

Theories of International Investment

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Product life cycle

(Raymond Vernon, 1966)

Product life cycle includes

- * introduction,
- * growth,
- * maturity, and
- * decline,
- and the location of production depends on the stage of the cycle.

Stage 1: Introduction

New products are introduced to meet local (i.e., national) needs, and new products are first exported to similar countries,

Stage 2: Growth

A copy product is produced elsewhere and introduced in the home country (and elsewhere) to capture growth in the home market.

Stage 3: Maturity

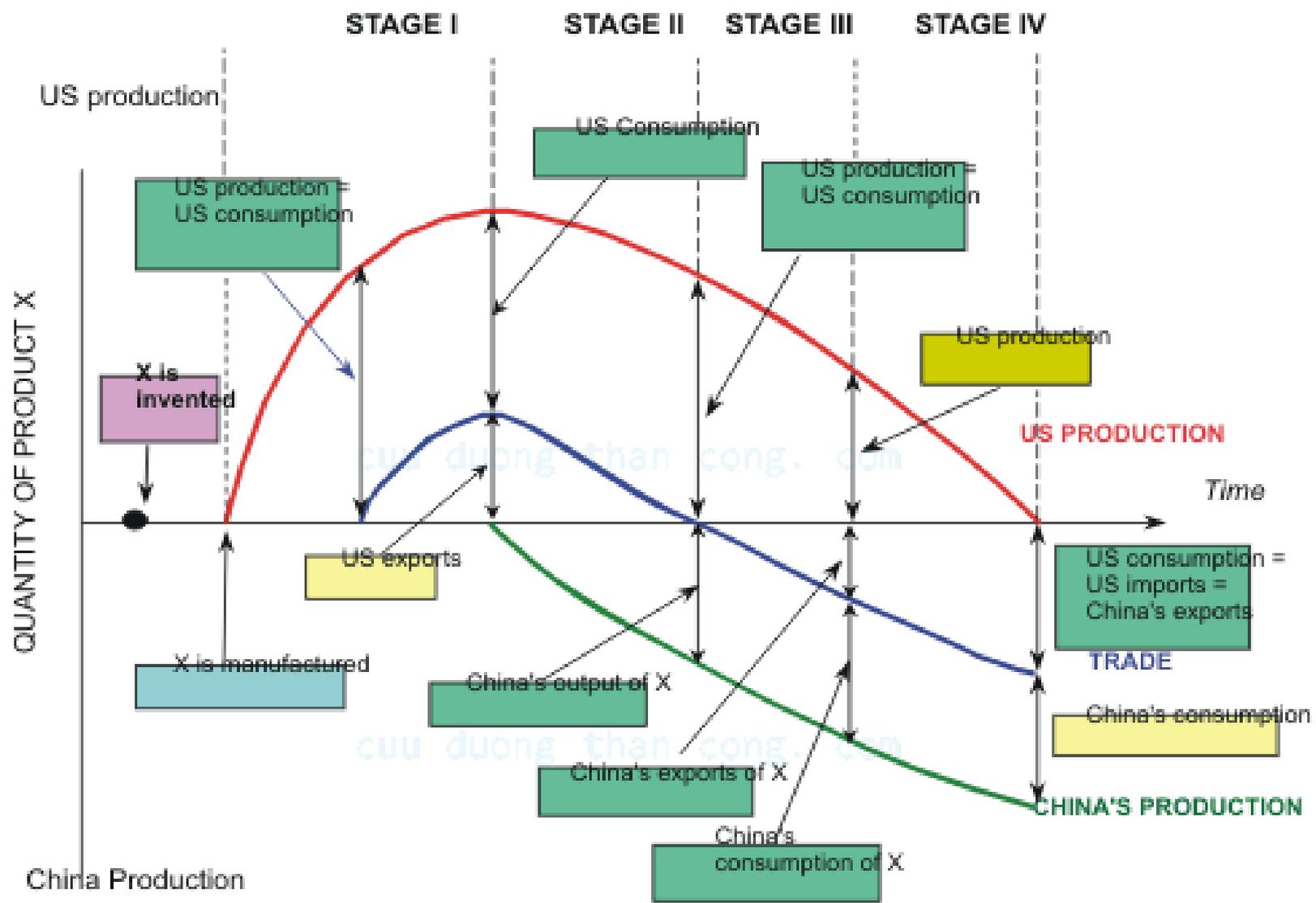
The industry contracts and concentrates -- the lowest cost producer wins here.

Stage 4: Decline

Poor countries constitute the only markets for the product. Therefore almost all declining products are produced in developing countries

Example: TV

- Introduction: 1940s-1950s Mass production in the US for the domestic market
- Growth: Initially exports and then production established in similar mkts (1950s-1960s), Also MNCs begin to develop their own TV
- Maturity: MNCs engage in FDI in NICs to take advantage of lower labour costs (1970s-1990s). Eventually MNCs from NICs become dominant exporting to the original market.
- Decline: Consumption of tube TVs declines in DCs. Only growth in LDCs. Meanwhile new product cycle begins in DCs for flat screen TVs (1990s-present)



Flying Geese pattern (Akamatsu, 1969)

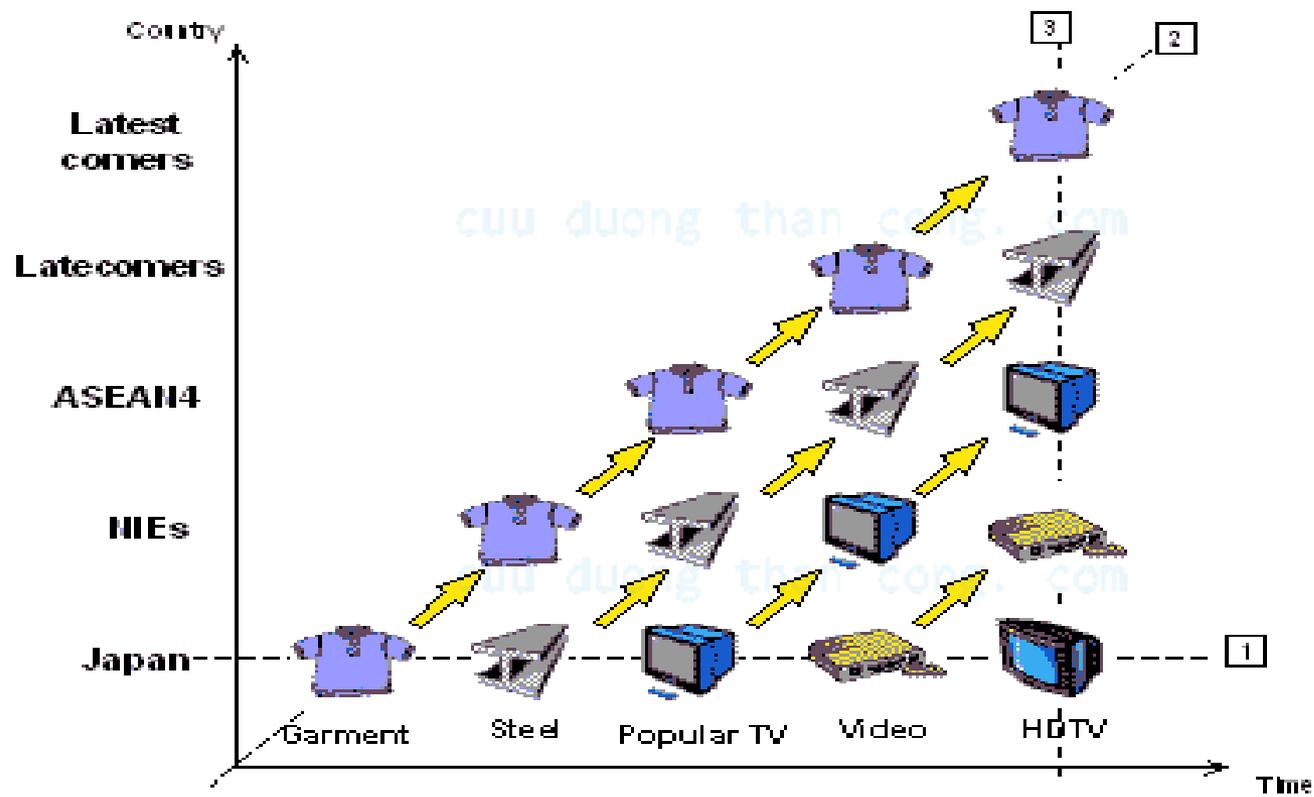
A series of industries take off one after another

- Explain the catching-up process of industrialization of latecomer economies

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Structural Transformation in East Asia



Theory of internalization (Ronald Coase)

- Internalization theory asks why business transactions take place within a firm (hierarchy) rather than between independent firms in a market

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Firm specific advantages

- To possess firm specific advantages is a necessary **but not sufficient** condition for FDI to take place
 - Why does the firm not serve the foreign market by **exports** ?
 - Why does it not **licence** a domestic firm to produce ?
 - We must try to understand why the firm wishes to make use of **its advantage itself**

Market imperfections

- Due to **market imperfections**, there may be several reasons why a firm wants to make use of its monopolistic advantage itself (or organise an activity itself)
- Buckley and Casson (influenced by Coase), suggested that a firm overcomes market imperfections by creating its own market – **internalisation**
 - Ensure product quality (forward integration)
 - Ensure stable supply of raw materials (backward integration)

John Dunning 's eclectic paradigm

(Buckley & Casson, 1976; Dunning 1977)

an overall framework to explain why MNEs choose FDI rather than alternative modes such as licensing, joint ventures, strategic alliances, management contracts and exporting

so called **O-L-I** paradigm

- Ownership specific advantages
- Internalization advantages
- Localization advantages

Location
China's
Z-Park

Examples of types of location-specific factors are *markets, resources, production costs, political conditions, cultural/linguistic affinities, concentration of knowledge development*.

Location
France's
wine industry

Examples of types of ownership factors *technology, knowledge, patent, know-how, size*.

Location Advantage:
Location specific factors. These are external to the firm including factor endowment, transportation cost, government regulation, and infrastructure factors.

Examples *benefits from controlling the foreign business activity, rather than hiring an independent local company to provide the service*

Ownership Advantage:
Firm specific unique competitive advantage that overcome the disadvantages of competing with firms in their own market e.g. name recognition and other core competencies.

Internationalization:
Cost advantage from vertical and horizontal integration, due to transaction cost caused by market failure

O.L.I

Japan's
auto industry

Microsoft's
Intellectual
Property

O = Ownership advantages

- Some firms have a firm specific capital known as **knowledge capital**: Human capital (managers), patents, technologies, brand, reputation...
- This capital can be replicated in different countries without losing its value, and easily transferred within the firm without high transaction costs

I – internalization advantages

- Problem:
 - If the agent interrupts the contract it can use the technology to compete with the mother company
 - In the case of brands/reputation: if the agent damages the brand reputation
- Of course there are suitable contracts, but those are potentially
 - Incomplete or difficult to enforce
- The best interest for the firm to use these itself, rather than sell them or license them to other firms

L – Localization advantages

the firms interest to use these in combination with a least some factor inputs located abroad:

- Producing close to final consumers or downstream customers
- Saving transport costs
- Obtaining cheap inputs
- Jumping trade barriers
- Provide services (for most services production and delivery have to be contemporaneous)

How firms serve a market?

Market	O – adv	I – adv	L–adv
FDI	Yes	Yes	Yes
Trade	Yes	Yes	No
Licence	Yes	No	No

4 types of FDI in the OLI

- The typology of FDI was developed by Jere Behrman to explain the different objectives of FDI:
 - Resource seeking FDI
 - Market seeking FDI
 - Efficiency seeking (global sourcing FDI)
 - Strategic asset/capabilities seeking FDI

Resource seeking FDI

- To seek and secure natural resources e.g. minerals, raw materials, or lower labor costs for the investing company

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Market seeking FDI

- To identify and exploit new markets for the firms' finished products
- Unique possibility for some type of services for which production and distribution have to be contemporaneous (telecom, water supply, energy supply)

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Efficiency seeking FDI

- To restructure its existing investments so as to achieve an efficient allocation of international economic activity of the firms
 - International specialization whereby firms seek to benefit from differences in product and factor prices and to diversify risk
 - Global sourcing – resource saving and improved efficiency by rationalizing the structure of their global activities. Undertaken primarily by network based MNCs with global sourcing operations.

Strategic asset/capabilities seeking FDI

- MNCs pursue strategic operations through the purchase of existing firms and/or assets in order to protect O specific advantages in order to sustain or advance its global competitive position
 - Acquisition of key established local firms
 - Acquisition of local capabilities including R&D, knowledge and human capital
 - Acquisition of market knowledge
 - Pre emptying market entrance by competitors
 - Pre emptying the acquisition by local firms by competitors

Mini-test

- Reading: Chapter 4 WIR 2006
- Questions:
 - 1) What are differences between motivations and strategies of developing country TNCs' and of developed country's TNCs?
 - 2) In the aspect of Vietnamese policies, what should the government do to attract developing country TNCs? Are they similar from the policies attracting developed country TNCs? Why?