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Expert Meeting on Enhancing Productive Capacity of Developing Country Firms through Internationalization
Geneva, 5–7 December 2005

REPORT OF THE EXPERT MEETING ON ENHANCING PRODUCTIVE CAPACITY OF DEVELOPING COUNTRY FIRMS THROUGH INTERNATIONALIZATION

Held at the Palais des Nations, Geneva,
from 5 to 7 December 2005

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Chapter I

CHAIRPERSON'S SUMMARY

1. The Expert Meeting on Enhancing Productive Capacity of Developing Country Firms through Internationalization was held from 5 to 7 December 2005 in Geneva, as decided at the ninth session of the Commission on Enterprise, Business Facilitation and Development. Its first objective was to examine how enterprise competitiveness in developing countries and economies in transition could be enhanced through internationalization, with a focus on outward foreign direct investment (OFDI), particularly by small and medium-sized enterprises (SMEs). Its second objective was to identify policy options that would help developing countries strengthen their firms' competitiveness by investing abroad. The meeting discussed the main trends of OFDI from developing countries, drivers, the impact on enterprise competitiveness, policy practices and programmes supporting enterprise internationalization.

Opportunities for, and challenges of, internationalization for SMEs

2. Experts emphasized the importance of the SME sector for economic development. They noted that trade without enhanced productive capacity was not a sustainable way to attain the Millennium Development Goals. As globalization led to expanded trade across nations, there was an increasing need to ensure that the process became more equitable, participatory and fair. Trade liberalization was not an end in itself, but its ultimate objective should be to raise the living standards of people, especially those who were weak and most vulnerable, through accelerated growth and income opportunities. In order to address this issue, trade had necessarily to be linked to industrialization, so that developing countries enterprises could integrate into global production chains and add value to their processed exports.

3. In this regard, SMEs have a special and vital role because of their proven ability as a catalyst for employment generation and wealth creation. Internationalization can help in this process by improving competitiveness through, for example, access to finance, technology and know-how. Evidence showed that owing to increasing competitive pressure, reduction of direct subsidies and elimination of measures for infant industry protection, the majority of SMEs could no longer take their own home market for granted, and were therefore looking for external opportunities to alleviate the effects of strong competition from foreign firms in domestic markets.

4. However, the opportunities provided by internationalization could not be fully exploited by SMEs from developing countries because of various constraints and challenges, which needed urgent solutions.

5. The main obstacles to SMEs' internationalization may be grouped as internal or external ones. Internal obstacles include informational barriers (e.g. unreliable data on the international market), functional barriers (e.g. lack of competencies and trained personnel), product and price barriers (difficulty in matching competitors' prices) and lack of bargaining power, distribution and logistics barriers (e.g. complexity of foreign distribution channels). External obstacles include poor and inefficient infrastructure, lack of financial resources, lack of conducive regulatory and macroeconomic policies, unfair trade policies, procedural

barriers (e.g. unfamiliar exporting procedures), governmental barriers (e.g. unfavourable home rules), customer and foreign competitor barriers (e.g. different competition habits), business environment barriers (e.g. foreign exchange risks), and tariff and non-tariff barriers (e.g. inadequate property rights protection). Furthermore, even in economies where a package of services for internationalization is provided, few of these are geared to smaller firms.

Main trends and key issues of OFDI

6. Experts noted that the internationalization of developing country firms through OFDI has been increasing. OFDI from developing countries rose from $147 billion in 1990 to over $1 trillion in 2004. The number of developing country firms among the Fortune 500 companies rose from 29 in 1998 to 45 in 2005. The industries where OFDI by developing country firms is most prominent include electrical, electronics and information technology, food and beverages, petroleum, telecommunications, transport, utilities, and tourism and hotels. The quality of developing country OFDI has also improved, as it becomes increasingly strategically oriented.

7. Such internationalization could be defined as a second wave of OFDI from developing countries, which is different from the first wave in the 1970s. The second-wave firms take advantage of the benefits of globalization and leverage on their latecomer advantages, particularly by using advanced technology and management systems to accelerate their internationalization through global connections and linkages with existing transnational corporations (TNCs). It was argued by some of the experts that unlike in the first wave, developing country firms do not need to grow big domestically to begin to internationalize in the second wave.

8. A number of benefits of internationalization through OFDI were discussed. They include increased competitiveness of firms, knowledge and technology acquisition, market expansion abroad and increased profitability, including as a result of economies of scale. OFDI is not about "hollowing out" or capital flight, but is a process of engaging with globalization and the global economy. Another benefit of OFDI is that it can be an important mechanism for South–South cooperation in addition to its role in strengthening North–South relations. A number of cases discussed at the meeting illustrated the positive impact of OFDI on the competitiveness of developing country enterprises and home countries.

9. The challenges and risks of internationalization were also discussed. The challenges faced by developing country firms, particularly SMEs, in internationalizing through OFDI include the lack of information about host country markets and regulations, access to finance and insurance coverage. Limited direct support from home Governments is another restricting factor. The lack of human capital and the limited knowledge of internationalization are further impediments that need to be addressed. Institutional challenges such as capital controls, regulatory burden, problems in accessing foreign exchange and the lack of institutional infrastructure for OFDI support services are factors that have restricted developing country firms’ internationalization.

10. A number of risk factors were identified, including failure, the loss of capital or closure and the risk of being taken over by foreign firms. Given these risks, an incremental approach to internationalization would be prudent. The existence of a sound corporate base with strong economic fundamentals (before expansion abroad is attempted) and adoption of

an appropriate sound business model and strategy could help to reduce risks. Furthermore, the use of risk mitigation mechanisms to facilitate exchange of experiences, the adoption of appropriate policies and institutional support are important. Governments or the private sector, including industry clubs and business associations, could provide such support.

11. Experts noted that the lack of quality data had limited the analysis and understanding of the OFDI phenomenon. Where data are available they do not necessarily reveal important details, such as the fact that for some countries a large amount of OFDI is concentrated in tax-haven countries. Data related to the impact of OFDI on firms' competitiveness are particularly lacking, especially for the SME sector.

Motives and drivers for companies to invest abroad

12. Companies' motives for investing abroad include access to markets, natural resources and strategic assets such as brand names and technology, as well as risk diversification and improving efficiency. The motives for OFDI by firms from developing countries do not differ from those of developed country firms, although developing country firms have a greater tendency to invest in neighbouring countries and in other developing countries.

13. Experts noted that developing countries' improved perception of OFDI, which is less regarded as de-industrialization, had also contributed to explaining the phenomenon. Bilateral investment guarantee agreements, double taxation avoidance and free-trade-area arrangements have also played a role in encouraging OFDI from developing countries. Other factors discussed included dual citizenship and ethnic ties.

14. The OFDI motivations for SMEs are in general similar to those for larger firms. However, a few differences are notable. Developing country SMEs were more likely to be motivated by cost reduction factors and factors related to personal relationships, ethnicity and social connections. Additionally, OFDI by SMEs has a greater tendency to go to neighbouring countries to diversify risk and access new markets, compared with OFDI by large enterprises or TNCs. SMEs face greater challenges in internationalizing. In particular, they have insufficient or fewer resources to meet the costs of information collection and to overcome uncertainties, risks and obstacles associated with OFDI activities.

Regional and company experiences

15. In the examination of regional trends and characteristics of developing country OFDI, both similarities and differences were identified in terms of motives, destinations, policy support and programmes. In all regional cases, geo-cultural proximity and affinity were important in influencing the direction of OFDI. The motives were largely similar across regions and were dependent on the types of OFDI (market-seeking, efficiency-seeking, resource-seeking, asset-augmenting).

16. The international expansion of enterprises in Latin America takes place primarily in neighbouring countries, and SMEs play a very marginal role, except in Argentina. OFDI by Argentine SMEs in the autoparts, agricultural machinery and software sector is prominent. OFDI by Latin American firms is mainly market-seeking and natural-resource-based. These firms often internationalize through mergers and acquisitions, operate in niche markets and

associate with TNCs. Furthermore, as soon as regional or subregional networks of internationally active companies have developed, they often become the target of takeovers by TNCs, which is one of the main risks linked to OFDI. In general, logistics and distributions systems (not technology) are crucial to internationalization. It was noted that one could hardly talk of a "Latin American" process of OFDI, and in most Latin America an explicit development strategy with a clear set of priorities was missing.

17. The main reasons for OFDI in Asia are market factors, efficiency considerations and access to natural resources. Increasingly, Asian firms are also investing abroad through mergers and acquisitions and acquire strategic assets such as technology, research and development, and brand names. The need to follow customers, neutralize competitors' strength, access low-cost labour and take advantage of opportunistic investments in real estate, infrastructure or services projects are also specific reasons. An expert stated that Republic of Korea SMEs account for a significant percentage of OFDI by Korean firms. Most of their investments are in neighbouring countries. The expert indicated that Korean OFDI had led to a trade surplus because of intra-firm trade. The growth of OFDI had increased domestic production through reallocation of resources instead of hollowing out of domestic industries, which has a positive impact on the economy of the Republic of Korea. Regional integration in ASEAN had encouraged intra-ASEAN investment, which contributes to South–South FDI flows.

18. African OFDI is mainly from South Africa. SMEs from Uganda are investing abroad, facilitated by a joint venture arrangement with TNCs, in response to competition and to strengthen trade channels. There is an urgent need to raise African Governments' awareness of how global and regional players could be created without losing most of the home country benefits. OFDI in Africa is indirectly supported by policies and by regional integration, one example being the Common Market for Eastern and Southern Africa. Much of African OFDI takes place in neighbouring countries. South African firms have used their relatively lower cost of capital to invest in other African countries where capital markets were not developed. As in other regions, OFDI from Africa has been driven by both push and pull factors. Market saturation, higher production costs and the need to secure natural resources pushed South African firms to go abroad. Investment opportunities and privatization in the continent also encouraged South African and other African countries' OFDI in the region. Cultural and historical links and the improved corporate financial position of South African enterprises also played a role in the internationalization process. The Government's encouragement and support for African companies to invest in Africa was specifically mentioned.

19. It was noted that there were considerable differences in the OFDI situation among the transition economies, depending on their size and geographical location. This made generalization difficult. The main drivers of OFDI included system escape, the search for market and efficiency, and cost reduction. The lack of the rule of law and transparency often stimulated OFDI, as did the need to follow clients in the case of banking and other service industries. In the past there had been objections to OFDI and it had been considered unpatriotic, but now the main constraint was the lack of skills, finance and relevant experience for companies to internationalize their operations. Most OFDI was located in neighbouring countries, with the ethnicity factor playing an important role and the timing of recent liberalization being a common denominator.

20. Despite their different backgrounds, the company cases that were presented confirmed the general observations on motives, obstacles and impacts on competitiveness associated with enterprise internationalization. Most of these cases showed that it is possible for a domestic company that started small to grow into an internationalized SME.

21. Experts also discussed the impact of OFDI on firms' competitiveness and how it could be measured. A number of indicators could be used, including financial evaluation (profitability) and non-financial indicators (survival rate, stability of shareholding). Case studies, surveys and questionnaires are further sources of information that could be considered.

Policies and programmes to support developing country firms in investing abroad

22. To the extent that OFDI contributes to improving competitiveness, experts agreed that developing country governments should support the internationalization of their countries' enterprises and adopt appropriate policies. Coherent, long-term and targeted government policies are necessary in order to support the strategic vision for internationalization of firms and to move to higher-value-added, knowledge-based activities, as well as to expand a pool of competitive and efficient local enterprises. Experts further agreed that there is a need to build institutional support to facilitate and encourage OFDI from developing countries. In this regard, reference was made to countries such as China, Malaysia and Singapore that provide institutional support to facilitate enterprise internationalization. Improved access to finance, for example, could be provided by export-import banks, which offer financial products to serve home customers wanting to invest abroad. Furthermore, market entry can also be facilitated through matching of joint-venture partners and provision of industrial parks.

23. Experts shared the experiences of their countries regarding policy issues and programmes that support enterprise internationalization through OFDI. While the experiences of countries vary, some countries such as China and India have recently liberalized their policy environment to encourage their enterprises to go abroad. Some provide market information and organize investment missions, which include private sector delegation. In the case of Malaysia, the Government has been encouraging Malaysian firms, including SMEs, to internationalize by providing institutional support, promotion programmes and fiscal incentives. Malaysia offers a number of facilities such as a fund for OFDI, export credit insurance and guarantee schemes, overseas project financing and the Malaysia–Singapore Third Country Business Development Fund. In the case of China, OFDI approval procedures have been simplified and the Investment Promotion Agency, established under the Ministry of Commerce, provides support in helping Chinese enterprises to invest abroad. Countries' liberal foreign exchange has also contributed to OFDI by developing country firms.

24. The export-import banks of India and Turkey have played an important role in supporting internationalization by firms from these countries through provision of insurance coverage and financial facilities. In the case of Brazil, capacity-building programmes such as the making of "global players" offered by Fundação Dom Cabral have helped some Brazilian firms strengthen their managerial capacity and increase their knowledge of cross-cultural and internationalization issues, thus assisting them in their internationalization efforts. The Government of the Republic of Korea is supporting OFDI through deregulation of foreign

currency management and provision of information on the investment environment of host countries in the context of bilateral investment treaties and free-trade-area arrangements.

25. Experts made a number of specific recommendations to support internationalization of developing country enterprises, including SMEs, through OFDI. They agreed that consideration should be given to countries' different levels of economic development and to the need for a differentiated approach to different types of SMEs (active vs. passive investors). OFDI needs to be regarded as part of a developing country's strategy. Effective public–private sector dialogue is necessary in order to exchange information and to facilitate policy discussion. International organizations such as UNCTAD could help address the issue of data limitation and data collection, framing the arguments regarding what is meant by OFDI, and assist in policy advice and capacity building. Experts also agreed that it would be useful to develop a "global or regional players programme" similar to the one offered by Fundação Dom Cabral to share best practices and experiences regarding enterprise internationalization through investing abroad.

26. Training courses on internationalization could be provided for policymakers and managers of developing country enterprises, including events that would help raise awareness of the benefits of enterprise internationalization through OFDI. This could help countries to understand that OFDI could be a useful instrument at a microeconomic level, one which helps firms to increase competitiveness and integrate into the global economy.

Conclusion

27. A wide range of different trends, motivations, drivers, competitiveness gains and policies for OFDI were identified, all of which deserve further attention and in-depth analysis. In most cases OFDI was a relatively new and little studied phenomenon, and there was a need to carry out more research and analysis, especially on the impact of OFDI on the competitiveness of domestic enterprises and on home countries. In this respect, an awareness-building effort was needed to increase the understanding of developing countries' Governments and businesses regarding the possible ways to increase the potentially beneficial impact of OFDI and to minimize its possible negative effects. While there are risks inherent in internationalization, these can be mitigated if developing country enterprises are better prepared for the challenges.

Chapter II

ORGANIZATIONAL MATTERS

A. Convening of the Expert Meeting

28. The Expert Meeting on Enhancing Productive Capacity of Developing Country Firms through Internationalization was opened at the Palais des Nations, Geneva, on 5 December 2005 by Mr. Khalil Hamdani, Officer-in-Charge, Division on Investment, Technology and Enterprise Development, UNCTAD.

B. Election of officers
(Agenda item 1)

29. At its opening meeting, the Expert Meeting elected the following officers to serve on its bureau:

Chairperson:	Mr. Hussam Al Husseini (Jordan)
Vice-Chairperson-cum-Rapporteur:	Mr. Luciano Barillaro (Italy)

C. Adoption of the agenda and organization of work
(Agenda item 2)

30. At the same meeting, the Expert Meeting adopted the provisional agenda circulated in document TD/B/COM.3/EM.26/1. The agenda for the Meeting was thus as follows:

1. Election of officers
2. Adoption of the agenda and organization of work
3. Enhancing productive capacity of developing country firms through internationalization
4. Adoption of the report of the meeting

D. Documentation

31. For its consideration of the substantive agenda item, the Expert Meeting had before it an issues note and five case studies prepared by the UNCTAD secretariat: "Internationalization of developing country enterprises through outward foreign direct investment" (TD/B/COM.3/EM.26/2); "Case study on outward foreign direct investment by enterprises from Argentina" (TD/B/COM.3/EM.26/2/Add.1); "Case study on outward foreign direct investment by Indian small and medium-sized enterprises" (TD/B/COM.3/EM.26/2/Add.2); "Case study on outward foreign direct investment by Singaporean firms: Enterprise competitiveness and development" (TD/B/COM.3/EM.26/2/Add.3); "Case study on outward foreign direct investment by Russian enterprises" (TD/B/COM.3/EM.26/2/Add.4); "Case study on outward foreign direct investment by South African enterprises" (TD/B/COM.3/EM.26/2/Add.5).

E. Adoption of the report of the Meeting
(Agenda item 4)

32. At its closing meeting, the Expert Meeting authorized the Rapporteur to prepare the final report of the Meeting under the authority of the Chairperson.

Annex

ATTENDANCE [*]

1. Experts from the following States members of UNCTAD attended the Meeting:

Afghanistan
Angola
Argentina
Cambodia
China
Colombia
Croatia
Egypt
El Salvador
Ethiopia
Holy See
Indonesia
Iran (Islamic Republic of)
Italy
Jordan
Malaysia
Mexico
Morocco
Nepal
Nicaragua
Philippines
Poland
Republic of Korea
Russian Federation
Saudi Arabia
Senegal
Slovenia
South Africa
Syrian Arab Republic
Thailand
Timor-Leste
Turkey
Ukraine
Zambia
Zimbabwe

2. The following United Nations organization was represented at the Meeting:

United Nations Development Programme

3. The following specialized agency and related organization were represented at the Meeting:

United Nations Industrial Development Organization
World Bank

4. The following non-governmental organizations were represented at the Meeting:

Exchange and Cooperation Centre for Latin America
International Federation of Free Trade Unions
World Association of Former United Nations Interns and Fellows

5. The following panellists attended the Meeting:

Opportunities and challenges of internationalization for small and medium-sized enterprises

Mr. Bamanga Tukur, Executive President, African Business Roundtable, and Chairman, NEPAD Business Group
Mr. D. Massawe, Assistant Director/Head of SME Section, Ministry of Industry and Trade, United Republic of Tanzania
Mr. Narayan Prasad Sanjel, Under Secretary, Ministry of Industry, Commerce and Supplies, Nepal

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[*] For the list of participants, see TD/B/COM.3/EM.26/INF.1

Mr. Toru Ueno, Principal Administrator, OECD Centre for Entrepreneurship, SMEs and Local Development (CFE), Small and Medium-sized Enterprise (SME) and Entrepreneurship Division, OECD
Mr. Ozman Atac, Director, Enterprise Management Development Section, International Trade Centre, Geneva

Internationalization of developing-country firms through outward FDI: Main trends and key issues

Mr. John Mathews, Professor, Sydney, Australia
Mr. Tariq Sayeed, Former President, Federation of Pakistan Chambers of Commerce and Industry, Chairman G77 Trade Fair Authority and Former G77 Chairman, Islamabad
Mr. Moon Yearn Hwang, Director, International Investment and Regional Cooperation Division, Ministry of Finance and Economy, Republic of Korea
Mr. Charles Ocici, Executive Director, EMPRETEC, Enterprise Uganda, Kampala
Mr. Rizar Idomo Nazaroedin, Director of Bilateral and Multilateral Cooperation, Investment Coordinating Board (BKPM), Jakarta, Indonesia
Ms. Dilek Aykut, Economist, International Finance Team, World Bank

Top Glove Corporation (Malaysia): An internationalizing enterprise

Mr. Lim-Wee Chai, Founder and CEO, by video-conference from Kuala Lumpur

Regional and global players: What drives companies to invest abroad?

Mr. Michael Mortimore, Chief, Investment and Corporate Strategies, ECLAC, Santiago, Chile
Mr. Peter Brimble, President, Asia Policy Research Company Limited, ESCWA, Thailand
Mr. Reginald Rumney, Director, Business Map Foundation, Johannesburg, South Africa
Mr. Marjan Svetlicic, Professor, Centre of International Relations, Faculty of Social Sciences, University of Ljubljana, Slovenia

Impact of investing abroad on enterprise competitiveness: Selected cases an indicators

Mr. Miao Gengshu, Senior Economist, Former President of China Minmetals Corporation and Vice President of China Association of International Trade, Beijing
Mr. Hussein K. Salem, Founder and Chairman, HKS Group, Cairo, Egypt
Mr. Jadranka Lemut, Owner and Managing Director, Le Tehnika, Ljubljana, Slovenia
Mr. Cesar Cini, Founder and CEO, Cinex, Brazil
Mr. Samuel Joseph Jebarai, EXIM Bank, London

Does OFDI increase competitiveness of firms and how could competitiveness from OFDI be measured?

Mr. Andrea Goldstein, Senior Economist, OECD Development Centre, Paris

Policy issues and programmes supporting developing country firms to invest abroad

Mr. Sherban Leonardo Cretoiu, Programme Manager, Global Players, Fundação Dom Cabral, Brazil
Mr. Yu Hua, Deputy Director General, China Investment Promotion Agency, Beijing, China

Ms. Rohana Ramly, Director, Small and Medium Industries Development Corporation, (SMIDEC), Kuala Lumpur, Malaysia
Mr. H. Ahmet Kilicoglu, General Manager, EXIM Bank, Turkey

6. The following special invitees attended the Meeting:

M. Jean-Daniel Clavel, Clavel Consulting, Montreux, Switzerland
Ms. Cong Guoling, businesswoman, MINMETALS Corporation
Mr. John Dunning, International Business, University of Reading, United Kingdom
Mr. Ayman Hamdy, Chairman's Assistant, HKS-Group
Mr. Li Guomin, Manager of President's Office, MINMETALS Corporation
Mr. Hussein Salem, Chairman, HKS-Group
Mr. Wang Yansheng, Vice President, MINMETALS Corporation, Germany

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