFDI stock totalled $29 billion in 2004 (UNCTAD 2005). FDI outflows have exceeded FDI inflows in most years since 1990 (table 1). South Africa ranked among the top 10 largest outward investors among emerging economies.

Geographical distribution. The largest share of its OFDI was in Europe and Africa. More recently OFDI also targeted North America (particularly the United States). South African OFDI is geographically concentrated, with over 90 per cent of the country's OFDI stock in 10 host economies in 2003 (table 2). Most OFDI is associated with large South African enterprises, but there are notable exceptions among South African SMEs investing mainly in Africa.

In the 1990s, South African enterprises acquired assets abroad to strengthen their position and international image in preparation for the transfer of stock exchange listings abroad. The transfer of listing to the London Stock Exchange in 1994 was a key development that contributed to the rapid growth of South African OFDI. About three quarters of South Africa's OFDI stock was in Europe and another 9 per cent each in the Americas and Africa (figure 1).

Fifty-seven companies listed on Johannesburg's Securities Exchange (JSE) in 2004 had also a listing in at least one other foreign stock market. Twenty-seven of them were listed on the London Stock Exchange (LSE). They included large South African companies such as Billiton, Anglo American, Old Mutual, South African Breweries and Dimension Data.

South Africa is the largest investor in Mozambique and among the leading investors in many other African countries.[107] The number of South African companies doing business in Africa has more than doubled in a decade since 1994 and by the beginning of 2005; 34 of the top 100 JSE-listed companies had 232 investment projects in 27 African countries,

* This paper was prepared by Reginald Rumney, former Executive Director, BusinessMap Foundation, South Africa.

[106] South African enterprises grew through acquisitions of foreign interests that divested in South Africa during the apartheid years. Other means included acquisitions of smaller enterprises by larger mining companies.

[107] See (http://www.sabcnews.com/economy/business/0,2172,89935,00.html).

Table 1. South Africa: inward and outward FDI flows, 1990-2004
(Millions of rand)

Year	Inward FDI flows	Outward FDI flows	Exchange rate Rand to one US dollar
1990	-203	71	2.58732
1991	685	574	2.76131
1992	10	5 524	2.85201
1993	33	974	3.26774
1994	1 348	4 388	3.5508
1995	4 502	9 059	3.62709
1996	3 515	4 485	4.29935
1997	17 587	10 831	4.60796
1998	3 104	9 841	5.52828
1999	9 184	9 659	6.10948
2000	6 158	1 878	6.93983
2001	58 404	-27 359	8.60918
2002	7 958	-4 195	10.5407
2003	5 443	4 365	7.56475

Source: South African Reserve Bank.

Table 2. South Africa: Top 10 OFDI destinations, 2003
(Millions of rand)

Rank	Country	Amount
1	United Kingdom	44 084
2	Luxembourg	43 704
3	Belgium	23 080
4	United States	14 936
5	Austria	11 183
6	Australia	6 804
7	Germany	6 559
8	Netherlands	5 925
9	Mozambique	5 071
10	Mauritius	4 106
	Total (top 10)	**165 452**
	Total OFDI stock	**180 507**

Source: South African Reserve Bank (2005).

Note: Ranking in terms of OFDI stock. Exchange rate in 2003 (end of year): R 6.64 = US $1.

employing 71,874 people.[108] South African OFDI in Africa spans a wide range of industries, from cellular communications to mining activities.

More than 22 per cent of FDI flows received by the South African Development Community (SADC) in 1994-2004 were from South Africa. Its share of total FDI went up to more that 40 per cent in some years (table 3). Despite earlier exchange controls, OFDI from South Africa to the neighbouring countries of the Common Monetary Area (e.g. Lesotho, Namibia and Swaziland) has never been restricted.[109] South Africa's largest banks, for instance, had established subsidiaries long before the outward investment increase in SADC.

Sectoral distribution. The bulk of South Africa's OFDI stock in 2003 was from the private non-banking sector (table 4). OFDI activities by State-owned enterprises (SOEs) contributed only 2.5 per cent to the OFDI stock. OFDI by SOEs is a more recent phenomenon. The strong commitment of the Government in promoting the New Partnership for African Development (NEPAD) encouraged SOEs to expand into Africa. In fact, it was only after 2000 that South African SOEs started investing notably in Africa, contributing mainly to infrastructure development in the region.[110] Given the long experience of South African banks in Africa, the amount of OFDI in the banking sector in the region may be even higher than that indicated by available statistics. South African investment in banking has been driven by investment opportunities provided by privatization in the region, which offered assets at bargain prices.

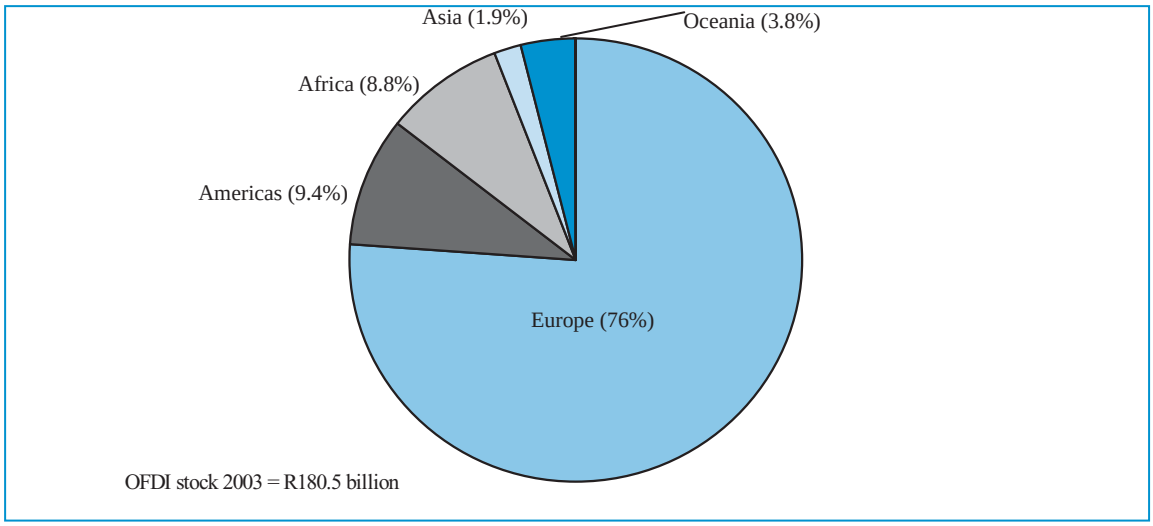
Financing of FDI. The financing strategy of South African OFDI differs by types of institutional investors. The largest share of the private non-banking sector's OFDI activities has been financed

[108] "Africa Inc", Who Owns Whom and the South Africa Institute of International Affairs, published in "Who Owns Whom 2005", Dun and Bradstreet 2005.

[109] South Africa is a member of the Common Currency Area.

[110] Bridging the Divide between South Africa and the Region through Development, keynote address by Jeff Radebe, Minister of Public Enterprises, to the HSRC–FORUM 150 Conference, 29 March 2004, Pretoria.

Figure 1. South Africa: OFDI stock, by region, 2003



Source: South African Reserve Bank (2005).

Note: Exchange rate in 2003 (end of year) R 6.64 = US $1.

Table 3. South Africa: OFDI to SADC, 1994-2004

(Millions of dollars; percentage)

Year	Total FDI to SADC	South African OFDI to SADC	South Africa's share of FDI to SADC
1994	60	26	43 %
1995	1 420	214	15 %
1996	1 149	97	8 %
1997	2 517	1 062	42 %
1998	5 085	1 988	39 %
1999	1 282	114	9 %
2000	904	281	31 %
2001	9 808	1 585	16 %
2002	4 600	1 884	41 %
2003	7 443	932	13 %
2004 (Ist half)	4 976	597	12 %
Total	39 244	8 781	22 %

Source: Business Map Foundation Database of Announced FDI.

Note: SADC includes Angola, Botswana, the Democratic Republic of the Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, the Seychelles, Swaziland, the United Republic of Tanzania, Zambia and Zimbabwe.

through reinvested earnings, while the banking sector preferred using equity capital. The SOEs used other forms of capital such as intra-company loans. The different financing strategies reflect the different degree of exposure of the different types of institutions to internationalization and the influence of government regulations on raising corporate finance abroad. The lion's share of OFDI by the private non-banking enterprises was financed through reinvested earnings. This suggests that the private non-banking enterprises have been profitable and reinvested earnings for capital expansion. Favourable OFDI experience and prospects of overseas operations in supporting long-term corporate growth also played a role. A lower level of reinvested earnings in the banking sector and SOEs is due to relatively recent OFDI activity. Thus, profitability has not been as high as that from other locations or internally generated

Table 4. South Africa: OFDI stock, by institutions and types of finance, 2003
(Millions of rand; Percentage)

Types of corporations/financing components	Value	Percentage
Public corporations	4,707	**2.6**
Equity capital	81	0.04
Reinvested earnings	1,653	0.9
Other capital	2,973	1.6
Banking sector	3,758	**2.1**
Equity capital	2,605	1.4
Reinvested earnings	1,153	0.6
Private non-banking sector	172,042	**95.3**
Equity capital	58,909	32.6
Reinvested earnings	102,727	56.9
Long-term capital	4,231	2.3
Short-term capital	6,175	3.4
Total OFDI	180,507	**100**

Source: South African Reserve Bank (2005).

funds may have not been sufficient to finance OFDI activities. Consequently, there is a need to resort to using equity or loan financing arrangements. A tax on foreign dividends levied until 2004 by the South African Government also encouraged reinvestment in OFDI activities by South African companies.

South African companies acquired assets abroad as part of their strategy for internationalization. M&A purchases were undertaken for various reasons, which range from financial and stock exchange listing motives to access to markets and natural resources. Most M&A purchases were in developed countries, primarily the United Kingdom, Australia and the United States (table 5). Fewer M&As were in developing countries and mainly concentrated in Africa because of privatization in host countries. Zimbabwe and Zambia received the largest South African M&A purchases among the developing countries in 1995-2004.

Some two-thirds of the M&A purchases were in services industries, led by finance and trade activities (table 6), suggesting the importance of market access, trade-supporting, diversification and long-term corporate growth motives. Because of its strong capital market, historical ties and investment opportunities, the United Kingdom was a prominent target country for South African M&A. M&As in software industries were also prominent and mainly in technologically advanced countries in Europe and the United States. Access to technology and skills are important drivers for South African M&A purchases by enterprises in the software industries. Mining has been an important area for acquisition of assets abroad to secure immediate access to natural resources and control over value chains.

C. Drivers and motivations

South African companies are investing abroad for various reasons, which differ at different times, between industries, types of corporations and host locations (tables 7 and 8). OFDI from South Africa is generally motivated by two sets of factors: (i) policy and macroeconomic factors, including home market economic condition and policies; and (ii) company-specific factors driving OFDI.

- **Policy and economic factors**. One of the key drivers of OFDI from South Africa was the end of the political isolation in the 1990s, which offered new opportunities for internationalization by South African companies. Prior to that, South African companies were investing abroad to diversify from the home economic environment and to prepare for their transfer of listing to stock exchanges abroad. BusinessMap noted in a study of the London listings in 2003 that while the reasons South African companies

Table 5. South Africa: Cross-border M&A purchases, by economy, 1995-2004
(Number of deals)

Economy	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	1995-2004
World	23	25	36	45	71	66	34	32	19	21	372
Developed countries and territories	13	15	24	35	61	52	25	22	14	14	275
United Kingdom	3	2	10	11	19	16	6	9	4	3	83
Australia	–	6	3	12	14	11	9	6	6	5	72
United States	2	2	5	4	9	11	6	3	1	1	44
Germany	4	2	1	1	3	3	1	1	–	–	16
Netherlands	–	–	1	1	3	–	1	1	1	–	8
Canada	–	1	–	1	2	2	–	1	–	1	8
Developing countries and territories	10	10	12	10	9	14	9	10	4	7	95
Africa	9	7	10	5	6	8	5	5	3	6	64
Zimbabwe	1	1	1	–	4	–	–	2	–	2	11
Zambia	1	–	4	2	–	2	1	–	–	–	10
Namibia	–	–	2	–	–	1	–	–	2	1	6
Malawi	–	3	–	1	–	–	1	–	–	–	5
United Republic of Tanzania	2	–	–	1	–	2	–	–	–	–	5
Botswana	1	1	1	–	–	–	1	–	–	1	5
Mozambique	–	1	1	–	–	1	1	–	–	–	4
Latin America and the Caribbean	–	3	–	3	–	1	–	3	–	–	10
Asia and Oceania	1	–	2	2	3	5	4	2	1	1	21
India	–	–	–	–	–	2	–	1	–	–	3
Thailand	–	–	–	–	2	–	–	–	–	–	2

Source: UNCTAD cross-border M&A database.

Table 6. South Africa: Cross-border M&A purchases, by indusdry, 1995-2004
(Number of deals)

Economy	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	1995-2004
Total industry	23	25	36	45	71	66	34	32	19	21	372
Primary	2	4	1	5	5	6	7	4	7	4	45
Mining	2	4	1	4	5	6	7	4	7	4	44
Secondary	5	9	10	4	8	14	4	6	3	8	71
Food, beverabes and tobacco	2	1	1	–	3	–	–	–	–	–	7
Wood and wood products	–	1	3	–	–	4	–	1	1	2	12
Oil and gas; petroleum refining	1	–	–	–	–	2	1	3	–	1	8
Chemicals and chemical products	1	2	2	–	1	1	–	–	–	1	8
Metal and metal products	–	2	–	2	1	1	–	1	–	–	7
Machinery	–	1	1	–	2	4	–	–	1	2	11
Electrical and electronic equipment	–	1	1	1	1	2	2	–	–	2	10
Services	15	11	25	36	58	46	23	22	9	9	254
Construction firms	–	–	1	–	1	1	–	–	1	1	5
Trade	–	1	6	14	16	7	4	3	–	2	53
Transport, storage and communications	1	–	2	1	3	1	1	–	2	2	13
Finance	12	9	10	11	18	16	11	16	6	3	112
Investment & commodity firms, dealers, exchanges	6	7	5	8	11	12	2	12	2	3	68
Insurance	2	–	4	1	–	2	1	2	2	–	14
Business activities	1	1	3	8	17	16	7	3	–	1	57
Prepackaged software	–	1	3	3	7	9	5	2	–	–	30
Business services	1	–	–	4	7	6	2	1	–	1	22

Source: UNCTAD cross-border M&A database.

Table 7. Drivers and motives of OFDI by South African enterprises, by types of enterprises and industry

Industry	*Drivers and motives*	*Enterprises*
Stated-owned enterprises	Government policy supports regional ooperation and infrastructure development Investment opportunities Privatisation in host countries Regional network of operations	Industrial Development Corporation Eskom PetroSA Transnet South African Airways
Private enterprises		
Natural resources and agriculture	Access to natural resources Investment opportunities from privatization Control value chains Access markets Lower cost of production	Anglogold Ashanti Illovo Sugar Metorex Sappi
Manufacturing	Access to markets and expand growth Sourcing of materials Diversification Trade-supporting	Mondi Sappi Steinhoff DPI Plastics Spamjaard Universal Footwear Sasol, Illovo Sugar
Services	Access to markets and expand growth Investment opportunities from privatizations Strengthen market position Regional networks Financial motives Transfer of listing and raising of capital	Datatec MTN Standard Bank Absa Bank Dimension Data Anglo American

Source: Author.

provided for changing their listing varied, their core motivations have been the same (Goster 2002). These reasons include the following:

(i) Access to larger and cheaper capital to finance expansion;

(ii) The possibility of being listed on the London Stock Exchange; and

(iii) Companies that encountered saturated domestic market were seeking expansion of markets abroad.

Increasing competition and market saturation at home encouraged South African companies to invest abroad to improve competitiveness and profitability. Historical ties played a role in the internationalization, as did investment opportunities that emerged in neighbouring countries through privatization (box 1). For instance, long familiarity with the business environment in the United Kingdom and strong personal and historical ties with the host country were the main reasons for South African OFDI in the United Kingdom. The policies adopted by the South African Government to strengthen regional cooperation have led South African SOEs to invest in the region in developing infrastructure facilities and to support business in Africa under the "African Renaissance" initiative. OFDI in the SADC region was influenced by the selective relaxation of exchange controls within the regional group (see OFDI policies). The improved OFDI policy environment (liberalization and relaxation of exchange controls) also contributed to the internationalization of South African companies.

- **Company drivers.** Corporate-specific factors in South African OFDI are similar to those for OFDI of other developing countries. They can be grouped, for instance, into resource-seeking and market-seeking.

Resource-seeking. Access to natural resources had led South African companies to invest in Africa and as far away as Australia. For example, in 2003, PetroSA acquired an interest in offshore facilities in Gabon and in Algeria. In 2004, it acquired an interest

Box 1. Privatization and investment opportunities for South African OFDI

Privatization and investment opportunities in neighbouring countries such as Mozambique and the United Republic of Tanzania encouraged South African companies and SOEs to invest in these countries. The State-owned Industrial Development Corporation (IDC) supports infrastructure development in the Southern African region through taking up equity stakes in projects. For instance, it took a 25 per cent equity interest in the first phase of the Mozal aluminium smelter project in Maputo (Mozambique) and participated in Mozal 2, the expansion project, for a cumulative investment of $538 million.[a] IDC has an interest in 89 projects and overseas activities in 28 African countries.[b] Its investment in the continent supports the South African Government's policy towards African regional cooperation and also responds to investment opportunities offered by privatization in the host country. Similarly, Eskom, an energy utility SOE, has invested in a joint venture project to supply electricity to the Mozal project in Mozambique. It invested about $32 million in 2002 in Lesotho's main telecommunications service provider. Transnet (a transportation SOE), through its airline subsidiary South African Airways (Pty) Ltd (SAA), acquired a 49 per cent stake in the Tanzanian national airline and has a 19 per cent interest in the Railway Systems of Zambia. Absa Ltd has operations in four African countries: Mozambique, Zimbabwe, the United Republic of Tanzania and Namibia. The first three were results of privatization that provided investment opportunities in Banco Austral in Mozambique, Commercial Bank of Zimbabwe and the National Bank of Commerce in the United Republic of Tanzania.

Source: Author, based on companies' information, BusinessMap database and IDC website.

Notes: [a] BusinessMap FDI database.
[b] IDC website: www.idc.co.za.

Table 8. Selected small and medium-sized TNCs from South Africa

Company	Subsidiary/host country	Industry	Reasons for OFDI
Spanjaard Ltd	• Molyslip Zimbabwe (100%) • Spanjaard UK (100%)	Chemicals speciality	Geographical diversification Its UK investment was to establish a conduit for exports of specialized lubricants and metal powders to that market. The company derives 28% of its revenue outside South Africa.
Metorex	• Metorex Burkino Faso BV (Netherlands/Burkino Faso) (100%) • Abbey Commodities (Switzerland) (100%) • Chibuluma Mines Plc (Zambia) (85%) • Ruashi Project (DRC) (68%)	Industries are zinc, marketing, copper and cobalt.	Resource seeking Metorex is a medium-sized mining company.
DPI Plastics (Pty) Ltd	• DPI Oregon (Zimbabwe) (50%) • DPI-Simba (Tanzania) (50%) • Aqualia (Pty) (Mauritius) • DPI International Ltd (Mauritius) (100%)	Plastics manufacture	Market seeking
Universal Footwear (Pty) Ltd	Two subsidiaries in China	Retailing-wholesale	Source materials and access to production facilities

Source: JSE Securities Exchange, various publications.

in an offshore oil field in Nigeria. The company also bought a stake in a gas-to-liquid fuel project in the Islamic Republic of Iran and in a fuel grade methanol project in Qatar. PetroSA OFDI was to access natural resources in oil and gas. Anglogold Ashanti (gold production), a merger between Anglogold (South Africa) and Ashanti (Ghana), has operations in 11 countries. Investment opportunities provided by the opening up of mining industries in host countries and access natural resources were among the key motivations for OFDI.

Market-seeking. The small size of the South African market has encouraged many firms to expand abroad. For example, the main reason for MTN's expansion is that as a dominant firm in the cellular telephone market in South Africa, it was impelled to seek new markets to pursue rapid growth. Cellular services provider such as MTN Group has expanded mainly in Africa. In July 2005, MTN acquired a 51 per cent interest in Loteny Telecom (Cote d'Ivoire). Similarly, Datatec invested in countries where telecommunications and Internet services are deregulated, especially in developed countries. Standard Bank Ltd has extensive operations in Africa. It has a network spanning 17 African countries. Standard Bank also has, through Standard International Holdings, subsidiaries in Asia, the United States, Brazil, Russian Federation and Turkey.

OFDI by South African SMEs. Market saturation, market-size limitation at home and the attractiveness of overseas markets have encouraged small and medium-sized South African TNCs to internationalize. But they are doing so at a slower pace and with smaller volumes of investment than larger companies. Despite the more favourable regulatory environment for OFDI, and the possibilities offered by market liberalization since 1990, only a few companies take advantage of opportunities abroad. An examination of the 100 companies by market capitalization on the JSE Securities Exchange reveals that only about 22 have one or more foreign affiliates abroad.[111] The motives for OFDI were largely the same for small and medium-sized companies as they were for the larger enterprises (table 8).

But trade support and market access were prominent reasons for the former (e.g. Spanjaard, Universal Footware). The geographical spread differs between the larger TNCs and the small and medium-sized ones. The latter tend to invest closer to home, often in the neighbouring countries, while the former ventures both near and far. Access to natural resources drives South African SMEs, as it did for large companies, to invest where they can secure supplies.

D. OFDI and implications for enterprise competitiveness

Of the top 50 non-financial TNCs from developing economies in 2002, seven were South African companies as compared with three in 1997 - a fact which implies strengthened positions vis-à-vis other developing country TNCs (table 9).[112] More than 50 per cent of these South African TNCs' assets are overseas and a significant proportion of their sales was generated from foreign operations. Five out of the seven TNCs have a transnationality index[113] of at least 50 per cent, which suggests that they are highly transnationalized.

OFDI has increased the competitiveness of South African companies in terms of increased profitability, revenues, market and assets expansion, access to technology and exposure to international business practices (tables 10 and 11). For example, *Anglogold Ashanti, Naspers, Barloworld, Sappi, Nampak, Alexander Forbes and Illovo Sugar* generated more than 50 per cent of their revenues, and have a significant proportion of their assets, outside the country. About four-fifths of *Illovo Sugar* profits in 2003 were generated abroad, mainly from neighbouring countries. *Mondi* trebled its turnover to $7 billion a year, of which $5.5 billion originated from operations in Europe.[114] *Steinhoff Ltd*, a furniture manufacturer, generated 73 per cent of its revenue in the European Union and the Pacific Rim, and 17 per cent in Africa. Of its net assets, 74 per cent are outside Africa. Steinhoff has operations in Poland, other European countries and Australia. *Datatec* is South Africa's most transnationalized IT company, with 95 per cent of its revenue in 2004 from overseas activities, mainly generated in the United States and the European Union (table 11). About two-fifths of *MTN* subscribers are now outside South Africa, with 31 per cent of them in Nigeria. Its average revenue per user (APRU) in Nigeria in the financial year 2004 was $51, down from $57 in 2003, but still substantially higher than the figure for its home base, South Africa, where the ARPU was roughly $31.

[111] These enterprises have a small turnover, number of employees and profits. They are not affiliates of larger companies and have invested, or are likely to invest, outside the country. They are enterprises listed at the lower end of the JSE listing.

[112] Ranked by foreign assets.

[113] The Transnationality Index is calculated as the average of three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

[114] Mondi contributed 22 per cent to Anglo American Corp's earnings in 2003, thus becoming the second largest contributor to the Anglo group.

Table 9. South Africa: Largest non-financial TNCs, ranked by foreign assets, 2002[a]
(Millions of dollars)

Corporation	Industry[c]	Foreign[c]	Assets		Sales	
			Total	Foreign[e]	Total	TNI[b] (%)
Sappi Limited	Paper	3 733[d]	4 641	2 941	3 729	71.7
Sasol Limited	Industrial chemicals	3 626	8 960	3 687	7 114	38.4
MTN Group Limited	Telecommunications	2 582	3 556	729	1 991	52.1
Anglogold Limited	Gold ores	2 301	3 964	831	1 761	54.4
Naspers Limited	Media	1 655[d]	2 498	412	1 148	39.0
Barloworld Limited	Diversified	1 596	2 569	1 984	3 409	54.5
Nampak Limited	Rubber and plastics	782[a]	2 281	328	1 317	48.9

Source: UNCTAD (2004, pp. 22-23).

[a] All data are based on the companies' annual reports unless otherwise stated.

[b] TNI is the abbreviation for "Transnationality Index". The Transnationality Index is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.

[c.] Industry classification for companies follows the United States Standard Industrial Classification as used by the United States Securities and Exchange Commission (SEC).

[d.] In a number of cases companies reported only partial foreign assets. In these cases, the ratio of the partial foreign assets to the partial (total) assets was applied to total assets to calculate the total foreign assets. In all cases, the resulting figures have been sent for confirmation to the companies.

[e] Foreign sales are based on the origin of the sales. In a number of cases companies reported only sales by destination.

South African companies have in general prospered with their OFDI activities in Africa. However, some South African companies have also experienced difficulties, especially when their overseas investments were not in their core businesses. Some companies have also overeagerly seized investment opportunities that came along without a proper risk assessment. There have been M&A failures, particularly those that did not create synergies with the core business.

E. OFDI policies

The existence of exchange controls for residents influenced the decision of South Africa's major companies to move their domiciles and primary listings offshore. Exchange controls became stringent in 1961. This was caused by the deterioration in the balance-of-payments, which made it necessary to restrict capital outflows.[115] When OFDI was allowed, it was by a special dispensation, since the general rule was prohibition. The screening process took into account the long-term benefit to the economy, such as the promotion of exports of both goods and services, including technology, the protection of existing markets and the development of new ones, and the protection of essential imports of goods and technology.

Selective easing of exchange controls has been used to encourage investment first in Southern Africa, specifically the SADC countries, and then in Africa. In March 1997, the Government relaxed exchange controls and South African firms were allowed to invest up to R30 million abroad, with an additional R20 million for investment in member countries of the SADC. This was followed by further relaxation in 1999 that allowed South Africa-resident firms to invest up to R250 million per approved investment in the SADC region. Fixed investment in new ventures allowed in the rest of the world was raised to R50 million. The investment ceilings were further relaxed in subsequent years. By 2004, South African companies were allowed to invest up to R2 billion per project in Africa, and half of that level for investment outside Africa. In addition, the amount that enterprises could raise in loans locally over and above the investment ceiling was increased from 10 per cent to 20 per cent. Despite the relaxation of

[115] Exchange Control Regulations, Orders and Rules 1961, which were promulgated in Government Notices R1111 and R1112 of 1 December 1961, issued under of the Currency and Exchanges Act (Act No. 9 of 1933).

Table 10. South Africa: OFDI and selected competitiveness indicators, by types and enterprises

Types/indicators of competitiveness	Enterprises	Remarks
Increased revenue and expanded markets	Sappi, Sasol, Anglogold, Barloworld, Mondi, Steinhoff, MTN Group, Datatec, Illovo Sugar	A significant proportion of revenues generated abroad. Access to overseas markets contributed to expanded market; improved market position.
Significant portion of assets located abroad	Sappi, Sasol, Anglogold, Naspers, Barloworld, Nampak, Steinhoof MTN Group, Datatec	Suggest greater exposure to international business. Able to diversify risk.
Increased profitability	Illovo Sugar, MTN Group	Overseas operations are more profitable than at home. A significant proportions of profits came from abroad.
Access to technology	Dimension Data Holdings, Datatec	Access to R&D and technology infrastructure and facilities of host countries, which contribute to competitiveness.

Source: UNCTAD.

Table 11. Growth and profit of Top South African TNCs, 2005

Avg. percentage growth — last 5 years (financial)			***Percentage of revenue generated outside South Africa***	***Percentage of assets outside South Africa***
Company	***Market capitalization***	***Attributable income***		
Sasol Ltd	28.8%	16.8%	38.0%	37.7%
MTN Group Ltd	43.3%	96.2%	36.5%	56.9%
Anglogold Ashanti Ltd	29.1%	31.3%	67.0%	50.0%
Gold Fields Ltd	29.5%	2.9%	49.7%	67.4%
Naspers Ltd	53.6%	71.2%	58.0%	32.0%
Bidvest Ltd	2.2%	1610.0%	35.0%	44.0%
Barloworld Ltd	82%	107.7%	54.0%	51.0%
Steinhoff International Holdings	21.1%	25.0%	73.0%	74.0%
Sappi Ltd	17.2%	-17.2%	74.0%	68.3%
Nampak Ltd	11%	17.2%	74.0%	68.3%
Alexander Forbes	2.6%	2.6%	52.0%	71.0%
Illovo Sugar	20.7%	-1.7%	52.0%	–
Datatec Ltd	24.4%	68.1%	95.2%	–

Source: Johannesburg Stock Exchange (data extracted a at 26 July 2005), media profiles and annual reports.

the exchange control limits, South African companies would still be required to make application to South African Reserve Bank's Exchange Control Department for monitoring purposes, as well as for approval, including the need to demonstrate benefits of the project to South Africa.[116] In June 2004, the tax on foreign dividends repatriated to South African shareholders in companies where those shareholders have more than a 25 per cent beneficial interest was removed. The existence of this remittance tax had the unintended incentive of encouraging investment in developed or capital-exporting countries rather than developing countries, such as those in Africa.[117]

F. Conclusion

Exchange controls prior to 1997, which were eased gradually thereafter, discouraged OFDI as well as portfolio investments. Residents were not allowed to have foreign bank accounts or invest in foreign funds. Neither outward nor inward direct investment was at the top of the agenda at the time of political instability in the 1970s and 1980s. The restriction on South African companies in raising finance against domestic assets limited OFDI. The lack of institutional support also played a role. Despite these obstacles, South African companies, SOEs and private enterprises, large enterprises and SMEs, have invested abroad to improve competitiveness in earlier periods and recently. They have invested in greenfield projects and acquired assets abroad to strengthen their market position, access new markets, secure natural resources, increase profitability, gain better control of their value chains, and access technology, skills and management expertise. An improved policy environment, liberalization and relaxation of exchange controls have further encouraged South African OFDI.

OFDI by South African SMEs has been limited as compared with that by larger enterprises. This is because SMEs faced more constraints than larger firms in investing abroad. These include the lack of access to finance and market information, concern over the additional risk of operating in an unfamiliar environment, and the lack of managerial skills and expertise in handling international business activities. OFDI by SMEs could be encouraged by providing support measures such as information on market and investment opportunities in target host countries or regions. Financing facilities for SMEs could be offered when consistent with the development objectives of the country. Equally useful would be the setting up of a special agency or division to cater to the specific needs of South African companies with regard to internationalization. OFDI promotion programmes such as outward investment missions can be useful as well as facilitation activities such as public-private sector dialogue and forums to exchange experiences, including with regard to policy issues, on internationalization through OFDI. Training and linking with business schools can also play an important role in strengthening capacity-building, especially regarding doing business abroad, risk management, cultural differences and international management.

The analysis of the internationalization of South African SMEs through OFDI in this chapter has been limited by the lack of statistics. This is one area to which attention should be given in order to gain insights into the strategies, drivers, challenges, benefits, obstacles and risks for South African SMEs with regard to investing abroad to improve competitiveness.

[116] "Exchange control on outward FDI abolished", Business Africa, 26 October 2004 (http://business.iafrica.com/mini_budget_2004/385554.htm).

[117] Medium Term Budget Policy Statement 2003, National Treasury, Republic of South Africa, 12 November 2003 (http://www.finance.gov.za/).

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CHAPTER XII

OUTWARD FOREIGN DIRECT INVESTMENT BY ENTERPRISES FROM TURKEY*

A. Introduction

OFDI from Turkey has increased significantly in recent years. The bulk of Turkish OFDI is in the neighbouring countries. Most of the Turkish firms that have invested in the neighbouring area are SMEs, although large enterprises account for most of the total OFDI value.[118] A combination of "push" and "pull" factors drove Turkish OFDI. Access to markets in the neighbouring economies such as the European Union, Middle East, Caucasus and the Russian Federation and Central Asia, including North Africa and the United States, was an important pull factor. The ability of Turkish firms to exploit these market opportunities also played a role. Among the push factors, the recent domestic economic crises, including high taxes and rising labour costs, encouraged Turkish enterprises to go abroad. The improved policy environment had also facilitated the OFDI process.

This paper focuses on the key issues related to OFDI by SMEs from Turkey. It provides an analysis of the current trend, drivers, motivations, market entry strategies, obstacles, and policies on OFDI. The paper draws on findings from interviews with Turkish firms by the author.

B. OFDI from Turkey: Trends and development

OFDI from Turkey has grown since the early 1990s. After the country's economic downturn in 1994, Turkey's OFDI accelerated (table 1).[119] The subsequent economic crises which occurred in 2000-2001 further pushed Turkish enterprises to go abroad. UNCTAD's Outward FDI Performance Index, measured as the ratio of a country's share in world FDI outflows to its share in world Gross Domestic Product (GDP), for Turkey rose from -0.004 in 1988 to 0.104 in 2003 (table 2). The ranking of Turkey among outward investors has also changed from 87th position to 64th out of 128 countries. The improved scores registered by these indexes suggests the strengthening of ownership-specific advantages of Turkish firms, including their desire to exploit these advantages abroad for strategic reasons and the weakening of the relative locational advantages of Turkey for both national and foreign firms (UNCTAD 2004).

Turkish OFDI flows as a percentage of gross fixed capital formation (GFCF) and Turkish OFDI stock as a percentage of GDP are below both the world total and developing countries percentages. However, the official OFDI data are likely to be under-reported (box 1).

Geographical distribution. Some 1,500 enterprises from Turkey invested $7 billion abroad in 1992-2004 (table 3). Most Turkish OFDI went

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[118] Based on the author's interviews with Turkish enterprises.

[119] UNCTAD as well as OECD data on the Turkish annual OFDI flows are those reported by the Turkish Central Bank in the Balance of Payment statistics (http://tcmbf40.tcmb.gov.tr/cbt.html). The Turkish Central Bank collects these data on a monthly basis from the foreign exchange position reports filed by Turkish banks. These data reflect currency transfers only and do not include in kind transfers that are supposed to be included in the Turkish Treasury statistics.

Table 1. Turkey: OFDI Trends, 1991-2003

(Millions of dollars; Percentages)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
FDI outflows ($ millions)	*27*	*65*	*14*	*49*	*113*	*110*	*251*	*367*	*645*	*870*	*497*	*175*	*499*
% of World FDI outflows	*0.013594*	*0.032247*	*0.005729*	*0.017052*	*0.031544*	*0.027689*	*0.052219*	*0.053402*	*0.059051*	*0.073304*	*0.068884*	*0.029338*	*0.081509*
% of Developing Countries FDI outflows	*0.227034*	*0.257172*	*0.035288*	*0.103247*	*0.214343*	*0.175517*	*0.312557*	*0.686778*	*0.854439*	*0.879415*	*0.830255*	*0.397648*	*1.402038*
FDI outward stock ($ millions)	*1,184*	*1,249*	*1,263*	*1,312*	*1,425*	*1,535*	*1,786*	*2,153*	*2,798*	*3,668*	*4,581*	*5,047*	*5,546*
% of World FDI outward stocks	*0.060783*	*0.060974*	*0.056338*	*0.051347*	*0.049179*	*0.047833*	*0.049418*	*0.050857*	*0.055403*	*0.061304*	*0.072313*	*0.070004*	*0.067660*
% of Developing Countries FDI outward stocks	*0.838789*	*0.759294*	*0.621083*	*0.515755*	*0.461726*	*0.426665*	*0.338470*	*0.394571*	*0.401176*	*0.462374*	*0.574306*	*0.633645*	*0.645874*
Outflows as % of GFCF (Turkey)	*0.1*	*0.2*	*0.0*	*0.2*	*0.3*	*0.2*	*0.5*	*0.7*	*1.6*	*2.0*	*1.9*	*0.6*	*1.4*
Outflows as % of GFCF (World)	*4.1*	*3.9*	*4.7*	*5.2*	*5.8*	*6.3*	*7.5*	*10.7*	*16.1*	*17.1*	*10.8*	*9.0*	*8.4*
Outflows as % of GFCF (Developing Countries)	*1.0*	*2.0*	*3.1*	*3.8*	*3.5*	*3.9*	*4.3*	*3.3*	*3.8*	*6.1*	*3.6*	*3.0*	*2.1*
Outward stock as % of GDP (Turkey)	*0.8*	*0.8*	*0.7*	*1.0*	*0.8*	*0.9*	*0.9*	*1.1*	*1.4*	*1.8*	*3.0*	*2.7*	*2.3*
Outward stock as % of GDP (World)	*9.0*	*8.2*	*9.3*	*9.8*	*10.0*	*10.8*	*12.2*	*14.4*	*16.6*	*19.1*	*20.4*	*22.6*	*23.0*
Outward stock as % of GDP (Developing Countries)	*4.0*	*3.3*	*4.9*	*5.5*	*5.7*	*6.1*	*8.5*	*9.4*	*11.8*	*12.4*	*12.6*	*12.6*	*12.2*

Source: UNCTAD (http://stats.unctad.org/fdi/)

Table 2. Turkey: OFDI Performance Index, 1988-2003

	1988-1990	1989-1991	1990-1992	1991-1993	1992-1994	1993-1995	1994-1996	1995-1997	1996-1998	1997-1999	1998-2000	1999-2001	2000-2002	2001-2003
A*	-0.004	0.002	0.017	0.024	0.028	0.033	0.047	0.064	0.073	0.086	0.096	0.113	0.107	0.104
B**	87	81	76	80	81	79	83	70	72	68	56	57	60	64

Source: UNCTAD (*http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3241&lang=1*).

* Turkey's Outward FDI Performance Index.

** Turkey's Ranking of Outward FDI Performance Index among 128 Countries. Outward FDI Performance Index is calculated as $OND_i = [(FDI_i / FDI_w)/(GDP_i / GDP_w)]$ where OND_i = Outward FDI Performance Index of the ith country; FDI_i = FDI outflows in the ith country; FDI_w = World FDI outflows; GDP_i = GDP in the ith country; and GDP_w = World GDP.

Box 1. Turkey: statistical issues on OFDI

Under-reporting of OFDI flows is a serious problem in developing countries (Aykut and Ratha 2004; World Bank 2005a). For example, the relatively small stock of Turkey OFDI ($157 million) in the Russian Federation as reported in official statistics suggests under-reporting of outflows. On the basis of interviews with large enterprises such as Koc Holding, Enka Holding and Anadolu Holding by the author, and based on information provided by the Foreign Economic Relations Board ((DEIK) 2005), it is estimated that at least $2 billion Turkish OFDI is in the Russian Federation. Enka Holding alone had invested about $1 billion in the Russian Federation, according to its founder. Further, the number of Turkish firms in the Russian Federation (87) (table 3) contrasted significantly with the number (600) reported by Russian sources (RusyaOfisi.com 2005).

Based on interviews with executives of Turkish firms and Turkish experts by the author, OFDI is significantly understated by official statistics. The main reasons include:

- Official statistics do not include financing component of OFDI in host or third countries through foreign banks or international capital markets.
- Transactions under $5 million, reinvested earnings of foreign affiliates and funds transferred abroad through, for example, over-invoicing of imports were excluded.

It was estimated that cumulative Turkish OFDI is at least $15 billion, more than double the official figure provided by the Turkish Treasury (Dikbas 2005).

Source: Author.

to the Netherlands; however, part of the OFDI was trans-shipped from the Netherlands to a third country. Financial motives such as benefits of favourable taxes attracted Turkish OFDI to the Netherlands, as did the double taxation treaty concluded in 1986 between the Netherlands and Turkey (General Directorate of Incomes 2005).[120]

Azerbaijan was the second most preferred destination, led by significant OFDI from the Turkish Petroleum Corporation (TPAO) in the Azeri energy sector in the early 1990s. TPAO, a State-owned petroleum enterprise, has large investment in other countries in the Caucasus, Central Asia, the Middle East and North Africa.[121] This company alone accounted in that period for about $2 billion of the total Turkish OFDI. TPAO's objective is to participate, mainly through the Turkish Petroleum International Company Ltd. (TPIC), in international oil and natural gas exploration that would help Turkey access to natural resources.[122] The Russian Federation is another important OFDI destination. Most Turkish OFDI to the Russian Federation is concentrated in retail services, durable and non-durable consumer goods, real estate and property development activities. Market access and geographical diversification were the two main motivations.

Sectoral distribution. The energy sector accounted for more than a quarter of the total OFDI in 1992-2004 (table 4), dominated by TPAO's investment in Azerbaijan. Manufacturing and banking each accounted for about a one-fifth share. Manufacturing concentrated in the Netherlands, and together with Germany accounted for most of the banking OFDI activities. The case studies surveyed for this paper and information reported in the Turkish press suggest that both the large enterprises and SMEs have relied on mergers and acquisitions (M&As) in their internationalization. For instance, Koc Holding and Sabanci Holding, Turkey's two largest conglomerates, have pursued acquisitions aggressively in both developed and developing host countries. Many Turkish SMEs have invested in the neighbouring countries to take advantage of

[120] For instance, participation income arising from dividends and capital gains received from subsidiaries can be exempt from Dutch corporate income tax at holding companies. When a Dutch holding company distributes its participation income to its Turkish individual and corporate shareholders, they would be subject to 20 per cent and 5 per cent dividend and withholding taxes, respectively, in the Netherlands, but would be exempt from additional taxes in Turkey. This encourages Turkish companies to have intermediary holding companies in the Netherlands for corporate OFDI purposes.

[121] http://www.tpao.gov.tr.

[122] TPIC was incorporated in 1988 in Jersey Channel Islands.

investment opportunities offered by privatizations in the Balkans and Central Asia. They acquired State-owned enterprises in these host countries. The case studies also highlighted that Turkish firms prefer majority-owned joint ventures with local partners initially to minimize uncertainty and start-up costs, cope with host country bureaucratic obstacles, and to gain access to superior technology. They eventually acquired full ownership and control of their foreign affiliates after having exploited the initial benefits of joint venture.

Characteristics of OFDI by Turkish SMEs. According to a survey conducted by the Observatory of European SMEs, only 3 per cent of SMEs in Europe had undertaken OFDI; however, there were differences among countries.[123] Little is known empirically as to why SMEs choose OFDI and even less is known about the extent to which they realize their OFDI objectives. No national data on OFDI by SMEs exist in Turkey. In fact, no reliable statistics exist on Turkish SMEs (OECD 2004c). The special services that the Istanbul Chamber of Industry provides to support its SME members do not include facilitation of OFDI. SMEs in Turkey do not receive any specific direct and proactive support from any public organization for OFDI. Investment abroad is to a large extent still regarded with hostility. Nonetheless, despite the lack of public institutional support, Turkish SMEs invest abroad to survive, grow and become more competitive. The Chamber conducts annual surveys on its 11,000 members, of which 98 per cent have fewer than 250 employees, for their planned investments and the realization of those plans. The surveys revealed that both large companies and SMEs viewed OFDI as increasingly critical to their competitiveness and profitability (Istanbul Sanayi Odasi (ISO) 2005). The surveys also report that firms had planned to increase their OFDI by 17 per cent during the first half of 2004 but only 3 per cent had realized those plans. In the second half of 2004, 15 per cent had planned to increase their OFDI but only 4 per cent realized their plans. As for 2005, 25 per cent of all its members planned to invest abroad, of which 22 per cent were small-scale firms. The ISO states that its members find it increasingly more attractive to invest abroad than at home due to rising intermediate input prices and declining profitability in Turkey (ISO 2005). In the absence of adequate proactive support from the Turkish Government, the Foreign Economic Relations Board (DEIK), a private non-profit making Turkish business association established in 1986, played a major role in promoting OFDI.[124] The primary objective of DEİK is to improve Turkey's international economic relations through bilateral business councils (BBCs) formed between Turkey and countries that have significant trade and investment ties. DEIK provides services to Turkish companies that either already have or intend to develop business relations in the respective partner countries. The BBCs, which meet regularly, aim not only to improve the conditions of existing bilateral trade and investment ties, but also to provide a forum for the development of new ones by collecting and exchanging information on potential business opportunities in and outside Turkey. There were 67 BBCs operating under DEIK's umbrella as of June 2005. Many Turkish companies that are BBC members are also SMEs.

C. Drivers and motivations

The motivations of Turkish enterprises investing abroad differ according to size of firms (tables 5 and 6). The relative importance of the factors also varies across different companies. Liberalization, unfavourable economic conditions at home and privatization in neighbouring countries were among the key drivers (table 6). Saturated home market had encouraged Turkish enterprises to venture abroad to diversify risk, improve competitiveness and expand markets. Other important motivations include access to new markets, natural resources, technology and brand names. While cost motive is an important factor, it is not the overriding reason, particularly for the efficiency-seeking OFDI. The rise in Turkish TNCs has been described as belonging to the "second wave" of third-world TNCs whose "…globalization is less driven by cost factors per se, but more by a search for markets and technological innovations to compete successfully in the global economy" (Yeung 2000).

- **Liberalization and improved policy environment.** As the Turkish economy became more outward-oriented since the 1980s, the Government started to liberalize the country's OFDI regulatory environment. The improved policy environment played a role driving Turkish enterprises to go abroad. Competition at home and from abroad (through imports and inward FDI) also contributed to encouraging OFDI. In the nine companies interviewed by the auhor, liberalization of the home regulatory environment ranks a priori factor for OFDI. Along with the liberalization of the foreign exchange controls, the Turkish foreign trade regime has also been progressively liberalized, as a result of both the Uruguay Round and Turkey's customs union with the European Union, allowing much greater competition from imports. Turkey's inward FDI regime has also been liberalized, although not to the same

[123] http://europa.eu.int/comm/enterprise/enterprise_policy/analysis/doc/smes_observatory_2002_report1_en.pdf.

[124] http://www.deik.org.tr/default_eng.asp.

Table 3. Turkey: OFDI flows, by destination, 2002-2004

	2002		2003		2004		Cumulative total, 1992-2004	
Host Country	No. of Firms	Exported Capital $1,000	No. of Firms	Exported Capital $1,000	No. of Firms	Exported Capital $1,000	No. of Firms	Exported Capital $1,000
Netherlands	10	157,706	10	42,469	7	181,632	82	2,243,841
Azerbaijan	2	177,374	4	298,687	1	580,742	117	1,621,565
United Kingdom	3	196	2	4,529	–	18	60	524,209
Germany	12	3,760	10	2,738	2	4,483	139	473,965
Kazakhstan	3	593	5	1,664	3	3,901	74	435,228
Luxembourg	–	2,000	1	12,938	–	–	18	248,712
United States	10	6,477	4	932	2	859	76	180,439
Russian Federation	6	-3,201	7	-1,697	8	2,173	87	156,990
Romania	6	-10,034	10	7,774	7	4,721	129	135,024
Virgin Islands	4	8,904	1	821	–	–	10	118,848
France	–	–	2	57	4	163	33	93,448
Switzerland	2	151	2	1,175	–	–	36	84,877
Northern Cyprus	12	2,524	18	810	25	294	159	81,263
Bulgaria	6	9,299	3	4,950	–	4,943	43	62,568
Turkmenistan	–	7,879	–	4,976	–	60	25	57,437
Belgium	2	59	–	0	1	55	17	52,377
Hungary	–	–	1	15	1	9	9	43,144
Austria	–	734	–	0	–	–	9	40,440
Bahrain	–	188	–	0	–	–	11	39,381
Ireland	1	1,828	–	1,550	–	1,218	18	33,427
Georgia	–	–	–	36	–	–	16	30,622
Malta	–	–	2	1,500	–	–	12	26,464
Algeria	–	25,808	2	232	1	209	7	26,342
Kyrgyzstan	–	–	–	248	–	–	15	23,961
Uzbekistan	2	497	–	541	2	507	58	20,770
Others	17	20,409	18	11,947	25	23,559	233	207,724
Total	**98**	**413,149**	**102**	**398,893**	**89**	**809,548**	**1,493**	**7,063,066**

Source: Turkish Treasury (http://www.hazine.gov.tr/english/bak/country_year.xls) (Accessed in fourth quarter 2005).

Table 4. Turkey: Cumulative distribution of OFDI flows, by industry and destination, 2004

(Thousands of dollars)

Host Country	Energy	Manufac-turing	Banking	Other Financial Services	Trade	Tele-commu-nications	Tourism	Construc-tion	Mining	Trans-por-tation	Insu-rance	Others	Total
Netherlands	6,412	739,468	324,826	880,966	128,052	158,518	5,540	–	–	–	–	58	2,243,841
Azerbaijan	1,552,576	28,641	3,560	–	11,084	23,200	–	6	2,067	–	432	–	1,621,565
United Kingdom	–	210,799	111,575	7,218	169,419	–	3,012	–	–	44	–	22,142	524,209
Germany	–	45,114	369,512	–	20,610	–	16,028	21,510	–	208	909	74	473,965
Kazakhstan	287,673	40,988	32,309	555	17,126	12,883	38,771	1,724	–	3,000	–	201	435,228
Luxembourg	–	–	89,500	25,616	121,850	–	–	11,746	–	–	–	–	248,712
United States	–	55,700	63,408	15	50,800	1,500	935	5,834	–	500	–	1,748	180,439
Russian Federation	50	40,923	65,340	–	47,516	–	98	2,958	–	–	–	105	156,990
Romania	–	72,107	10,002	2,113	28,017	–	7,112	2,931	12,550	56	77	59	135,024
Virgin Islands	–	–	–	65,231	44,713	–	7,117	1,787	–	–	–	–	118,848
France	–	199	17,312	–	14,671	56,677	3,755	–	–	834	–	–	93,448
Switzerland	–	16	51,966	9,333	10,318	–	–	13,116	–	41	29	57	84,877
Northern Cyprus	–	914	67,838	2,429	1,051	2,031	5,539	255	30	59	1,092	25	81,263
Bulgaria	158	11,430	22,791	120	27,770	–	225	68	–	5	–	–	62,568
Turkmenistan	–	41,695	2,885	–	500	–	2,804	995	8,557	–	–	–	57,437
Belgium	–	3,528	–	–	47,008	–	1,683	–	–	159	–	–	52,377
Hungary	–	40,529	2,601	–	5	–	–	9	–	–	–	–	43,144
Austria	–	2,997	35,104	–	2,302	–	37	–	–	–	–	–	40,440
Bahrain	–	–	37,958	1,423	–	–	–	–	–	–	–	–	39,381
Ireland	–	4,947	50	26,050	44	–	215	2,120	–	–	–	–	33,427
Georgia	–	9,459	3,796	–	6	16,762	–	600	–	–	–	–	30,622
Malta	–	–	300	11,145	13,519	–	–	–	–	1,500	–	–	26,464
Algeria	25,808	67	–	–	348	–	–	100	–	20	–	–	26,342
Kyrgyzstan	–	16,594	2,048	–	5,319	–	–	–	–	–	–	–	23,961
Uzbekistan	–	10,717	2,379	–	7,619	–	50	–	–	5	–	–	20,770
Others	11,768	52,326	33,832	2,033	51,932	29,691	638	19,424	3,111	1,420	–	1,550	207,724
Total	1,884,445	1,429,158	1,350,893	1,034,246	821,599	301,262	93,559	85,184	26,314	7,849	2,538	26,018	7,063,066

Source: Turkish Treasury (http://www.hazine.gov.tr/english/bak/country_sector.xls) (Accessed in fourth quarter 2005).

Table 5. Case studies: OFDI characteristics of selected Turkish enterprises

Enterprise	OFDI Characteristics								
	Host countries	Major OFDI activity	Names of foreign affiliates	Greenfield vs. Brownfield	Joint venture vs. full ownership	Foreign affiliate assets as percentage of total assets	Foreign affiliate employment as percentage of total employment	Foreign affiliate sales as percentage of total sales	Trans-nationality Index
Koc Holding	Russia	Retail services, Consumer durables	Ramenka Beko	Greenfield Greenfield	Joint venture Full ownership				
	China	Consumer durables	Chung Mei	Greenfield	Joint venture				
	Bulgaria	Retail services Oil & Gas distribution	Ramstore Opet/Aygaz	Greenfield Greenfield	Full ownership Full ownership				
	United Kingdom	Electronics	Fusion Digital	Greenfield	Joint venture				
	Germany	Consumer durables	Blomberg Werke	Brownfield	Full ownership				
	Romania	Consumer durables	Arctic	Brownfield	Full ownership				
	Netherlands	Holding company	Ardutch	Greenfield	Full ownership				
	Uzbekistan	Automotive	SamKocAuto	Greenfield	Joint venture				
	Azerbaijan	Retail services	Ramstore	Greenfield	Full ownership				
	Kazakhstan	Retail services	Rambutya	Greenfield	Joint venture				
	The Former Yugoslav Republic of Macedonia	Retail services	Ramstore	Greenfield	Full ownership				
	Austria	Consumer durables	Elektra Brengenz	Brownfield	Joint venture				
						8%	10%	11%	10%

Table 5. Case studies: OFDI characteristics of selected Turkish enterprises *(continued)*

Enterprise	OFDI Characteristics								
	Host countries	Major OFDI activity	Names of foreign affiliates	Greenfield vs. Brownfield	Joint venture vs. full ownership	Foreign affiliate assets as percentage of total assets	Foreign affiliate employment as percentage of total employment	Foreign affiliate sales as percentage of total sales	Trans-nationality Index
Sabanci Holding	Egypt	Industrial Nylon	Nile-Kordsa	Greenfield	Joint venture	7%	15%	17%	13%
	Islamic Republic of Iran	Industrial Nylon	Kian-Kordsa	Brownfield	Joint venture				
	Germany	Industrial Nylon	Interkordsa	Brownfield	Joint venture				
		Polyester	Advansa	Brownfield	Full ownership				
	United States	Holding Company	Kordsa Int.	Greenfield	Full ownership				
		Industrial Nylon	Dusa	Brownfield	Full ownership				
		Industrial Nylon	Kordsa	Brownfield	Full ownership				
		Industrial Nylon	Interkordsa	Brownfield	Full ownership				
	Netherlands	Holding Company	Advansa	Greenfield	Full ownership				
	United Kingdom	Polyester	Advansa	Brownfield	Full ownership				
	Brazil	Industrial Nylon	Dusa	Brownfield	Full ownership				
	Argentina	Industrial Nylon	Dusa	Brownfield	Full ownership				
Haznedar Refrakter	The Former Yugoslav Republic of Macedonia	Industrial Bricks	Vardar Dolomite	Brownfield	Full ownership	25%	29%	26%	27%
Borova	Azerbaijan	Retail Services	Master Tibot	Greenfield	Joint venture	20%	36%	10%	22%
Ener Holding	Romania	Hotel Services	Majestic Hotel	Brownfield	Joint venture	15%	100%	50%	55%

Table 5. Case studies: OFDI characteristics of selected Turkish enterprises (*continued*)

Enterprise	OFDI Characteristics								
	Host countries	Major OFDI activity	Names of foreign affiliates	Greenfield vs. Brownfield	Joint venture vs. full ownership	Foreign affiliate assets as percentage of total assets	Foreign affiliate employment as percentage of total employment	Foreign affiliate sales as percentage of total sales	Trans-nationality Index
Oynurden Kimya	Bulgaria	Wine Nursery	Agroden	Greenfield	Full ownership	3%	10%	10%	8%
Emsas	Kazakhstan	Hotel Services	Alatau Hotel	Brownfield	Full ownership	90%	35%	90%	72%
Aksan Kalip	Bulgaria	Industrial Electronics	Mikroak	Brownfield	Full ownership	43%	49%	38%	43%
Turkuaz	Kazakhstan	Retail Services/Food	Turkuaz	Greenfield	Full ownership	100%	100%	100%	100%
	Kyrgyzstan	Retail Services	Turkuaz	Greenfield	Full ownership				
	Tajikistan	Retail Services	Turkuaz	Greenfield	Full ownership				
	Uzbekistan	Retail Services	Turkuaz	Greenfield	Full ownership				

Source: Interviews conducted by the author.

extent as the import regime (Erdilek 2003). The increasing competitive pressure from imports and inward FDI on domestic firms has forced Turkish firms to seek foreign markets through exports and OFDI.

- **Unfavourable domestic economic environment.** The business environment in Turkey in the past decades has been a challenge or enterprises, particularly SMEs. "An inflationary economic climate and increasing public sector debt have led to a lack of confidence, a series of financial crises, a sharp rise in real interest rates and marked depreciation of the Turkish lira. GDP has fluctuated widely, punctuated by recessions, and average growth has been modest given the Turkish economy's growth potential and its needs." (OECD 2004c). Since 2003, the economic performance has improved substantially, with low inflation and higher real economic growth rates, and significant regulatory reform (World Bank 2004, 2005b). However, many of the problems that burden SMEs remain. According to the companies interviewed, most firms cited escape from the home economic environment as the main OFDI driver (five out of the nine cases). This is especially true for Koc Holding and Sabanci Holding, which faced increasing competitive pressure from imports. The two enterprises used OFDI as a means to increase their geographical diversification and enhance their competitiveness. The SMEs (Ener Holding, Emsas, and Aksan Kalip) also cited this factor as the main OFDI driver. High corporate and personal income tax rates in Turkey have also encouraged Turkish OFDI. The corporate income tax rate in Turkey is 30 per cent, compared with 15 and 16 per cent respectively in Bulgaria and Romania. Most of the Turkish business executives interviewed regard Turkey's tax system as a major obstacle to increasing their companies' competitiveness. Fiscal motives (avoidance of high tax rates) have been cited a significant OFDI driver for all but one of the nine companies interviewed.

- **Attractive investment environment abroad.** A major change in the investment environment occurred in several countries close to Turkey, which brought the adoption of market based economies. The opening up of these countries (e.g. the former USSR and the Balkans) to inward FDI, especially through the privatization of State-owned enterprises, has enabled Turkish firms to increase their presence in these countries. Of the nine cases interviewed, all but one (Sabanci Holding) have reacted to the change in the investment environment to either initiate or increase their OFDI to these countries.

- **Access to natural resources.** Access to natural resources has been an important motive for resource-seeking OFDI. Resource-rich neighbouring countries such as Azerbaijan witnessed strong Turkish OFDI. Among the nine cases, OFDI by Haznedar Refrakter, an SME, was driven by the acquisition of high quality dolomite deposits in Macedonia.

- **Access to markets.** Accessing new markets is a key motivation of Turkish OFDI. Saturated domestic market and competition from imports and inward investment were the prime reasons for Turkish market-seeking enterprises to venture abroad. Koc Holding and Sabanci Holding and SMEs such as Borova, Ener Holding, and Oynurden Kimya went abroad to gain access to new markets. Many Turkish firms, especially SMEs, have resorted to OFDI in the Balkans, the Russian Federation, and the Turkic Republics in Central Asia for trade-supporting motives. The motivations included avoiding high tariffs, rising transportation costs, high value of the Turkish currency, and bureaucratic obstacles to imports in these regions. In all nine cases, access to markets and geographical risk diversification had been cited as key OFDI drivers.

- **Access to technologies and brand names.** The companies surveyed reported access to technology as an important driver. For example, Sabanci Holding has benefited technologically from its joint venture with DuPont. Koc Holding has also gained access to new technologies, including hundreds of patents, through its acquisition of international brands such as Grundig (Germany). Among the seven SMEs, Aksan Kalip illustrated that the company's initial internationalization was driven by its determination to overcome its technological shortcomings. Oynurden Kimya, another SME, indicated that access to technology was not initially an OFDI driver but later became a dominant factor. Some companies also used OFDI to acquire international brands in their quest to strengthen their global presence (Koc Holding and Sabanci Holding). In order to facilitate its expansion in consumer durables in Europe, Koc Holding initially bought several brands, such as Blomberg (Germany), Elektra Brengez and Tirolia in Austria, the bankrupt appliance maker Brandt (France), and the Flavel and Leisure in United Kingdom. Koc Holding purchased later, in a 50-50 joint venture with

Alba (United Kingdom), the much better-known consumer electronics Grundig brand, along with Grundig's 717 patents. Sabanci Holding became the sole licensee of DuPont technologies, patents and trademarks in its businesses in Europe, the region of the former USSR and Africa, after buying out DuPont, the largest polyester company in Europe. In both cases, accessing foreign brands through OFDI has increased the competitiveness of these two Turkish TNCs both at home and abroad. They exploited the acquired brands, which led to increase in sales and profits as a percentage of total sales and profits. Turkey's largest beer producer, Efes Pilsen, produces the host country local brands such as Stary Melnik, Beliy Medved, Sokol, and Amsterdam Navigator in the Russian Federation; Karagandinskoe in Kazakhstan; Caraiman in Romania; Vitanta, Chisinau, and Arc in the Republic of Moldova. It also produces the leading international brands Warsteiner and Zlatopramen under license in the Russian Federation.[125]

D. OFDI and implications for enterprise competitiveness

OFDI had improved the competitiveness of most of the enterprises studied. Koc Holding (KH) and Sabanci Holding (SH) have learned to do business under very different conditions in different markets and have benefited from scale economies. Through OFDI, they diversified their business and country risks and they improved the quality of their products by competing with their rivals in foreign markets. OFDI has also led to increase in R&D and in-house technology development. Their Turkish managers who had worked in foreign affiliates returned home with valuable international experience in doing business under different conditions. KH and SH have increased their geographical diversification while at home they concentrated on core businesses, decreasing their sectoral diversification. All seven SMEs viewed OFDI as a way to reduce their risks from overdependence on the home market. All but one revealed that enhancing market access through OFDI has enabled them to increase their competitiveness through either geographical or product diversification. Several of these SMEs had not only improved their competitiveness through OFDI, but had also ensured their survival.

For example, in 2004, KH recorded 37 per cent of its total sales from combined exports and foreign affiliate sales. These combined exports and foreign affiliate sales rose from $1 billion to $7 billion during 2000-2004. KH's Arcelik in 2002 bought several brands through acquiring strategic European companies to facilitate its expansion in Europe. In 2003, Arcelik established in England an R&D and marketing affiliate, Fusion Digital Technologies, of which it owns 50 per cent shares. This joint venture, which develops digital technologies, aims to establish the Beko brand as the leader in Europe's TV market. Since its acquisition by Arcelik, Grundig's market share in Germany tripled from 3 to 9 per cent. In Romania, Arcelik acquired Arctic, a refrigerator manufacturer established in 1970. After modernizing Arctic and doubling its productive capacity, Arcelik made significant profits. Arctic, which also makes washing machines and other white household goods, has 50 per cent domestic market share in refrigerators and exports about 40 per cent of its output. Arcelik's combined exports and foreign affiliate sales led to a 29 per cent increase in its total revenues, and 70 per cent increase in its net income in 2004.

In retail services, KH's Migros group has been expanding overseas faster and with higher profitability than at home. Its foreign affiliate sales, in the Russian Federation, Kazakhstan, Azerbaijan, and Bulgaria, accounted for 16 per cent of its total sales of $1.7 billion and 39 per cent of its total profits in 2004. Although the sales in the Russian Federation alone accounted for about 15 per cent of the Migros sales in Turkey, the net income in the Russian Federation accounted for 50 per cent of the Migros net income.

The case of SH explains well the use of international expansion for establishing ties with advanced country firms in order to gain access to their knowledge, technologies and market connections. SH entered into its first joint venture with DuPont in 1987. The second joint venture was established in 1999. According to interviews with senior management, SH's major initial objective in these joint ventures was to access DuPont's technologies. In later years, SH's dependence on DuPont and other foreign technologies was reduced through SH's own R&D. SH has improved its international competitiveness significantly through its OFDI. In 2003, SH relocated its major R&D centre for industrial nylon from Chattanooga, Tennessee to Izmit, Turkey, as its in-house R&D capabilities reached global standards. The fact that SH has been able to buy out its major foreign partner, DuPont in both of its major fields of activity in a short period, and stand on its own feet in global markets, shows that SH has become a major TNC in the world in polyester and industrial nylon businesses. According to the senior executive, the crucial effect of OFDI on SH's competitiveness was to leverage the domestic reputation, trustworthiness, to the international level. Based on its international

[125] http://www.efesbev.com/our_group/beer_brands.aspx.

Table 6. OFDI drivers of selected Turkish enterprises

Enterprise	OFDI drivers							
	Libera-lization of home regulatory environ-ment	Home environ-ment as push factors	Foreign environ-ment as pull factors	Fiscal motives	Access to natural resources	Access to markets	Access to techno-logies	Access to brands
Sabanci Holding	X	X	–	X	–	X	X	X
Haznedar Refrakter	X	–	X	X	X	X	–	–
Borova	X	–	X	X	–	X	–	–
Ener Holding	X	X	X	X	–	X	–	–
Oynurden Kimya	X	–	X	X	–	X	X	–
Emsas	X	X	X	X	–	X	–	–
Aksan Kalip	X	X	X	X	–	X	X	–
Turkuaz	X	–	X	–	–	X	–	–

Source: Interviews conducted by the author.

experiences, the company can take fast decisions with greater confidence and decisiveness, to take advantage of new investment opportunities, without relying on foreign partners, with its own resources.

Haznedar Refrakter (HR), whose OFDI was driven by the acquisition of high-quality dolomite deposits in The Former Yugoslav Republic of Macedonia, has enhanced its competitiveness significantly both at home and abroad by increasing its product range and vertical integration. Its Macedonian plant, Vardar Dolomite, built close to high quality dolomite deposits, far superior to those found in Turkey, exports almost all of its output to HR for further processing into dolomite bricks, used primarily in the steel and cement industries. As the products of Vardar Dolomite are not produced by HR in Turkey, they increased HR's product as well as geographic diversification, making HR more competitive both at home and abroad. According to HR, "… the new plant in [The Former Yugoslav Republic of] Macedonia will not only introduce high quality dolomite to Turkey, but also it will make HR much more competitive among European suppliers, with its ISO 9002 certificate as the symbol of its proven quality." HR's access to high quality dolomite deposits of Vardar Dolomite has enabled it to increase its refractory industrial brick exports, due their improved quality, from Turkey to markets in Europe and the Far East.

Oynurden Kimya (OK), a family-owned business in manufacturing of industrial glues, originally intended to invest in Bulgaria to develop a market for its industrial glues. However, it later decided to exploit OFDI opportunities in the Bulgarian agricultural sector instead. Its successful wine grape nursery OFDI enabled it to transfer the wine nursery technology to Turkey. OK's wine nursery OFDI, an unintended but successful sectoral diversification has resulted in an important technology transfer from its host country to its home country, which has enabled OK to acquire the dominant competitive position in an entirely new business in Turkey.

In the SME cases, OFDI has helped the companies survive through the harsh economic conditions at home. A significant percentage of the total sales of the SMEs surveyed (Emsas, Haznedar Refrakter, Ener, Aksan Kalip and Turkuaz) were generated outside Turkey through OFDI (table 5).

- Ener Holding's Majestic Hotel in Bucharest has enabled the parent firm to survive the economic crises of 2000-2001, when its construction and tourism businesses in Turkey almost collapsed. Emsas's OFDI, an opportunistic investment in hotel services in Kazakhstan, enabled it to maintain financial viability under unfavourable conditions it faced in its construction business at home. Emsas finds its construction business in Turkey too competitive and not very profitable. It considers its OFDI highly successful and profitable, and has provided a steady cash flow for its overall operation.
- Aksan Kalip (AK), a manufacturer of electro-mechanical metal parts, relied on its wholly-owned Bulgarian affiliate (Mikroak) to make plastic moulds for its metal parts production at home. Mikroak has enabled AK to increase its production of the electro-mechanical parts with greater flexibility and reliability through in-house production of the moulds. Mikroak, which exports all of its output, three quarters to Turkey and the rest to Western Europe, has contributed significantly to AK's international competitiveness through product and geographical diversification.

E. OFDI policies

The liberalization of Turkey's regulatory environment, especially the relaxation of restrictions on foreign exchange and financial account transactions, has spurred OFDI. By promoting exports of goods and services to countries in the former USSR and the Balkans, the Turkish Government has paved the way for many Turkish enterprises to enter these markets first as exporters and then as direct investors.

The first important regulatory reform that encouraged OFDI is the liberalization of the foreign exchange regime. Turkey's regime governing foreign exchange transactions and capital movements is based on Law 1567 for the Protection of the Value of Turkish Currency, which was enacted in 1930.[126] This law, which initially and severely restricted Turkish foreign exchange transactions and capital movements, was subsequently amended in 1936, 1942, 1950, 1954, 1966, 1985, 1989 and 2003. The final amendment relaxed the restrictions.[127] Prior to 1989, the Turkish currency was inconvertible for both current account and financial account transactions. Turkish residents are now allowed to transfer, without seeking permission, up to $5 million, in either currency or in-kind, such as machinery, for OFDI purposes. Transactions exceeding $5 million would require government approval.

The officials of the Banking and Exchange General Directorate stated in interviews that very few applications for OFDI exceeding $5 million have been rejected. The few that were rejected were mainly because of the lack of proper documentation.[128] The requirement that capital transfers greater than $5 million must be authorized by the Turkish Treasury does not deter OFDI.

Aside from liberalization of exchange controls, the Turkish Government does not have specific policies promoting OFDI and the public perception of OFDI is mostly negative as it is seen as replacing domestic investment and employment losses. OFDI is viewed as a delocalization process that might benefit the investing firms but hurt the national economy.

Turkey has bilateral tax treaties on avoidance of double taxation with 60 countries[129] and bilateral investment treaties to promote and protect FDI with 79 countries.[130] These bilateral tax and investment treaties provided indirect encouragement for OFDI, although they were initially and primarily aimed at facilitating inward investment.

The Turk Eximbank played a very important role in the initial wave of OFDI into the Balkans, the Russian Federation and the Turkic Republics in Central Asia. It provided various types of export credit facilities, guarantee and insurance programs to Turkish enterprises, most of them SMEs. Since 1989, Turk Eximbank has provided under its Country Credit/ Guarantee Program financial facilities to Turkish

[126] http://www.tcmb.gov.tr/yeni/mevzuat/DISILISKILER/TPKKhakkinda1567Sayilikanun.htm.

[127] http://www.tcmb.gov.tr/yeni/mevzuat/DISILISKILER/32sayilikarar.htm.

[128] The proper documentation includes specific financial and operational information about both the Turkish parent firm and its foreign affiliate. After receiving permission for OFDI, the Turkish parent firm is expected to file periodic reports on the financial and operational activities of its foreign affiliates. The form that is expected to be filled out by Turkish parent firms consists of 17 questions. The first 15 questions ask for detailed data on the financial and operational characteristics of the affiliate. The last two questions are qualitative and subjective, asking about the "Problems Encountered," and "The Reasons and Expectations that Led to the Realized Investments." The officials of the Banking and Exchange General Directorate stated, however, that they receive relatively few such reports and very few of them are completed satisfactorily for any use. They also revealed that since they are short of qualified personnel they would not be able to process and analyze the reports even if they were completed satisfactorily. In other words, the Turkish Government has very limited financial and operational data, which can be used for either academic or policy research, on the OFDI activities of Turkish firms. This is also true of the IFDI activities of foreign firms in Turkey.

[129] http://www.gelirler.gov.tr/gelir2.nsf/CifteVergilendirme?OpenPage.

[130] http://www.yased.org.tr/page.asp?PageID=1230 .

firms investing overseas. About $2.2 billion in credits and guarantee facilities provided in 1989-2004 by the bank supported Turkish OFDI in 21 countries, mostly in the Balkans, Eastern Europe and Central Asia. Since 1996, Turk Eximbank has provided finance to Turkish OFDI projects in shopping malls and chain stores through the Overseas Chain Stores Investment Credit Program. It extended this program in 2003 to investments for establishing Turkish brands and promoting Turkish designer goods abroad, with a minimum fixed investment of $200,000 and a lending ratio of 85 per cent of the invested amount. The bank has considered implementing an Overseas Investment Insurance Program to provide insurance cover to Turkish OFDI against political risks.[131]

Turkish embassies and consulates in the host countries of the companies surveyed were helpful in providing information and intermediation to the enterprises in their initial stage of OFDI to the host countries. The customs union with the EU in 1996 and prospect of full EU membership have created opportunities for Turkish SMEs to undertake OFDI to the neighbouring countries in the region. Ankara European Information Center (AEIC)[132], financially supported by the European Commission, provides a platform for Turkish SMEs and EU enterprises interested in starting joint ventures in either Turkey or the EU to make contact with each other. On AEIC's website, Turkish SMEs can search for the profiles of EU enterprises that are potential joint venture partners.[133]

F. Conclusion

This study analyzed the trends, causes, policy consideration and effects of OFDI by Turkish firms on enterprise competitiveness. The emphasis has been on SMEs. Most Turkish firms that have invested in the neighbouring countries are SMEs, although large enterprises such as Koc Holding and Sabanci Holding account for most of the total value of OFDI transactions. The motives of large enterprises are mainly strategic and relate to long-term investment planning. However, those of SMEs are entrepreneurial, innovative, idiosyncratic and opportunistic. They invest abroad to exploit unique circumstances, to stay competitive and to survive in light of challenges they face in the domestic market environment. The drivers and motivations of OFDI vary between firms, and between Turkish SMEs and large TNCs. The key drivers appear to be liberalization of the home regulatory environment, constraints of home market, fiscal motivations and access to markets. High taxes, rising unit labour costs and trade supporting motives encouraged OFDI. Access to technologies, brand names and natural resources also played a significant role. Large Turkish construction companies have significant investment abroad. They paved the way in the 1970s for the rest of the Turkish private sector to enter international markets, first as exporters and later as direct investors. This process accelerated in the early 1990s, following the collapse of the USSR and the communist regimes in the Balkans, which acted as a powerful pull factor for Turkish OFDI.

Turkish enterprises, as later comers, have used different linkages, such as joint venture and original equipment manufacturer (OEM) relationship, with foreign enterprises in initiating and expanding their OFDI activities. Joint ventures appear to have been a common mode of entry to minimize risk and to access technologies of foreign partners. Both large enterprises (e.g. Koc Holding and Sabanci Holding) and SMEs used OFDI as a source of cumulative learning process (Johanson and Vahlne 2003).

Evidence from the nine case studies conducted suggests that OFDI has strengthened the competitiveness of Turkish enterprises in different ways. Geographical diversification against systemic and specific risks, and market access have benefited Turkish firms both in terms of economies of scale and improvement in quality standards of products and services. Access to technologies and brands benefited the large enterprises as it did for SMEs. For some SMEs, OFDI is seen not just as a means to improve competitiveness, but to ensure survival in light of home market environment, mounting competition and economic crises.

There is widespread concern in Turkey about OFDI. However, any effort to avoid delocalization should address the problems SMEs face in investing and growing at home. To the extent that OFDI increases the competitiveness of Turkish enterprises, the Turkish Government could consider facilitating OFDI as a step to improve the international competitiveness of both large Turkish enterprises and SMEs. The government agencies responsible for helping the formation and development of SMEs could add OFDI facilitation measures to their portfolio of services for SMEs. The Government can play a much more significant role in facilitating OFDI, especially by SMEs. The establishment of an Overseas Investment Insurance Program under the aegis of the Turk Eximbank would be another important step. The responsibilities of the Small and Medium Industry Development Organization (KOSGEB) of the Ministry of Industry and Trade, which provides

[131] http://www.eximbank.gov.tr/html_files/kisaeximbankpg.htm.

[132] AEIC was founded in 2002. It is a joint project of the Small and Medium Industry Development Organization (KOSGEB) of the Ministry of Industry and Trade and the Ankara Chambers of Commerce and Industry.

[133] http://www.abmankara.gov.tr/default.asp.

a wide range of services, such as export promotion, to SMEs should expand to include provision of not only information on the Internet but also individual and customized advice on OFDI opportunities and ways to realize those opportunities. The Chambers of Industry should also do the same and promote a better understanding of internationalization of enterprises through OFDI, including the challenges and how such internationalization process can help improve enterprise competitiveness. The Turkish Government should also channel the *required* resources into the collection and analysis of the data on OFDI activities of Turkish enterprises so that both academic and policy questions on the causes and effects of OFDI can be better answered.

Given that OFDI is becoming an increasingly important phenomenon relative to total economic activity in Turkey, the Government could consider allocating resources for studying the causes and effects of OFDI, especially by SMEs. The starting point for this could be the formation of a reliable database on OFDI by SMEs. The requirement for Turkish OFDI to be authorized by the Turkish Treasury could be removed, especially when such authorization requirement has been recently abolished for inward investment. The Treasury could consider more effective ways of collecting data on the financial and operational activities of Turkish affiliates abroad.

Turkey does not yet have an investment promotion agency (IPA) for either inward or outward FDI. An Investor Relations Office (IRO), established in the Turkish Treasury, provides timely and useful macroeconomic information for investing in Turkey and abroad. If an IPA were to be established, it could also serve as a catalyst for OFDI, especially by SMEs, in providing information and enabling contacts between Turkish and foreign enterprises.

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