The Specificity of German TNCs' activities

in the Asia-Pacific Region

A Research Proposal Presented to
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by

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Abstract

The issue of transnationalization has been much discussed by scholars due to the rapid development of TNCs’ activities in the twentieth century. However, researchers have generally focused on transnationalization processes in developed countries, while emerging countries have remained unexplored. Due to the problem of global imbalances and shift of economic power from West to East in the recent years, Asian developing countries have become of key importance for largest transnational corporations. This study aims at expanding the research on transnationalization by examining German transnational corporations’ activities in the Asia-Pacific Region. In order to determine key factors that foster German TNCs to operate in Asia, we will use multimethod research design. First, we will look at the case within the framework of well-known transnationalization theories. Then we will analyze important economic indicators in order to reveal factors that have an impact on FDI volumes from Germany to Asian countries. This study will contribute to the existing knowledge about German TNCs’ activities in Asia, as well as investment environment in the Asia-Pacific Region, advantages and challenges of doing business in Asia.

Key words: transnationalization, Asia-Pacific, Germany, FDI, TNC

Introduction

Recently there has been a growing concern about the problem of global imbalances. Amidst weak growth rates of developed European countries and the USA, the rapid economic growth of Asian countries shows the shift of economic power from West to East. According to the experts of the International Monetary Fund, by 2030 the Asia-Pacific Region will account for 40% of the global GDP (International Monetary Fund, 2010). Economic growth in Asia has positively affected the living standards of the Asian population: more and more
people are considered to be middle class, who can afford buying imported goods. An increased purchasing power of the Asian population has received a large amount of attention from transnational corporations. Germany, as an economic driver of the European Union, understands the perspectives of winning Asian markets and is actively developing production and marketing activities in the region. Due to high operational costs and taxes within a country, German companies tend to shift production to cheaper locations with more favorable investment climate. The Asia-Pacific Region is an optimal direction for foreign investment due to low labor and energy costs, favorable investment climate. Moreover, due to an increase in the incomes of Asian population, Asia attracts foreign companies not only as a place for locating production facilities, but also as a perspective sales market.

Researchers have become increasingly interested in the topic of transnationalization. Many scholars directed their attention towards describing the causes of transnational corporations' emergence and rapid development as well as reasons for foreign direct investment. (Hymer, 1960; Buckley, Casson, 1976; Rugman, 1986). According to Hymer's theory of market imperfections (1960), firms' decision to invest abroad can be explained as a strategy to make profit on using the foreign countries' shortcomings. These can be firm's poor trade policy, factors of production and other imperfections. However, this concept was argued by Porter (1990), who determined that it is not market imperfections, but firms' competitive advantages that explain success of entering a foreign market. Nevertheless, no study has been reported about the reasons explaining why foreign direct investment is the most desirable form of using the firm's advantage and how the locations for FDI are chosen.

The insufficiencies of the previous studies have been overcome by a British economics, J. Dunning in a theory known as OLI-Paradigm (Dunning, 1979). In this research Dunning described the necessary preconditions for foreign direct investments which are ownership, location and internalization advantages. Ownership advantages include patents,
trademarks, know-how that give a foreign firm an advantage over local ones. Location advantage means comparative advantage of the host country, such as lower operational costs and taxes, membership in trade organizations, availability of natural resources. Finally, internalization advantage supposes that foreign firms tend to keep control over production assets abroad instead of selling licenses or creating joint ventures with foreign partners.

It should be noted that most of the mentioned studies have concentrated on the issue of transnationalization in advanced economies. Nevertheless these studies have largely overlooked the need for analyzing developing countries, particularly emerging economies in the Asia-Pacific region. Thereby, in this research we attempt to extend the OLI-model by examining the case of German transnational corporations’ activities in Asia-Pacific. The purpose of this study is to find out what factors foster German TNCs to operate in Asia. To this aim, the study will address the following research questions:

1. What are the main factors that foster German TNCs to operate in the Asia-Pacific Region?
2. What is the impact of Asia’s middle class emergence on its’ attractiveness for FDI?
3. What is the correlation between investment climate and FDI in the country?
4. What attracts German companies in Asia most of all? What challenges do they face in the region?

To answer these questions, we will use mixed-methods research design. Firstly, we will look at the case within the framework of OLI-Model developed by J. Dunning (Dunning, 1988). Moreover, we will analyze some indicators collected from secondary sources (statistical reports and surveys). They include investment climate index (Vriens and Partners, 2014), consumer confidence index and share of the middle class population (Homi, 2010). Finally, we will look at the study where the main motives of German FDI are revealed. (The Association of German Chambers and Commerce Industry, 2016).
Thus, we expect this study to advance the research as far as transnational companies’ operations in Asia are concerned. We believe this study may be of use not only to researchers, but also to foreign companies interested in Asia-Pacific.

**Literature Review**

Due to the rapid development of the process of transnationalization in the second half of the twentieth century, a variety of different approaches in economic theory have been suggested in order to analyze the reasons for TNC emergence and development. One of the most well-known transnationalization theories was first introduced by Stephen Hymer (Hymer, 1976). Hymer’s theory of monopolistic advantage explains why transnational corporations manage to perform more successfully on foreign markets in comparison with the local firms. On the one hand, foreign companies have less favorable conditions than local companies such as lack of knowledge about the market, higher transportation costs and existence of language barriers. On the other hand, these disadvantages can be compensated by “monopolistic advantages” that foreign companies possess: originality of the product, advantages of scale, advanced technology and easy access to credit.

Another group of scholars have focused on transaction cost theory (Coase, 1937) to explain the nature of FDI and TNCs existence and development. Thus, supporters of internalization theory (Buckley, Casson, 1976; Rugman, 1986) believe that TNCs internalize market imperfections that occur due to excessive transaction costs. Thereby, a firm will tend to internalize if benefits from internalization will be higher than costs, thus leading to larger profits.

Nevertheless, the aforementioned theories do not explain, why foreign direct investment is the most desirable form of using the firm's advantage. That is why a British economist J. Dunning developed a theory known as OLI-Paradigm, which combined previous
internalization theories with Dunning’s own conclusions. According to OLI-model, necessary
preconditions for FDI are ownership advantages (know-how, trademarks, patents that
distinguish a foreign company from local ones), location advantages (benefits of doing
business in a host country, such as market size, energy costs, investment climate) and
internalization advantages (benefits of own production in comparison with export or
licensing) (Dunning, 1979).

It should be noted that most of the mentioned studies concentrated on the issue of
transnationalization in advanced economies. Nevertheless, recently this process has covered
developing countries, particularly emerging economies in the Asia-Pacific region. World’s
largest transnational corporations tend to move their production facilities and sales offices to
emerging Asian countries due to lower operational costs, favorable investment climate and
growing purchasing power of the Asian population. Thereby, in this research we attempt to
extend the model by examining the case of German transnational corporations’ activities in
Asia-Pacific. To begin with, we appeal to the report of the Federal Ministry of Finance of
Germany (2014). It reflects the structure of German foreign direct investment by regions and
sectors of economy. Thus, we can see the share of German FDI to Asia-Pacific from the total
amount of outward FDI. Then we will look at the study conducted by the consulting agency
Vriens and Partners (2014). The research evaluates the impact of economic and political
governance on FDI to 20 Asian countries. The study also determines parameters that affect
investment climate in a country, including level of corruption, political stability, openness to
international trade, taxation, rule of law, fiscal and monetary administration. The research
ranks 20 Asian countries by the level of FDI and investment climate. Thus, according to the
research, Singapore, New Zealand, Hong Kong and Australia are on the top of the list by
investment climate index. However, this study has several limitations for our research. For
instance, it does not include information on economic relations between Germany and Asian countries.

Therefore, we appeal to the study conducted by the German Chamber of Commerce in China (2015). The research centers on German TNCs operating in China, describes advantages of the country for foreign investors as well as challenges they face there. While such advantages as favorable investment climate have been mentioned in previous studies, the difficulties e.g. finding qualified staff, increasing labor costs and bureaucracy, are firstly mentioned in this research.

Nonetheless China is the most important Germany's partner outside the EU, it is not the only one in Asia-Pacific. Thereby, we consider the survey conducted by the Association of German Chambers of Industry and Commerce (2016). It is based on the answers of 5200 German enterprises. This study includes the findings about German FDI in Asia-Pacific as a whole. It describes main motives of German companies investing in the region, the most important of which is sales and customer service development. It also shows the share of total German FDI that accounts for Asia-Pacific. Thus, according to the research, China is the second most attractive investment direction after Europe for German companies- 37% of German enterprises invest in China. As far as other Asian countries are concerned, currently 25% of German companies invest in them.

**Methods**

In order to determine the key factors that attract FDI from Germany to Asia-Pacific we will employ multimethod research design. First, we will look at this case within the framework of OLI-Model, developed by J. Dunning (Dunning, 1988). We will estimate, whether the necessary preconditions for foreign direct investment have been fulfilled in the
The case of German FDI to Asia. Then, we will analyze the indicators collected from secondary sources (statistical reports and surveys). They include investment climate index (Vriens and Partners, 2014), consumer confidence index and share of the middle class population in Asian countries (Homi, 2010). Then we will look at the volumes of FDI from Germany to Asia in comparison with the rest of the world in order to evaluate the importance of the region for German companies. Finally, we will look at the study where the main motives of German FDI are revealed. (DIHK, 2016).

To begin with, we will describe key concepts of OLI-Framework and apply it to our case. With this model in mind, we can better understand the motives of German FDI in Asia-Pacific. Then, we will analyze investment climate index in order to examine the dependence between investment climate in Asian countries and the level of inward FDI from Germany. This data will allow us to test the hypotheses, whether favorable business environment attracts more FDI. Next, consumer confidence index and share of middle class population in Asian countries should be analyzed. This is appropriate when we state that growing purchasing power of Asian middle class has a direct correlation with the increasing levels of FDI from Germany. Finally, we will examine the survey based on answers of 2500 German enterprises that reveals main motives of German FDI in Asia.

The study has several limitations. Firstly, investment climate index was calculated in 2014, thus it cannot be considered timely enough. Secondly, the answers of 2500 German enterprises represent opinion of only half of the total number of German companies. Finally, this research is limited by several factors that seem most relevant as we do not attempt to cover all factors that favor German FDI to Asia. Thus, we believe that the key factors are favorable investment climate, lower operational costs, growing purchasing power of the Asian population.
Expected Outcomes

We plan to contribute to the academic literature on transnational corporations’ activities abroad. We will try to fill the research gap by focusing on emerging Asian countries as recipients of German FDI.

This study will contribute to the body of knowledge about the investment environment in the Asia-Pacific Region. It may be of use not only to German companies that were analyzed in this research, but to transnational corporations from other countries as well. Foreign investors seeking to expand their business operations in Asia need to be aware of the key features of doing business in the region. Our results suggest that Asian countries have become an attractive investment region for German companies due to a variety of reasons, including lower production costs and taxes, increasing purchasing power of Asian population and ease of doing business. Nevertheless, our preliminary results highlight the importance of various hurdles that international companies usually face in Asia. The most challenging of them are corruption, bureaucracy, lack of qualified workers and poor quality of production.

Our results can doubt on the growing importance of Asian countries as an investment direction of German companies due to increasing wages in the recent years. We can observe that many German corporations have withdrawn their operations in Asia and come back to Europe. However, for other companies Asia-Pacific remains an attractive investment destination. Thereby, establishing outlooks of Asian countries for German investors in the future may become a worthwhile endeavor.
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