

FDI FROM EMERGING COUNTRIES: MOTIVATIONS AND IMPACTS

IED PROCEDENTE DE PAÍSES EMERGENTES: MOTIVACIONES E IMPACTOS

Federico Carril Caccia
Universidad de Granada
federicocarril@ugr.es

Juliette Milgram Baleix
Universidad de Granada
jmilgram@ugr.es

Recibido: marzo 2018; aceptado: julio 2018

ABSTRACT

In the last decade, the share of Foreign Direct Investment (FDI) outflows from emerging countries (EOFDI) increased dramatically, and substantially changed the landscape of the world economy. This paper summarises the findings of the flourishing literature about the reasons and consequences of EOFDI. We first review the economic theories that explain emerging multinationals investments abroad, building on the conventional theory of FDI and the institutional theory. We also draw the conclusions emerging from empirical studies. In a second step, we provide an overview of the expected effects of EOFDI on the host. We also report the findings of the scant studies that recently attempted to assess these effects. Clearly, the institutional and economic home contexts contribute to shape firms advantages and in turn, their motivations to invest abroad and their location choice and finally, the impact of these investments. Thanks to recent studies, motivations and location choices are now better understood, but more research is needed to clarify the rest of the process, a promising area of research. In particular, the coverage of studies should be extended in several directions. The results would helpfully guide FDI promoting policies in the South and in the North.

Keywords: Outward Foreign Direct Investment; Emerging Countries; China; Eclectic Theory; Institutions.

RESUMEN

En la década pasada, el porcentaje de Inversión Directa Extranjera (IED) procedente de países en desarrollo aumentó drásticamente y modificó de forma sustancial la economía mundial. Este artículo resume las aportaciones de la creciente bibliografía sobre las causas y consecuencias de la IED. Primero se revisan las teorías que explican la inversión extranjera de las multinacionales que se basan en la teoría convencional de la IED y la teoría institucional. También se incluyen las conclusiones que se extraen de los estudios empíricos. Posteriormente, se revisan los efectos esperados de la IED en los países receptores. También incluimos los resultados de los escasos estudios que han evaluado estas consecuencias recientemente. Se observa que el contexto institucional y económico del país emisor contribuye a las ventajas de la empresa y sus motivaciones para invertir en el extranjero, así como la elección del destino y finalmente el impacto de la inversión. Gracias a los estudios recientes se pueden entender mejor las motivaciones y las decisiones sobre la localización, aunque se necesita más investigación para clarificar el resto del proceso, lo cual supone una prometedora área de investigación. En particular, el ámbito de estudios podría ser extendido en varias direcciones, lo que permitiría un mejor asesoramiento de las políticas de promoción de la IED tanto en el Norte como en el Sur.

Palabras clave: Inversión Directa Extranjera; Países emergentes; China; Teorías eclécticas; Instituciones.

JEL Classification: F2.

1. INTRODUCTION

In the last decade, the share of FDI outflows from developing countries increased from 6.3% in 1998 to 28.1% in 2016, after plummeting about 43.5% in 2014 (UNCTAD, 2018). In particular, Outward Foreign Direct Investments (OFDI) from BRICS account for almost half of these flows, and China for 88% of BRICS outflows, in 2016. Moreover, considering the number of large mergers and acquisitions (M&A), China ranked second in 2016 (UNCTAD, 2017). These new patterns have substantially changed the landscape of the world economy and naturally raised concerns about their motivations and their implications. Policymakers fear that these flows could threaten national security or sovereignty. Similarly, domestic firms worry about these new players given that multinationals from emerging countries (EMNEs) may intensify the competition or violate property rights (PR). Instead, other countries welcome this helpful entrance of capital flows.

As far as the academy is concerned, the topic represents a new and fast growing field of research. Studies have attempted, in a first step, to provide explanations for this new trend. This gave rise to a flourishing literature that examines from a theoretical and empirical point of view, whether the conventional theory of FDI is adequate to explain the internationalization of EMNEs. Indeed, Developed country Multinational Enterprises (DMNE) built their internationalization on firm specific advantages (FSA). In contrast, EMNEs would use FDI to overcome their weaknesses or to exploit abilities different from DMNEs' ones. Home and host countries contexts may also shape these FSA. A new strand of literature has shifted onto the consequences of OFDI from emerging countries (EOFDI) on performance, growth, technology of the host countries, opening a vast and promising area of research.

This paper looks into the findings of this new literature. Section 2 reviews the competing theories explaining EMNEs' investments abroad and their empirical validations. Section 3 provides an overview of the possible effects of EOFDI on the host countries based on recent contributions. Section 4 concludes and suggests avenues for future research.

2. WHY EMERGING COUNTRIES INVEST ABROAD?

2.1 THE CONVENTIONAL THEORY REVISITED

In the following, we discuss to which extent firms' motivations to invest abroad as described by FDI conventional theory (Dunning 1993) adequately reflect the rationale for the surge of EOFDI.

Through FDI, investors attempt to access more consumers or to use new locations to support exports to third markets (Ekholm *et al.*, 2007), both implying horizontal FDI. In this case, the size of the market, accessibility, infrastructure, natural and artificial trade costs are especially relevant to the investors (Horstman and Markusen, 1987). Indeed, firms face a trade-off between reducing access costs and carrying large investments costs. To the extent that EMNEs would face high trade barriers that could outweigh their price differentials, market-seeking motivations could fit with their expansion in large markets.

Firms may incur in efficiency-seeking FDI in order to reduce their inputs or labour costs, what evidently translates into vertical FDI. Typically, this was a main motivation for DMNE to invest in low wages countries (Buckley *et al.*, 2007). At first sight, this does not seem relevant to explain OFDI from emerging countries with low labour costs. Nevertheless, for example in China wages of low- and high-qualified workers have been increasing (Cai, 2012; Lemoine, 2013). Though, EMNEs investments in low income countries in manufacturing sectors could respond to this logic.

Resource seeking FDI intend to secure access to natural resources and originates vertical FDI. This interest could obviously suit any EMNEs, but particularly benefits State Owned Enterprises (SOEs) intending to guarantee energy or food access.

Strategic asset-seeking refers to firms intending to promote their long-term competitiveness. It is representative of DMNEs aiming to exploit and expand their ownership advantages (Amal *et al.*, 2013). Conversely, EMNEs would need to explore and acquire new assets (Luo and Tung, 2007; Sanfilippo, 2015). In both cases, developed countries would be natural recipients for these projects (Amighini *et al.*, 2013b). EMNE would seek to overcome disadvantages related with products quality, technology, high-qualified skills, recognized brands, management and tacit knowledge (Amal *et al.*, 2013; Buckley *et al.*, 2012; Brienen *et al.*, 2013; Child and Rodrigues, 2005). For this purpose, EMNEs may rely mainly to M&A to access assets quicker and cheaper. Some findings of the international business challenge this view by arguing that EMNEs could also benefit from specific ownership advantages (e.g. Luo *et al.*, 2011¹; Cuervo-Cazurra and Ramamurti, 2017).

2.2. INFLUENCE OF HOME AND HOST CONTEXTS

Apart from the motivations emanating from the firm itself, the literature has put forward several interactions between FSA and the home and host countries contexts.

EMNEs may flee the home country for several reasons. First, liberalization processes may lead to tighter competition (UNCTAD, 2006) or significant

¹ Combinative, hardship- surviving, intelligence, networking, and absorptive capabilities.

structural changes (Luo and Tung, 2007). Second, EMNEs may invest in developed countries to escape from institutional or economic deficiencies (See Cuervo-Cazurra and Ramamurti, 2017 for a review).

Conversely, home institutions may support actively OFDI as the Chinese “Go Global” policy does (Luo *et al.*, 2010). Finally, SOEs facing softer financial constraints may engage in FDI for political or economic reasons (Chen and Tang, 2014; Globerman and Shapiro, 2009; Giuliani *et al.*, 2014). Equally, institutional and market deficiencies could give rise to innovations valuable in other emerging market (Cuervo-Cazurra & Genc, 2008; Cuervo-Cazurra and Ramamurti, 2017). EMNEs may have more abilities than DMNEs, in dealing with bad governance and would refrain less to invest in culturally or institutionally distant countries.

Host countries would attract FDI depending on their characteristics. Depending on firms’ motivations, investments will locate in markets with different characteristics regarding size, wages, fiscal incentives, trade costs, infrastructure, PR, technologies. Natural resources may also be a significant pull factor.

2.3. EMPIRICAL VALIDATIONS

We identified 32 related empirical studies published in the last decade. The majority concentrates on Chinese OFDI, 2 on Indian OFDI, 8 on both, and 4 on all developing countries. Macro data provided by official statistics are frequently used (13 studies), while recent studies often rely on firms’ data, focusing either on greenfield investments (6), on M&As (4), or both (9).

All the studies emphasise that EMNEs are market-seekers. This is especially the case of private firms, while SOEs are more resource seekers (Amighini *et al.*, 2013a and b; Kolstad and Wiig, 2012; Ramasamy *et al.*, 2012). Some OFDI in developed countries correspond to intangible asset seeking (Amighini *et al.*, 2013a; Brienens *et al.*, 2013; Buckley *et al.*, 2012; Yoo and Reimann, 2017), more frequent for Chinese than for Indian firms (De Beule and van Den Bulcke, 2012; De Beule and Duanmu, 2012; Nunnenkamp *et al.*, 2012; Pradhan, 2011). EMNEs prefer acquisitions when they aim at accessing technical competences (Amendolagine *et al.*, 2015; Piscitello *et al.*, 2014). Though, Indian MNCs belonging to a technology-intensive industry, are more likely to opt for greenfield investments (Rienda *et al.*, 2012).

In line with the market seeking objective, Chinese and Indian OFDI are mainly trade-supporting and follow exports (Duanmu *et al.*, 2008 for instance). They could be induced by inward FDI in their home market (Yao *et al.*, 2016). Investments outflows appear as long as countries get more developed (Das, 2013). Previous patterns follow the logic of an investment development path, as suggested by Dunning (1983) to explain the internationalisation of DMNEs. Though, EMNEs have switched more rapidly from exports to OFDI than DMNEs did (Luo and Zhang, 2016). Emigrants’ networks are usually found to boost OFDI and Confucius institutes contribute to Chinese inflows (Akhtaruzzaman

et al., 2017; Lien *et al.* 2012). Networks prove to help EMNEs overcoming cultural barriers, what may justify why geographic distance has often a non-significant effect.

Regarding host country characteristics, macroeconomic stability and efficient labour markets attract EMNEs, in particular greenfield investments² into Europe (Amighini and Franco, 2013; Brienen *et al.*, 2013) and private firms' OFDI (Amighini *et al.*, 2013a). Both Chinese and Indian EMNEs tend to avoid highly competitive markets (De Beule and van Den Bulcke, 2012) and high corporate taxes (Duanmu *et al.*, 2009). Depreciation against host currency exerts conflicting effects on FDI. Indeed, Duanmu (2012) for Chinese outflows (especially SOEs) and Pradhan (2011) for Indian and Chinese outflows, report positive effects. Conversely, Buckley *et al.* (2012) unveil a negative impact on Indian acquisitions, and Zhang and Daly (2011) a non-significant effect on Chinese outflows.

Even if large amounts of Chinese OFDI fly to African countries, accessing natural resources does not always motivate these flows. In fact, only seven of the eleven reviewed studies provide evidence of this hypothesis. SOEs usually drive Chinese investments in natural resources but Chinese OFDI in Africa also spread to agriculture, manufacturing, and service (Amighini *et al.*, 2013a; Claassen *et al.*, 2011; Mlachila and Takebe, 2011). Africa offers great opportunities for Chinese private enterprises with strong entrepreneurship (Gu, 2009; Song, 2011) or those operating in low-skill manufacturing activities (Chandra *et al.*, 2013).

As regards institutions, Das (2013) offers support to the institution-escapism theory. Chen *et al.* (2016) find that China invests relatively more in unstable African countries. This is in line with Duanmu (2012) who finds that SOEs are less political and economic risk averse. However, Kolstad and Wiig (2012) and Amighini *et al.* (2013a) argue that Chinese investors are attracted overall by resources, which correlate with bad governance. This echoes several studies putting forward that EMNEs are not significantly attracted by political instability, at least in last years (Pradhan, 2011; Quer *et al.*, 2011)³. Indian and Chinese MNEs are not reluctant to similar environments but prefer host with better governance (De Beule and van Den Bulcke, 2012; Nunnenkamp *et al.*, 2012). The prevalence of SOEs would justify why the negative effect of political risk is lower for Chinese MNEs (Quer *et al.*, 2017) and higher corruption does not refrain large EMNEs (Cuervo-Cazurra and Genc, 2008; Cheung *et al.*, 2012). Yoo *et al.* (2017) add that EOFDI is attracted by weaker PR protection, especially if the host possesses knowledge-based assets. Finally, institutional distance does not affect South-South FDI (Aleksynska and Havrylchyk, 2013; Demir and Hu, 2016).

² Greenfield represent approximately 50 percent of all outward FDI from China and India into Europe (Milelli and Hay, 2008) but Chinese and Indian M&As in Europe most often target production plants and R&D facilities.

³ Buckley *et al.* (2007) find that Chinese OFDI increases with host political risks in the previous period (1984-2001).

3. NEW PLAYERS, NEW OUTCOMES?

3.1. EXPECTED IMPACT OF FDI ON HOST COUNTRIES

According to the standard theory, MNEs may benefit the local economy by improving domestic firms access to inputs, making new technology available, training local workforce, and increasing competition, employment and wages. However, FDI can also exert a negative impact on the host. Foreign firms can push out less productive domestic firms, make markets less competitive or directly relocate part of the acquired firms in another country⁴.

In addition, these effects may differ depending on the origin of FDI as argued by Fortanier (2007) and Demir and Duan (2018). Verifications for MNEs originating from different developed countries are few but robust⁵. Unfortunately, evidence for EMNEs is nearly inexistent.

Several works show that DMNEs are larger, more technological intensive and productive than EMNEs (Gold *et al.*, 2017; Lipsey and Sjöholm, 2011; Liu *et al.*, 2015; Sanfilippo, 2015), consolidating the view that DMNEs' FSA come from their home competitive advantage. Then, DMNEs would generate larger impact on productivity, R&D or wages than EMNEs (Demir and Duan, 2018; Kamal, 2015; Liu *et al.*, 2015; Wei and Liu, 2006). In addition to the potential lack of FSA, Bertrand and Betschinger (2012) and Cozza *et al.* (2015) point that M&As involving EMNEs are less likely to succeed given their limited experience and reputation, and due to cultural barriers.

Similarly, FDI would generate positive spillovers on condition that the affiliates meet the capacity to absorb managerial changes, implement new technologies and survive the surge of competition (Aitken and Harrison, 1999; Caves, 1974). In fact, positive spillovers are more likely and larger, the smaller is the technological gap between the investor and the recipient country and industry (Amighini and Sanfilippo, 2014; Santangelo, 2018). Furthermore, Javorcik and Spatareanu (2011) and Ni *et al.* (2017) stress that MNEs' interactions with local suppliers are prerequisites for spillovers to emerge. Similarly, higher trade costs are expected to incentive MNEs sourcing from the local economy, while larger institutional and technological differences would refrain it. Kamal (2015) and Liu *et al.* (2015) add that cultural similarity between source and host countries could stimulate these outcomes. Alternatively, M&As by EMNEs improve affiliates access to acquirer's markets; affiliates could benefit from different competitive advantages (Bertrand and Betschinger, 2012) and from diversified technologies and managerial styles (Zhang *et al.*, 2010).

In countries with underdeveloped institutions, Gold *et al.* (2017) argue that EMNEs prove to be more successful than DMNEs and exert a larger positive impact. EMNEs, conscious of the bad reputation of their home country, would

⁴ About the impact of FDI see for example Aitken & Harrison (1999), Bertrand & Zitouna, 2008, Blomström & Kokko (1998), Blonigen *et al.* (2014), Caves (1974), Girma & Görg (2007), Hymer (1970), Myeong-Gu & Hill (2005).

⁵ Bloom *et al.* (2012); Bertrand and Zitouna (2008); Girma and Görg (2007).

contribute more actively to the host country development to counteract this disadvantage (D'Amelio *et al.*, 2016; Demir and Hu, 2016; Gold *et al.*, 2017). In contrast, Santangelo (2018) refutes these findings and reveal that DMNEs have more incentives to foster welfare and development due to social and institutional pressures received from their home country.

In sum, EOFDI might generate lower positive impact than DMNEs owing to their technological and knowledge disadvantages. On the opposite, EMNEs might generate larger positive spillovers in low-income countries (LICs) where this gap is smaller. Moreover, EMNEs could outperform DMNEs in LICs thanks to their capacity to deal with weaker institutions and through innovations valuable for low-income consumers.

3.2. EMNEs' IMPACT: EMPIRICAL FINDINGS

Evidence on EOFDI impact is still scant and focuses mainly on Africa and selected Asian countries, while the investments of EMNEs in developed countries are even scarcer. Only two studies tackle this issue in a broad geographic framework with conflicting conclusions: Demir and Duan (2018) emphasize that South-South FDI would foster human capital growth to a certain extent, while having no significant impact on productivity and Demir (2016) reports that South-South FDI worsens institutions.

- Africa

In the context of Africa, discrepant findings are reported. Amighini and Sanfilippo (2014) show that greenfield projects from EMNEs provoke a larger export diversification and better quality in low-tech industries than investments from elsewhere. Similarly, Gold *et al.* (2017) indicate that FDI in Sub-Saharan Africa has a larger positive impact on productivity when it comes from non-OECD. However, only FDI from other African countries generates employment. Focusing on Nigeria, Izuchukwu and Ofori (2014) highlight that Chinese FDI foster economic growth while Busse *et al.* (2016) find no significant effect for Africa, at least during 1991-2005.

Relying on case studies, Mlachila and Takebe (2011) look into the consequences of large investments in the mineral and oil sectors, oil-related services and manufacturing realized by BRICS into Angola, Liberia, Sudan and Zambia. They conclude that BRICs' FDI has improved the exploitation of natural resources, infrastructure and regional integration, enhanced manufacturing capacity and technological spillovers. In this line, D'Amelio *et al.* (2016), discover that FDI in 15 Sub-Saharan countries, have promoted access to electricity. These indirect effects are larger when investors come from countries with lower institutional quality, thanks to their experience in operating in similar environments. Santangelo (2018) reports experiences that are more negative: Chinese and Indian FDI in agriculture have damaged environment in some developing countries and the acquisition of land by Southern investors would have worsen food security.

- Asia

Most of the works exploring the implications of South-South FDI in Asia, focus on investments made in China and compare FDI from OECD countries with other Asiatic sources such as Hong Kong, Macao and Taiwan (HMT). Du *et al.* (2012) and Wei and Liu (2006) evidence larger productivity spillovers for investments coming from OECD. According to Chen *et al.* (2011), FDI overall increases inter-firm wages inequality since MNEs pay a wage premium and have a negative effect on domestic firms' wages⁶. Turning to the impact of FDI according to the source, investments from HMT would generate larger negative spillovers on domestic wages, perhaps because of weaker technological spillovers compared with the rest of MNEs. Domestic firms' access to new technology could offset this negative effect. Kamal (2015) indicates that OECD affiliates outperform HMT ones in terms of post-acquisition productivity, profits, wages and capital intensity. Similarly, Liu *et al.* (2015) demonstrate that acquisitions from HMT, Japan, Korea and Singapore stimulate employment, while those from UK, Germany, France, US and Canada foster wages. They conjecture that the differential impact on wages is due to the technological superiority of DMNEs, which tend to pay a wage premium to limit labour-turnover. Anwar and Sun (2015) outline that FDI in R&D in the transport equipment sector exacerbates the likelihood of firms to exit the market, regardless if investors come from HMT or not. The origin of FDI would be more relevant when backwards and forward linkages are considered. In contrast, for the textile sector, Sun and Anwar (2017) find that FDI reduces indigenous firms' domestic revenues, but increases their export revenues, irrespective of the origin⁷.

Turning to other destinations in Asia, Takii (2011) reports that East Asian MNEs provoke larger positive productivity spillovers than Japanese and non-Asian MNEs in the Indonesian manufacturing sector. In Vietnam, unlike non-Asian firms, Asian firms (mainly from China and Taiwan) exert positive backwards spillovers (i.e. domestic firms improve their product to meet MNEs' demand), and negative horizontal spillovers by crowding out domestic firms (Ni *et al.*, 2017).

Overall, results are not clear-cut but tend to confirm that FDI coming from DMNEs would translate into larger wages.

- Europe and USA

Although significant attention has been paid to the drivers of EMNEs' growth in Europe and USA, little is known about the implications. Javorcik and Spatareanu (2011) analyze the FDI productivity spillovers in Romania originating from European, American and Asian MNEs, and report that only Americans generate significant backward and forward effects. Sanfilippo (2015) compares

⁶ MNEs hire the best qualified workers with higher salaries, while domestic firms end hiring low-qualified workers with lower wages.

⁷ They divide the origin by HMT and non-HMT countries.

BRICS MNEs with other MNEs located in Europe and evidences a productivity-gap between EMNEs and their local competitors, except when the affiliates are located in Eastern Europe. Likewise, this difference vanishes when comparing the most productive and successful firms between both sides. On balance, EMNEs investment would have harmed the European productivity at the industry level.

More interestingly, the impact of EMNEs on innovation investments may prove to be positive. Hofmann *et al.* (2012) show that M&As from countries less technologically intensive than Spain tend to boost R&D efforts of the affiliates. In contrast, when investments come from countries with similar technological level as Spain the impact is not significant, and negative when it comes from Germany, USA and Japan. Through a qualitative analysis, Giuliani *et al.* (2014) explore the consequences of FDI in the Italian and German sectors of industrial machinery and equipment, on innovation⁸. EMNEs' subsidiaries are usually less passive than DMNEs. DMNEs rely on their headquarters' knowledge, they do not interact with the local innovative networks and neither invest in R&D. In contrast, EMNEs transfer knowledge back to headquarters and some of them engage in local innovative activities with research centers, universities and local suppliers. Then, the increasing presence of EMNEs' subsidiaries could boost R&D in advanced economies. Piperopoulos *et al.* (2018) offer additional support for these positive outcomes, based on innovation realised by Chinese subsidiaries in developed countries.

Unfortunately, other results are less optimistic. For the USA, Chen (2011) studies the impact of M&As on public listed firms. Takeovers from DMNEs would lead to higher increase in labor productivity and profitability than takeovers from EMNEs. Similarly, investments from DMNEs would increase employment while EMNEs' investments would translate into employment losses. Chari *et al.* (2012) report a positive response to the entrance of EMNEs investors on firms' valuation. In terms of performance, their study indicates that profitability increases, but employment, sales and plant property and equipment decrease after the acquisition.

4. CONCLUSIONS AND FUTURE RESEARCH

Ten years ago, South-North FDI looked opportunistic if anything, while South-South investments were assimilated only with natural resources. Recent research draws now a less naive but more complex picture. Overall, EMNEs seek markets while resource seeking is more evident for SOEs. In the North, EMNEs also seek technological and knowledge assets, in particular through M&As. But private EMNEs have valuable assets to exploit in LICs, which could also provide them with efficiency gains and generate positive outcomes for the host country. Clearly, the institutional and economic home contexts contribute

⁸ They interview 47 firms from 25 countries.

to shape firms' advantages and in turn, their motivations to invest abroad, their location choice and finally, the impact of these investments. Thanks to recent studies, motivations and location choices are now better understood, but more research is needed to clarify the rest of the process.

In particular, further work is needed to understand how EMNEs achieve their advantages. The crescent availability of firm level data could shed some lights on this issue. Besides, the evidence about the impact of OFDI is still scant and heterogeneous, making any generalization risky, but these preliminary results suggest that the origin could matter and EMNEs may bring both positive and negative outcomes. To consolidate these results, the coverage of studies could be extended in several directions. First, most works do not consider the entry mode, or focus on the consequences of M&As, while EMNEs tend predominately to invest abroad through greenfield investment (71.8% of outward FDI)⁹. Second, the literature overlooks OFDI from emerging countries other than China and EMNEs' investments in South America and developed countries. Finally, to shed light on the non-yet understood interactions, it seems crucial to differentiate investments made by private firms and SOEs and to account jointly for the entry mode, the origin and destinations in terms of countries and sectors. The issue is key for FDI- promoting policies and of interest for growth-promoting policies in the South, and PR, R&D and labour policies in the North.

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⁹ Authors' calculations based on UNCTAD (2017) for the period 2003-2016.

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