

# Economics of Multinational Enterprises

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# Definition of Multinational Enterprises (MNEs)

## According to OECD Guidelines of Multinational Enterprises (2008)

- A precise definition of multinational enterprises is not required for the purposes of the *Guidelines*.
- These usually comprise **companies or other entities established in more than one country and so linked that they may co-ordinate their operations in various ways.**
- While one or more of these entities may be able to exercise a significant influence over the activities of others, their degree of autonomy within the enterprise may vary widely from one MNE to another.
- Ownership may be private, state or mixed.

# Definition of Foreign Direct Investment (FDI)

## According to OECD Benchmark Definition of Foreign Direct Investment Fourth Edition (2008)

- Direct investment is a category of cross-border investment made by a resident in one economy (*the direct investor*) with the objective of establishing a lasting interest in an enterprise (*the direct investment enterprise*) that is resident in an economy other than that of the direct investor.
- The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise.
- The “lasting interest” is evidenced when the direct investor owns at least 10% of the voting power of the direct investment enterprise. Direct investment may also allow the direct investor to gain access to the economy of the direct investment enterprise which it might otherwise be unable to do.
- The objectives of direct investment are different from those of portfolio investment whereby investors do not generally expect to influence the management of the enterprise.

# Types of FDI

## ➤ Based on direction of investment

- ✓ Inward FDI
- ✓ Outward FDI

## ➤ Based on types of activity

- ✓ Horizontal FDI
- ✓ Vertical FDI: Backward vertical FDI vs Forward vertical FDI

## ➤ Based on modes of entry

- ✓ Owned subsidiaries
- ✓ Merger & Acquisition
- ✓ Joint Venture

## ➤ Based on nationality of investors

- ✓ Wholly foreign owned
- ✓ Joint venture between foreign firm and local firm

# Types of FDI

## ➤ Based on motives of FDI (Dunning 1980, 1981)

- ✓ **Natural resource-seeking FDI:** MNEs choose a specific host country based on **sources of natural resources at the lowest relative cost**. This type of MNE is normally associated with the export of resource-based products from the host country.
- ✓ **Market-seeking FDI:** MNEs expand their production abroad to **new customers in new markets** or by **extending and preserving their existing markets**. In terms of trade, this type of FDI can sometimes generate an import substitution effect, but often also leads to trade creation.
- ✓ **Efficiency-seeking FDI:** This type of FDI reflects **a rationalization of the MNE's operations and normally is related to a specialization of various affiliates in its internal network**. This can increase both intra-firm knowledge and goods flows. However, Hiratsuka (2006) suggests that indeed efficiency-seeking motive of FDI can be regarded as one type of resource seeking FDI
- ✓ **Strategic asset-seeking FDI:** In this case, **assets of foreign firms are utilized to create synergies with the existing FSAs through common ownership**. This could be done by modes of entry such as joint venture or acquisition.

# Determinants of FDI

## Dunning's OLI framework (Dunning 1977, 1981)

- **Ownership advantages (O advantages):** A firm's ownership advantage can come in many possible forms. According to Dunning (1983a and 1983b), these advantages may relate to **assets (Oa advantages)** and **transaction skills (Ot advantages)**.
  - ✓ The former advantages arise from the ownership of assets which are specific to the firm and to which other firms do not have access (unique assets), such as **firm-specific knowledge, managing capability, marketing capability, etc.**
  - ✓ The latter advantages relate to **the capabilities of MNEs to capture transactional benefit** (or economizing transaction costs) **through the coordination of assets located in different countries.**
  - ✓ For a firm to engage in FDI, the benefit from these ownership advantages should outweigh the cost of doing business abroad.
- **Location Advantages (L advantages):** These advantages can be related to **government controls and regulations**, such as tariffs and quotas, **political risk**, and **cultural values**. It can also come from the **foreign market's cheap factor prices**, and can be related to **transportation costs**. Factors such as **access to customers and local opportunities** are also important sources of location advantages.
- **Internalization advantages (I advantages):** A firm may decide to engage in **FDI** rather than **exporting** or **licensing** to **overcome market imperfection problems**. According to Rugman (1982), the imperfections of the market can be both natural market imperfections (e.g. the public good characteristic of knowledge) and structural market imperfections (e.g. government controls and regulations)

# Determinants of FDI

## FSA/CSAs framework (static and dynamic)

- **Firm-specific advantages (FSAs):** a firm's unique resources and heterogeneous capabilities can generate competitive advantages, which can lead to sustainable superior returns (Rugman and Verbeke, 2002; Barney, 1991). For example firms' knowledge, managing capability, managerial capability
  
- **Country-specific advantages (CSAs):** These advantages arise from the environment of the country.
  - ✓ These CSAs may include **natural market factor endowments, factor prices, government regulations**, and **market access** (Sukpanich and Rugman, 2010).
  - ✓ Asian Development Bank (2006) describes that a country attractiveness as a host of FDI depends on
    - (1) Comparative advantage in international production
    - (2) Investment climate: Foreign investment regime and general investment environment

# Impact of FDI to host and home country

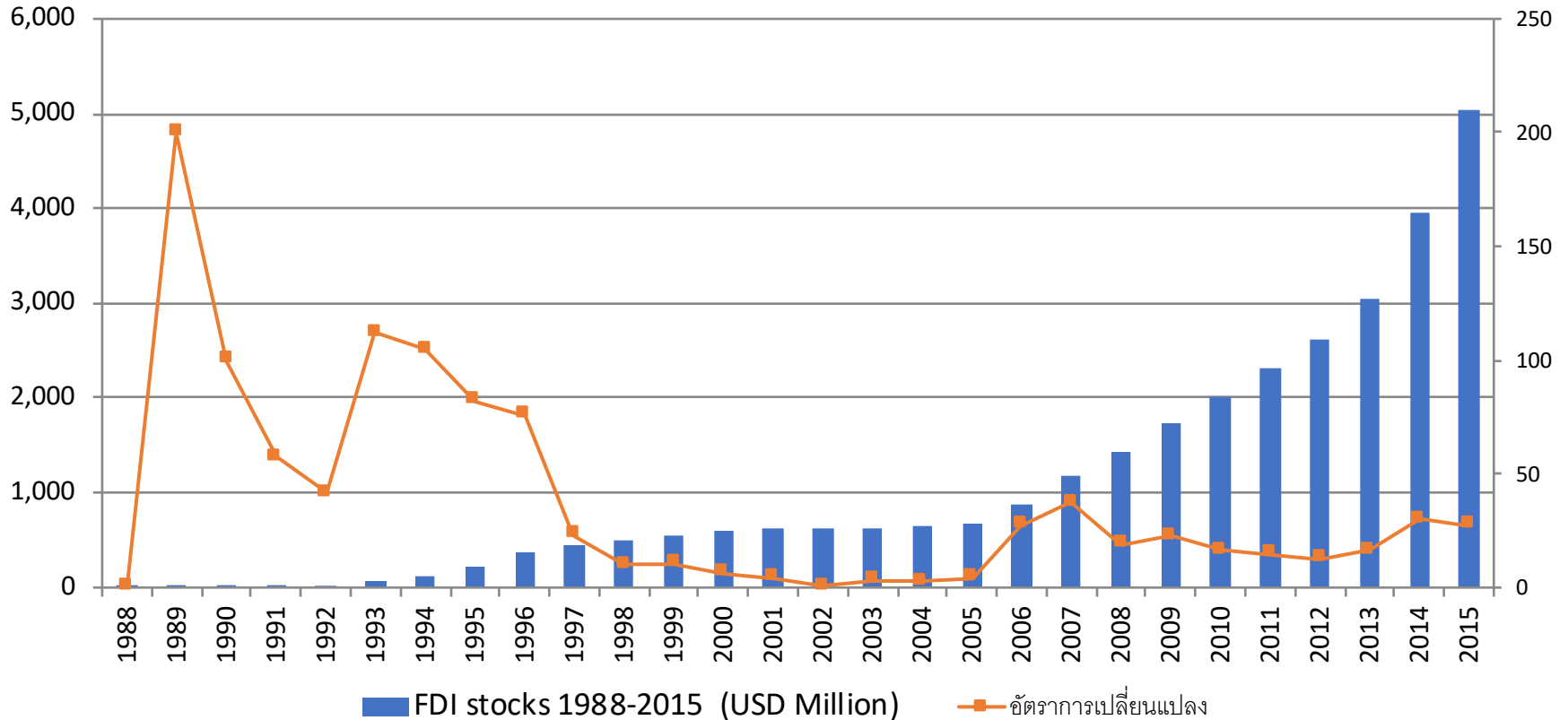
- **Resource allocation**
- **Technology transfer**
- **Income distribution**
- **Trade**
- **Employment**
- **Economic development**

**etc.**

# Case study: FDI in the Lao PDR

# FDI stocks (net inflows) to the Lao PDR (1998 – 2015)

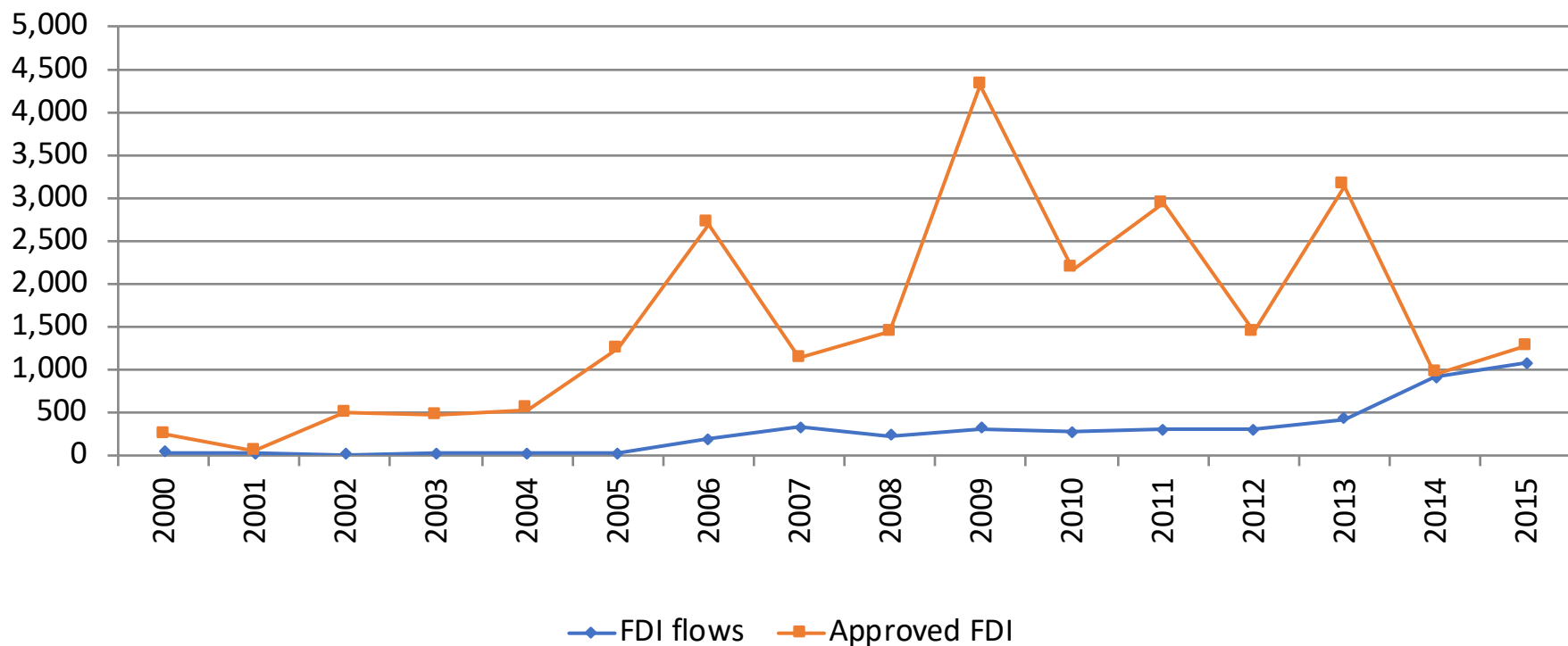
Million US dollars



Source: World Bank (from CEIC database)

## Compared FDI flows vs. Approved FDI in the Lao PDR (2000 - 2015)

Million US dollars

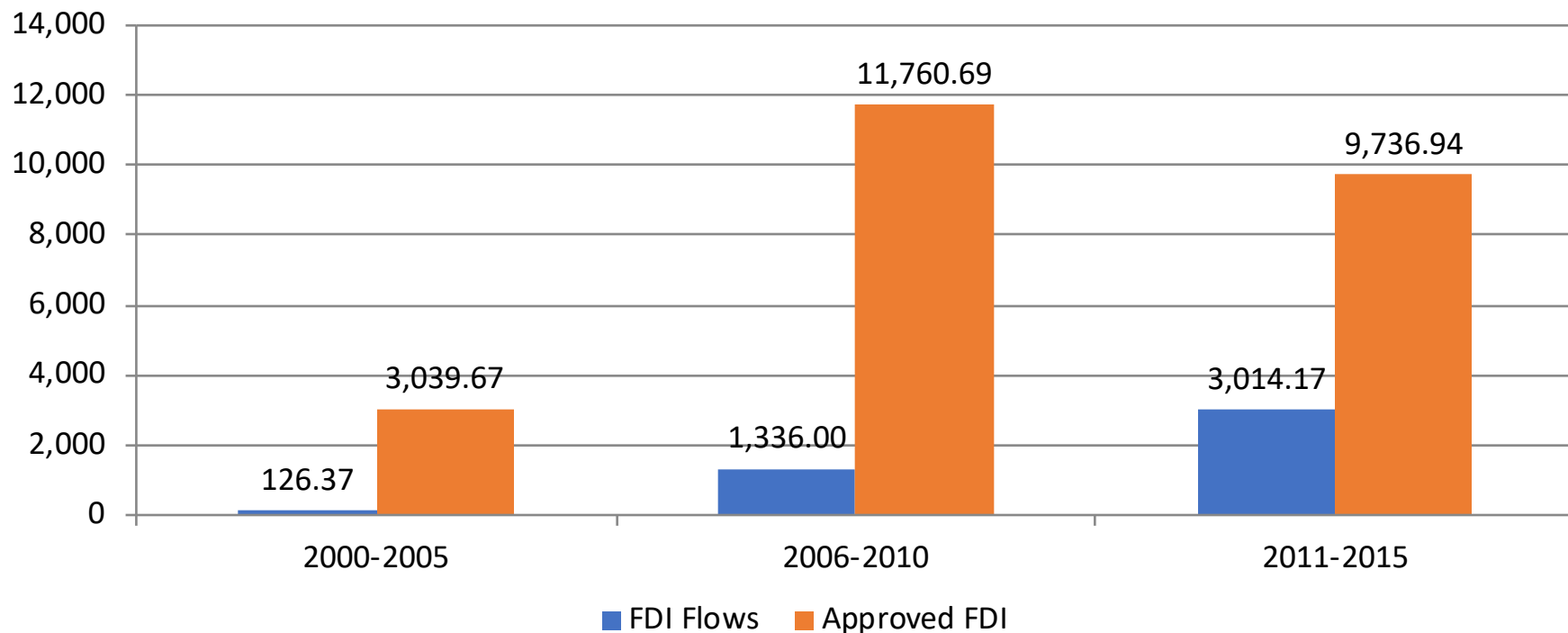


Source: FDI flows data in 2000-2015 are from World Bank (from CEIC database)

Approved FDI data 2000-2014 are from Lao Statistics Bureau (from CEIC database) 2015 data are from Ministry of Planning and Investment (2016)

## Compared actual FDI vs. Approved FDI in the Lao PDR (2000 - 2015)

Million US dollars

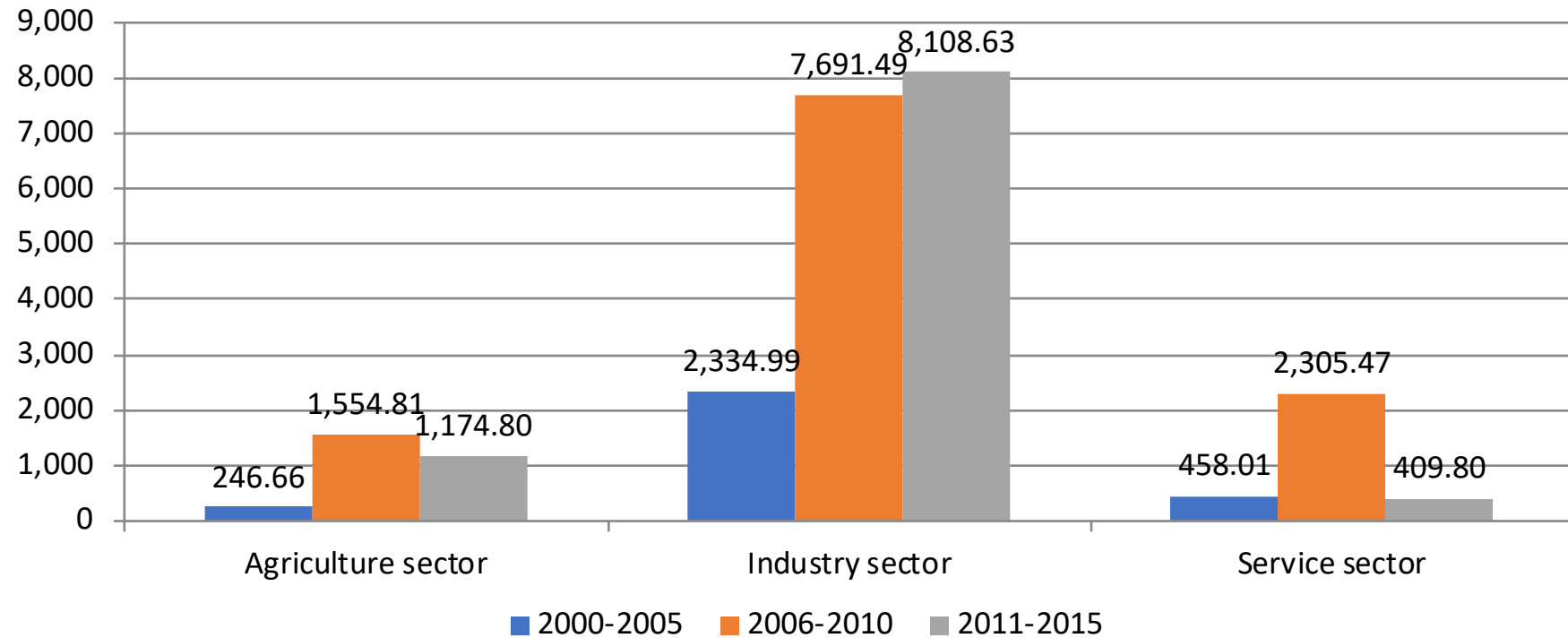


Source: FDI flows data in 2000-2015 are from World Bank (from CEIC database)

Approved FDI data 2000-2014 are from Lao Statistics Bureau (from CEIC database) 2015 data are from Ministry of Planning and Investment (2016)

# Approved FDI by sectors (2000 – 2015)

Million US dollars

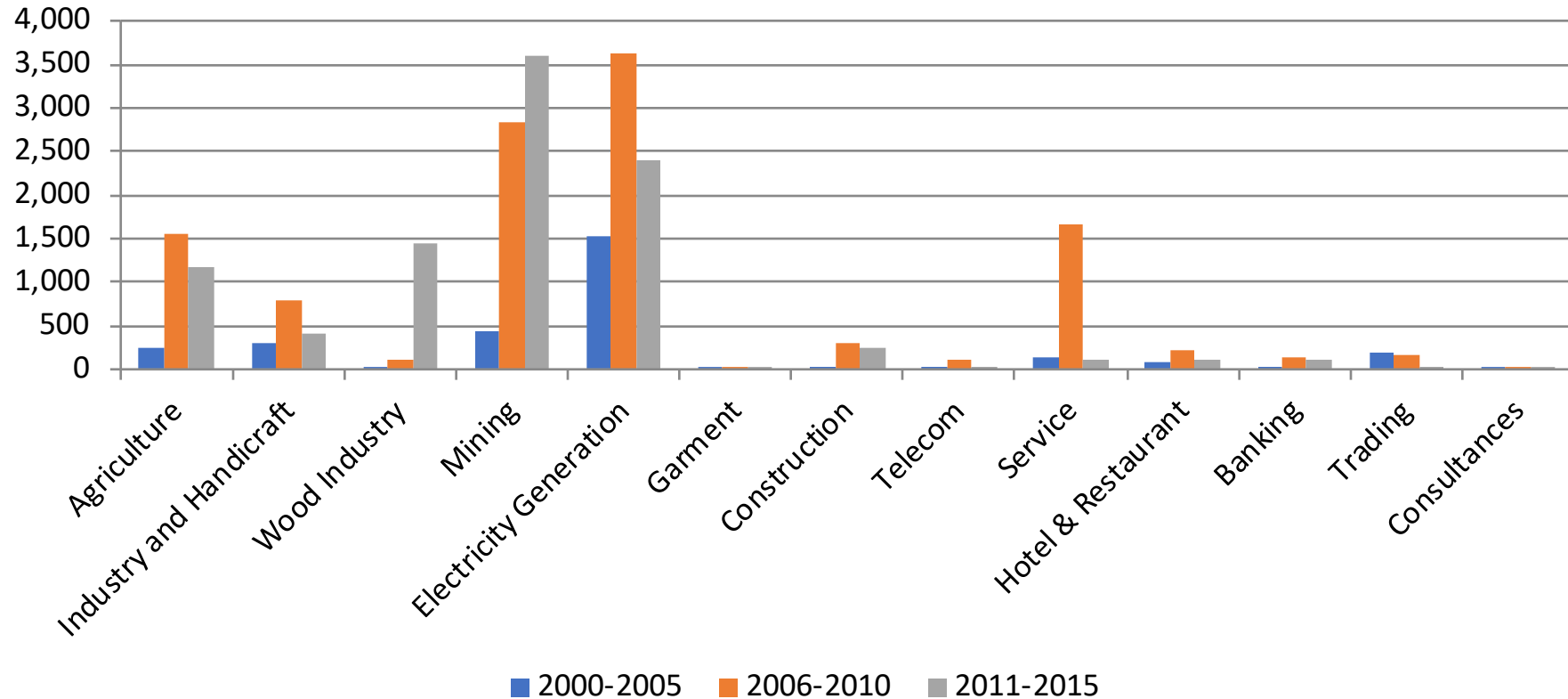


Source: ข้อมูลปี 2000-2014 มาจาก Lao Statistics Bureau (สืบค้นจากฐานข้อมูล CEIC)

ข้อมูลปี 2015 มาจาก Ministry of Planning and Investment (2016)

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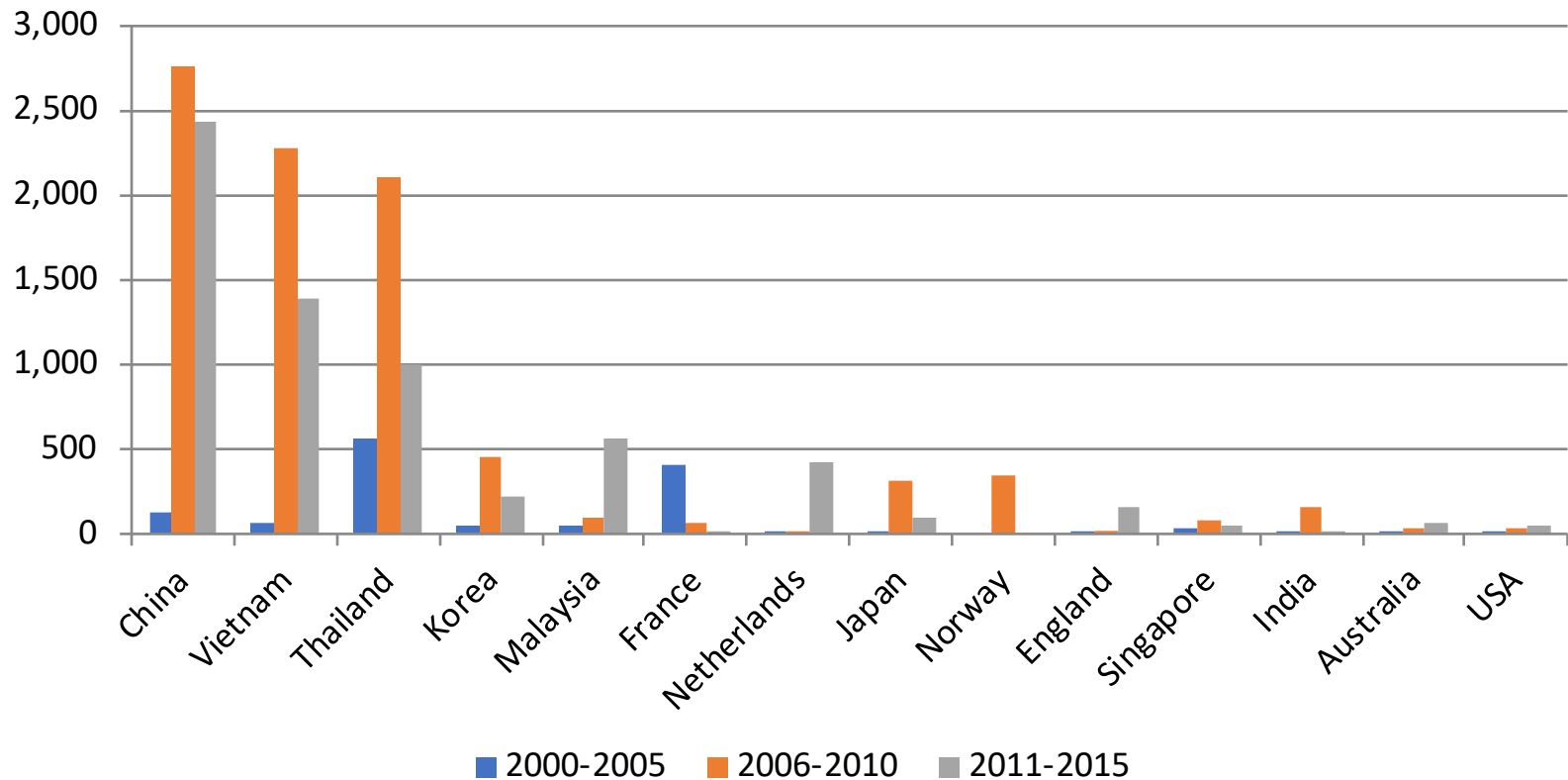


Source: Data 2000-2014 are from Lao Statistics Bureau (from CEIC database)

2015 data are from Ministry of Planning and Investment (2016)

## Approved FDI by country (2000 – 2015)

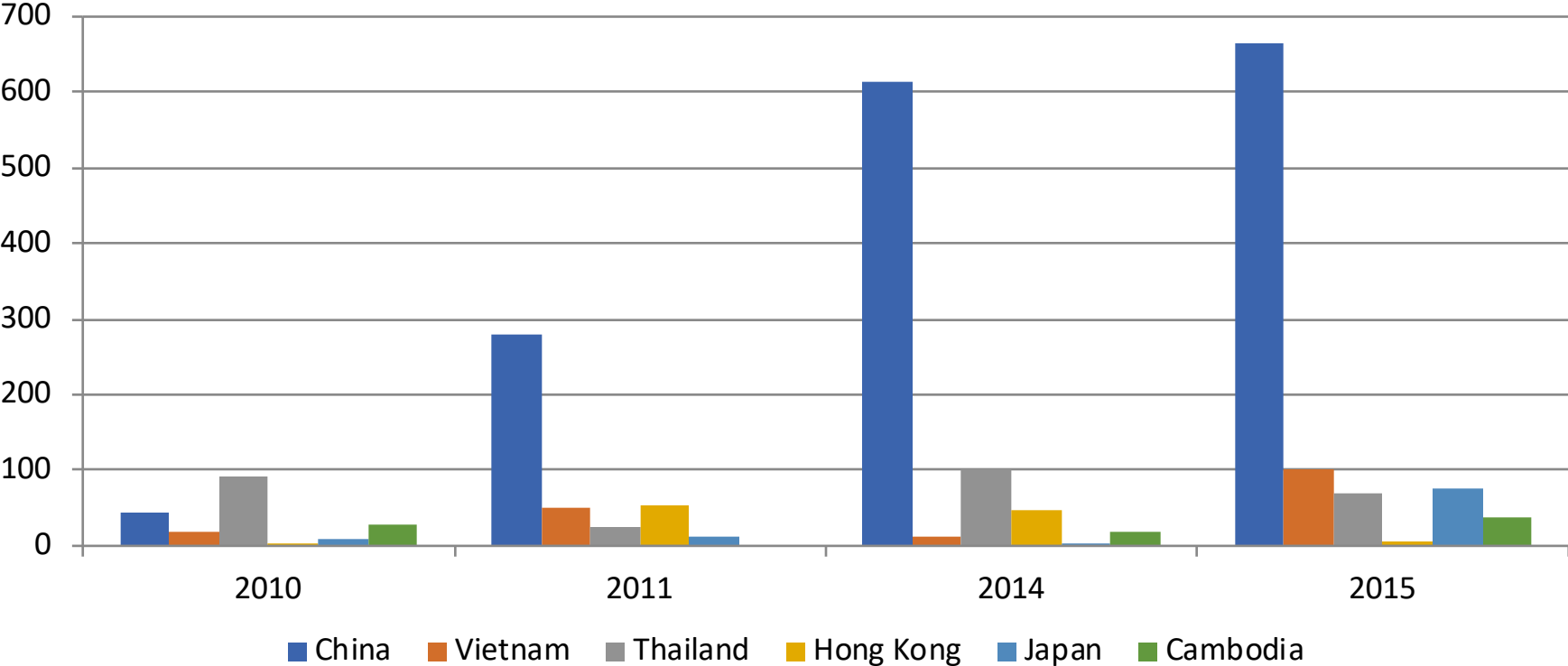
Million US dollars



ที่มา: Ministry of Planning and Investment (สืบค้นจากฐานข้อมูล CEIC)

# FDI inflows by country

Million US dollars



หมายเหตุ ปี 2012 และ 2013 ไม่มีข้อมูล  
ที่มา: ASEAN Statistic Database (2016)

# Discussions

## (FDI motives and determinants in Lao PDR)

Pick one of these business to invest in the Lao PDR

- Thai restaurant and/or coffee shop
- Coffee bean plantation or any agricultural product plantation
- Beauty clinic
- Zipline tourist activity business
- Hydropower project or any infrastructure project
- Factory producing cloth or other manufacturing industry



The map of Lao PDR

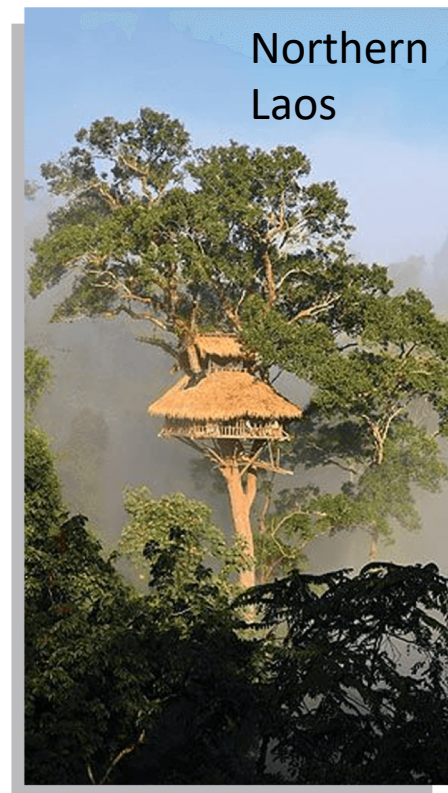


Xyaburi Hydropower Project in the Lao PDR

(Thai SOEs and private sector 80%, the Lao PDR government 20%)

Coffee plantation in the Lao PDR





Zipline business in the Lao PDR



Wuttisak Clinic in Vientiane



Black Canyon in Vientiane

# Discussions

## (FDI motives and determinants in Lao PDR)

Based on the industry the group pick analyse

- **FDI motives** (natural resource seeking, market seeking, efficiency seeking or/and strategic asset seeking)
- **Home country specific advantages (and disadvantages)** --- in this case study home country is Thailand
- **Host country specific advantages (and disadvantages)** --- in this case study host country is Lao PDR
- **Firm specific advantages**: this part the group can assume

# Discussions

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# Discussions

## (FDI motives and determinants in Lao PDR)

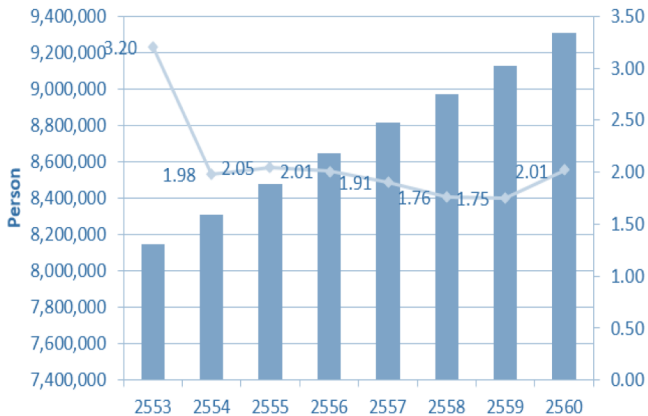
- Some data or information that can be used for the analysis provided in slides no. 26 – 32.
- The group can also bring in data and information from other lectures to support your analysis.
- The group may look for supplement information relevant to your group FDI industry to support your analysis

# Some macroeconomic indicators of Lao PDR

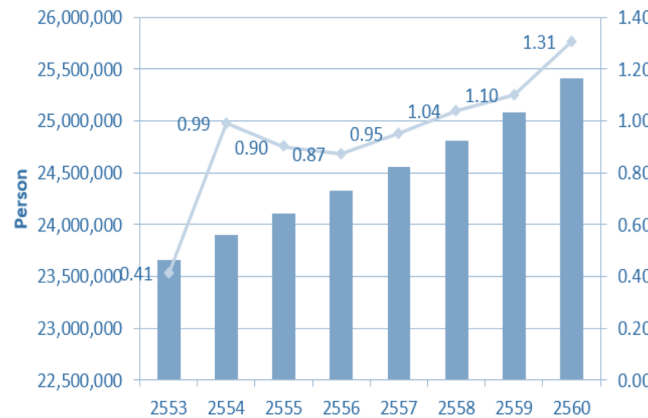
- [https://databank.worldbank.org/views/reports/reportwidget.aspx?Report\\_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=LAO](https://databank.worldbank.org/views/reports/reportwidget.aspx?Report_Name=CountryProfile&Id=b450fd57&tbar=y&dd=y&inf=n&zm=n&country=LAO)
- <https://www.worldbank.org/en/country/lao/publication/macroeconomic-stability-amidst-uncertainty-lao-pdr-economic-monitor-january-2019>
- [https://www.scbeic.com/th/detail/file/product/6074/fdb0azin19/CLMV\\_Q2\\_2019\\_TH\\_external.pdf](https://www.scbeic.com/th/detail/file/product/6074/fdb0azin19/CLMV_Q2_2019_TH_external.pdf)
- <https://www.xe.com/currencycharts/?from=USD&to=LAK&view=5Y>
- <https://www.xe.com/currencycharts/?from=THB&to=LAK&view=5Y>
- <http://www.lsx.com.la/>

# CLMV Labor force (LF)

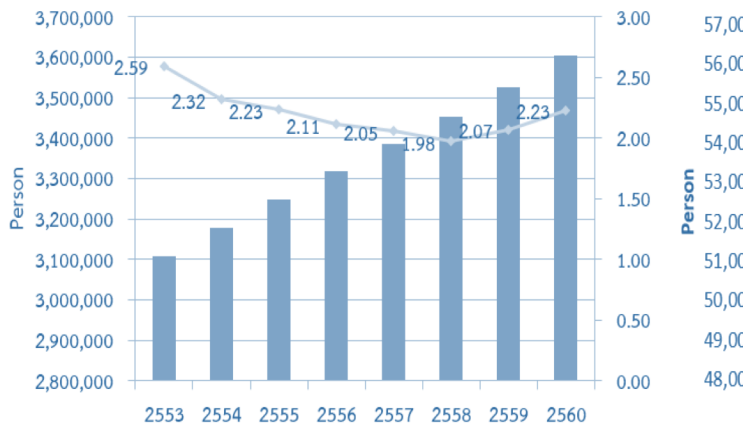
## Labor force in Cambodia



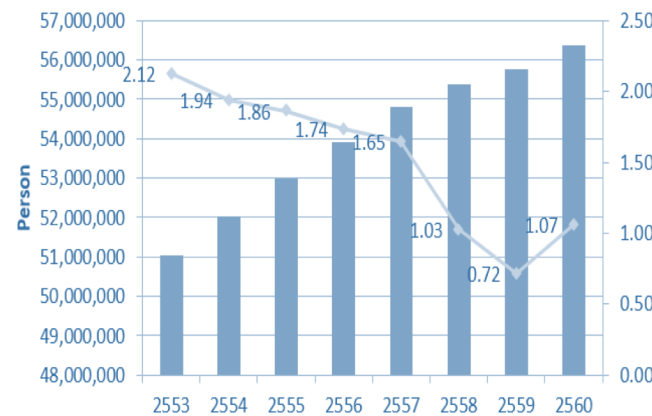
## Labor force in Myanmar



## Labor force in Lao PDR

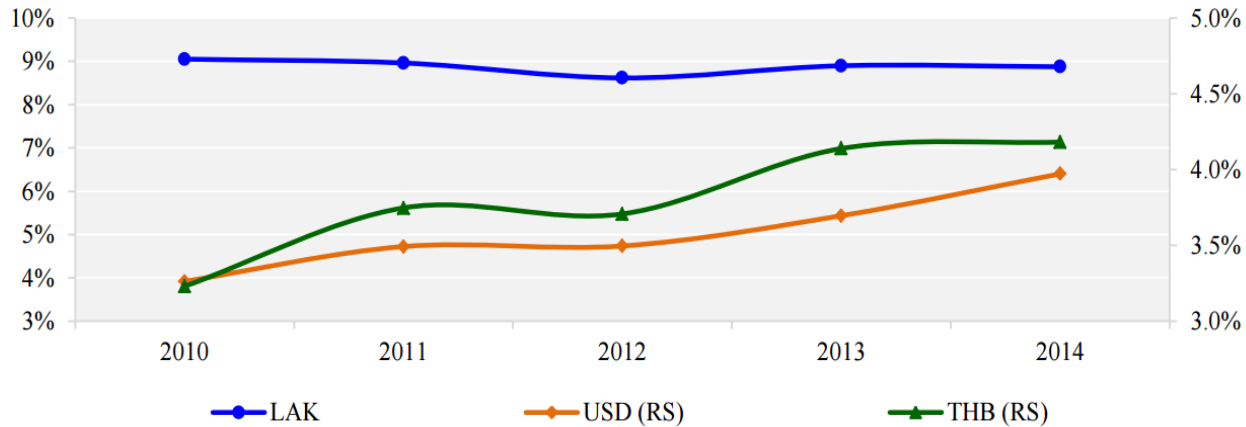


## Labor force in Vietnam



- Vietnam has the highest labor force level (in 2017 LF in Vietnam was 56.4 millions) followed by Myanmar, Cambodia and Lao PDR (at 25.4, 9.3 and **3.6 millions**, consecutively)
- Labor force in CLMV tends to continuously increase, with LF growth rate approximately 1 – 2
- This reflects population structure in CLMV that the group of people at LF age is quite large

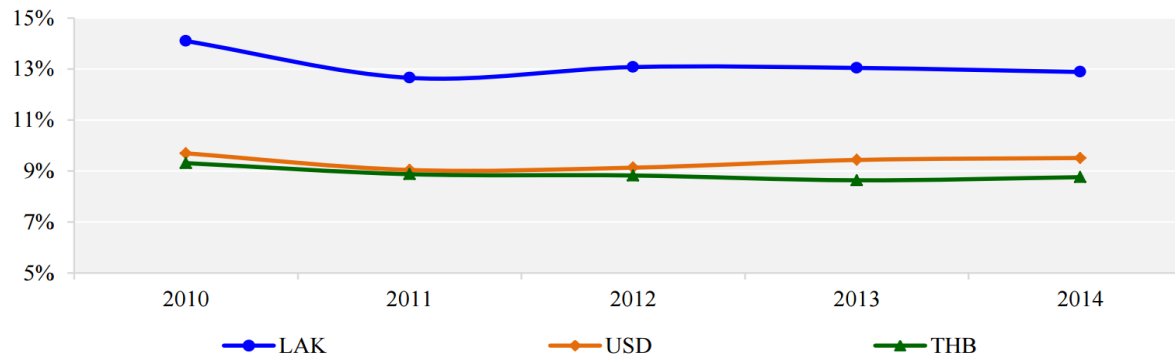
## Deposit rate in Lao PDR (12 months)



Source: Bank of the Lao PDR (2014)

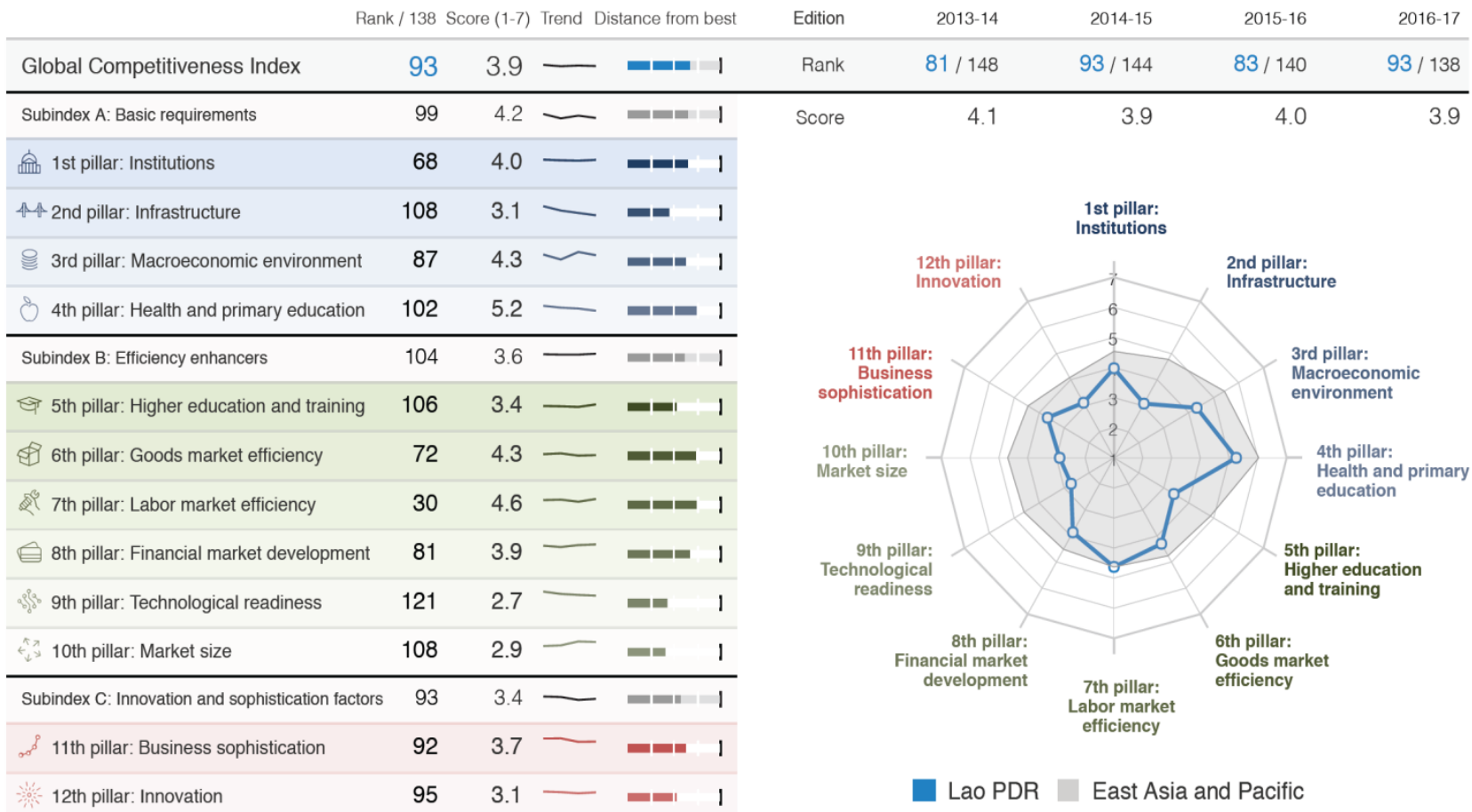
In general the deposit and lending interest rate in LAK is higher than the rate in USD and THB

## Lending rate in Lao PDR (12 months)



Source: Bank of the Lao PDR (2014) หน้า 11

# Global Competitive Index (GCI) 2016 by World Economic Forum

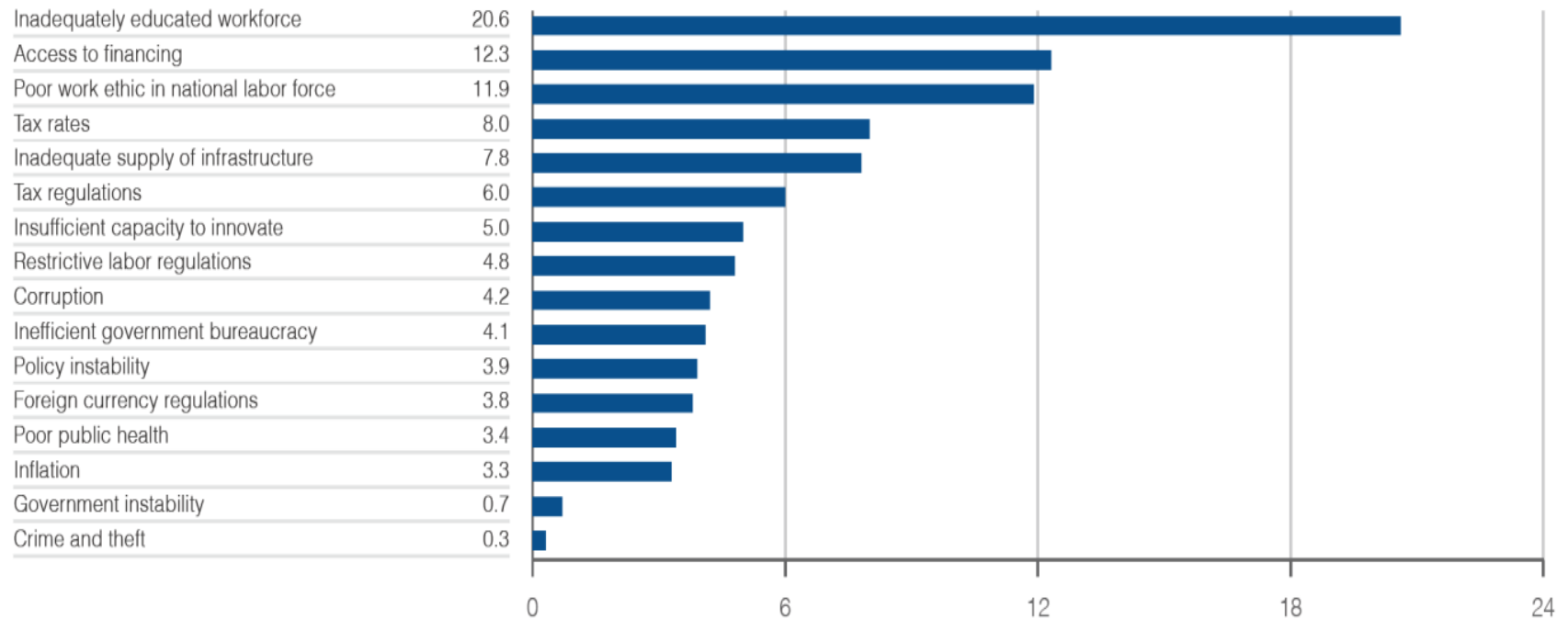


Source: World Economic Forum (2016) page 230

GCI of the Lao PDR is lower than the average level of countries in East Asia and Pacific in almost all aspects, especially in terms of market size, technological readiness, infrastructure and higher education and training.

# Global Competitive Index (GCI) 2016 by World Economic Forum

## Problems of doing business in the Lao PDR (2016 – 2017)



**Note:** From the list of factors, respondents to the World Economic Forum's Executive Opinion Survey were asked to select the five most problematic factors for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

ที่มา: World Economic Forum (2016) หน้าที่ 230

**Important problems of doing business in the Lao PDR are inadequate educated workforce, access to financing, poor work ethic in national labor force, tax rate and inadequate supply of infrastructure, respectively.**

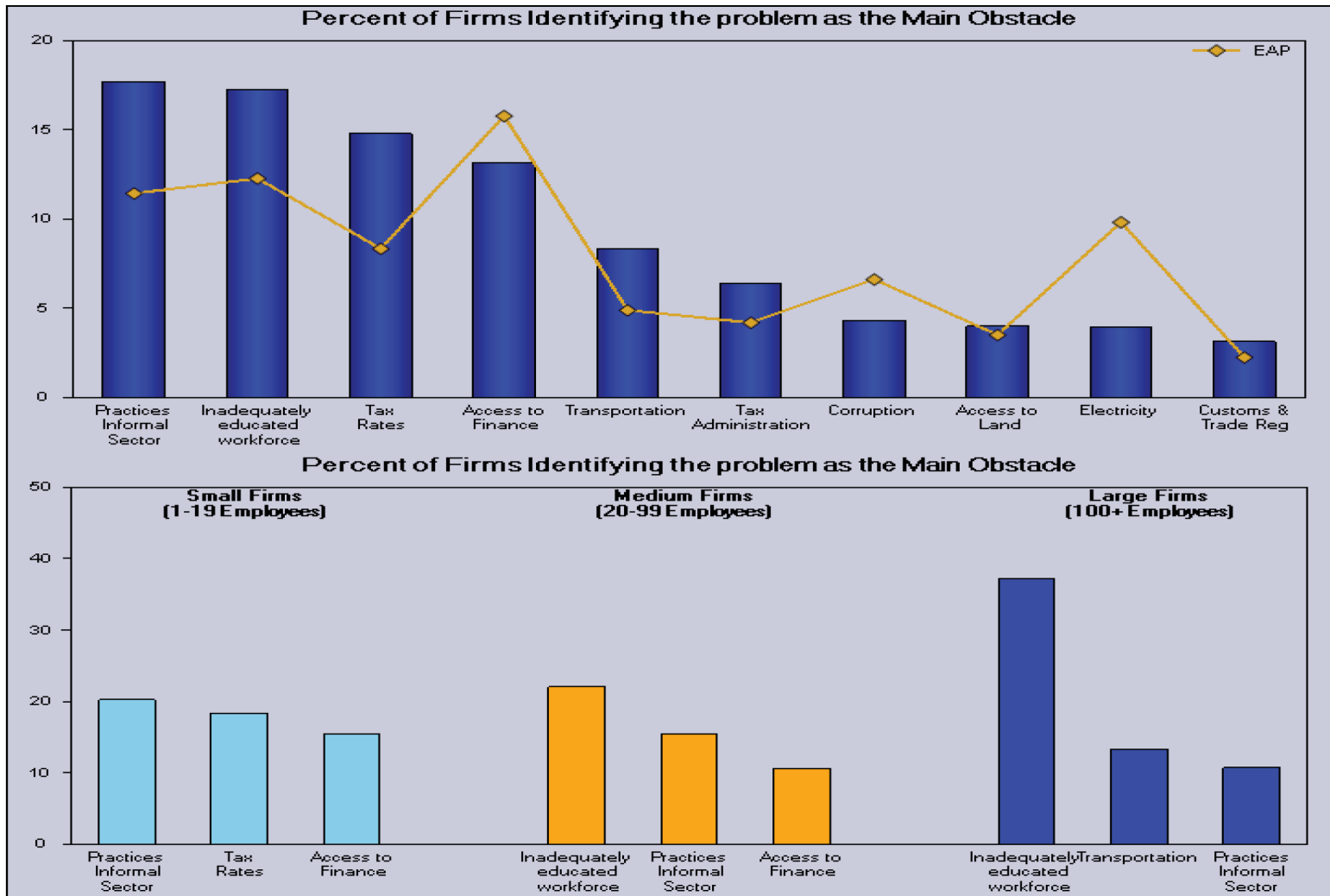
## Ease of Doing Business 2017 by world bank (rank from 190 countries)

Category	Cambodia	Laos	Myanmar	Vietnam
<b>Ease of Doing Business</b>	<b>131</b>	<b>139</b>	<b>170</b>	<b>82</b>
1. Starting a Business	180	160	146	121
<b>2. Dealing with Construction Permits</b>	<b>183</b>	<b>47</b>	<b>66</b>	<b>24</b>
3. Getting Electricity	136	155	149	96
<b>4. Registering Property</b>	<b>120</b>	<b>65</b>	<b>143</b>	<b>59</b>
5. Getting Credit	7	75	175	32
6. Protecting Minority Investors	114	165	179	87
7. Paying Taxes	124	146	119	167
8. Trading across Borders	102	120	159	93
<b>9. Enforcing Contracts</b>	<b>178</b>	<b>88</b>	<b>188</b>	<b>69</b>
10. Resolving Insolvency	72	169	164	125

Source: Ease of Doing Business database by world bank

**Factors that the Lao PDR has advantage over Cambodia and Myanmar (but still disadvantage to Vietnam) are dealing with construction permits, registering property and enforcing contracts**

# Obstacles of doing business in the Lao PDR (from Enterprise Surveys)



Source: World Bank and International Finance Corporation, 2011, page 4

# Thai-border & Vientiane



# Vang Vieng



# Luang Prabang



Thank you  
Q&A