1. Investment Strategies in Emerging Markets: Introduction to the Research Project

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INTRODUCTION

Foreign Direct Investment (FDI) is widely believed to make major contributions to the economic development of emerging markets (for example UNCTAD 2001). At the same time, emerging markets play a pivotal role in the global strategies of many multinational enterprises (MNEs), notably those with ambitious growth targets. Thus MNE and local policy makers have a common interest in encouraging foreign investment. Their objectives vary: externalities for the local economy or profits and corporate growth. Yet cooperation between local and foreign partners can create beneficial outcomes for both.

This study investigates the foreign investment strategies in four emerging markets, their determinants and their implications for the local economy and for public policy. The outcomes of FDI in terms of both corporate and social performance are highly dependent on how the operation is initially set-up. Entry strategies concern the key characteristics of the foreign investment project, including for instance entry mode, timing, and location. The entry strategy establishes where, when and how a foreign investor establishes a new operation, setting the stage for the affiliate's own performance and its impact on local partners. This study uniquely incorporates business strategy in the analytical framework and addresses both corporate and social outcomes of FDI.

A wide range of host-country specific factors influences inward FDI into emerging markets. Foreign investors are attracted to large and growing markets, as well as to host countries' endowments of natural and created assets. In emerging markets, many investors are focused on a particular factor as market-seeking FDI seeks large populations with rising incomes, while resource-seeking FDI seeks labour forces at affordable costs, or specific national resources such as mineral, or oil and gas. Moreover, the institutional

context in the location of their (potential) investment is crucial for where and how to establish FDI, and particularly so in emerging economies. Hence, the volume of FDI a country receives is influenced by a wide range of FDI-specific laws and regulations (for example Guisinger et al. 1985) as well as the overall institutional development (Henisz 2000, Bevan, Estrin and Meyer 2003, Globermann and Shapiro 2003). Equally, the institutional context shapes the characteristics of inward FDI, notably the preferred entry mode (for example Meyer 2001).

International business and strategic management scholars have analysed the merits of alternative forms of international entry and their implications for corporate performance. The literature has analysed in particular alternative ownership arrangements (for example Anderson and Gatignon 1986, Tse *et al*. 1997), and the choice of acquisitions or greenfield entry (for example Hennart and Park 1993, Kogut and Singh 1988). Most studies have focused on project- and firm-specific aspects, such as the investor's global strategy, research and advertising intensity and international business experience, using as empirical base primarily FDI between mature market economies where the institutional context is comparatively homogeneous. Recently, empirical studies have begun to analyse entry modes in emerging markets such as Eastern Europe (for example Brouthers and Brouthers 2000, Meyer 2001, Meyer and Estrin 2001) and China (for example Pan and Tse 2000, Luo 2001, Chen and Hu 2001). Other emerging markets remain under-researched. Moreover, most studies pay only scant attention to local resource endowment and institutional peculiarities, as few have systematically explored the institutional variations between and within emerging markets, and their impact on FDI.

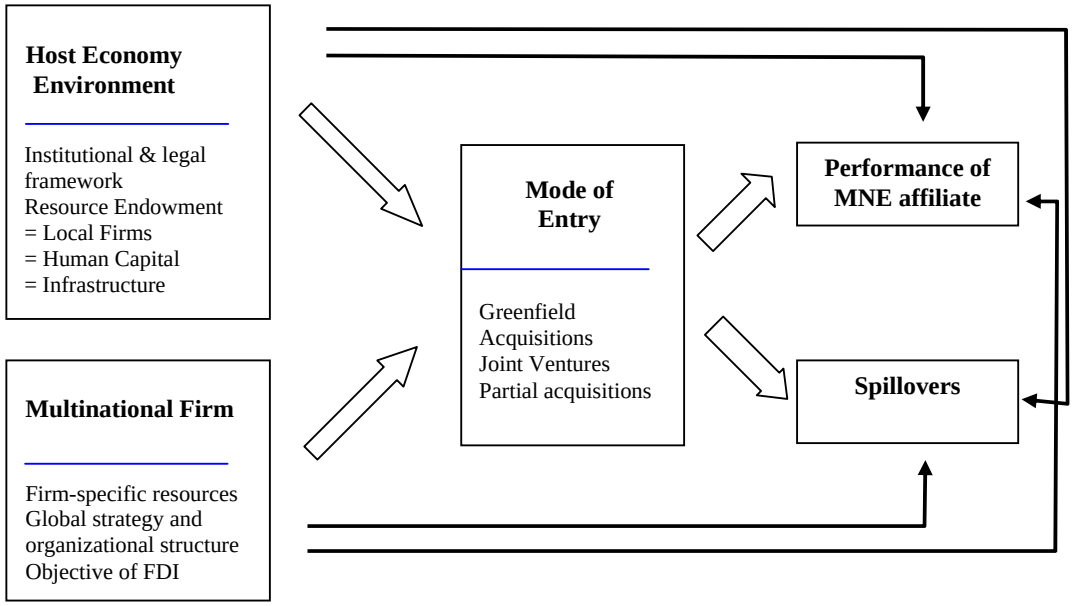
Our study analyses the link between the host country environment and foreign investment strategies. We use case research to explore and refine the concepts of entry modes, paying special attention to the concepts of

resource transfers, ownership and control, and their evolution over the first years of operation of the project. We also use a survey to understand the determinants of entry modes, and the relationship between FDI motivation, entry modes and the performance of the newly established affiliate.

We also examine the benefits the host economy can gain from the interaction with foreign investors, commonly known as spillovers. These arise through a variety of channels, including impact on the balance of payment, employment and investment. Probably the most important ones are knowledge transfer and diffusion that benefit not only the affiliate of the foreign investor, but its local business partners as well. Foreign investors generally transfer resources to their affiliates, thus creating new operations replicating their operations elsewhere in the case of greenfield investment, and or restructuring, upgrading and integrating existing businesses in the case of acquisitions. This process affects not only the affiliate, but also local businesses with which they are in contact. Suppliers may be required to achieve higher standards of quality and service, and receive support when striving to accomplish them. Customers may receive higher quality products, complemented with advice on how to improve their application or marketing. Even unrelated firms may benefit from observing new business practices applied in their local context, and learning from this 'demonstration effect' (Altenburg 2000, Blomström and Kokko 2002, Fan 2002). The potential of such impact will be greater the larger the technological gap between source and recipient economy, which makes it particularly relevant in emerging markets.

To understand the mechanisms of spillovers, it is important to understand processes within the investing MNE, and its interaction with the local environment. Policy makers need to understand MNE behaviour in order to develop policies to influence FDI. Therefore, we analyse spillovers

Figure 1.1 Conceptual framework of this study



and corporate strategy in a comprehensive framework summarised in Figure 1. We use this as the conceptual framework for the case studies in this book.

FDI IN EMERGING MARKETS

Over the past decade, emerging markets have become major recipients of FDI as multinational enterprises have expanded their global strategies to take advantage of business opportunities. Emerging economies are attractive for business because of their sometimes large and often fast growing markets, and because they provide access to resources, notably raw materials and labour not available at the same cost, in mature market economies. Total FDI flows worldwide had grown from US$ 200 billion in 1990 to US$ 1,500 billion in 2000, before falling back to US$ 735 billion in 2001. Of this, developing nations and transition economies account for US$ 206 billion (28 percent) in 2001. However, FDI in emerging economies is distributed very unequally, with China receiving the largest share (US$ 47 billion), followed by Mexico, Brazil and Hong Kong with over US$ 20 billion each in 2001. The poorest economies of Africa or Latin America, in contrast, receive only negligible sums (all data from UNCTAD 2002).

Despite their attractions, emerging markets pose particular challenges to investors because of the weaknesses in the institutional environment. The legal framework concerning business law tends to be less developed with respect to, *inter alia*, competition policy, regulatory policy, corporate taxation, and definition and enforcement of property rights (not just intellectual property). Moreover, even where the necessary laws are in place, their implementation and enforcement may be inhibited by, among other causes, lack of qualified accountants, bureaucrats and lawyers. Intermediaries and information systems, such as audited corporate accounts and business

directories, may also be lacking, and the laws may be subject to frequent changes, which creates considerable uncertainty for businesses.

In addition informal institutions can differ greatly from those of Western market economies. For instance, traditional value systems are more widespread, including collectivist, particularist, and family-oriented values, as well as religion. Relationship-based interactions with business partners are more common, in part due to low trust in both governments and outsiders to the society. Markets - especially for capital and skilled labour - may be thin or illiquid and inhibited by numerous market failures. These "institutional voids" (Khanna and Palepu 1999) can cause high transaction costs in markets, such that investing firms may prefer to 'internalise' business transactions in situations, where they would use market-transactions in mature economies. At the same time, few local firms match international standards in technology and management. This means that firms following entry strategies in emerging markets face special problems that may require unique solutions.

For this study we have selected four emerging economies that despite significant cultural, geographical and economic differences are quite similar with respect to FDI. Each has substantially increased their FDI receipts in the mid to late 1990s although they are still not among the top recipients: India, South Africa, Egypt and Vietnam (Table 1.1).[1] All four countries were relatively closed economies with a large extent of state involvement, but each had gone through substantial liberalisation in the 1990s.

[1] However, the high levels seen around 1999/2000, when this research was conceptualised, have not been maintained in all cases, notably Egypt. The high value of FDI for SA in 2001 is due to the unbundling of shareholdings between Anglo and de Beers, which generated a significant capital transfer into South Africa for the purchase of Anglo American shares from de Beers and its owners. But this was not FDI in the usual sense - these associated companies were both SA-based until 1997, when Anglo shifted its headquarters to London, and a large proportion of its activities remain in SA.

Table 1.1 FDI in emerging markets

Year:	82– 89	90	91	92	93	94	95	96	97	98	99	2000	2001	2002
South Africa	49	-5	-8	-42	-19	380	1241	818	3817	561	1502	888	6789	754
India	113	236	155	233	574	973	2144	2525	3619	2633	2168	2319	3404	3449
Egypt	926	734	352	459	493	1256	598	636	887	1065	2919	1235	510	647
Vietnam*	5	16	32	385	523	1936	2336	1803	2587	1700	1484	1289	1300	1200

Source: UNCTAD 1994 to 2003.

Notes: Annual Average

In million US$

We use the latest available revision of the data, i.e. WIR 2002 for data for 1996 onwards.

* In the case of Vietnam, this involves a considerable downward adjustment of the data from 1996 onwards, compared to the data reported in UNCTAD 2001.

By the end of the 1990s they had achieved macroeconomic stability and economic growth prospects were considered to be favourable. Also, these countries were ranked similarly by the Human Development Report 2002 with positions between 107th and 124th worldwide (Table 1.2).

India has operated for many years as a mixed socialist-capitalist economy, but has embarked on major, though gradual, liberalisation of both the domestic economy and its FDI regime since 1991. Egypt formally abandoned the ideas of central planning in 1971, but the process of liberalisation has been very slow and only accelerated in the 1990s; many FDI restrictions have been removed in the 1990s, though others remain in place. Vietnam belonged to the socialist block since the 1970s, but embarked on gradual reform from 1986, along a similar path to China. South Africa's economy was severely constrained by the international embargo of the apartheid regime, but the regime change in 1994 led to a more open economic system with new business opportunities. Table 1.2 provides an overview of economic and social indicators in each country.[2] The institutional change affecting FDI in each country is presented in greater detail at the outset of each of the country sections of this book.

Market-seeking foreign investors are first and foremost interested in large and fast growing economies. At a time when mature markets in Europe, Japan and (to a lesser extent) North America offer little growth potential, many firms seek business opportunities by serving the growing demand in emerging markets. India is a large economy, with an annual GDP of US$ 447 billion courtesy of its large population and despite its low average per capita income. Although ahead of Vietnam, India is a low-income economy with per capita GDP of US$ 460 at current exchange rates, thus lagging considerably behind Egypt (US$ 1,490) and South Africa (US$ 3,020). Vietnam has achieved very high economic growth in recent years with 7

[2] We thank Maria Bytchkova for assembling this information.

percent growth in the second half of the 1990s, ahead of both India and Egypt. On this score, South Africa performs poorly as its growth rate in recent years is more comparable to that in mature market economies.

All four countries have substantially reduced their inflation rate over the decade to reach single-digit inflation in 2000, and trade has grown, increasing the interdependence with the international economy. However, the trade data show some interesting variations: South Africa is the only country with a trade surplus, with substantive exports of the mining industry and, by the end of the decade, of basic processed goods. In Egypt, the falling price of oil has slowed trade, which thus fell from 52.9 percent in 1990 to 19.2 percent of GDP in 2000, while imports exceed exports by over 50 percent in both years. The volume of trade is largest relative to the country's GDP in Vietnam (96.1 percent).

Table 1.2 Key economic and social data

	Egypt		India		S. Africa		Vietnam	
	1990	2000	1990	2000	1990	2000	1990	2000
Population, million	52	64	835	1.016	34	43	66	79
GDP, US$ billion	48	95	315	471	113	129	5	31
GDP per capita, US$	926	1.490	377	460	3.325	3,020	78	390
GDP per capita, at PPP int $	2.640	3.690	1.449	2.390	8.524	9.180	n/a	2.030
Average annual GDP growth (%), *	3,8	5,4	5,4	5,7	0,7	2,6	7,7	7,0
Consumer price inflation	14,0	4,3	10,5	7,6	11,3	6,7	n/a	3,7
Exchange rates, Local currency per US$, av.	2,00	3,70	18,10	46,80	2,60	7,60	8,13	14,51
Exports, US$ bn	9,6	4.7	22,5	42.4	28,0	30,0	1,4	14.3
Imports, US$ bn	15,8	13.6	26,9	28.8	21,1	29.7	1,8	15.2
Ratio of trade to GDP (%)	52,9	19.2	15,7	19.4	43,4	46.3	62,0	96.1
Household consumption, % of GDP	72	72	68	68	63	64	90	70
Government consumption, % of GDP	11	10	12	11	20	18	8	7
Gross Fixed Capital Formation, % of GDP	27	24	23	25	19	15	13	25
Life expectancy at birth **	52,1	66,9	50,3	62,9	53,7	53,9	50,3	67,8
Adult literacy rate		55.3		57.2		85.3		93,4
HDI index	0,574	0,642	0,511	0,577	0,714	0,695	0,605	0,688
HDI rank	na	115	na	124	na	107	na	109

Gini index ***	na	28.7	na	37.8	na	59.3	na	36.1
Tertiary enrolment rates, % ****	15,8	20,2	6,1	6,6	13,2	18,9	1,9	4,1
Urban population, % of total **	43,5	42.7	21,3	27.7	48,0	56.9	18,8	24.1
Agriculture % of GDP	19	17	31	28	5	4	37	26
Industry % of GDP	29	33	27	25	40	32	23	33
of which: manufacturing	24	27	17	16	24	19	19	n/a
Services % of GDP	52	50	42	46	55	64	40	42
Value Added of SOE (% of GDP)	30,0		13,4		14,7		n/a	
Phone lines (# per 1000 people)	30	86	6	32	93	114	1	32
Mobile phones (# per 1000 people)	na	21	na	4	na	190	na	10
R&D expenditures as % of GNP	na	1,9	na	0,6	na	0,6	na	na
Scientists and engineers in R&D per million people	na	493	na	158	na	992	na	274
Net FDI inflows, % GDP	1,7	1,3	0,1	0,5	-0,1	0.8	0,2	4.1
Stock market capitalisation, US$ bn	1,8	32,8	38,6	184,6	137,5	262,5	0	0
Listed domestic companies	573	1.032	2.435	5.863	732	668	0	0
Av. price of traded company, US$ mn	3	32	16	31	188	393	n/a	n/a

Sources: IMF: International Financial Statistics; World Bank: World Development Report, Competitiveness Indicators; UN: Human Development Report, various years.

Notes: * averages over the 1990-1995 and 1996-2000, ** data refer to 1975 and 1999, *** Gini coefficient refers to different years between 1993 and 1998, **** data refer to 1990 and 1995.

Turning to social development indicators, Vietnam is performing as well, if not better than the other countries, despite its much lower GDP. Thus, Vietnam is ranked 109th in the Human Development Index developed by the UN, only 2 ranks behind South Africa (rank 107), and ahead of both Egypt (rank 115) and India (rank 124). The socialist emphasis on education and health care is reflected in a remarkable adult literacy rate of 93.1 percent and a life expectancy at birth of 69 years. Life expectancy has increased since the 1970s in Vietnam (by 19 years), Egypt (15 years), and India (13 years), while it has in recent years fallen back on 1970's levels in South Africa, mainly due to the AIDS crisis.

However, other indicators of industrial and economic development show South Africa ahead of the other countries, which is indicative of its dual economy: some aspects of the economy resemble a mature market economy, while large parts of the society live under conditions more typical for developing countries. This is reflected in an unusually high Gini-coefficient of 59, high urbanization of 56.9 percent, higher tertiary (university) enrolment rate of 18.9 percent (second to Egypt with 20.2 percent), and a high share of the service sector in GDP (64 percent). Also, telecommunications in terms of fixed phone lines or mobile phones are far better developed than in the other three countries. Natural resource industries that provide an important basis for economic development include mining in South Africa, oil exploration in Egypt and agricultural products in Vietnam.

India and Vietnam are far less urbanised (28.1 percent and 19.7 percent, respectively), and agriculture continues to account for a very large share of GDP (28 percent, and 24 percent). University education is still an exception, and less than two percent have a phone line, while the number of Internet hosts is negligible. Yet, since Internet cafés are more common than private connections, many people do have access to the worldwide web. These indicators are of interest to investors because they illustrate the

resource endowment, and indicate a growing middle class, which may be demanding Western-style consumer goods. Even in a relatively poor country like India, the large numbers in the urban middle class have purchasing power meriting investment in serving them (Dawar and Chattopadhay 2002).

The last rows in Table 1.2 report data of special interest to financial investors. South Africa has the largest capital market in terms of market capitalisation, which makes it attractive for foreign portfolio investors. However, both India and Egypt have more listed domestic companies, which suggest an active local equity market. In socialist Vietnam no stock exchanges had yet been established. Foreign direct investment, which Table 1.1 shows to be of similar magnitude in the four countries, has quite a different impact relative to the size of the host economy: in Vietnam, it amounts to 4.1 percent of GDP, while it is only 0.5 percent in India.

Table 1.3 Country Risk Indices

	Egypt	India	S. Africa	Vietnam
Overall country risk	3,0	3,1	2,4	3,1
Political risk	3,0	3,5	2,5	3,0
Economic risk	3,0	3,0	2,5	3,5
Legal risk	3,5	3,0	2,0	3,0
Tax risk	3,0	2,5	1,5	3,0
Operational risk	3,0	3,0	2,0	3,5
Security risk	2,5	3,5	3,5	2,0

Source: World Markets Research Centre, Country Analysis Report, 2002.
Note: Risk ratings, with 1=little risk, for 2002

Table 1.3 reports country risk indicators by a risk consultancy agency for the four countries for different aspects of risk. Overall, South Africa is evaluated somewhat less risky for investors, except for security risk,

which is high because of the high crime rate. As the EIU (2002) puts it, "The high level of crime is perceived to be one of the obstacles to economic growth, however, studies of foreign investors' attitudes to crime present a mixed picture." It can be seen that the other three countries appear rather similar through the lenses of financial risk analysts.

STRATEGIC MANAGEMENT ISSUES

Companies investing abroad have to take many strategic decisions on how to enter a foreign country. This includes, inter alia, entry mode, timing, and within-country location, which are often interdependent with operational strategic issues concerning marketing, logistics or human resource management. International business and strategic management scholars have analysed the merits of alternative forms of international entry and their implications for corporate performance. The choice of mode concerns both the resources to be employed in the new affiliate and the ownership and control over these resources. Separate lines of research have analysed alternative ownership arrangements (for example Anderson and Gatignon 1986, Buckley and Casson 1998, Tse et al. 1997), and acquisitions versus greenfield decisions (for example Barkema and Vermeulen 1998, Hennart and Park 1993, Kogut and Singh 1988). Although in practice the decisions are often intertwined, different issues have to be considered.

Our analysis takes the framework in Meyer and Estrin (2001) and the literature on entry mode choice as starting point, but also draws upon literature in international business strategy concerning post-acquisition management (Buono and Bowditch 1989, Haspeslagh and Jemison 1991, Jemison and Sitkin 1986, Birkinshaw et al. 2000), the role of subsidiaries within MNEs (for example Birkinshaw 2000), and the impact of institutions

on corporate strategies (Oliver 1997, Peng 2000, Meyer 2001). Our main focus is on how foreign investors adapt their business to a specific context. Since imperfect institutional frameworks and weak resource bases exist throughout emerging economies, investors have to accommodate these challenges by developing appropriate entry modes.

Entry Modes in Emerging Markets

Foreign investors' entry modes are commonly classified in three types, greenfield (start-up), acquisition and joint venture (JV).[3] A greenfield project entails building a subsidiary from bottom up to enable foreign sale and/or production. Real estate is purchased locally and employees are hired and trained using the investor's management, technology, know-how and capital. Acquisitions are 'purchase of stock in an already existing company in an amount sufficient to confer control' (Kogut and Singh 1988, p.412). The new affiliate is integrated into the investing company as a going concern that normally possesses production facilities, sales force, and market share. Cross-country acquisitions have become a dominant feature of FDI worldwide, and they are also increasing as a share of inward FDI in emerging markets (for example UNCTAD 2000). In the 1990s, acquisitions in emerging markets were sometimes related to privatisation, especially in Central and Eastern Europe (for example Antal-Mokos 1998, Meyer 2002, Uhlenbruck and De Castro 2000).

An important distinction in the analysis of entry mode is the origin of the resources employed in the new operation (Meyer and Estrin 2001, Anand and Delios 2002). Whereas a greenfield uses the resources of the

[3] Some researchers include non-equity modes in a study of entry modes (for example Kim and Hwang 1991, Tse et al. 1997). We follow Pan and Tse (2000) who argue and show empirically that entrants first decide between equity and non-equity modes, and then decide the specific mode of their investment project.

investor and combines them with assets acquired on local markets, an acquisition uses assets of a local firm and combines them with the investor's resources, notably managerial capabilities. A greenfield project gives the investor the opportunity to create an entirely new organisation specified to its own requirements, but usually implies a gradual market entry. In contrast, an acquisition facilitates speedy entry and immediate access to local resources, including access to local networks and business licenses that help the investor to reduce transaction costs of operating in the emerging market context. However, an acquired company may require deep restructuring to overcome a lack of fit between the two organisations. In some acquisitions in emerging markets, this restructuring is so extensive that the new operation almost resembles a greenfield investment, which Meyer and Estrin (2001) call 'brownfield'. The paucity of firms and the underdeveloped nature of capital markets may also limit the possibility for acquisitions in emerging markets.

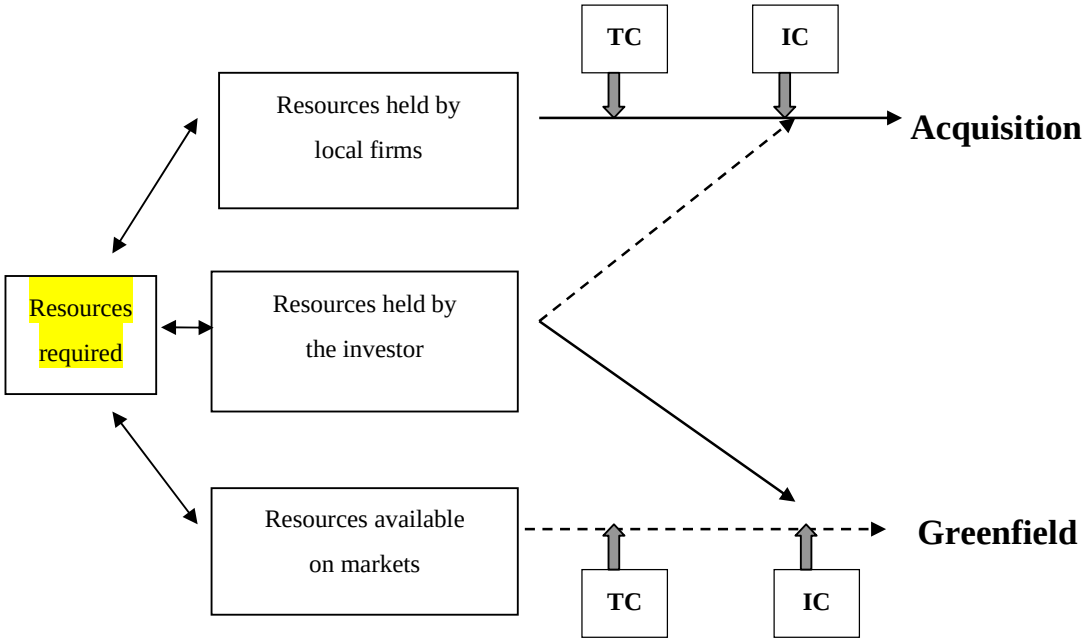
The third major mode of entry is a joint venture, which implies creation of a new organisation with resource contributions from two or more parent firms. The parents share strategic and operational control of the firm. A joint venture is created as a new legal entity like a greenfield, but jointly by two or more firms that both contribute resources. Like an acquisition, a JV provides the foreign investor with access to resources of a local firm, whereas a greenfield does not. Joint ventures are designed in a variety of different ways depending on the resource availability, concerns for control, and bargaining power. Last but not least, partial acquisitions share some characteristics with both acquisitions and joint ventures. The investor becomes involved with an existing firm rather than a newly created one, but control is shared with other shareholders.

Acquisition versus Greenfield

From a strategic management perspective, the choice between greenfield and acquisition is foremost a decision over the origins of the resources for the new venture (Meyer and Estrin 2001, Anand and Delios 2002, Danis and Parkhe 2002). A greenfield uses resources of the investor and combines them with local assets, whereas an acquisition uses primarily assets of a local firm and combines them with the investor's. The preferred entry mode thus depends first on the resources needed, which in turn depends on the strategic objectives of the project, and second on the resources that are found (i) within the entering multinational enterprise, (ii) in unbundled form on local markets, and (iii) in bundled form in local firms (see Figure 1.2). Resources are here defined broadly, including for instance network capital in form of relationships with other businesses or authorities.

Entry modes are influenced by transaction costs in the pertinent markets, which in turn are shaped by institutions, such as competition policy, profit repatriation rules, protection of property rights, taxation and other aspect of government intervention. Moreover, costs of restructuring and integrating acquired firms affect acquisitions, which in turn depend on, for instance, the strategic, cultural and technological fit. The capability to manage this process is build through prior experiences (for example Buono and Bowditch 1989, Haspeslagh and Jemison 1991), the strategic and organisational fit between the acquired firm and the acquirer organisations (Kogut and Singh 1988, Birkinshaw et al. 2000), and the cultural distance between the two firms (for example Barkema et al. 1996).

Figure 1.2 A Model of Entry Mode Choice



Notes: TC = Transaction costs of the relevant markets, IC = Costs of adapting and integrating resources.

Source: Meyer and Estrin 2001.

In this study, we draw on both the resource-based view and transaction cost analysis in analysing mode choice. Transaction costs in emerging markets are high due to incomplete and evolving institutional frameworks governing market relationships (for example Peng 2000, Meyer 2001). Acquisitions internalise certain markets and bring together complementary resources, but these resources need to be integrated effectively (for example Haspeslagh and Jemison 1991). Resource acquisition and absorption is of crucial importance for transformation of enterprises unable to cope with the consequences of liberalisation and privatisation (for example Kogut 1996, Uhlenbruck and De Castro 2000, Uhlenbruck, Meyer and Hitt 2003).

Following the framework of Figure 1.2, the first aspect to be investigated concerns the strategic intent underlying the entry. The key distinction is between market-seeking and resource-seeking entry (Dunning 1993). For instance market-seeking FDI pursuing first-mover advantages may seek a local partner to provide market intelligence or access to distribution networks, brand names and market share. Resource-seeking investment may aim to utilise the local human capital to strengthen the global R&D of the investor. Our research thus reassesses how strategic objectives relate to investor's preferred entry mode in the emerging market institutional context.

Greenfield is preferred by investors competing with resources that can be transferred internally and can constitute core competences of the new business unit. This includes managerial resources (Penrose 1959), financial resources (Chatterjee 1990), and capabilities with firm-specific public good properties (Caves 1971). On the other hand, resources of local firms can attract acquisition entry, for instance technological assets or market share in the target markets. Finally, local markets provide assets required in greenfield ventures, such as real estate, business licenses, local blue-collar workers, and supplies of intermediate goods. Our research thus analyses the role of

resources in the host economy, in particular, what kinds of resources controlled by local firms induce foreign investors to pursue a JV or an acquisition entry.

Bringing together resources previously held by different businesses incurs transaction costs either in the market for corporate control, or on local markets for complementary assets. Markets for corporate control are highly imperfect in emerging markets, which raises transaction costs of foreign acquisitions. In emerging markets, the transaction costs in equity markets can be a major constraint on foreign acquisitions. Neither can the markets for complementary resources be presumed to be efficient in emerging markets. Hence, we consider how institutions of the host economy such as infrastructure, the legal system, and regulation of FDI, affect the choice of entry strategy.

The investment is not complete with the acquisition of resources; they have to be amalgamated to create an efficient new business unit within the investors' network. Mode choice therefore has to reflect the costs and time lags required for integration and adaptation. A firms' capability to manage the post-entry integration process thus feeds back into their choice of entry strategy. Greenfield investors avoid the costs of integration, but are more sensitive to relocation costs associated with the international transfer of resources. Thus we explore how factors specific to the investing firm and its potential local target, such as emerging market expertise and psychic distance, affect the entry mode choice.

Generally, our expectation is that less developed local institutions are associated with more joint ventures, while weak local firms would lead investors to favour greenfield entry. This is in addition to investor firm-specific influences on mode choice.

Joint Ventures

A joint venture (JV) with a local partner provides access to selected resources contributed by the partner, without the responsibilities that arise from taking over an existing organisation. A new entity is created under joint ownership of two or more parent firms that all contribute in various ways to the organisation. While providing access to selected resources, a JV requires sharing of control, which many MNEs prefer to avoid. Market transactions or internal organisation provide clear governance structures, whereas JVs are subject to possible conflicts between the two parent firms that may pursue objectives that are not entirely complementary. Strategic flexibility may be greatly reduced if strategic decisions need to be cleared by all parents.

A joint venture may therefore easily conflict with other objectives of the entry. If the marketing, logistics and human resource practices have to be negotiated with a local partner, this poses severe constraints on an MNEs' ability to integrate the new operation with its global structures and processes. On the other hand, JVs are a means to accelerate entry and to gain access to crucial complementary assets more quickly than if these resources have to be acquired and built by the foreign firm internally. Hence, if timing is urgent, then market-seeking investors may prefer a JV, at least initially.

Transaction cost economists looking at alternative organisational forms, analyse why firms would prefer a JV despite the apparent disadvantages of shared control (Buckley and Casson 1976, 1998, Hennart 1988). JVs offer the opportunity to establish a business operation in a foreign country when establishment of a wholly owned affiliate is not feasible, or is too expensive. As an intermediate form between market and intra-firm coordination, a JV reduces transaction costs of the market, at the expense of coordination costs between the parents. Multinational firms often consider JVs as a second best mode of entry for emerging markets because they provide only a limited degree of control,

which greatly reduces the investor's flexibility. As we have seen, shared control can lead to coordination conflicts between the partners, especially if their objectives are not compatible or cultural barriers inhibit communication. Hence, transaction cost economists argue that JVs are only used if specific conditions apply:

- The project depends on resource contributions from two or more partners;
- The markets for the contributions from the parents are subject to market failure, that is transaction costs are high;
- It is not feasible to internalise the whole operation with one partner taking over the other(s). This would apply for instance when the project is small relative to the parents, or if one of the parents is state-owned.

Anderson and Gatignon (1986) apply transaction costs in a different but complementary way, outlining the conditions when firms would prefer a high control mode, that is a JV rather than a contract, or a wholly owned affiliate rather than a JV:

- If markets fail due to high asset specificity or information asymmetry, and the partner could take advantage of this. This applies even more if the business environment is highly uncertain. Hence environmental uncertainty has a moderating effect on the primary causes of transaction costs, asset specificity and information asymmetry.
- If the firms face major obstacles to communication, or to observe and monitor independent local agents. This could for instance arise due to cultural distance.
- If the local partner could free-ride on the investor's reputation, for example use the brand name without adhering to the quality standards associated with the brand.

In emerging markets, JVs are sometimes a response to legal requirements. For example, India had placed an upper limit on the maximum share of equity that foreigners were allowed to hold in many industries, which was gradually removed over the 1990's. In the case of larger projects, ownership constraints may have to be negotiated with government authorities. The decision to set up a joint venture thus involves adaptation to local institutions, minimization of transaction costs, optimising control, and access to resources.

Mode Dynamics

Entry strategy decisions are about more than selecting between prototypical organisational forms. The broad classifications of 'acquisition', 'greenfield', and 'joint venture' disguise a wide variety of organisational forms. Many entries can be described as hybrids of different modes, including 'brownfield' (Meyer and Estrin 1999, 2001) and partial acquisition. Moreover, initial organisational arrangements may be temporary, and from the outset, the foreign investor may prepare to replace resources, thus developing a brownfield, or to eventually fully take over a JV or a partial acquisition.

Some projects that are formally classified as acquisition in fact resemble greenfield projects. The foreign investor may initially acquire a local firm, but almost completely replace plant and equipment, labour and product line. The new operation is built primarily with resources provided by the investor. After only a short transformation period, often less than two years, the acquired local firm has gone through deep restructuring, and both its tangible assets, such as physical equipment, and its intangibles such as brand names and organisational culture have been reduced to a supplementary role. Meyer and Estrin (2001) thus propose to distinguish such entries from conventional acquisitions by defining it as follows: a brownfield

is a foreign acquisition undertaken as part of the establishment of a local operation. From the outset, its resources and capabilities are primarily provided by the investor, replacing most resources and capabilities of the acquired firm.

This research aims to establish the broader relevance and the performance implication of brownfield entry strategies beyond European transition economies. The existence of brownfield FDI in other emerging markets, its underlying motives and strategies, as well as its implications are important research questions. Thus we explore how prevalent the brownfield phenomenon is across different emerging markets, and under which circumstance it emerges.

The initial ownership set-up of an FDI may change quickly. Control arrangements are known to be unstable, especially in 'staggered acquisitions' (frequently observed in privatisation) or in "foreigners' fade-out" arrangements. JV may be time-limited from the outset, or unexpected changes in the local firm or in the foreign parent's global strategy may induce amendments of the ownership and control arrangements. Acquisitions may be implemented with stepwise ownership transfer, especially in the context of privatisation of SOE (Meyer 2002). This study aims at refining the typology of entry modes to incorporate the post-entry dynamics and thus re-examines typologies of entry modes, giving particular attention to the dimensions of resource transfer, control, and time.

From Entry Mode Choice to Affiliate Performance

Foreign investors establish their foreign operations using the mode that most suits their needs, and one would expect that the less they have to compromise on their optimal mode, the better the performance of the operation. Managers themselves generally argue that full control would be preferred in most cases,

and that joint ventures risk too many conflicts. However, this sentiment is not necessarily supported by prior empirical literature. On the other hand, acquisitions are reportedly often failing to meet their original objectives, not only in emerging markets but also in a mature market context. This has been attributed to a variety of causes, including managers underestimating the effort required to restructure and integrate the acquired firm. Given the distance of organisational cultures between the emerging markets in this study and the countries of origin of many of the investors, this issue is likely to be of particular concern.

The theoretical considerations suggest that corporate performance will be best when firms have freely chosen their entry mode in accordance with resource and transaction cost considerations, while changes in strategy to accommodate regulatory requirements, for instance a maximum foreign share in equity, would worsen corporate performance. However the study of performance implications of mode choice is complicated by the endogeneity of entry mode choice; in other words the environmental factors influencing performance also influence the selection of entry modes.

IMPACT ON HOST ECONOMIES

FDI influences the host economy in a variety of ways, including technology transfer, technology spillovers, R&D, employment quantity and quality, exports and imports, and competition. This makes it of interest to policy makers in emerging markets, and has triggered considerable research, reviewed by Altenburg (2000) and Blomström and Kokko (2002). This literature has mostly been concerned with testing the hypothesis that FDI has a positive effect on local firms in the industry or in vertically related industries. It finds horizontal spillovers in the same industries hard to

establish, except in transition economies (Haddad and Harrison 1993, Aitken and Harrison 1999, Sinani and Meyer 2002).[4] However, there is strong evidence in favour of vertical spillovers (for example Smarzynska 2002). Moreover, the local industry's own technological capabilities and the 'absorptive capacity' (Cohen and Levinthal 1990) are found to be crucial for their ability to benefit from inward FDI (for example Kokko et al. 1996).

This research is largely conducted using official statistical data that do not contain information on many of the constructs that are relevant from a theoretical perspective. For instance, more information is required on the knowledge and resource transfers within the multinational firm, a precondition for technology spillovers to occur. To provide policy advice, it would be necessary to both know whether spillovers occur at an aggregate level, and what would increase them. Hence, conditions prevailing in the local economy need to be incorporated in the analysis, notably the absorptive capacity and the institutional context. Moreover, this literature rarely differentiates FDI projects when assessing its impact on local firms. The literature on FDI and spillovers thus raises many questions, some of which we address in this research, notably concerning the dynamics of resource transfers and the role of entry modes.

Entry strategies profoundly affect the ways in which foreign investors interact with the local economy, and may thus be generating beneficial spillovers. Empirical studies have addressed some of these issues in OECD countries, but no systematic evidence exist for less advanced economies. The World Investment Report 2000 (UNCTAD 2000) reviews the available literature and infers that the long-term impact of FDI, established by different entry modes, would not differ systematically by most

[4] This refers to studies using panel data. Older studies using cross-sectional data often found positive spillovers within the same industry. Yet this approach is methodologically problematic (Görg and Strobl 2001), and reverse causality is highly plausible (Fan 2002). Several studies suggest that the causality may be reverse because MNEs are found to transfer more technology when local industry is more competitive (Kokko et al. 1996).

criteria. However, due to path dependency of networks and competence development, acquisitions tend to retain and develop existing supplier links and, as a consequence, continue to share technology with local partners.

In the short term, a number of impact parameters may differ considerably across investment projects. Greenfield investors create new businesses and have positive direct effects on employment and gross domestic investment. They may increase competitive pressures on local competitors, which induce them to improve their efficiency, or be forced to exit the market. Investors typically set up new production facilities with their own management and technology, and import machinery from their own home country. While greenfield projects require more technology and other know-how transfers, the investor is better able to control the diffusion of specialist know-how beyond the affiliate. For example, production with low-cost labour for worldwide markets uses greenfield operations, especially in specifically designed economic zones. Greenfield projects tend to have their strongest economic links with their parent and other affiliated companies, rather than with the local economy.

Greenfield moreover contributes to local capital formation, and thus to gross domestic investment possibly beyond the sum of the FDI reported in balance of payment statistics if additional local sources of funds are mobilised. However, locally raised funds can also crowd out local investment. Greenfield FDI also has direct positive effects on employment levels, since all jobs in a project are newly created. Crowding out effects of local firms that use traditional labour intensive methods of production are however possible.

Acquisitions, on the other hand, are at the time of entry existing enterprises, integrated in the host economy. They may have indigenous R&D operations, local brands, and a local supplier network, and are thus well positioned to act as relatively autonomous affiliates within a diversified

MNE. Following the acquisition, traditional business relationships may or may not be continued by the new owners. Yet, even if some acquisitions discontinue local R&D, local sourcing or local brands, on average acquired affiliates would be more local in these respects that greenfield operations. Evidence on this comes for example from Belderbos *et al.* (2001) who find a higher share of local content in acquired affiliates of Japanese MNE, and to a lesser extent in their joint ventures, compared to greenfield FDI.

However, crucial for an assessment of the impact is the counterfactual "what would have happened to the firm without the acquisition?" (for example Zhan and Ozawa 2001). Investors do not necessarily have both options, greenfield and acquisition, to choose between. And, for the local firm the alternative to being acquired may not be prosperity as an independent firm.

From a theoretical perspective, the impact of acquisitions or greenfield investment differs between advanced and transition economies due to, among other factors, the technological gap, quality of resources in local firm, and development of the regulatory and institutional framework. Hence empirical research is required, as inferences from empirical studies elsewhere are only to a limited extent transferable. Table 1.4 presents a preliminary assessment based on the literature, especially UNCTAD (2000). Greenfield investments are more predictable in their development path, while post-acquisition restructuring can proceed in very different ways, dependent on the investor's strategic intent and the envisaged role of the new affiliate within the multinational network. In general, the dominant views in the literature can be summarised as follows:

- In the short term, FDI in the form of acquisitions or greenfield projects differs in its impact on the transfer of financial resources, investment, technology transfer, technology diffusion, original

R&D, employment quantity and quality, employee training, exports, imports and competition, and institutional development.

- In the long term, differential impact effects of acquisition and greenfield investment diminish, leaving no substantial and systematic differences, yet with specific exceptions. Path dependency of networks and competence development lead to persistence of differences in the use of local suppliers, technology sharing with local suppliers, and local R&D.

Table 1.4 Impact of FDI by different modes

	Short-term Impact	**Long-term Impact**
Transfer of financial resources	Acquisitions require the immediate transfer of financial resources, whereas transfers for greenfield are more likely to be stretched over time.	Considering subsequent investment and investment in restructuring, both modes may lead to transfer of financial resources to similar extent.
Investment in capital stock	Greenfield ads directly to productive capital stock, while acquisitions would only do so through subsequent restructuring investment, notably in cases of brownfield.	Subsequent investment in acquisitions may exceed that of greenfield projects. Both modes may have an indirect negative effect through crowding out local firms.
Transfer of knowledge to the affiliate	Greenfield normally requires transfer of technology or marketing knowledge (depending on purpose of the FDI), but only what is needed for the specific operation. The knowledge transferred to acquired firms may vary considerably.	Technological upgrading of affiliates is driven by the same strategic considerations and thus unlikely to differ.
Knowledge diffusion	Acquired firms with strong local links are likely to retain them, which facilitates spillovers. If local partners were weak before acquisition, linkages may be discontinued. Greenfield typically has stronger linkages with MNE, less with local firms.	Path dependency of networks and competence development suggests that differences are likely to persist.

Technology generation	Unless there are strong specific R&D capabilities locally, greenfield investors are unlikely to establish local R&D beyond adaptation of products. If an acquired firm has very strong R&D capabilities, these may be strengthened ('asset-seeking FDI'), else discontinuation and centralisation of R&D is likely.	In the long-term, location of R&D is likely to follow availability of R&D resources in the environment. Yet, a path dependency effect is likely, that is acquired firms retain R&D, and an early decision of upgrading or discontinuation of R&D may have long-term effects.
Employment (quantity)	In a greenfield, every job is created new. Acquisitions may lead to reduction of employment if motivation is 'efficiency seeking' or 'short-term financial gains', or if the acquired firm has overcapacity. However, this may be 'employment saving' depending on the counterfactual.	Crowding out effects may arise from both acquisition and greenfield. Else, no systematic differences between modes expected.
Employment quality	Greenfield may establish a new and thus more modern work environment, which facilitates higher quality employment, in terms of wages, work conditions, etc. Early unionisation may be less likely. Acquisitions may face inertia as older norms may persist.	No systematic differences between modes expected.
Skills, Training of workforce	Acquisitions face possible initial inertia to skill transfer, possible brain drain by moving people abroad. Greenfield has to recruit top people, often from local	No systematic differences between modes expected.

	firms. Either way, no major differences to be expected.	
Exports	Acquisitions typically continue to serve the existing local markets. Greenfield is often established either to use factor cost advantages for global markets, or to serve the local market.	No systematic differences between modes expected.
Imports	Acquisitions build on local supplier linkages if these are good quality. Greenfield rely to a larger extent on imports (e.g. Belderbos et al. 2001).	Path dependency of networks and competence development suggests that differences are likely to persist.
Market structure	A greenfield entry as such reduces concentration, and enhances competition. The impact of acquisition or brownfield entry crucially depends on the market position of the acquiring firm prior to the acquisition.	International mergers may join foreign affiliates and thus reduce competition, thus acquisition entails a risk of negative impact on competition. Else, the dynamics of competition in the local market may lead to crowding out effects or subsequent entry independent of how the foreign firm entered.
Competitive behaviour	Not expected to vary by mode.	Not expected to vary by mode.

Source: UNCTAD 2000, and own extensions.

RESEARCH APPROACH AND OUTLINE OF THIS BOOK

We aim at gaining a comprehensive perspective on the issues and thus use multiple complementary research methods. In each of the four countries of this study, we have conducted three case studies, and a questionnaire survey with at least 150 received responses for each. Moreover background papers review the pertinent institutional and economic environment as well as trends of FDI and their entry modes. Researchers affiliated with leading local institutions, have conducted this research in close coordination with the research team at London Business School.

The case studies were conducted on the basis of a common framework that has been developed jointly, and modified on the basis of initial reports on cases of FDI. This framework established key issues that the field research teams were to consider for each case, including the multinational investor, the local partners, the entry motives and modes, the institutional environment, post-entry restructuring processes, as well as corporate performance and spillovers. In each country, the cases include two manufacturing cases and, except for Vietnam, one service company (Figure 1.3). The case studies consider both local and foreign perspectives and, being prepared by local partners, avoid the common bias of FDI research, focusing on the perspective and information provided by the foreign investor only.

The survey has been conducted with a common research instrument that has been translated to local languages where appropriate. In all countries the sample includes all FDI established over a ten-year period 1990-2000, that have at least 10 employees and foreign equity participation of 10 percent. To coordinate the research, to discuss the research questions and to design the common research instruments, the research teams met four times between November 2000 and March 2003, including a field research workshop in

Cairo that concentrated on local perspectives and information provided by foreign investors.

This book presents the research following the following structure: The next chapter summarises and interprets the data obtained in the survey study in a comparative perspective, and thus sets the stage for discussing patterns for the individual country analyses. Chapters 3 to 10 present the results for each of the countries, following a common structure. Each country is introduced with an overview of key contextual issues that may influence FDI, and a summary of key findings from the survey in that country. The second chapter for each country presents three in-depth case studies of foreign investors. The book concludes with two chapters that draw inferences and practical implications respectively for managers in multinational firms and their local partners, and for policy makers at the national and multinational level.

Figure 1.3 Case studies

	Egypt	India	South Africa	Vietnam
Services	ECMS (telecom)	ABN Amro (banking)	ABN Amro (banking)	---
Food & beverages	Heinz (ketchup)	Bacardi-Martini (spirits)	---	SEAB / Carlsberg (brewing)
Manufacturing, intermediate products	---	Packaging (packaging)	NGK / Behr (automotive suppliers)	ABB (Electrical components)
Manufacturing, final products	GlaxoSmith-Kline (pharmaceu-ticals)	---	EST (electrical equipment)	Honda (motorcycles)