Government motivations in influencing fdi

Government

For many years multinational enterprises known in short as MNEs have looked to foreign economies as a method of expansion. Foreign markets can offer an untapped resource of potential consumers, a wealth of knowledge that could be used to the companies advanced and possibly a chance to gain access to rare or unique resources.

The influx of FDI can offer many benefits for the chosen government's country. Many jobs can be created from the MNE entry, the MNE may bring in new knowledge unknown to the host country, a transfer of capital andtechnologymay also occur along with possible political strategic resource benefits.

Therefore it is no surprise in the past two decades we have seen the growth of world FDI stock to GDP raise from 5% to 16% and also the amount of transnational parent firms raise from 7000 to 40, 000 (Deresky H, International Management, 3rd ed)

This essay will look at the motivations behind government motivations to control and influence FDI and also themotivationand stimulus behind developed/emerging economies influencing FDI flow using China's policies as a prime example.

Firstly we will start off with a deeper insight into the benefits and foundations of FDI and how the motivation for government to influence FDI arises from this. We will look at why the Chinese economy in 1979 approved the law on joint ventures involving Chinese and foreign investment after years of communist rule. We will look in depth at how this opened up certain parts of

the Chinese economy and the effects it is having on the country as it gathers more FDI than any other emerging economy.

This will then be followed by an overview of other country governments such as the U. S, South Africa, India, Nigeria and such companies as Bridgestone, GM, PepsiCo, with regards to how FDI affects them and how their involvement benefits governments and provides them with the motivation to invite FDI investment within their economy.

Finally we will look at the more negative issues of FDI and the theories surrounding the complexities of FDI in both the short and long term. As well as the motivation for governments to try and influence FDI terms and conditions to meet their own benefits and control potential down falls.

Several primary factors have been key toward the raise in FDI over recent decades. FDI can offer numerous benefits to both the government and its investing MNE which we will discuss shortly.

But we must first consider what stimulates a successful MNE to search outside its home country and how a government should the reasons for doing so.

Primarily a MNEs key motive is to satisfy it stakeholders and among this is the desire for profit and expansion, FDI provides the MNE with an alternative option to typical profit enhancement schemes. The option to tap into potential markets of millions or even billions of consumers as well other possible advantages is too good an option for any MNE to decline.

FDI from MNEs however occurs in two key forms, so it is best we understand these forms of FDI before discussing government motivations behind influencing its flows.

Firstly FDI can be gained through the acquisition of a firm within the potential host country; this is a very popular method for FDI investment. Usually a firm would acquire a foreign business to gain instant access to a new potentially profitable market or to help the company with horizontal/vertical integration and rationalized production of their supply chain. A real life example of this would be Bridgestone tires. In 1980 the president of Bridgestone stated that its policy was to establish its presence in American, so in 1982 it used FDI to purchase a tire truck plant from Firestone. Later this was followed by the purchase of more plants across Europe in Italy, France, Spain as well as having 5 Plants in North American. This form of FDI has allowed Bridgestone to become the worlds second largest tire provider. For example they provide tires for 40% of North American vehicles built by ford and 21% of GM vehicles (Daniels J, Environments and Operations, 2001, pg275)

This buying of companies allows MNEs to avoid start-up problems and also the large amount offinancerequired to start a fresh.

Another key factor as it was with Bridgestone purchase of Firestone is the purchase of an already established business brings with it skills already in place. This can provide a great way to acquire new skills or upgrade current ones.

A benefit for both forms of FDI investment is it allows the horizontal/vertical integration and rationalized production. More commonly firms tend to use rationalized production to produce their goods. It is now very common place for parts of cars and many other products to be made in several different places due to cheaper labour or cheaper parts. Mercedes-Benz for example has shifted some production to Brazil to avoid raising costs in its home country (Daniels J, Environments and Operations, 2001, pg290)

HSBC have also recently followed suit by placing there telecommunication support centres in India rather than in England (Financial Times, 30th September edition)

This leads us to very interesting cartoon illustration by Chip Bok that highlights perfectly the effects of FDI for the consumer. Shown in Figure 1.

Concerns for the governments are to look at the rationalized production. For most home countries this can be a big concern and is something that needs to be influenced through restrictions for example. Host countries however may try to influence this into their countries.

Secondly companies can build assets and production centres in another potential host country. This usually occurs when there is no desired company available to purchase or in existence within the MNEs chosen country and market.

It can also be because of the problems that acquisitions carry. Many firms that are purchased can have problems already embedded within the firm or resistance from the firm regarding its take over. Going back to the

Bridgestone case discussed earlier they faced several problems when purchasing Firestone. Firestone operations and plants were much less efficient than they had assumed. Bridgestone had to spend large amounts ofmoneyto correct this. (Daniels J, Environments and Operations, 2001, pg281)

If they had built then they would have avoided these acquisition problems.

As we said earlier the main objective of most MNEs is to make a profit. One of the key factors therefore comes down to the potential market of a country. This can be measured in the size of a population. With developing countries such as China harbouring 1. 3 billion people and countries such as India, Nigeria, and South Africa offering similar figures there is plenty of potential consumers to be sort after.

However many factors such as the infrastructure, stability, political status, government regulations and importantly economic growth are also key factors.

McDonalds for example have suffered with its operations in Russia, in 1998 the ruble dropped in value by 70% as the Russian economy collapsed (Daniels J, Environments and Operations, 2001, pg117). McDonalds would have known some of the risk connected to Russia but went on the economies potential of size. However this economic instability will give warning to other MNEs who maybe put off investing. Therefore a good stable infrastructure and economy is key for governments to influence FDI flows into its country. Investment in such things aseducationand local enterprise are a good starting ground for governments.

Growth factors of countries such as China and India have been very influential in the government attracting FDI. With India being touted as a possible economic giant with ever increasing incomes and sales we have seen such companies as PespiCo and CocaCola fighting it out in the soft drink market to gain advantage and consumer preference to massive potential sales.

Other reasons for MNE to engage in FDI are plentiful and to shorten this assignment are situated briefly in Figure 2

Now that we know the stimulus behind MNEs investing capital in other countries we need to know what benefits and hindrances this may bring governments and why they should strive to influence its flows.

Most observers believe that FDI inflow into countries can enhance local development.

Many countries especially developing countries can have a reasonable level of unemployment. FDI allowed within a country can offer the chance for employment of unused labour. This has certainty been the key factor with the case of South Africa's decision about trying to influence FDI into its country.

South Africa in 1999 had unemployment levels estimated at 24 to 37% (Daniels J, Environments and Operations, 2001, pg399), this is a massive hindrance to a countries growth and development. The chance of influencing FDI into South Africa is an ideal way of stimulating investment within the country and creating the opportunity for new capital and employment

opportunities. MNEs especially ones building fresh capital ventures will require a labour source. This is why South Africa in recent years has enticed FDI into the country with Tax incentives, $5 Billion dollars in defence contract to foreign firms as well as $17 billion in development contracts (Daniels J, Environments and Operations, 2001, pg401), although it must be said that many countries offer incentives to entice FDI.

Looking at China as another positive example of FDI we see that in 1991 the amount of employment in China within MNE firms totalled over 1. 65 million workers. This has since rose to 5. 87 million workers in 1998 and has since risen again. (Source: Chinese Business Council, FDI in China 2002).

This is a giant gain to any economy and that is one of the key reasons why governments continue to try and influence FDI inflow. Fuller employment allows for plenty of social development as the unemployed are given new skills and disposable income.

Domestic economic growth is another reason for governments to try and influence FDI. Many countries have too low a domestic savings and investment rates to be able to stimulate enough growth.

The opportunity for countries suffering from low capital inflows such as South Africa to allow FDI is an ideal way to gain extra inflow.

Growth rates in China for example have been experiencing massive raises since 1979. The overall amount of FDI inflow into the country has increased from 200 million in 1980 to over 52 billion utilized dollars in 2002 (Source: Chinese Business Council, FDI in China 2002). This is a massive increase of

FDI and has enabled China to cement its place as one of the last emerging major economies of the world.

This will allow for China to build up reserves of capital which would allow the country to operate during times of trade deficit as well as develop its infrastructure with improvement in education and services.

Looking at figure 3 we can see other benefits that FDI flow brings to government.

Two of the major sectors of figure 3 that would be considered important for a government influencing FDI flows would be human resources and technological advantages.

When a MNE is allowed by a country to invest it is often likely that a transfer of knowledge or skill will occur.

It is very common for investing MNEs to send over managers (known as expatriates) from their home country to implement the smooth transfer of the MNEs investment. This in turn will bring over a transfer of skills and cultural understandings. Take for example the merger of Daimler Benz and Chrysler (Daniels J, Environments and Operations, 2001, pg743). It is was very important for the transfer of management in this case so that they understand each other cultures and work together as a new company, which as an advantage allows the merging home countries of the companies to gain new skills, understanding of cultures, technologies and political strategic resource gains.

The investing MNEs will want their workforce to have the skills that the company desires. In developing countries it can often be the case that these skills are lacking. So the opportunity for a MNE to enter their country and provide training to their workforce can be a very good incentive for governments to influence FDI flow

Technology also tends to come hand in hand with new training and knowledge. Let's look back at the China case and how technology has helped them.

Back in 1979 when China first opened up its markets it was not renowned for being one of the highest producers of computers and peripherals. However with the inflow of FDI and the technology, knowledge and training it has seen brought in from MNEs we now see China as the third highest producer of computers and peripherals second to only Japan and the United States. 50% of the firms within China that have brought them to this high standing are funded through foreign investment (Source: Professor Stephen Tallman and Alain Verbeke of The Journal of International Business Studies). This is a clear indication of the importance that FDI inflows have had toward the rise of China's economy.

Governments can also negotiate benefits for themselves during the process of inviting FDI. For example, India decided to allow PepsiCo to invest in its country but only under strict terms and conditions that would greatly benefit their country. In the terms was the joint venture for PepsiCo to establish an agricultural research centre to improve India's agricultural technology. This is as well as setting up new fruit and vegetable plants and also bringing in an

estimated 25, 000 extra jobs (Daniels J, Environments and Operations, 2001, pg435). This has allowed for the upgrading of current resource quality with the new research centre as well as an increase in jobs and production and also an increase of efficiency in the wastage of Punjabi fruits.

It also forces local business to face the new competition and either become more efficient or face closure. For example India's main soft drink home firm Parle Exports would have had to become more efficient due to the incoming of Coca-Cola and PepsiCo.

Government can usually gain access to more FDI through other methods such as trade restrictions and offering incentives. Surprisingly trade restrictions can help bring in FDI. If imports into a country are banned or limited then it is likely that if a country has potential market size then MNEs will invest within the country in the form of FDI. The Automobile market in Brazil bans imports but entices producers into the market due to its size (Daniels J, Environments and Operations, 2001, pg288).