Globalization of Manufacturing Firms from Developing Countries

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Introduction

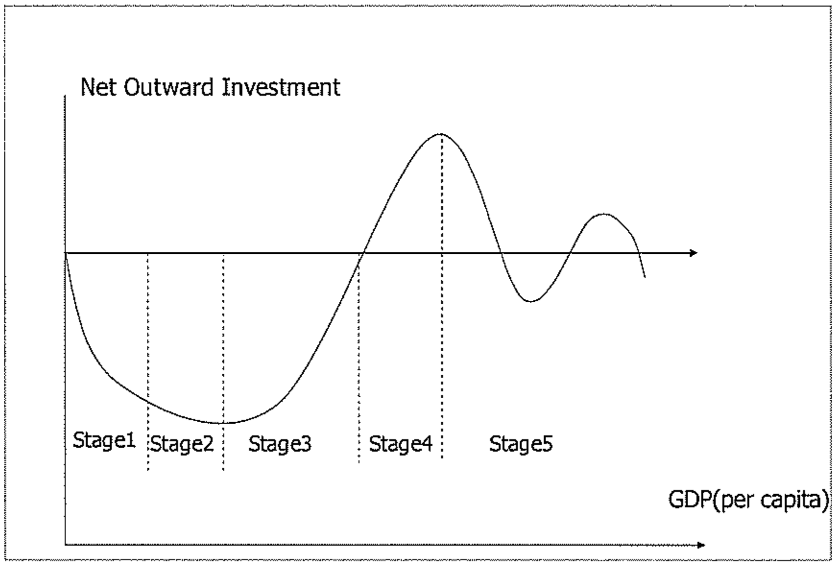
Increasing number of manufactures in developing countries invested overseas to be global players. Since the FDI (foreign direct investment) by these firms is a rather new phenomenon, only a few comprehensive researches were conducted in this field. In the macro economics, IDP (investment development path) shows the possible processes for developing countries to be global investors. When they reach the stages where the outflow investment surpasses inflow investment, they can be recognized as emerging investors in the world. The main objective of this paper is to identify factors which enabled manu factures in developing countries to establish their subsidiaries. In order to be global players, it is necessary for these firms to have competitive advantages. The management resources which enabled them to go abroad must be investigated. Along with this investigation, the development and accumulation process of the management resources will be also examined.

1. Investment Development Path (IDP)

With the economic progress, developing countries will gradually climb up IDP. Growing outflow of FDI in the latter stages of IDP shows the increasing FDI by manufactures in these countries. We can also observe that the development process of the manufactures in these countries. The strategies of these manufactures have been changing from export to FDI in general. It seems very important to investigate the factors relating with these changes.

In order to understand the increasing FDI from developing countries, from macro economic perspectives, it will be useful to utilize IDP. As it is shown in Figure 1, IDP has five possible development stages. The net outward investment (NOI) is negative in the first stage of IDP with limited inflow of FDI which concentrates mainly in the natural resource development and almost no outflow of FDI. The countries in this stage will be identified as the least developed countries. The NOI will show larger negative figures in the second stage with growing inflow of FDI due to the rather favorable economic condition of the host countries for MNCs (multinational corporations) such as cheap

Figure1 Investment Development Path



source: Narula Rajneesh, *Multinational Investment and Economic Structure,* Routledge, London, 1996, p.22.

labor for export oriented MNCs. Other MNCs will find FDI opportunities in the import substituting industries, to which it is getting harder to export their products from home countries under the high tariff protection. In the third stage, outflow of FDI by domestic firms emerges and NOI position will be improved. Due to the higher per capita GDP and higher wage level, some labor intensive industries will not have the comparative advantages any more and both MNCs and local firms in these industries will relocate production facilities to the less developed countries, where they can find enough cheap labor. The inflow of FDI still exceeds the outflow of FDI. The good infrastructure and industrial clusters in specific industries such as E&E (electronics and electrical) will facilitate the FDI by MNCs. The purpose of FDI by them will not be resource seeking as it was observed in the second stage but efficiency seeking. Some countries at the end of the third stage might be called NIEs (newly industrializing economies). The fourth stage indicates the shift to positive NOI position with higher per capita GDP. Higher wages will be one of the push factors for the FDI by local firms. Some local firms will be MNCs with large amount of FDI to several countries. The countries reached this stage can be called advanced countries. The comparative advantages in these countries will shift to capital or technology intensive industries. Intra-firm trade within the MNCs tends to increase with growing numbers of subsidiaries all over the world. The final stage of IDP is characterized by the fluctuation of NOI position.

Some factors will affect how fast one specific country climbs up the IDP from lower stages to higher stages. These factors are;

① resource structure
② market size
③ strategy of economic development
④ the role of government.

2. Two Types of FDI by Firms from Developing Countries

The IDP shows that there will be some stages for developing countries to go up and at the end of the second stage and afterward, some local firms will begin to invest abroad. It will be possible to classify the types of FDI by firms in the developing countries. One will be called traditional type and the other the new type of FDI.

As it was referred in Kojima model, the traditional type of FDI will be caused by the changing comparative advantages in the home countries. This type of FDI will be typically seen in the labor intensive industries such as textile and clothes. Those firms in the countries in the second and third stages of IDP invest in the less developed countries to make use of the cheap labor since the wage level in the home countries was raised. In the 1970s, Japanese firms in the labor intensive industries invested in the East and Southeast Asian countries for this purpose and followed by Korean and Taiwanese firms in the 1980s.

The new type of FDI by firms in the developing countries increased in recent years, especially in the E&E industry. Those who became the domestic suppliers to MNCs began to participate in the global networks or supply chains of MNCs and established subsidiaries in the other developing countries. Most of the firms came from the third IDP stage countries and invested in the countries in the second or third IDP stage countries. By being the suppliers of MNCs from advanced countries such as US and Japan, the capability of these domestic suppliers was enhanced partly by the demonstration effects and partly through the inter-firm technology transfer by MNCs. Once they became reliable suppliers to MNCs, there will be more opportunities for them to go abroad with MNCs.

In this paper, we will pay more attention to the latter, namely the new type of FDI. This type of FDI will not be explained by the traditional comparative advantage theory. In stead of it, the competitive advantage approach will be introduced to explain it.

The competitive advantage approach tries to identify the determinants of the FDI by MNCs. We can find various types of competitive advantages of MNCs from developing countries. These advantages include human resourses, technology, access to resources and activities, production capabilities, and so forth. Given these competitive advantages and the conditions of host countries, the FDI strategies (motivations), such as market-seeking, efficiency-seeking, resource-seeking and created asset-seeking would be decided by MNCs.

The competitive advantage approach was first introduced by Hymer and Kindleberger. They tried to figure out the company specific advantages of MNCs. This approach was inherited and enhanced by Dunning. In his eclectic theory (OLI paradigm), he showed that firms must have the competitive advantages, in his terminology, the ownership specific advantages (O), to go abroad. The destinations of the FDI will be decided based on the location specific variables (L). The internalization incentive advantages (I) will work to maximize ownership specific advantages. Both ownership specific advantages and location specific variables will play more important roles to climb up the IDP.

The next task for us is to try to find out the ownership specific advantages (competitive advantages) of manufactures from developing countries, which contributed to be global players. Some empirical studies described the determinants of the FDI by MNCs from developing countries. Since the FDI by those manufactures is a rather new phenomenon, only a few comprehensive research were conducted. In order to understand the FDI by them, it is necessary to have an intensive research of these firms. Facts finding through case studies would contribute to identify the specific competitive advantages of manufactures from developing countries or in a broader sense MNCs from developing countries. The competitive advantages of these MNCs would be different from firm to firm and from industry to industry. It is also expected that the case studies would help the future theoretical development in this field.

In the case of MNCs from developing countries, the management resources which enabled their FDI were sometimes transferred from outside. The linkages with MNCs from advanced countries may have played important roles in this regard through spillover effects. Together with the identification of competitive advantages, the process of obtaining and developing them should be observed.

3. The Role of MNCs from Advanced Countries

MNCs from advanced countries in the developing world will have more management resources than firms in the host countries. The management resources necessary for doing business in the host developing countries will de transferred from the parent firms or other subsidiaries.

Existing MNCs from advanced countries will have some effects to the local firms. They will give local firms the chance to experience the latest technology. It can be one of the demonstration effects to local firms. Those who work for the MNCs can learn higher level of management resources, for instance, technology. If they set up new firms, the management resources will be diffused outside the MNCs. We can call it spillover or spin-offs even though this kind of spillover will not be observed so much in the developing countries.

The other way of enhancing the capability of local suppliers will the inter-firm transfer of management resources. The first step is creating the transaction between MNCs and local suppliers. MNCs prefer to purchase some intermediate goods from local firms mainly because of the lower prices and shorter delivery time. However, the quality of their products must be the same as the international standard or at least acceptable for MNCs. For the import substituting MNCs, we can find more opportunities to purchase intermediate goods from local suppliers because they mainly supply their products to the domestic markets where the high quality products at high prices will not be preferred. On the other hand, export oriented MNCs prefer to purchase from parent firms or foreign firms which can produce higher quality parts and components. MNCs will take into account both quality and prices and choose the suppliers so that not many local suppliers can supply to MNCs. However, some local firms succeeded to create business opportunities with MNCs.

As it was already explained, MNCs have some reasons to purchase intermediate goods from local suppliers. However, for the local firms it is not easy to be major suppliers of the MNCs. It is partly because of the quality of their products and partly because of the production volumes. If the quality of their products is not as good as it is expected by MNCs and the quality gap is not big enough, MNCs will provide technical assistance to local suppliers to improve the quality. On the other hand, it is quite difficult for the local suppliers, which are in general small in size, to invest huge amount of money to buy new machinery and other facilities to increase production volumes.

4. Case Studies in Malaysia

Intel

Intel Malaysia was established in the early 1970s in the State of Penang, the northern part of Malaysia. Until the early 1980s, Intel had been importing almost all the parts and components from US and their products were exported back to US. In the late 1980s, Intel concentrated on introducing new products and began to outsource tooling and production engineering from local firms. Intel organized in-house seminars and other training programs to local suppliers. These seminars and training programs for local firms facilitated them to enhance their capabilities. Some local suppliers succeeded to accumulate enough management resources and became global players by accompanying to Intel when it established new factory in the Philippines.

In the late 1990s, increasing training costs for local suppliers made it harder for Intel to continue in-house training programs and establish the new cooperation system with a local training institute and other MNCs, such as Motorola in Penang. This program was called global supplier program and many MNCs join and provided special training courses with the help of training institute so that they can save the costs for providing assistance to local suppliers. Before the introduction of this joint assistance program, each MNC provided it own training to local firms.

Panasonic

The first subsidiary of Panasonic in Malaysia was established in the 1960s. Currently, Panasonic has around 20 subsidiaries all over Malaysia. The oldest subsidiary of Panasonic provided special assistance to some promising local suppliers. At first, it was very hard for Panasonic to persuade the local firms the importance of training. Panasonic continued to send retired Japanese engineers to 10 local firms for one year. They learn QCD (quality, cost, delivery) from Panasonic and improved their capabilities. They became reliable suppliers and some concluded new transactions with other Japanese MNCs.

When Panasonic established new factory in Vietnam, one of the major local suppliers decided to set up joint venture with Japanese firm near the new factory to supply some parts and components to Panasonic in Vietnam. This firm has never exported it products before. It skipped the exporting process and jumped into FDI process. It became possible by establishing good relationship with Panasonic.

SONY

One of the subsidiaries of SONY was established in the late 1980s in Malaysia to produce audio visual products. One local supplier developed new sophisticated parts by the cooperating with SONY. This is the only one supplier which succeeded to produce these parts and began to export to the other subsidiaries of SONY all over the world. When SONY established new factory in China, this firm was required to set up the factory nearby to supply these crucial parts to SONY.

Above-mentioned cases show that those local suppliers enhanced their capability with the assistance by MNCs became reliable suppliers to MNCs and obtained the chance to invest outside Malaysia. It is very difficult for some local manufactures to penetrate foreign markets by themselves. By becoming the reliable suppliers to MNCs, some firms get the way to be global players.

5. Theoretical Framework

Here we try to consider the theoretical framework which enables to explain the globalization of manufactures from developing countries. We will refer to the flagship model and quasi-internalization for this purpose. The flagship model tries to emphasize the role of the big MNCs as the flagships. Flagship, in this sense, means the firm which controls the related firms including subsidiaries and suppliers. A network created by the flagship will break down the value chain into discrete functions and locate them where they can carry out effectively, where they can access necessary resources and where they can penetrate the markets. The firms from developing countries, if they can become the reliable suppliers to MNCs, will succeed to be involved in the network of the flagship MNCs. In other words, being the member of the network will facilitate local firms to be global players.

Internalization theory is currently the main stream of MNC or international business theories. Internalization means to establish markets within the firms. These markets are not open to the public and only the subsidiaries can access to the markets. MNCs prefer to organize the networks of their subsidiaries and control them instead of using markets. If the local supplier can be a sole or exclusive supplier, it seems possible for it to be a part of the organization or play the same role as the subsidiary. It is not always necessary to be a subsidiary to be the member of the organization. It might be possible to expand the concept of the internalization and expect the almost the similar system as internalization, namely, quasi-internalization.

6. Summary

As it was explained by IDP, we can assume that developing countries go up the ladder to be advanced countries. With increasing per capita GDP, or with the development of the manufacturing bases, there will be more opportunities for manufactures from developing countries to be global players. There will be two ways to be global players. One is through traditional way of FDI, namely the FDI based on the changing comparative advantages. It can be typically observed in the case of the labor intensive industries. The other one is to be the suppliers of MNCs and enhance capability necessary to go abroad. In most cases, local suppliers accompany the MNCs to set up new factories. Flagship model or quasi-internalization can be theoretical background of this new type of FDI by local suppliers.