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The Impact of Global Economic Shift on Outward Foreign Investment

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Abstract—This paper aims to see the impact of the global economic shift on the pattern of outward foreign direct investment. It was conducted by the literature study method, by comparing a number of countries over different time periods. The results of the study show that the pattern of outward foreign direct investment is strongly influenced by the level of global integration pressure and local pressure responsiveness level. The results fit with [2] Bartlett & Ghoshal's model of international business. It also shows that the pressure of global integration and local responsiveness tend to increase over time. There are 3 factors that need to be considered in this condition, namely: customization, competence, and arbitrage. However, these results are obtained from very few case studies. In the future this study needs to be elaborated further by using more samples.

Keywords—:Economic shift, outward foreign direct investment, globalintegration, local responsiveness.

Introduction

Globalization or the increasing tendency of interaction between people on a world scale due to advances in transportation and communications technologies, is an inevitability. The development of transportation and communications technology has made goods, services, capital, people and cultural values can move quickly from one place to another [6] (Giddens, 1991). Globalization simultaneously affects and is influenced by natural resources, social resources, environmental conditions, economic and business conditions. The global community has a complex network of power that is interesting to explore further.

Globalization cannot be separated by the process of capital mobility from one place to another. One form of capital mobility is foreign direct investment (FDI) or an investment form that seeks to control ownership of a business entity existing in a different country from that source of capital (lexicon.ft.com, 2018). International trade and FDI are the key drivers of the global value chain. The total value of FDI has reached a huge value, reaching $ 1.76 trillion by 2015 (UNCTAD, 2016). Interesting phenomenon is that outward FDI (OFDI) is no longer dominated by developed countries but also from newly industrialized country (NIC) and emerging economic [15] (Rasiah, et al., 2010).

In this article we will discuss the trend of outward FDI (OFDI) from newly industrialized country (NIC) and emerging economic. This paper also examines the typology required for companies to compete globally. The *first* part discusses the research background. The *second* section discusses Hymer's theory of FDI. The *third* part discusses the shift in the global economy that spawned several new economic forces. The OFDI phenomena in a few Asian countries is reviewed in the *fourth* section. The *fifth* section discusses what strategies need to be developed to become a global company. The theoretical constructions are described in the *sixth* section. The last session presented the conclusions.

Hymer's Theory on FDI

First, con In the decade of 60s, the phenomenon of capital movement was explained by using neoclassical theory about portfolio flows [4] (Dunning &[18] Rugman, 1985). This theory is rooted in classical trade theory from David [17] Ricardo (1817) who saw the trade and movement of capital triggered by differences in the cost of goods production between countries [17] (Ricardo, 1817). There are three factors that encourage the movement of capital between countries namely: the production costs, product differentiation and economies of scale. The company will move to a country that provides lower production costs. Neoclassical portfolio flows theory is more general than classical trade theory. Portfolio flows are not only related to production

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costs but also with capital flows and debt flows between countries. Neoclassical theory sees portfolio flows in a barrier-free world with perfect competition and no transaction costs [4] (Dunning & [18] Rugman, 1985). Capital will move to find the best interest rate or profit.

Foreign direct investment (FDI) was not discussed specifically in neoclassical portfolio flows theory [4] (Dunning & [18] Rugman, 1985), although there is a fundamental difference between foreign portfolio investment (FPI) and FDI. FPI is the process of flowing funds from one country to another country through stock market, bonds market or cash equivalent instruments [13] (O'Sullivan & Sheffrin, 2007). Investors flow funds by depositing money in foreign countries, buying shares in the stock market in foreign countries, or by buying foreign state bonds. Portfolio investment usually involves securities transactions that are very liquid or can be bought and be sold very quickly. In FPI instruments investors are not directly involved in the management of the company. FPI is very different from FDI which allows investors to control the management directly, up to certain levels, into the company [13] (O'Sullivan & Sheffrin, 2007). FDI is also less liquid, so it cannot be bought or be sold instantly.

FDI from US companies grew rapidly in the 60s. This phenomenon is difficult to explain by using neoclassical portfolio flows theory. Stephen Hymer in 1960 did research that focused on direct investment activities by multinational enterprises or MNE [7] (Ietto-Gillies, 2012). This research was published as his PhD dissertation. This work makes Hymer regarded as the father of "International Business, due to his contribution in the study of FDI and the theory of multinational corporations.

The theory proposed by Hymer differs from neoclassical theory which does not specifically distinguish portfolio investment (FPI) and direct investment (FDI). The most fundamental difference is that FDI gives higher control over the management of companies in foreign countries, relative to FPI. Hymer also criticized the neoclassical perspective because the theory of capital movement cannot account for international production. Interest rates are also not the main motive of international investment. If the interest rate is the main motive, then the flow will be concentrated to several countries only. In fact, FDI occurs in many countries. Interest rates are the drivers of FPI, but not for FDI.

The core value of Hymer's dissertation is to see the MNE as manifestations of market imperfection [4] (Dunning & [18] Rugman, 1985). Companies can reduce competition through FDI, from exporting goods or services to perform production activities in foreign countries. This step will reduce conflicts that arise in the market and provide specific benefits for MNEs, such as increasing market power globally. FDI is a capital movement associated with the operations of international companies that aim to control production. Competition is suppressed through the control of skilled labor, cheap raw materials and access to capital markets or technology. Profits in a country also do not have positive and perfect correlations to profits in other countries. Consequently, international diversification will provide aggregate profit stability, thus becoming a risk mitigation strategy. The current understanding of FDI has evolved. FDI has been seen as a strategy for nonfinancial transfers and empowering intangible assets [18] (Rugman, 1981). FDI is a strategy to transfer intermediate products, such as knowledge and technology, to various countries to scale up value to the company.

Global Economic Shifts

Starting in the 70s-80s, four Asian tigers Hong Kong, Singapore, South Korea and Taiwan experienced significant economic development [3] (Bozyk, 2006). The four countries have rapidly approached developed countries and high-income economies. This phenomenon then popularized the term newly industrialized country (NIC). On further developments, in the 90s-2000s decade, there were many new countries categorized as NICs, such as China, India, Indonesia, Thailand, Malaysia, South Africa, Brazil and Mexico. There are several characteristics of these countries, such as: tend to have an open political process, high GNI per capita, and export-oriented economic policies [3] (Bozyk, 2006). NIC countries now not only reach but have surpassed many developed countries.

The global economic shift changed the motivation, the way and the performance of multinational companies from NIC countries and developing countries. Firms from developing countries doing internationalization categorized into three motivations phase ([1] Aulakh, 2007). At the beginning they did internationalization by expanding into other emerging markets by exploiting their advantages. Then, by positioning their selves in the supply system of established multinational companies. The third phase, they are competing in more advanced countries, and they are improving their capabilities to add value-added on product and services.

There were shifts in motivation, path, and performance of multinationals from developing countries ([1] Aulakh, 2007). *The motivation*, the firms doing international business due for assets seeking or assets exploitation. Asset exploitation is when the firms already have the assets and doing international business to exploit these assets whereas asset seeking when the firms doing internalization to improve their resources. In addition, enhancing their capabilities are also the rationale of doing

internationalization. *The paths*, they focus on the acquisition of capabilities that improve their current advantages. *The performance*, it is found that the business group affiliation is more beneficial when done with others developing countries with similar institutional environment compared done with developed countries. [15] Ray &Chittor (2007) stated that the inter-group performance in Indian pharmaceutical industry are similar or no significant differences. Furthermore, the effective multinational strategies also related with the leaders of the firms. In general, the articles in this special issue agreed that there are dynamic aspects and constant interplay in exploiting and acquiring resources and capabilities.

The New Waves of OFDI

There are two types of foreign direct investment (FDI), namely: outward foreign direct investment (OFDI) and inward foreign direct investment (IFDI). Both concepts contradict each other. IFDI is an activity of external entities (foreign) to invest directly in the domestic economy (Investopedia.com, 2018a). Meanwhile OFDI is a business strategy in which domestic companies invest directly into foreign countries (Investopedia.com, 2018b). In the 60s to 90s, in emerging countries, IFDI was more dominant than OFDI. But in the last few decades OFDI has grown dramatically in emerging countries [15] (Rasiah, et al., 2010). FDI no longer only flows from develop countries to developing countries but also from developing economies to develop economies. There are many companies from developing countries that invest in developed countries like Haier (China), Embraer (Brazil), Mittal (India) and Samsung (South Korea). This phenomenon encouraged [15] Rasiah, et al. (2010) to explore the strategic drivers of OFDI. This exploration was conducted using the 3 waves of OFDI framework that formulated by Peter Gammeltof (2008). There are 3 waves of OFDI [5] (Gammeltoft, 2008), which have different characteristics.

The *first* wave occurred in the 60s to the mid-80s. The motivation of OFDI in this period was to find resources, markets and exploit existing assets. The development of the business structure was conducted horizontally or increasing the production of goods or services on the same part of the supply chain. The dominant sector of the time was small-scale manufacturing.

The second wave occurred in the late 80s until the mid-90s. OFDI's motivation in this period was not only resources and markets seeking but also assets seeking. In addition to exploiting assets, the company also increased the asset value by adding new elements (asset augmentation). The development of business structure was not only conducted horizontally but also vertically or increasing the production of goods or services in different parts of the supply chain. OFDI to developing countries was dominated by the financial and infrastructure sectors. Meanwhile OFDI to developed countries was dominated by mature and competitive sectors such as automotive, electronics and IT.

The third wave has occurred since the late 90s. The motivation is like the second wave, but more emphasis on asset augmentation and increase market power. The business structure is more complex, ranging from horizontal, vertical, and business integration or synergize organizational systems to enhance corporate value. Business expansion to developed countries is increasing rapidly.

The characteristics of ODFI on each wave vary. But in general, there are 6 key drivers of ODFI from developing countries, namely: market seeking, labor seeking, natural resource seeking, value chain control seeking, financial incentive seeking, and technology seeking [15] (Rasiah, et al., 2010). In the long run ODFI can increase the resources, market size, financial and technological capabilities of domestic MNEs companies. Short-term national interests, which inhibit OFDI in developing countries, can be detrimental in the long term. [15] Rasiah, et al. (2010) has provided different policy recommendations than mainstream prescriptions. OFDI is believed to increase the competitiveness and capabilities of MNEs from developing countries to benefit long term economic sustainability.

There are unique characteristics of economic shifting for each country. The new wave of OFDI needs to be elaborated further using a case study approach. For that we will elaborate on the experience of China and Indonesia, as twobig countries that have made significant economic progress.

Case Study in China

There was significant increasing number of China’s outward FDI, thus, there were some characteristics of China’s outward FDI based on its size, its target location, and the players [12] (Morck, et al., 2008). *The size*, China’s outward FDI rose significantly from null in the 1970s to more than $ 17.6 billion in 2006. Despite, its huge increased, the weight was relatively small, it was only accounted for 2,3% of global outward FDI. *The target location*, generally, its war targeting all around the world. However, the China’s outward FDI’s was mostly in South-East Asia (41%), followed by Africa (26%) and Western Europe (17%).

If China’s outward FDI’s classified by the target countries, then, Cayman Island ranked number one for almost 44,4%, and Hongkong ranked number two for 39,3%. Cayman Island offers tax havens whereas Hongkong provides access to financial and trade opportunity. In addition, China’s companies in Hongkong might act as subsidiaries as Chinese

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applied lower tax for Foreign-Owned Companies (FOE) than local companies [12] (Morck, et al., 2008). *The players*, China's outward FDI's was mostly done by Chinese Stated Owned Companies (SOE). From the thirty largest companies doing outward FDI's only two not explicit stated controlled; Lenovo and Huawei. In addition, those SOEs usually playing monopolized in their industry. China's outward FDI's aimed for natural resources such as Minmetals in Norand. In the next two sections, the author will describe the perspective from macro level and micro level.

Macro Level

There are three characteristic of China's macro-economic condition that linked with outward FDIs; high saving rate, weak corporate governance, and distorted capital allocation [12] (Morck, et al., 2008). *High saving rate*, there are saving from household, from enterprise and from government. Household saving accounted 16% of China's GDP. The high number of households saving due to the culture of Chinese that saved money for education, housing, pension, medical expenses or for durable goods. However, the trend was decline for some reasons such as an aging population or higher accumulation of saving. Corporate saving, in this case are retained earning calculated 20% of Chinese's GDP. The number was the highest compared to USA, France, Japan, Korea, Mexico, and India. The rationale behind this fact that most players in China's industry are SOEs are dividend averse. Data from the Shanghai and Shenzhen stock exchange, more than fifty percent of SOEs did not pay the dividends, despite its high returns.

From 1381 listed companies, 65% of their share were non-trade able shares in which fifty percent on it belongs to governments and its organ, and other fifty percent owned by large stated-controlled enterprise [12] (Morck, et al., 2008). In short, most of 1381 listed companies were owned by the government. Consequently, small shareholder had no power or influence, firms did not pay the dividends to the state, the firms' party committee and state have the authority to select the executive positions. In addition, as those executives mostly from the government, high retained earnings were associated with good performance so that the company was stable and able to maintain low unemployment rate and able to acquire other companies in other countries. *Capital Market Distortion*, Banks were the dominant players of China's capital market especially China's big four (SOEs). Those four banks accounted for half of all banking assets and three fourth of all commercial loans. However, those banks only accorded loans for the states' firms or companies in which they have only limited capabilities. As a result, the increasing number of China's FDI outward was because of the inability to invest in capable or growing local companies.

Micro Level

There are some rationales from firms' level perspective on the increasing number of outward FDI [12] (Morck, et al., 2008). Internalizations, the boss and private benefits of control. *Internalizations*, there are some concepts of internalizations that did not match with the fact in China such as the investment not to enhance the productivity or the target countries did not have the bigger market to increase economic of scale and scope. In fact, China's outward FDI are mainly in Africa and Southeast Asia. However, China FDI strategy matched on internationalization concept in resources. Chinese firms had the capabilities to deal with complex environment such as weak institutional, not so good governance and political constrain. Thus, Chinese firms enter the countries that have kind characteristics.

On the other hand, other countries such as Japan or USA having difficulties to deal with kind of problems [12] (Morck, et al., 2008). *The boss*, at the beginning the inflow FDI to China only used China as a cheap place to produce whereas the R&D and the brand building image or others important factors hold by the foreign companies. However, due to maturity in the industry, cost and quality become the major factors to win the market. Thus, the operational aspect on producing became the important factors (that hold by the Chinese firms'). *Private benefits of controls,* the TMT has their own goals, not long-term financial viability. They want to hold dominant control for super-voting shares, insider trading or self-dealing, to control the natural resources, to be control instead of to be controlled, and to enhance national pride.

Experience from Indonesia

In the late decades of 60s to the early decades of the 90s Indonesia's economy experienced significant economic growth, with average values well above 5% [10] (Lecraw, 1993). This growth was driven by natural resources such as timber, fish, minerals, oil and natural gas. This condition was followed by efforts to maintain the import of goods from the country, to encourage the domestic manufacturing sector. In the mid-1980s, Indonesia began to deregulate the economy. This policy pushes IFDI significantly. This condition is also simultaneously followed by a significant increase in domestic investment.

Industry and trade deregulation policies encouraged Indonesian companies to become larger and more efficient [10] (Lecraw, 1993). On the other hand, IFDI also plays roles in encouraging Indonesian exports. In the next developments some companies in Indonesia not only sold products but also run overseas operations. The OFDI wave has

diverse backgrounds, such as: overseas commitment or regulation, cost efficiency, access to capital and resources, technology acquisitions, and so on.

[10] Lecraw (1993) found that the performance of Indonesian firms investing abroad has increased dramatically. Overseas investment also included efforts to encourage management expertise, exports, product quality, and cost efficiency, relative to the company's previous performance. [10] Lecraw (1993) concluded that Indonesian multinational companies have invested abroad not only to exploit profits, but also to access and develop new capabilities, which were not previously owned.

How to be a Truly Global Company

In the last few decades, the process of globalization has accelerated. On the other hand, the current is facing several new challenges such as the wave of anti-global trade, financial crisis, and so forth. The problem is not globalization but the institutional factors [14] (Prahalad & Bhattacharyya, 2011), which has not been able to work well to anticipate structural changes in the global economy. Most large companies are based in the United States, Europe, and Japan. The global economy has been decentralized to new economies. The characteristics of existing business models become inaccurate or irrelevant to fit with the new environment. To survive in the long term, global companies must be able to integrate three strategies, namely: customization, competence, and arbitrage [14] (Prahalad & Bhattacharyya, 2011).

- Customization is an effort to deliver products and services in locally competitive ways. These products and services must meet the diverse needs and wants of customers, in terms of features, affordability, and cultural proximity. This element is also influenced by social factors, such as variations in income and different consumption orientations.

- Integration of competencies is an effort to align all business units spread globally to achieve the core objectives of the company. Each element must understand the common core objectives, although they have different geographic functions and geographical areas. Every individual must know the company's strategic principles, which are the same all over the world, but are adapted differently at the local level. Wal-Mart Stores Inc., for example, has the principle of providing "low prices every day". But its implementation is flexible, such as joint venture operations in India, restaurant, and bank operations in Mexico, and so on.

- Arbitrage is an attempt to increase the effectiveness and cost reduction by optimizing raw materials, manufacturing processes, logistics systems, financial resources, or business infrastructure. The majority of companies have adapted this strategy tactically but often ignore back-office work. Companies often move manufacturing to locations with lower labor costs but on the other hand increase management costs. Business process improvements must be streamlined in their production and cost chain. This initiative, for example, optimizes the location of raw material sources, the location of existing factories, and labor, because the company is essentially a hub of spatially dispersed resources.

- The challenge for global companies is to build consumer-oriented institutions. This effort relies heavily on the ability to deliver goods and services of the highest quality, which are in line with consumer conditions at the local level. Customization, competence, and arbitrage [14] (Prahalad & Bhattacharyya, 2011) are three important factors in formulating business models that are in line with today's global dynamics.

THEORETICAL CONSTRUCTION

[2] Bartlett & Ghoshal (1991) suggests the strategic development of a multinational company's business development is largely determined by two pressures: local responses & global integration.

- The low pressure of global integration and low pressure of local responsiveness fit with international strategy, which seeks to drive efficiency but remains focused on domestic operations.

- The low pressure of global integration and high pressure of local responsiveness fit with the multi-domestic strategy, which seeks to maximize local markets by increasing customization.

- The high pressure of global integration and low pressure of local responsiveness fit with global strategy, which focuses efficiency through pushing economies of scale.

- The high pressure of global integration and high pressure of local responsiveness fit with transnational strategy, which seeks to maximize benefits through local responsiveness and global integration simultaneously.

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	Low Pressure for Local Responsiveness	High Pressure for Local Responsiveness
High Pressure for Global Integration	**Global** Morck, et al. (2008): China in the early 2000s	**Transnational** Rasiah, et al. (2010): Asia in the late 2000s
Low Pressure for Global Integration	**International** Hymer (1960): the world in the early decades of the 60s	**Multi-Domestic** Lecraw (1993): Indonesia in the early decades of the 90s

Figure 1. Theoretical constructions of international strategies from several OFDIs in different countries and times, using the [2] Bartlett & Ghoshal's model (1991).

- The OFDI pattern evolves over time, according to the dynamics of its environment. In the 60s, when Hymer's theory was published, the pressure to global integration and pressure was relatively small. Multinational companies tended to use international strategy. OFDI in Indonesia in the early decades of the 90s was strongly influenced by the high pressure of local responsiveness [10] (Lecraw, 1993). Many companies from Indonesia tended to use multi domestic strategy. OFDI in China in the early 2000s was driven by the high pressure of global integration [12] (Morck, et al., 2008), which tended to use global strategy. In the case of emerging economies in Asia in the late 2000s, OFDI was used to meet the demands of global integration and high local responsiveness simultaneously [15] (Rasiah, et al., 2010). More and more companies used transnational strategy.

CONCLUSSION

Globalization cannot be separated by the process of capital mobility from one place to another. One form of capital mobility is foreign direct investment (FDI). The FDI theory is rooted in Hymer's critique with neoclassical approach that does not distinguish between foreign direct investment (FDI) and foreign portfolio investment (FPI). In further development outward FDI (OFDI) not only came from developed countries. OFDI from newly industrialized country (NIC) and emerging economic has increased significantly. The motivation and characteristics of the OFDI has developed, according to the pressure of location integration and local responsiveness. This study shows that the pressure of global integration and local responsiveness tend to increase over time. There are 3 factors that need to be considered in this condition, namely: customization, competence, and arbitrage.

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