JÖNKÖPING INTERNATIONAL BUSINESS SCHOOL
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# Foreign Direct Investment

A Study of Medium-Sized Manufacturing Companies in Jönköping County

Master Thesis within Business Administration

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Jönköping December 2005

## Master Thesis in Business Administration

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| **Date:** | **2005-12-20** |
| **Subject terms:** | **foreign direct investment, FDI, motives for FDI, entry mode, risks, SME, Jönköping County** |

# Abstract

The world we live in is getting more and more global and this development carries many affects, not least for the business environment. During the last decades foreign direct investments have increased rapidly. Historically speaking, foreign direct investments were primarily undertaken by large corporations with high turnover and financial strength. However, with the alleviation of investment regulations smaller companies now also have an opportunity to reap the benefits of international business. Jönköping County is known for its entrepreneurial spirit and high density of small- and medium sized companies. We found that it would be interesting to discover the reason why these, usually successful, firms conducted foreign direct investments.

The purpose of this thesis is to describe the reasons and factors behind a foreign direct investment undertaken by medium-sized manufacturing firms in the Jönköping region.

The research was carried out by using a qualitative method. We found five firms within this region that were of medium size and wanted to participate in our study. The companies that we interviewed were; Eldon AB, Carlfors Bruk AB, AB Pettersons Järnförädling, IDAB WAMAC International AB, and RH Form AB.

The main reason for conducting a foreign direct investment mentioned by these firms was market seeking motives. The companies wanted to enter new markets in order to grow and widen their customer base. The firms were mainly seeking markets that were large and had a good potential for growth. The remaining company based their decision on a resource seeking motive. The firms have decided to enter these markets through different entry modes. The firms that saw risks and lack of knowledge as important factors have chosen to use a joint venture as an entry mode. The companies that wanted a quick entry chose acquisitions as their form of entry. The two firms that have done green-field investments have done so for different reasons. One had knowledge and contacts already and did not see the need to acquire another firm and the other wanted to keep the full control of its technology. We have found that the factors in the host markets are most influential in the decision to invest abroad, and that push factors from the domestic market has had little significance. The firms are aware of the risks involved but do not choose location based on them.

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# 1 Introduction

*This chapter presents the background and problem of the thesis. The problem discussion will be followed by a presentation of the purpose. The chapter finishes with an explanation of the limitations and the disposition of the study.*

## 1.1 Background

A shared view among many societies today is that we live in an age of increased globalization. The political and economical maps have changed dramatically this last century and countries are more dependent on each other than ever before. Countries are collaborating across the borders on economical and political issues in an ever increasing fashion. Regional and international cooperation in commerce has led to trade unions designed to ease the cooperation and integration of economies. The European Union (EU) is a perfect example of this kind of trade association. In the EU, all barriers to trade are removed in order to transform the European continent into one single market for goods and services. Other major trade unions that play a significant role in economic integration globally are the North America Free Trade Area (NAFTA) and MERCOSUR, which is a regional trade union among the South American countries. Almost every country in the world is part of some trade union and today it is easier to openly trade across borders and with fewer trade barriers. A global marketplace for goods and services has opened up opportunities for companies to expand beyond their domestic markets, and more and more firms today operate internationally (Ekström, 1998).

A trend among several countries and regions in the world is that, especially over the past 20 years, there have also been deregulations concerning foreign investments into the country (UNCTAD, 2005). This has opened up opportunities for companies to engage in foreign direct investments (FDI) and thereby becoming multinational corporations (MNC). An FDI is usually categorized as the process in which a firm establishes production abroad either through a subsidiary or as a merger with a foreign partner (Eun & Resnick, 2004). The number and volume of foreign direct investments has in the last decades increased rather rapidly, as illustrated in figure 1.1 below:

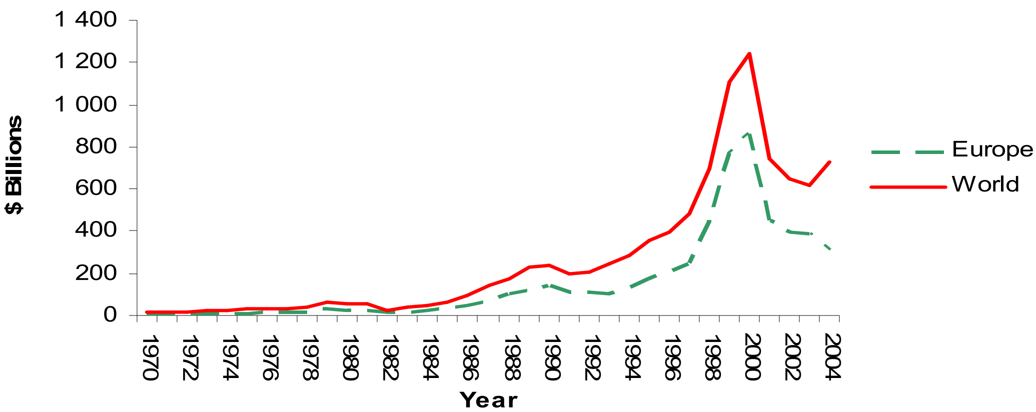


**Figure 1.1** FDI outflow $ billions (UNCTAD, 2005).

The figure 1.1 above demonstrates the growth of outward FDI in the entire world and in Europe. As can be seen, there has been a rapid increase in the volume of investments conducted abroad since the 1970s and up until 2000. After that there was a three year decline which was mostly due to an overall global economic recession (Eun & Resnick, 2004).

Historically speaking, foreign direct investments were primarily undertaken by large corporations with high turnover and financial strength. However, with the alleviation of trade and investment regulations smaller companies now also have an opportunity to reap the benefits of international business, which in part also accounts for the rapid growth of outward FDI illustrated in figure 1.1 above.

## 1.2 Problem discussion

Sweden has historically been a country characterized by a high level of manufacturing industries, and in 2005 the manufacturing businesses accounted for about 21% of Sweden's total economy. However, there has been a decrease in the number of jobs within the manufacturing industry in Sweden over the last few decades. As in the rest of the developed countries Swedish firms have taken advantage of the possibilities of foreign investments, and many firms have moved abroad or outsourced their production. More than 10,000 jobs within the manufacturing industry have been moved abroad in 2005 (Munter & Bergström, 2005). There may be several different reasons why Swedish companies move abroad or conduct foreign direct investments. Several authors identify cost efficiency as one of the main reasons for firms to do a foreign investment (Griffin & Pustay, 2002; Eun & Resnick, 2004; Butler, 2000). Swedish manufacturing companies face greater competition today than a few decades ago. A more open market and trade deregulations have increased the pressure on firms to produce more cost efficient in order to compete. Sweden has relatively high factor costs and regulations, which makes it an expensive location for production. Table 1.1 presents data about the average hourly labor cost of production in Sweden and other selected countries as of 2001.

| Country | Average Hourly Cost ($) | Country | Average Hourly Cost ($) |
|---|---|---|---|
| Germany | 23.04 | Taiwan | 5.44 |
| United States | 20.67 | Mexico | 1.70 |
| Belgium | 20.25 | Philippines | 0.66 |
| Japan | 19.52 | China | 0.60 |
| Sweden | 18.41 | Indonesia | 0.22 |

**Table 1.1** Labor Costs around the Globe (Adaptation from EIU in Eun & Resnick, 2004)

When looking at the data in table 1.1 one can clearly see the huge differences in labor costs between the left and the right columns. Labor costs are the main cost when calculating production costs in manufacturing industries so it is understandable that Swedish firms move production abroad in order to become more cost efficient. Other factors in a company's decision to invest abroad may be centred on opportunities that exist in foreign markets or a desire to vertically integrate suppliers abroad. An opportunity that might exist in a market abroad is the possibility to find raw material at low costs. Vertical integration is a process in which a firm acquires control over suppliers in order to enjoy lower costs (Butler, 2000). Factors mentioned above are just some of the reasons a company may have to do an FDI, more factors and theories surrounding them will be further explained in the frame of reference.

Larger Swedish corporations have been fairly successful in exploiting the opportunities of growth through internationalization. These companies have been proactive in their approach and have succeeded in their attempts to generate benefits of foreign investments (Payne, 2005). For medium-sized companies it is not as easy to be proactive and take advantage of the opportunities that exist in foreign markets. These companies often lack the financial strength of the larger counterparts and are therefore limited in their options. In a study by Blomström, Fors and Lipsey (1997) Swedish medium-sized companies differ in their approach to FDI compared to U.S. firms of equal size. Companies in Sweden often opt to keep some of the production in the country and production located abroad is often situated in countries relatively similar to Sweden in terms of economical status. That is, high-income countries with a high standard of living. In the media however, companies are depicted as abandoning Sweden and moving production abroad in order to lower production costs.

There are areas in Sweden which are known to have a high density of manufacturing firms which are fairly successful. The Jönköping County is known as a region with a large number of small- and medium-sized manufacturing companies and through the history this region has been characterized by an entrepreneurial spirit. Companies within this region have been characterized as being on the forefront of development in many business areas. A disadvantage to FDIs is that it is very costly to conduct and it would be interesting to see why and how medium sized companies in the Jönköping region choose to invest abroad. When looking at the phenomena of FDI from a profit maximizing perspective it is interesting to study what reasons and factors that found the basis for a decision to undertake an investment abroad. The following research questions have been drawn from the discussion about medium-sized companies and FDI:

- ✓ What are the main motives behind a decision to conduct a foreign direct investment for medium-sized companies in the Jönköping County?
- ✓ What factors are important when medium-sized companies in the Jönköping County choose type of FDI?
- ✓ Are the factors in the domestic or host market most influential in the company's decision to conduct an FDI?
- ✓ How are the risks involved an important factor when deciding to conduct an FDI?

## 1.3 Purpose

The purpose of this thesis is to describe the reasons and factors behind a foreign direct investment undertaken by medium-sized manufacturing firms in the Jönköping region.

## 1.4 Limitations of the Study

When choosing suitable respondents for this study the authors limited their search to the Jönköping County. The type of companies selected was manufacturing firms and limitations have been made regarding characteristics exhibited by the companies. The companies needed to be of medium size. The definition of medium sized companies that has been used in this thesis derive in part from the classification brought forward by the European

Union (SCADPlus[1], 2005) and in part by the US government organ Small Business Administration's (SBA) definition. According to the EU (SCADPlus, 2005) the definition of a medium-sized company is regardless of industry, 50-250 employees and an annual turnover which is less than €50 millions (approx. 477 million SEK[2]). The SBA's definition of a medium-sized company is different due to the fact that they include industry specific factors. SBA argue that manufacturing firms are more labor-intense and therefore, they define a medium-sized manufacturing firm as a company which exhibits the following characteristics, 50-500 employees and an annual turnover of approximately $30 millions (approx. 237 million SEK[3])(SBA, 2005).

We argue that a more suitable definition of a medium-sized company for this study should be a combination of the two. Since, the manufacturing industry is more labor-intense than other industries it often requires a larger number of employees. Therefore the EU classification concerning employees is not as applicable when studying this industry. However, when looking at the annual turnover for the firms within the industry, the EU definition is the definition we felt was appropriate to use. Therefore the classification of a medium-sized company in this thesis is:

Number of employees: 50-500 persons

Annual turnover: less than €50 millions (approx. 477 million SEK)

[1] Service Central Automatise De Documentation

[2] €1 ≈ 9.3 SEK, as of 2005-12-10

[3] $1 ≈ 7.9 SEK, as of 2005-12-10

# 2 Methodology

*This chapter will present the methods used to perform the study. The structure follows the same chronological order as how the overall study was conducted. Further, a critical review of the methods will be introduced.*

## 2.1 Choice of Method

There are two types of methods that are commonly used: qualitative and quantitative. A researcher's choice of method is a reflection of the type of study one undertakes. The choice of method is dependent on what kind of data is available and what sort of result one aims to get. It is important to understand the pros and cons of both methods and to choose the most appropriate one in regards to the purpose of the study (Holme & Solvang, 1997).

When using a quantitative method the researcher gathers numerical data, often in form of surveys or questionnaires. A study based on relatively measurable data, such as numbers or statistics, often creates answers that are somewhat easy to analyze, since created hypotheses only can be either rejected or accepted. The measurability of the quantitative method makes the study more objective and this is one of the more positive sides of using this method. One of the more prominent drawbacks of the quantitative method is, however, that it requires a large sample in order to get a statistically viable result and to make correct assumptions about the entire population (Gordon & Langmaid, 1988).

A qualitative method is often employed in studies where the authors try to gain a deeper understanding of a problem. Instead of relying on numerical data, as the quantitative method, researchers using the qualitative method often employ interviews as a source of data collection (Silverman, 1993). Data that has been gathered through an interview will enable the researcher to analyze and explain a phenomenon in an in-depth fashion. The qualitative method is in its nature a subjective form of study, since it entails that the researcher interprets the data and by that giving the researcher a larger possibility to affect the outcome (Holme & Solvang, 1997). The subjectivity of the data and the method requires a lot from the researchers since the results are dependent on their views and interpretations. This is partly one of the drawbacks of the method (Eriksson & Wiedersheim-Paul, 1999).

We have used a qualitative research approach in this study since we strive to understand and explain the phenomena of medium sized companies conducting foreign direct investments. We would like to get an in-depth comprehension of how the respondents view investments made by their respective company. The aim is to fully grasp the reasons behind an investment and what factors that influenced the respondents' decisions. The choice of method is therefore a direct reflection of the purpose of this study. Since we do not intend to measure the relative importance or frequency of the reasons and factors, interviews were made. By doing interviews we tried to collect data which encompassed a larger subject and from this interpreted the responses with regards to the intended purpose of the study.

## 2.2 Sample

A population is any group or area of interest that researchers aim to study. The goal is always to capture the responses of the entire population, but this is often impossible due to the size of the group. It is therefore necessary to narrow down the number of respondents, and to create a sample. A sample is a smaller group within the population that is used to make generalizations about the characteristics of the population (Lekwall & Wahlbin, 1993). In order for the sample to be representative, the sample needs to be selected in a certain way. In a qualitative study, different strategies or techniques may be used when choosing a sample; some of these are purposeful, nominated, theoretical, and convenience sampling. The first one is when the researchers identify respondents that have certain characteristics that are desirable to study. Nominated sampling, also called snowball sampling, is when the initial respondents suggest other suitable respondents for further inquires. The technique where the theories of the study form the basis for selecting respondents is named theoretical sampling. The last one is, as the name implies, a technique concerned with selecting respondents that are convenient in the sense that they are available and willing to participate (Morse & Richards, 2002).

In this thesis we believed that a purposeful sampling method was most appropriate due to the nature of the study. We were only interested in finding medium-sized companies, and when selecting respondents the authors searched for certain characteristics that the companies possessed. A search was conducted on the database Företagsfakta through the Jönköping International Business School library in order to find suitable companies. The first criterion that the respondents needed to fulfill was that they were based within the Jönköping County. Since we were only interested in finding companies of medium size certain search parameters were applied in order to find firms with a number of employees between 50 and 500. This resulted in 237 companies with these characteristics. However, there was no possibility to limit the search further to see which companies had conducted an FDI, and had a turnover which was less than €50 million. We then had to manually investigate which companies that owned foreign subsidiaries and displayed the appropriate turnover, and this resulted in 18 firms which matched all criterions. Out of these 18, five firms were willing to participate in an interview. The respondents selected and presented in this thesis are: Eldon AB, Carlfors Bruk AB, AB Pettersons Järnförädling, IDAB WAMAC International AB and RH Form AB. In a qualitative study the number of respondents selected should be sufficiently large to draw conclusions of the results and to answer the purpose of it. Eisenhardt (1989) argues that the number of respondents in a qualitative study should be somewhere between four and ten. We argue that the number of respondents is sufficiently large to be able to draw conclusions from the results of the empirical study.

## 2.3 Data

Data collected by researchers is often referred to as either primary or secondary. Primary data is any data or information acquired directly in accordance with the purpose and problem of the study. Secondary data, on the other hand, is data that has been accumulated for a different study or purpose but is useful to the researcher (Eriksson & Wiedersheim-Paul, 1999).

In this particular thesis, we have only used primary data that has been collected through interviews with selected respondents. The collection of primary data has two inherent problems. First of all, it is important that the respondent has the appropriate position in the corporation and adequate information about the problem at hand. Therefore, we made sure that the interviews were conducted with a person at the companies which had knowledge and information about the foreign direct investment that the company had undertaken. Another important point was that the respondents occupied positions which were high up in the hierarchy and preferably had a degree in business administration. Secondly, the data collection should be carried out in a way that enables the researchers to acquire the right information needed (Lekwall & Wahlbin, 1993). Primary data collection carried out by researchers is often done using two basic techniques: through observations or some type of survey or interview. Surveys and interviews are used more frequently and the choice between these two techniques is often based on the size of the sample (Lantz, 1993). A large sample often calls for a survey type of study. The choice of data collection method is also connected to the purpose of the study. An interview enables the researcher to dive deeper into the problem and discuss the questions more thoroughly (Lekwall & Wahlbin, 1993). The choice to collect data through interviews was found to be the most appropriate with regards to the purpose of the study. How the interviews were conducted will be further explained in section 2.3.2.

### 2.3.1 Interview Guide

The frame of reference is the theoretical part of the thesis and it serves as the foundation of the study. It is important to link the theoretical framework with the empirical findings, and therefore we constructed an interview guide[4] based on the theories covered in the frame of reference. The theoretical framework mainly deals with the theories of foreign direct investments.

The chapter starts with theories concerning internationalization since it provides an understanding of and foundation for international business and this is followed by the specific theories surrounding foreign direct investments. We also chose to include theories of risks associated with an FDI in the frame of reference. The justification for this is that risks are by many researchers considered to be a very important factor when investing abroad. We claim that the theories covered in the frame of reference are relevant when conducting a study of FDI and in line with the purpose of this particular study. Although some of the theories covered have been written many years ago, they are fundamental to include in order to get a full understanding of the subject. In fact, most of the studies done in recent years are built upon the theories included in this study.

The interview guide is a tool which enabled us to keep a theoretical view on the discussions during the course of the interviews. The guide is divided into different sections and it starts with some basic questions about the company in general so that we can get a better comprehension of the respondents. The following questions are centered on the research questions which will ultimately help us to answer the purpose. Each question deal with a larger subject area and the plan is that the respondent will elaborate the answers given within the area. The follow-up questions are introduced as a way of keeping the answers on the right topics. The first question is based on theories about competition and competitive advantages. Questions two to five deal with the respondents' international trade and foreign direct investments made in other countries. These questions are based upon theories surrounding location selection, country-specific motives and reasons for FDI, and overall investment strategy. These are introduced in order for us to be able to answer the first and third research questions. The last two questions are about the type of FDI chosen by the respondents and what risks they have identified in their decisions to invest abroad, and will answer with research questions number two and four. These questions are based upon theories of FDI risks and entry modes.

[4] The interview guide has been included as Appendix A

### 2.3.2 Interviews

When carrying out an interview the researchers need to take certain things into consideration. Firstly, the choice of interview type needs to be determined. Then researchers need to decide how the interviews should be structured and lastly in what way the interviews should be made (Lantz, 1993).

There are five types of interviews in a qualitative study; explanatory, in-depth, goal-oriented, testing, and focused. An explanatory type of interview is aimed at giving the researchers a basic comprehension of a subject, in which they have little or no knowledge. If the interview is a way of enabling the researchers to achieve a greater understanding of a field an in-depth interview should be employed. The goal-oriented interview is aimed at acquiring knowledge of a certain subject that the researchers ask questions about. A testing type of interview is undertaken to see if there are data missing in the study. Finally, a focused interview type is carried out when the researchers wants to gain knowledge of particular themes (Darmer & Freytag, 1995).

There are three basic ways to structure an interview. The choice between these structures is often based on the purpose of the study and the size of the sample. If the sample is large, an unstructured type of interview can be too time-consuming and a survey or structured interview may be preferable (Lantz, 1993). The main difference between a structured and an unstructured interview is that the latter has more open questions, which leaves more room for the respondent to elaborate his answers (Morse & Richards, 2002). Through the unstructured interview the respondent is given an opportunity to describe a subjective view of a phenomenon. The subjectivity is interesting for the researcher since different respondents may have different answers to the same question. The structured interviews however are commonly based on pre-determined alternatives of answers, which lead to less subjectivity (Lantz, 1993). A third alternative is the semi-structured questionnaire; it is a mix of the two previously explained methods of interviewing. It is useful when the researcher has some knowledge within the field of study. The researcher is then able to formulate questions that is built upon the theories used in the study and that correlates with the purpose (Morse & Richards, 2002).

After deciding the method of questioning, the researcher needs to choose how to conduct the interviews. Typically there are two forms of interviews commonly used, which have their disadvantages and advantages. Personal interviews are generally preferred as the mode of questioning since it enables the interviewer to interact with the respondent (Lekwall & Wahlbin, 1993). This might also be a drawback since the interviewers could be affected by the respondents' personality or vice versa which might affect the results. Other drawbacks of using personal interviews are that it is time-consuming and can be somewhat costly. An alternative to personal interviews are telephone interviews. This type of interviews has its main advantages in cost and time savings (Eriksson & Wiedersheim-Paul, 1999).

The research carried out in this thesis has been a mix of two types of interviews, the goal-oriented and in-depth types. Through the literature search and knowledge gathering we possessed a fundamental understanding of the subject of FDI. The interviews were carried out in order to further this knowledge and to gain an in-depth awareness of the phenomena. The interviews were goal-oriented in the way that the interviews were structured around the frame of reference.

We had a desire to create an open dialogue with the respondents and tried to formulate questions that ensured this. However, we still wanted to steer the interview in a direction that was in line with the intended purpose and a fully unstructured interview was not found to be the best alternative. Before the interviews were conducted a semi-structured questionnaire was made and that helped us to keep the conversation focused on the purpose of the study.

Since we had no possibility to make any type of personal interviews with the respondents, due to time constraints of both the authors and respondents, telephone interviews were conducted. The interviews were conducted with a person within each organization that had sufficient knowledge of the studied subject, in all cases these respondents were upper management. The interviews were carried out in approximately 30-40 minutes each. Prior to the interviews, the interview guide was sent out to the respondents in order for them to gain a basic understanding of what the researchers were interested in. Although the personal interaction between the respondents and the interviewer might be different over the phone, the authors feel that the differences in answers should not be that great.

## 2.4 Criticism

It is important for researchers not to become overenthusiastic with the results or findings of their study. A critical mindset is important in order to keep the credibility of the study on a satisfactory level. Reliability and validity are two aspects that are frequently scrutinized in a study and used as measures of the credibility (Eriksson & Wiedersheim-Paul, 1999).

### 2.4.1 Reliability

Reliability is a concept concerned with random errors of the method employed in a study. To further explain, it is an answer to the question of whether the results can be duplicated by different researchers and on different occasions when using the same method. Reliability in a qualitative study is a somewhat complicated issue, since people's behavior and thoughts change over time. Qualitative studies aim to describe and explain the reality, from the respondents' apprehension of it, and the occurrence of an event may be interpreted in many different ways. The inherent subjectivity of a qualitative method makes it hard for researchers to fully protect the answers from fluctuations (Christensen, Andersson, Carlsson & Haglund, 2001).

In order to raise the reliability of this particular thesis an interview guide was constructed and sent out to the respondents prior to the interviews. This provided a certain structure to the interviews, and has increased the reliability a bit. However, follow-up questions and the interaction between the interviewer and respondents may be difficult to reproduce. We tried to tackle this problem by recording the interviews and at least the follow-up questions should be able to be replicated. Another important aspect is that we always did the interviews together and could therefore contribute with our individual opinions and experiences. One issue that might decrease the reliability of this thesis is the fact that we lack any greater experience in performing interviews.

### 2.4.2 Validity

The concept of validity is a measure of whether the study measures what it is intended to measure (Christensen et al, 2001). In this thesis, a high validity means that the results of the study are concurrent with the purpose of it. A qualitative study is aimed at achieving a deeper understanding of a problem and therefore the validity of the study is often high (Trost, 1997). In an interview, however, it is important that the questions are formulated correctly in order to ensure that the questions are fully understood and completely dealt with.

As explained earlier, we constructed an interview guide which was sent to the respondents. To ensure validity of the thesis and to make sure that the interviews were in line with the purpose of the study the guide was composed with the frame of reference as a base for questioning. Also, we asked single and easily understood questions, and made sure that respondent fully understood the questions. By asking follow-up questions we were able to ensure that we really got the answers we were looking for in regards to the theoretical framework. We believe that the validity in this study is sufficiently high.

# 3 Frame of Reference

*This chapter presents the theories that will be used in this thesis. The frame of reference is focused on the theories concerning internationalization and foreign direct investments; these will be used to analyze the empirical findings.*

## 3.1 Internationalization

The process of moving towards a multinational company is often a gradual one. Many companies opt to engage in different smaller and less complicated international operations first in order to acquire understanding and experience of foreign markets (Ågren, 1990). Johanson and Wiedersheim-Paul (1975) and Johanson and Vahlne (1977) have identified a sequential process in which companies internationalize their business, a theory known as the Uppsala School. The process often starts with simple exporting activities and gradually moves towards more elaborate investments, such as investments in foreign production facilities. A gradual movement through the process is a way for firms to gain experience and to minimize the risks associated with a foreign environment. The sequential process is illustrated in figure 3.1 below:

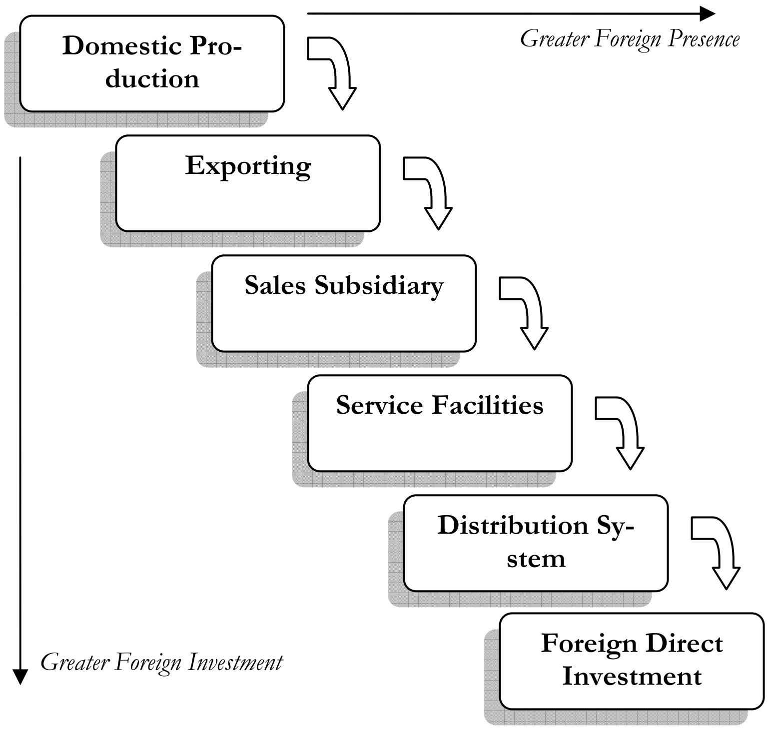


**Figure 3.1** The Sequential Process (Adaptation of Buckley, 1998)

In a study conducted by Johanson and Wiedersheim-Paul (1975), of Swedish firms and their behavior when investing abroad, the authors found that companies were more likely to initially invest in countries similar to Sweden. These countries include Norway, Denmark, Finland, Germany and United Kingdom, where culture, laws and the institutional environment are similar, and by the firms seen as less risky. Furthermore, the authors discovered that as companies learned from their initial experiences they were increasingly willing to expand beyond the familiar environments and raise their investments.

The theories concerning the Uppsala School have been criticized by various researchers. Some argue that the process is not as sequential as Johanson and Wiedersheim-Paul (1975) imply, but that firms leap past steps and move rapidly towards production abroad (Hedlund & Kverneland, 1983). Edvardsson, Edvinsson and Nyström (1991) observed that Swedish companies skipped several steps and directly acquired established firms abroad.

A common thread of the theories surrounding the Uppsala School and other internationalization theories is the view on foreign direct investments as the last step in companies' attempts of trading internationally (Ågren, 1990; Eiteman, Stonehill & Moffett, 2004).

## 3.2 Foreign Direct Investment

*"Foreign direct investment (FDI) is the process whereby residents of one country (the source country) acquire ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country (the host country)."* (Moosa, 2002, p.1)

There are several definitions of a foreign direct investment presented by a number of researchers. A central theme of the definitions available on FDI, where the one illustrated by Moosa (2002) is a typical example, is that the companies undertaking such a venture aspire to gain a controlling stake in the asset or entity purchased. An FDI is not to be confused with an international or portfolio investment where the aim merely is to diversify the holdings of the firm and make a financially sound investment (Buckley, 1998).

### 3.2.1 Classic FDI Theory

Theories concerning the existence of FDI have emerged from the traditional views of Hymer (1960) and Kindleberger (1969). These authors argued that the phenomenon of foreign direct investments was a response to imperfect markets. Kindleberger (1969) identified four market imperfections that could explain the occurrence of FDI: factor market imperfections, goods market imperfections, scale economies and government controlled restrictions. Market imperfections create differences between regions or markets and it can be advantageous for a firm in a region to exploit these imperfections. For instance, factor market imperfections can enable lower wage costs and cheaper production in one region.

Another fundamental issue of this theory is that firms investing abroad have certain disadvantages compared to their foreign competitors. The entrant usually has less knowledge and information about the new market than the existing companies. Also, a subsidiary in another country is often more demanding in terms of costs, commitment and attention compared to one in the home market. Hymer (1960) stated that in order for companies to operate abroad they needed a competitive advantage compared to foreign producers because of the disadvantages it faces. Kindleberger (1969) elaborates this statement further and claims that the financial effects of market imperfections can be the driving force behind an FDI if the advantages outweigh the disadvantages. An important point of the work of Hymer (1960) and Kindleberger (1969) is that they assume that companies undertaking an FDI are, due to their competitive advantage, operating within an oligopoly or monopoly. The authors argue that by having a competitive advantage the company will drive smaller firms without competitive advantages out of business. This is supported by Dunning (1985) which claimed that an important feature of multinational firms were the fact that they operated within markets characterized as an oligopoly.

Market imperfections and firm-specific competitive advantages could explain the existence of FDI but not why firms opted to undertake such investments when other options such as exporting were available. Other theories emerged as an attempt to further develop the theories surrounding FDI and to create an explanation as to why companies should invest abroad (Nordström, 1991).

### 3.2.2 Internalization and Transaction Cost Theory

The theories of internalization and transaction cost are closely related. Buckley and Casson (1976), among others, developed the theories of internalization of corporate assets as an attempt to understand the existence of FDI. The theory revolves around the hypothesis that there are imperfections in the markets for intermediate goods. In order for a firm to secure the flow of goods and factors of production it may opt to acquire a foreign company, and try to substitute market transactions with inter-corporate transactions. An important aspect of the theory is that it includes the internalization of knowledge, human capital and various patents. These factors create an incentive for the firm to internalize production abroad in order to preserve this competitive advantage. In order for the firm to preserve and keep the advantage in the long-run it must be hard for competitors to copy. This theory explains why foreign direct investments are in some cases preferred to other options, such as exporting or licensing (Moosa, 2002).

Coase (1937) developed the earliest theories of transaction costs, which stipulate that the costs of transactions are the basis for a decision of whether to buy goods and services on an external or internal market. This theory is also a result of the hypothesis of imperfect markets. If markets were perfect no transaction costs would occur and companies would not have any incentives to keep production within the organization. However, perfect markets do not exist and lack of competition will raise the price of goods. This will encourage a company to produce the needed products within its organization and thereby reducing transaction costs (Buckley, 1998). Other costs associated with a transaction outside the firm such as contractual costs can be lowered through internalization. Further, if an FDI is conducted there is no need for extensive monitoring or protecting of property rights which will lower costs (Teece, 1976). Incentives for an FDI will continue as long as the transactional costs are relatively higher than the costs associated with internalization (Buckley, 1998).

### 3.2.3 Location Selection

Vernon (1966) was one of the first researchers to focus on theories surrounding location selection when conducting a foreign direct investment. One of the basic theories stipulated that the host country should be chosen with regards to the complexity of the manufactured products. Investment in production of more technical and sophisticated products should be located in countries where the infrastructure, market and human resources are suitable. More standardized or uncomplicated products on the other hand could be produced in less developed regions where the costs are lower.

Another author that has strongly contributed to the research within FDI and internationalization is Dunning (1977). The theories of location selection that Dunning (1977) developed are focused on the factors of production in the host country. These factors provide incentives for firms to invest in a specific region or country. Location specific advantages that companies might seek are, among other things, access to natural resources or low-cost labor. When firms expand beyond their national border it might be because of so called push or pull factors. A financial event or change occurring within the home country might create a disadvantage for the firm and forcing the company to expand abroad. This is referred to as a push factor and is usually induced by rising wages or appreciation of the home country currency. This type is particularly strong in firms that are labor-intensive. Similarly, a change abroad might create incentives for the company to invest and is called a pull factor. An example of this is when the government in the host country creates incentives for foreign investments or when a location is favorable from a cost based perspective (Meyer, 1998).

Other authors have adopted an economic perspective on FDI and MNE theories. According to these theories a company will choose the location which will minimize total costs. Factors that are important in terms of cost minimization are mainly labor costs, which are a major part of a firms total cost, and logistical costs. Further, governmental incentives can be a strong factor when selecting a location. For instance, there might be taxes which are either beneficial or designed to hinder foreign firms (Luo, 1999).

### 3.2.4 The Eclectic Paradigm

Dunning (1977) felt that there were many theories about FDI, but that there was a lack of a theory which could capture all aspects. The eclectic paradigm, also known as the **OLI**-framework, was developed by Dunning (1977, 1988) and is an attempt to gather previous theories in the field into one theory. When building the framework the author used and elaborated on existing theories, which resulted in three main factors: **O**wnership, **L**ocation, and **I**nternalization advantages. The paradigm tries to explain the reasons for a firm to engage in foreign direct investments rather than other available modes of internationalization, such as exporting and licensing. Dunning (1977) claimed that three conditions needed to be satisfied in order for a foreign direct investment to occur:

**Ownership Advantage:** It is based on the theories of Hymer (1960) and Kindleberger (1969) surrounding firm-specific competitive advantage. It is important that the advantage is difficult to copy for competitors and must be easily transferable to foreign subsidiaries. This advantage may be a brand name or ownership of proprietary technology (Griffin & Pustay, 2002).

**Location Advantage:** The decision to invest abroad is influenced by the advantages a location offers for the firm. These advantages might include production at a lower cost or at a higher productivity than in the domestic market. Further, a large host market is also important in order to be eligible for investments. Other advantages may include natural resources or governmental incentives (Butler, 2000).

**Internalization Advantage:** As explained earlier, the internalization advantages revolve around the benefits a firm may receive by controlling the foreign business activity. It is an important part of protecting a company's competitive advantage (Griffin & Pustay, 2002).

### 3.2.5 Motives for FDI

Several theories concerning the reasons for a firm to use foreign direct investments as a way to internationalize its company have been developed (Nordström, 1991). The theories mentioned previously in this chapter have explained reasons for FDI on a more conceptual level and are closely linked to this part of the chapter. However, this part will be more focused on specific factors that influence the decision to invest abroad.

Li and Clark-Hill (2004) have developed a model regarding the economic determinants that need to be present in the host country and the underlying motives for companies to conduct an investment abroad. The model is presented in figure 3.2.

| | **Motives of FDI** | **Specific Economic Determinants in Host Country** |
|---|---|---|
| **Economic Determinants Host Country** | Market Seeking | • Market size and per capita income<br>• Market growth<br>• Access to regional and global markets<br>• Industrial linkages<br>• Local competition |
| | Resource Seeking | • Raw materials<br>• Skilled or unskilled labor<br>• Physical Infrastructure |
| | Efficiency Seeking | • Costs of resources above and knowledge-based assets, and technology and innovative capacity<br>• Other Input Costs e.g. transport or intermediate products |

**Figure 3.2** Economic Determinants of FDI (Adaptation of Li & Clarke-Hill, 2004).

According to Li and Clarke-Hill (2004) there are three main motives behind a company's decision to invest abroad. The first motivation is connected to a firm's aspirations to gain access into a foreign market. Determinants that companies look for in the host country in order for an FDI to be undertaken, in terms of market seeking motives, are among others the size and growth of the market. When firms invest abroad they often do so in new markets which are not satiated. Companies often tend to invest in markets where their products are in demand and where there are opportunities for growth. Even though a market might be attractive in many ways a firm should consider not entering if competition is too fierce. It is quite common that companies seek specific regions or markets which are experiencing a positive economic trend. The economic development in such a region can create a boost in demand for consumer goods due to higher overall level of income. Also, deployment in the host country might be seen as a gateway to other markets in the region or globally. For instance, Mexico is often seen as a gateway to the North-American market. Also, many forms of international business necessitate companies to have a physical presence in the market (Griffin & Pustay, 2002). Companies are sometimes obliged to expand their operations internationally due to industrial linkages. That is, firms have suppliers or other major stakeholders abroad which requires a closer geographic connection. If a firm has a large customer that moves abroad it can create an incentive for the company to follow this customer in order to keep it (Luo, 1999).

When companies expand their operations outside the domestic border it is often due to resource seeking motives. These motives are linked to factors of production and the relative abundance of them compared to the home country. Sometimes companies have a demand for a certain type of raw material which is not found or hard to obtain in the home market. This will force them to look abroad for these resources and a foreign investment is often a solution to the problem. By doing this the company tries to control and secure the supply of raw materials (Griffin & Pustay, 2002). Another aspect of resource seeking motives is the search for skilled labor. Companies can by investing abroad get access to a certain type of workforce which is hard to find in the home country. There might be regions which are particularly skilled in producing specific products and can induce firms to invest there. Companies that manufacture products that are labor-intensive may experience a lack of supply of workers in their domestic markets, and are sometimes forced to search for labor internationally (Luo, 1999). A resource seeking motive may also be that the infrastructure of the country is particularly developed and supportive of the firm. The physical infrastructure in a country include such things as railroads, roads, airports and ports, and is an important requirement for the host country to fulfill in order to enable the firm to operate efficiently. It is also important that the communication infrastructure is well-developed. However, in many developing countries there are an absence of supportive infrastructure and many firms conducting FDIs in these countries face problems. Notable though, are that some companies are more reliant on a well established infrastructure than others.

The most easily grasped motivational factor is when a company is efficiency seeking. It is closely connected to resource seeking motives, but this is more centered on lowering costs of production. Labor costs are a major expense for many manufacturing firms and is usually a big part of total production costs. An investment in production facilities abroad is more likely to occur when the cost of production is cheaper abroad than at home (Hood & Young, 1979). Decisions about where to localize production is often influenced by where companies can minimize production costs. Labor-intensive firms often undertake FDIs in foreign nations were the wage rates are low. These low costs are often one of the biggest factors for swaying multinational companies to invest in developing countries. However, recent trends within manufacturing industries are attempts to automate production and to lower direct labor costs. These attempts decrease the incentives for labor-intensive firms to move abroad. Another factor within the efficiency seeking motives is transportation costs. A great geographic distance between the company's target market and home market might encourage the company to locate production in the foreign market. Instead of exporting directly to the target market a company may manufacture the products in the country and significantly lower the transportation costs. Lower overall costs of production will ultimately lead to higher profit margins on each manufactured product. Dependency on a raw material can in some cases be very expensive for a company. If a firm can acquire these materials at an alternative location at much lower prices an FDI is a viable option to pursue (Luo, 1999).

Hood and Young (1979) identify an additional factor that plays an important role when deciding to invest in a foreign country. In some countries or regions there are trade barriers in place to limit the volume of exports into the country. Sometimes, the most effective way to bypass these barriers for a company is to set up production in the targeted country. There might also be laws and regulations in a country put in place to limit the volume of imports into the country, and an FDI is the only option available to penetrate the market.

### 3.2.6 Types of FDI

As discussed earlier, an important aspect that separates a foreign direct investment from a portfolio investment abroad is that the ultimate goal is to exert control over the acquired assets (Moosa, 2002). According to the definition brought forward by IMF (2004), a firm can be seen as having control when the company owns a majority of the asset in question. There are several different methods of FDI available to companies, which usually involve establishing or expanding subsidiaries abroad, joint ventures with foreign firms or acquisition of companies. Authors separate three types or methods of investments which constitutes as foreign direct investments (Barclay, 2000; Eiteman et al, 2004; Griffin & Pustay, 2002).

1. Green-field Investment
2. Acquisition
3. Joint Venture

#### Green-Field Investment

The first alternative involves an investment where the production facilities are built fresh and established fully by the company (Griffin & Pustay, 2002). The benefits associated with a green-field investment are that it provides the firm with modern production facilities and offers a fresh start in the host country. Buckley (1981) argued that a green-field investment may sometimes be more beneficial for a smaller company. It allows the firm to set up operations at a level which is suitable from an economic point of view and that will permit them to expand the factory at a pace which is consistent with the growth of their market share. Drawbacks are that it usually requires a large capital investment and can be quite time-consuming due to constructions and development of the organization (Eiteman et al, 2004).

#### Acquisition

The most frequently applied type of direct investment by firms is the acquisition of a foreign enterprise. It entails a purchase of an existing company and its assets abroad in order to gain control of it. A reason for the relative popularity of this entry mode compared to the others is that an acquisition of a foreign firm would not create additional competition in the market. Whereas a green-field investment would create a new player in the market, a takeover would only substitute one for another (Butler, 2000).

A positive effect of this kind of investment is that it enables the investor to quickly obtain production capacity in the foreign country. Further, if the human knowledge within the organization is kept, the investor will gain instant access and understanding of the culture and business environment. An acquisition is more beneficial than a green-field in the sense that there is no major down-time for the production facilities, which allows the company to continue production and generate profits (Buckley, 1981).

The disadvantages identified when acquiring a company are for one that it may be a very capital intensive operation in terms of actual purchase price. Also, the purchase of a firm brings with it that the investor assumes all liabilities. Not just financial liabilities, such as debts, but also issues concerning the stakeholders of the firm and the relationship between them (Griffin & Pustay, 2002).

#### Joint Venture

A joint venture is a special kind of a foreign direct investment and differs somewhat from the other available types of investments in the sense that control of the foreign assets is not always the end result. A joint venture is typically defined as a business enterprise which is partly owned by a firm together with one or more partners. Although this venture may take different forms and arrangements, it is usually an agreement between a local company and a foreign firm to set up a separate enterprise for production in the host country. The definition of a joint venture imply that the total share of assets owned in the host country company will be less than 50%, and therefore not controlled by the parent firm. A mutually exclusive fact with this definition is therefore that a foreign subsidiary does not fall into the category of a joint venture (Eiteman et al, 2004). An agreement between firms may be a very viable option and has several benefits compared to other alternative foreign direct investments. However, it is a prerequisite that the investing company finds a suitable local partner. Only then would a joint venture be an option worth pursuing (Griffin & Pustay, 2002).

Some of the advantages of a joint venture are that by joining forces with a local company the investor receives an instant comprehension of the culture and business environment in the host country. It will also be an opportunity for the company to acquire knowledge in the production or management which is not previously owned. Other advantages include an understanding of the market, which enables the company to better serve its customers. A joint venture is also the least capital intense form of foreign direct investment. There are disadvantages as well and these are closely connected to the topic of control. It may sometimes be a drawback to have an equally influential partner when views on decisions differ. As mentioned before, it is important to find the right partner in the host country. There are political and ethical considerations to be made when selecting a partner. If the associate were to operate questionably or in violation with acceptable ethical or moral standards it may reflect badly on the investor (Eiteman et al, 2004).

### 3.2.7 Risks of FDI

It is a common fact that there is a certain risk associated with an investment. Few alternatives are seen as risk free, and an investment in a foreign country is usually viewed as a risky investment regardless of whether it is an FDI or a simple portfolio investment. What separates a foreign investment from one made domestically, is that there are risks inherent in a cross-border investment that a company faces. The type of uncertainty or risk a company faces is usually country specific and it is important to evaluate the many different factors that play a part when investing in a foreign country. Country-specific risk is an estimation of the probability of an unexpected change in the host country's economic or political environment (Butler, 2000).

Clark and Marois (1996) have identified and categorized two different types of country-specific risk associated with a foreign direct investment: financial and political risks. Financial risks encompass many different aspects of both the host countries and the firm's financial abilities. There are both macro- and micro-economical considerations for a firm to make when evaluating the profitability of an FDI. In order for a country to been seen as a feasible location to invest in it needs to be relatively stable in terms of economical fluctuations. Other financial aspects are risks associated with a countries exchange rate, inflation, and interest rate. The exchange rate of a country is the most well-known and easily grasped concept of country specific financial risk. Fluctuations in the currency of a country may greatly influence the profitability of an investment and the firm should try to manage its currency risk in the short-run. All these factors will influence the firm's profitability in both the short- and long-run, and the company should try to handle or lower the risks of foreign investments.

Political risk is an important aspect to consider when looking to invest in notoriously unstable regions or countries. Political risk is, like financial risk, an estimation of how big the probability is of an unexpected change in the political environment. The risk is partly made up of risks associated with the current political system in the country and the legal environment. There are several different types of events that could occur which would decrease the profitability of the investment. The investing firm should be aware of and take political risks into consideration if the country could be viewed as relatively risky compared to the home market (Butler, 2000). Examples of political risk are, among other things, the occurrence of corruption, expropriation, wars, and specific production laws (Griffin & Pustay, 2002).

### 3.2.8 SMEs and FDI

Many of the theories covered in this chapter have originally been developed with large corporations in mind. There has been a general consensus that the theories of FDI developed apply to small- and medium-sized as well, and few theories exist specifically on foreign direct investments done by SMEs. Studies that have been done on SMEs and foreign direct investments have mainly been focused on finding SME specific factors to explain FDI through comparisons with larger firms. A common conclusion of these studies is that very few differences exist between an FDI decision made by a smaller and a larger firm. However, there are some factors or aspects which are more important for SMEs (Coviello & McAuley, 1999).

According to the OLI-framework developed by Dunning (1977, 1988) a firm-specific advantage is the ability to be innovative in the production process. Companies have an advantage in international competition if it is the technological leaders of the industry, and innovate activities are often unrelated to the size of the firm. Acs, Morck, Shaver and Yeung (1997) have even found that smaller companies are more successful at being innovators, because they are more adaptable to changes in the technological environment. It is also easier for SMEs to protect their technological solutions since the organization is not as large and information is less likely to leak. Another aspect of this is that when companies become large and more successful competitors are more inclined to copy the technology. Although SMEs might have an advantage in their ability of technological innovativeness, larger firms have a financial advantage and can spend more money on research and development.

The underlying factors and determinants that have previously been identified in this chapter are all applicable to SMEs as well. As explained earlier there are recent studies that have shown some factors SMEs find specifically important when deciding to invest abroad. Key factors in a SME's decision to conduct a foreign direct investment are according to Kuo & Li (2003), a desire to exploit local low-cost labor, to expand into the foreign market, and to follow a major customer into a new market. The authors further explain that the two first reasons are also common factors for larger firms, while the latter is more unique for SMEs.

Smaller firms may sometimes be extremely dependant on one or a few major customers and might be forced to follow the company abroad.

Other studies done on SMEs have focused on location selection. In a quantitative study by Masataka (1995) on the investment patterns of SMEs, the author found that smaller companies were more often inclined to invest in developed countries. In another study by Li & Hu (2002) the authors claim that location selection is dependant on the level of technological sophistication in the production process. Companies with a more advanced technology will invest in developed countries whereas more labor-intense firms seek lower labor costs in developing regions. SMEs have also been found to follow a more evolutionary or sequential approach and often invest in nearby situated counties or market first, in order to gain experience to expand further in a later stage (Camino & Cazorla, 1998).

# 4 Empirical Findings and Analysis

*This chapter will present the empirical findings of the qualitative study, which have been collected through interviews with the selected respondents. Further, analyses of the selected respondents from a theoretical point of view will be made. A comparative analysis will conclude the chapter.*

## 4.1 Eldon AB

| | |
|---|---|
| Place of origin: | Nässjö |
| Established: | 1922 |
| Industry: | Electrical fittings |
| Employees: | Consolidated group: 430 persons |
| | Sweden: 150 persons |
| Turnover: | Consolidated group: €40-50 million (372-465 million SEK) |
| | Sweden: 170 million SEK (approx. €18.3 million) |

The empirical findings presented in this part of the chapter have been obtained through an interview conducted with Magnus Ramfelt, manager at the financial department at Eldon AB[5].

Eldon manufactures a wide range of products within the electrical fittings industry. The standard products are enclosures, switchgear, electronic and electrical distribution systems. The firm has developed from a small family-owned business into a multinational company with active participation in several countries. Eldon has, as stated above, its headquarter in Nässjö where it also has its main production facility. Additional to that factory, Eldon has manufacturing plants in three other countries, all within the European Union. These countries are: England, Spain and Holland. Further, the company has established a site in Germany, but no production is currently in progress.

According to Mr. Ramfelt (personal communication, 2005-11-30) the competition in the Swedish market is fierce. The market is characterized by a large number of actors and small profit margins. Historically speaking however this has not always been the case. In the last five to ten years there has been a constant increase in terms of price competition and cost-minimization. Mr. Ramfelt (personal communication, 2005-11-30) explains that many of the competitors in the Swedish market have over the last decade tried to minimize costs by utilizing opportunities in foreign countries. Many of the competitors have chosen to move their production to low-cost countries, either through outsourcing or direct investments. Eldon has tried to maintain their competitive strength by offering short delivery times and by developing customer specific product solutions. Short delivery times and a flexible production are what Eldon views as its main competitive advantages. The company has how-

[5] subsequently also referred to as Eldon

ever recently been forced to look for other options to maintain their market share and will shortly downsize production in Sweden to about 60 employees. The loss of production in Nässjö will be covered by an increased number of jobs in Spain and by outsourcing some of the production to suppliers in Latvia and Poland. Mr. Ramfelt (personal communication, 2005-11-30) argues that this is the reality of the industry today. High factor costs in a labor intensive industry have forced companies to move production abroad, and production in Sweden is not a viable option in the long run if a company is going to stay competitive. Eldon has however chosen not to make further foreign direct investments initially in the two new countries. The choice of region is closely related to both cost and market considerations. Eldon could have chosen to outsource their production to even cheaper locations such as China or India, but opted not to do so since their target markets are within the European Union and the price of the products would not warrant the extra incurred costs of transportation (M. Ramfelt, personal communication, 2005-11-30).

When looking at the previous paragraph, two different theoretical connections are visible. First of all, Hymer (1960) and Kindleberger (1969) argued that a pre-requisite for companies when investing abroad, was that it need to have a competitive advantage in order to be successful. Eldon claims to have two main competitive advantages, short delivery time and customer specific solutions. We argue that these do not constitute as competitive advantages in terms of not being unique and company specific. Eldon has not proven to have any unique solutions neither in the production nor in logistics, and therefore it might be easy for competing firms to copy. Secondly, the authors assume that companies which undertake FDIs are, due to their competitive advantage, operating in an oligopoly. The market that Eldon is in does not have the characteristics of an oligopoly since there are many small competing firms and the overall competition is fierce. Our view on this is that, if the theories are accurate, Eldon should not be able to operate successfully in the international market.

The earliest foreign direct investments were done in Holland and Belgium in the 1970s. Early on, Eldon had a desire to establish itself on the European market and these investments were made in order to get closer to this market. The company acquired existing firms and their production facilities. Mr. Ramfelt (personal communication, 2005-11-30) explains that acquisitions were seen as the best option for Eldon in the long-run. The site in Belgium later on turned out to be a failure and was subsequently shut down. The investments in Holland continued and in the 90s further investments were made in England and Spain. These investments were also in the form of acquisitions of existing companies, and the purchases were made to gain access into the markets. Spain was seen as a very good investment location, since it provided both relatively low costs of labor and a geographical proximity to the southern parts of the European market. During this period the international part of the company outgrew the Swedish part, in terms of employees and sales. Mr. Ramfelt (personal communication, 2005-11-30) says that the international part of the corporation is extremely vital and that Eldon is constantly and actively scanning the market for investment opportunities abroad. As stated above, the company is currently in the process of outsourcing their production and has opted not to conduct a foreign direct investment. This is partly because Eldon wants to evaluate the progress in these new countries before considering an acquisition. However, if the collaboration with the new suppliers turns out to be a success Eldon may consider an acquisition of these firms later on.

Li and Clarke-Hill (2004) identified that there are certain motives a company has when investing abroad. The main reason why Eldon opted to invest abroad was a desire to access the targeted markets in Europe. We argue that Eldon's products and industry are rather specialized and the home market is somewhat limited in terms of the number of potential customers. In order for the company to expand its market it needed to establish itself internationally. When looking at the FDIs conducted by Eldon from an internalization perspective, one can argue that the company tried to maintain its perceived competitive advantage. By accessing the markets through FDIs the company would be able to establish itself closer to the targeted customers and keep its short delivery times. Also, when looking at the other aspect of the competitive advantage an investment will increase the knowledge of the market and will help the company to better understand its customers. Therefore, Eldon will be better at supplying and creating customer specific solutions. An investment in Spain may also be for efficiency seeking reasons, since the labor costs at the time of the investment was almost half of that in Sweden. One has to assume though that the market seeking motive was prominent in the location selection. If the efficiency seeking motive were the main reason it would have been more natural to conduct an FDI in the neighboring country Portugal where the labor costs are even lower.

The reasons mentioned so far have all been pull factors where opportunities in the host country have created incentives for the company to invest (Meyer, 1998). There are however some push factors as well that the company mentions which are important. First of all, the domestic competition has forced the company to expand internationally since the home market is satiated. Another factor is connected to the firm's decision to outsource production. The costs of production, mainly labor, are too high in Sweden and the company has been forced to outsource production to low-cost countries.

Acquisitions may sometimes be an effective and easy way for a firm to gain instant access to production capabilities and knowledge of the market (Buckley, 1981). Eldon's foreign direct investments consisted of purchases of existing companies in all the targeted countries. We believe that the choice of investment type is directly correlated to Eldon's desire to internalize the competitive advantage and to quickly access the market.

Dunning's (1988) eclectic paradigm states that three advantages; ownership, location and internalization, need to be present in order for a foreign direct investment to be a successful and viable option of internationalization. Although Eldon lacked one of these advantages, a sustainable competitive advantage, in our view the company has been doing well in their investments.

In terms of risks, Eldon did not consider the investments to be risky for any other reason than the financial burden of the acquisition and the probability of the investment turning out to be unprofitable. The company did not take any country specific risks under advisement since the locations were considered to be similar to Sweden in terms of political and cultural aspects.

Clark and Marois (1996) stated that there are two types of risks that a company should be aware of when investing abroad. Eldon has for natural reasons not been concerned with any types of political risks since the investments have all been made in European countries, which are often perceived as similar to Sweden. Most of the countries are today part of the European Monetary Union (EMU) and there are not differences between the host countries in terms of interest and exchange rates. The only risk which Eldon needed to take into account was the business risk, which is the risk of the venture turning out to be a bad investment.

## 4.2 Carlfors Bruk AB

| | |
|---|---|
| Place of origin: | Huskvarna |
| Established: | 1898 |
| Industry: | Aluminum manufacturing |
| Employees: | 58 persons |
| Turnover: | 120 million SEK (approx. €12.9 million) |

The empirical findings presented in this part of the chapter have been obtained through an interview conducted with Björn Lindwall, controller at Carlfors Bruk AB[6].

Carlfors mainly manufactures aluminum powder and paste for the lightweight concrete and paint industries. The company was founded in 1898 but is located at a site that has been the home of various manufacturers since the 16th century. The company started out as a producer of gold bronze powder, but gradually switched its production towards aluminum based products. The main production facilities are located in Huskvarna and 97% of the company's production is exported to other countries. Carlfors is currently the only producer of aluminum paste and powder in the Nordic countries (B. Lindwall, personal communication, 2005-11-30).

The industry is characterized by fierce competition. An excess supply in the market has since the 90s created a downward pressure of the price. Mr. Lindwall (personal communication, 2005-11-30) says that in recent years there has also been an increase in the competition from companies in low-cost countries, especially China and India. Further, Mr. Lindwall (personal communication, 2005-11-30) explains that the company tries to counter this competition through the manufacturing process. Carlfors has in its factory developed a production system which is highly rational and enables it to produce efficiently. The company has also built up a security concept regarding the products it manufactures, which is unique to the company in some markets. This is a competitive advantage which the company only has compared to some competitors. Mr. Lindwall (personal communication, 2005-11-30) states that a minor competitive advantage that Swedish companies have is that they have a good reputation and that this might help them to do business, compared to companies from other countries.

In the eclectic paradigm Dunning (1988) explains what constitutes a firm-specific competitive advantage and the importance of it. In Carlfors' case the advantage that the company identifies lacks one of the fundamental issues. The competitive advantages that Mr. Lindwall (personal communication, 2005-11-30) states are not sustainable and can be copied by the competitors. Another factor that is not in Carlfors' favor is that the competition within the industry is fierce, and according to Hymer (1960) and Kindleberger (1969) a company should be a part of an oligopoly if they want to conduct an FDI.

[6] subsequently also referred to as Carlfors

Carlfors has made one foreign direct investment in Brazil. The investment is a joint venture, in a Brazilian firm called Aldoro, with two other actors and has been undertaken in two steps. In the 1960s the company was approached by a Brazilian businessman who had a proposition for Carlfors to start a collaboration with a firm in Sao Paolo. In the beginning Carlfors licensed their production to this firm, but in 1975 Carlfors and their partner decided to run the company themselves. At this point Carlfors also invited a German competitor to be a part of this venture in order to widen the knowledge base. Carlfors mainly contributed knowledge to this venture and only had a 22% stake in the company. This collaboration continued until the middle of the 1990s, where Carlfors decided to increase its participation and ownership. The company added capital to the venture and the ownership rose to about 39%. The result of this investment was an ownership structure where Carlfors and the German company both owned 39% while the Brazilian investor had a 22% stake. Carlfors' owners are in the board of directors of Aldoro, and the CEO is a former employee at Carlfors in Huskvarna. Mr. Lindwall (personal communication, 2005-11-30) explains that there are several reasons for both the initial and added investment. First of all, the industry is dependent on a supply of raw materials and Brazil is a very mineral rich country. The Brazilian investor owned many different types of mines, including silver and gold, and Carlfors thought it would be beneficial to start a cooperation with this partner. Secondly, Brazil has very high tolls on foreign goods brought into the country, on some goods as high as 20%, and this created an incentive for Carlfors to operate within the area. Also, the potential market in Brazil was very geographically centered and enabled Carlfors to efficiently serve its customers. Another aspect is that the factor costs, especially labor costs, are lower in Brazil than in the home market. This has been an increasingly important factor in recent years. Carlfors is not actively searching for other opportunities to invest abroad. The industry is very capital intensive and a switch towards foreign production through acquisitions or green-field investments would be too costly. The company does not however exclude the possibility of other joint ventures or a purchase of the Brazilian company.

There are two main motives why Carlfors wanted to operate within Brazil, resource- and market seeking. The industry Carlfors is in requires that the company can obtain minerals used in the production. A foreign investment is often a way for companies to secure the supply of raw materials (Griffin & Pustay, 2002). Since Brazil possesses the minerals needed it proved to be a good investment location from this perspective. The other important aspect of the investment was that the company sought to enter the market, since the customer base was already established. Hood and Young (1979) states that when a country has put up trade barriers the best option to enter that market is through an FDI. The best solution for Carlfors to enter the market was by conducting a direct investment, since Brazil has high trade barriers. The importance of the low labor costs can be discussed, our opinion is that the company would have made the investment even if the costs were similar to the domestic costs. It can be seen more as a positive side effect. The only efficiency seeking motive that in this case affected the decision, in our view, is the lower costs of raw material.

Meyer (1998) states that push factors are particularly strong in labor intensive industries. However, Carlfors is a more capital intense company and it is not as easily affected by push factors in the home market. Although the competition is fierce both internationally and domestically it is not a great factor, for capital intense companies, to move production abroad in order to lower costs. Despite the fact that Carlfors lacks a unique sustainable competitive advantage we argue that it has been fairly successful in exploiting the opportunities of the foreign investment. Also in this case the OLI- framework is only fulfilled in two out of the three advantages Dunning (1988) puts forward.

When looking at the decision to form a joint venture the choice can be seen as rather natural. According to Eiteman et al (2004) a joint venture is usually the best option when a company wants to get an immediate understanding of the market and wants to enter the market through a less capital intense approach. When taking these aspects into account and the fact that Carlfors did not initiate the venture it is an obvious choice of business form. It is interesting though that Carlfors chose to include the German company. Our opinion is that the company did so, not only for the reason mentioned previously, but to also diversify the risk involved.

Mr. Lindwall (personal communication, 2005-11-30) clarifies that there are drawbacks as well when operating in a country like Brazil. Economically, Brazil is a very unstable country compared to Sweden, with a notoriously high inflation. Mr. Lindwall (personal communication, 2005-11-30) states that a market risk premium of 30% is common when investing in Brazil. Further, the country is also seen as relatively politically unstable. Corruption is widespread and part of everyday operations. Carlfors has tried to limit these risks by appointing a Swedish CEO. The company does not however have a strategy for managing exchange rate risks. Mr. Lindwall (personal communication, 2005-11-30) argues that the joint venture is a long-run investment and that currency risks will balance out.

Mr. Lindwall (personal communication, 2005-11-30) claims that the only thing that Carlfors has done to reduce the risk is to appoint a Swedish CEO. It is our opinion that, Carlfors unintentionally has decreased the risk of the foreign investment by choosing a joint venture as the mode of entry. By doing this the company obtained a local partner who had knowledge of the political and economical environment in Brazil.

## 4.3 AB Petterssons Järnförädling

| | |
|---|---|
| Place of origin: | Hillerstorp |
| Established: | 1921 |
| Industry: | Metal refinement |
| Employees: | Consolidated group: 100 persons |
| | Sweden: 76 persons |
| Turnover: | 175 million SEK (approx. €18.8 million) |

The empirical findings presented in this part of the chapter have been obtained through an interview conducted with Hans Irestål, CEO of AB Pettersons Järnförädling[7].

Today, Petterssons is the largest manufacturer of metal hooks and clips for clothes hangers in the world. It originally started out as a producer of metal wire, with products such as

[7] subsequently also referred to as Petterssons

nails and simple kitchen appliances. During the last decade, however, Pettersons has chosen to limit their product range and to niche its manufacturing to only two products. Mr. Irestål (personal communication, 2005-12-05) states that the company's business idea is to develop, produce and sell metal components to the world's clothes hanger industry. The company is currently dealing with 75 different countries and is considered to be the only real global actor in the industry. Pettersons sells directly to its customers in all of these countries except for Italy, where it has an agent due to complicated historical reasons that will not be explained in detail.

Mr. Irestål (personal communication, 2005-12-05) explains that the competition is different when looking at it from a global or local perspective. Since Pettersons is, by far, the largest company within the industry the global competition is very limited. However, the company encounters local competition in the many markets where it is active. These competitors are often smaller, family-owned firms, whereas Pettersons is a corporation, and do not pose a greater threat at a global level. A competitive advantage that Pettersons has is that the company has developed a unique production system. The system provides the firm with a technological advantage and enables high quality and productivity. Another advantage is that since the company is a large firm, compared to its competitors, it has certain economies of scale in the production. It gives the company an opportunity to manufacture large volumes of products at lower average costs. Petterssons highly value the advantages it has and works hard to protect it. The production is taking place behind closed doors and outsiders have restricted access to the production facilities when visiting. Also, the production is located in as few places as possible, at present only in Sweden and China. When Petterssons set up its manufacturing in China the firm chose not to transfer all the technological solutions it had in the Swedish factory. The company felt that the risk of exposing the unique system was too great, and therefore a totally new production concept was developed for the Chinese factory. It contained certain aspects of the Swedish version and other new features available on the market.

Hymer (1960) and Kindleberger (1969) stated a company needs to have a competitive advantage when investing abroad, in order to overcome the disadvantages it faces in foreign markets. The authors also argue that by having a competitive advantage the company is operating within an oligopoly. In our view, Pettersons has a competitive advantage since it is the technological leader of the industry. This is supported by Dunning (1988), who explains that firms which are innovative leaders often have a competitive advantage. Through the unique production system Petterssons has been able to increase the productivity and has made it more difficult for other firms to compete.

Historically, Pettersons has conducted quite a few foreign direct investments. In 1986 the firm acquired a competitor in the English market. This was done to both limit the competition and to expand into the English market. The plan was to manufacture products in the market for a shorter time period, and then close the production facilities and supply the market from Sweden. This concept proved successful and England is today one of the most important markets for the company. A few years later, in 1989, the company purchased an Italian firm. Mr. Irestål (personal communication, 2005-12-05) explains that this investment was a response to increased competition from their Italian counterparts. The Italian firms had different price and marketing strategies, which compelled Petterssons to react in some way. Petterssons response was to open up production facilities in the country and supply the market under similar conditions. This venture never proved profitable and was seen as a failure. In 1994 the plant was closed and the company has since then operated in Italy through a local agent. Around the turn of the century Petterssons recognized that the European market started to become satiated and needed to look at other markets as well. Mr. Irestål (personal communication, 2005-12-05) says that the industry in which Petterssons is operating is closely dependant on the ready-made clothing industry. Since most of the ready-made clothing manufacturers today operate in Asia this region was seen as a natural market for Petterssons to focus on. Another aspect that Mr. Irestål (personal communication, 2005-12-05) pointed out was that the market was expanding rapidly in this region. In 2000 the first step towards operating in Asia was taken when the firm started a sales and marketing department in Hong Kong. Although not a major capital investment, it was an important step for Petterssons since it provided initial access to the Asian markets. In the following years the company gained experience and knowledge of the market, and realized the large potential within the area, especially China. Also, the existing customers in the region requested that Petterssons could provide products faster through a production facility in the region. Consequently, the decision to enter China through an FDI was taken. Initially, the plan was to start a joint venture with a local competitor. However, the collaboration between the two parts did not work as good as expected. Mr. Irestål (personal communication, 2005-12-05) expounds what the fundamental issue of a successful joint venture is with the following statement;

> *"sleeping in the same bed, having the same dreams"*
>
> (Irestål, personal communication, 2005-12-05)

Pettersons felt that the Chinese partner did not have the same aspirations and views of the venture; hence the company rejected the idea of a joint venture. In the beginning of 2004 Pettersons decided to start and run a company on their own in China. Although China has alleviated some regulations concerning investments it is still a complicated process for foreign companies to enter the market. Firms need to apply for a certain license in order to conduct business in China. It took nine months and two employees working full-time to finish the application process and receive the license. During this period Petterssons rented an empty site, and after approval the company started to set up its newly developed production system. Further foreign direct investments are not planned by the company at the present moment since the venture in China is the number one priority. However, Mr. Irestål (personal communication, 2005-12-05) states that the company is interested to invest in other countries in the region. India is seen as a very attractive location because it provides Petterssons with access to a new and large market, not only the country itself but also other states which India currently has a free-trade agreement with.

When looking at the reasons for conducting an FDI that Li and Clarke-Hill (2004) have presented the market seeking motive is the one most applicable to Pettersons. In two of the investments made by Pettersons the aim has solely been to enter the market. In England the determinants were the size of the market and a desire to limit the local competition. An acquisition enables a firm to get full control and will not create additional competition in the market (Buckley, 1981; Butler, 2000). From a theoretical point of view, Pettersons made the right decision when choosing to enter the market through an acquisition of a local firm, since this type of entry would bring with it the benefits the company was looking for.

The Chinese investment was also made in order to get a physical presence in the market. There are however some other determinants that influenced the company's decision. First of all, the major factor that Petterssons sought was access to a large and growing market. Secondly, industrial linkages also created an incentive for the firm to be present in the market since all the major customers had established production in China. The failure of the initial attempt to start a joint venture is an example of the importance to find the proper local partner (Griffin & Pustay, 2002). We argue that it was beneficial for the company that the joint venture turned out to be unsuccessful. In fact, we believe that the decision to undertake such a venture is somewhat strange, since Petterssons has stated that it wants to protect its competitive advantage. A green-field investment is a better option since it enables the company to keep full control of the venture and its assets. It also has other advantages since it allows Petterssons to expand at a pace which is consistent with the growth of the market. This type of entry mode enabled Petterssons to build the new production system from scratch (Buckley, 1981).

The Italian investment was a response to the local competition. Although the motive behind the investment was mainly market seeking, the company had efficiency seeking motives since it wanted to acquire the same production costs as its Italian counterparts. The attempt was a failure, and we argue that this was due to the fact that Petterssons strayed from its competitive advantage and tried to compete with the same advantages that the Italian firms possessed. However, the Italian firms had more knowledge and information of production in this market.

The factors that have influenced the company to expand its international operations have been pull factors in foreign markets (Meyer, 1998). Petterssons did not experience a pressure to expand abroad, but instead saw opportunities in foreign markets. We argue that, besides the geographical limitations of the home market, there are no major circumstances that have affected the company's decision to move abroad.

When applying the eclectic paradigm, developed by Dunning (1988), on Petterssons decision to conduct a foreign direct investment, we argue that all the factors are present. The company has a sustainable competitive advantage and through this Petterssons has almost acquired a sort of monopolistic power in the market. Also the locations provide the company with incentives for production and internalization advantages is a decisive factor when selecting entry mode.

Pettersons was aware of the risks inherent with an investment in Asia, and China in particular. China is a non-democratic, capital-communistic state run by an elite within the governing party which makes it a very politically unstable country. Seeing that it is not a democratic state there is a risk of a sudden change in the political environment, which could ultimately be disadvantageous to foreign investors. China is a very underdeveloped country in many areas. The financial system in the country is very different compared to the western world. It is virtually impossible for firms to receive any financial assistance in raising capital for investments. Also, the payments are often not handled through banks but are actually physically retrieved at the location. Petterssons does not rely on banks for anything other than transactions services. Another risk is that the legal system is not developed and there is not a fully developed system for protection of immaterial rights. The risk that Petterssons feared the most was the technology transfer risk. This is why the firm developed a new production concept.

The political risk is the probability of a change in the political system of a country which will ultimately lead to disadvantages for a company (Butler, 2000). Considering the political risk, China is probably one of the most risky locations available. The political environment is highly unstable and the judicial system is unsupportive when it comes to foreign owned firms. We argue that Pettersons is probably correct in its assumption that the technology transfer risk is the most prominent one. An analysis of how Petterssons has dealt with the risk will lead to the conclusion that it has not made any other decisions than protecting the technology. Granted that political risks are hard to defend against and the financial risks are limited since the domestic financial system is used, the overall benefits are perceived to outweigh the disadvantages of doing business in the region.

## 4.4 IDAB WAMAC International AB

| | |
|---|---|
| Place of origin: | Eksjö |
| Established: | 1960 |
| Industry: | Mail-room systems |
| Employees: | 80 persons |
| Turnover: | 200 million SEK (approx. €21.5 million) |

The empirical findings presented in this part of the chapter have been obtained through an interview conducted with Lennart Svensson, financial manager at IDAB WAMAC International AB[8]

IDAB manufactures products for the newspaper printing industry. The company is one of the leading firms in the world within this business and it specializes in manufacturing equipment for the post-printing process and handling of the papers. The machines produced can be used for a wide variety of purposes, such as packaging, counting, conveying, stacking and folding the newspapers. IDAB has operations around the world and offers a large number of different mailroom equipment and systems, where the ultimate goal is to provide newspapers with a system which will increase the productivity. The company originally started out as a contract manufacturer in the 1960s by two entrepreneurs. In the 70s the two contractors decided to start their own production and the company became solely occupied with producing its own products.

The company is currently operating in a number of countries in addition to Sweden. These countries are mainly located in Europe and Asia where IDAB are considered to have its main markets. The industry is made up of a four large actors which are able to provide fully developed systems, and a number of smaller companies that manufacture certain components or parts of systems. IDAB is one of the few firms that produce total solutions and it is one of the more prominent ones. The overall competition in the market is extremely fierce. The four main actors have great knowledge of each other and they all compete in the same markets. In recent years the price of the products has been a major factor when competing for customers, while technological solutions historically have been an important aspect. The main competitive advantages that Mr. Svensson (personal communication, 2005-12-06) identifies are a flexible organization which enables the company to adapt to the needs and requirements of the customers. In addition to this, the company is on the forefront of developing technological innovations in the production which enables the company to provide customers with machines and systems that are faster than its competitors. The costs of production are, in terms of labor costs, not an important factor for the

[8] subsequently also referred to as IDAB

company. Although it ultimately affects the prices of the product, its main competitors operate in Switzerland were the production costs are even higher than in Sweden.

Acs et al (1997) identified that smaller firms often have an advantage compared to larger firms in terms of being innovative. The size and flexibility of the firm enables IDAB to be one of the technological leaders in the industry. One might argue that this is not sustainable in the long-run and does not constitute a real competitive advantage. However, we argue that it provides the firm with an advantage compared to its competitors. Dunning (1988) argued that technology leaders have a great advantage in international markets. By having this advantage IDAB will be able to compete successfully even in foreign markets were it is at a disadvantage, in terms of local knowledge and information of the market. IDAB also identified that the flexible organization in itself was a competitive advantage, since it enabled the company to supply its customers more efficiently. We believe that the flexibility is a pre-requisite for innovation, but is not really a competitive advantage on its own. An interesting point in the discussion about competition is that the company is operating in a market characterized as an oligopoly where price is the main competitive weapon.

IDAB has several subsidiaries in foreign countries. The company has invested in several locations all over the world; with an emphasis on the target markets identified namely Europe and Asia. In Europe, the international expansion has primarily been through capital investments in sales subsidiaries. England and Germany are two European countries were the company has a physical presence. The most recent foreign direct investment has been undertaken in India. Mr. Svensson (personal communication, 2005-12-06) states that India is a very important market with a large potential for the future. Newspaper manufacturing in India is becoming an increasingly automated process and the potential need for effective machinery is seen as an important factor. There were several other important determinants in India that persuaded the company to invest. First of all, IDAB is already the market leader in the country but in order to expand their market share the company needed a presence in India. An increasing need of information among the growing middle-class is consequently increasing the number of newspapers in the country. However, these newly started newspapers are often small and lack the financial ability to import products directly from IDAB and their Swedish factory. Therefore, it was imperative that the company established itself physically in the market. An aspect of this is that India has very high tariffs put on goods exported to the country, often as high as 50%, which makes it virtually impossible for IDAB to supply these smaller customers at a reasonable price. The company sees great potential with a direct investment in India and expects that there are about 1000 customers currently unsupplied in the market. There are also inherent advantages of investing in India. The country is part of a free-trade alliance with the neighboring countries which opens up a large potential market for IDAB. By investing in India, the company will be able to establish a base of operations within the region and circumvent the high tariffs in these countries as well. When deciding to invest in India the company looked at different options on how to go about investing. Mr. Svensson (personal communication, 2005-12-06) explained that IDAB looked for a quick and easy entry into the market. An acquisition of a company or product facilities was not found to be a good alternative, since it would require time to gain full capacity and establish a customer base. Instead, IDAB approached one of its local agents with a proposition of a joint venture. By undertaking a joint venture the company was able to gain productive capabilities and tap into the agent's existing customer network. IDAB currently owns a 30% stake in the company, but has through extensive contracts ensured control over the production. IDAB felt that it needed assertion that the quality of its products could be maintained and that it could influence the direction of the venture. Mr. Svensson (personal communication, 2005-12-06) states that even though the ownership is only 30% all major decisions are made in collaboration. IDAB is constantly reinvesting the profits of the venture and the aim is to reach an ownership of 50% in the company.

When comparing the reasons for a foreign direct investment that IDAB has stated above with the motives recognized in the frame of reference, one can argue that IDAB has made investments mainly because of market seeking motives. When investing in the European countries, England and Germany, IDAB wanted to access the markets because it sought to benefit from certain aspects present in the markets. Both markets had determinants identified by Li and Clark-Hill (2004) that were important for the company's decision to invest. The markets were attractive due to the size and by establishing a physical presence in the countries IDAB had an opportunity to combat the local competition. The investment in India was made because of several reasons. Primarily, the investment was made for market seeking reasons since IDAB identified that the market was large and had a great potential for growth. Further, an FDI is sometimes the only sensible option if trades barriers exist which limit the cross-border trade (Hood & Young, 1979). IDAB recognized India's restricting import barriers and needed to establish production in the country. Also, by producing in India it will gain access to other regional markets. We argue that the decision to conduct an FDI through a joint venture is a rational option in the sense that it acquired knowledge of the local conditions. However, a joint venture is not always the best option when a company wants to protect a competitive advantage like the one that IDAB has. An acquisition of a firm would have been a better option, from a theoretical perspective, since it would have internalized the competitive advantage.

The factors which have influenced the company to invest abroad have been pull factors (Meyer, 1998). In all cases, there have been factors present in the host countries which have influenced the company and provided it with incentives to expand abroad. IDAB has not experienced any factors in the domestic market which have forced the company to move abroad. In fact, the company claims that the domestic location enables it to produce more cost efficiently since its competitors operate in countries which are even more disadvantageous than Sweden.

India is usually considered to be a developing country and it lacks certain aspects that western companies often take for granted. There are problems in the banking system which makes it hard for companies to transfer money from India. Mr. Svensson (personal communication, 2005-12-06) explains that this is another reason why the profits are reinvested into the company and views this as a financial risk. Another risk that the firm identified early on was that the quality of the products may decrease when producing in the country. In order to ensure a higher level of quality, the company supplied the technology needed for production. However, this created a new problem for the company. IDAB was concerned that the technological solutions could be copied or sold to competitors. To solve this problem the company has created clauses in the production contracts that state the rules of conduct and punishment if the boundaries are breached.

We claim that risks in the host country were not a major factor which the company took into account when conducting the investment. Although the firm was aware of the risks inherent of an investment in India, it does not seem to have had a clear strategy how to handle the financial risk. It as been more focused on reducing the risk of technology transfer.

## 4.5 RH Form AB

| | |
|---|---|
| Place of origin: | Bodafors |
| Established: | 1977 |
| Industry: | Office furniture |
| Employees: | Consolidated group: 120 persons |
| | Sweden: 80 persons |
| Turnover: | 267 million SEK (approx. €28.7 million) |

The empirical findings presented in this part of the chapter have been obtained through an interview conducted with Stefan Lundmark, financial manager at RH Form AB[9].

The company was founded in 1977 by Rolf Holstensson, who saw the need for ergonomic chairs in the workplaces. The founder developed, in collaboration with ergonomists, a chair that enabled people to sit in a way that was ergonomically correct. The first product that was manufactured was unique at the time and become an immediate success. RH Form has tried to maintain the innovative spirit of the founder when developing new products and strives to be on the forefront in production. Today, RH Form is one of the largest manufactures of chairs and has an extensive range of products.

The industry is characterized by a high level of competition, especially in the Swedish market. RH Form competes with many large office furniture manufacturers in the home market, where the biggest competitors are Kinnarp's AB and IKEA. Mr. Lundmark (personal communication, 2005-12-05) further explains that competition from local and domestic producers also stretch beyond the Swedish border. Many of the firms have invested abroad and are present in several foreign countries. There is also fierce competition in some of the local markets abroad, especially in England and Holland. RH Form has tried to tackle both the international and domestic competition through the design of its products. Where most the other companies manufactures all sorts of office furniture, RH Form has chosen to niche its production and focus solely on ergonomic chairs. The focus on ergonomic chairs has been a success, and has created a competitive advantage compared to its competitors. RH Form has many patents on the design and manufacturing process of the chairs.

In the theories concerning foreign direct investments presented by Hymer (1960) and Kindleberger (1969) the authors express the importance for a firm to have a competitive advantage when investing abroad. It is not so easy to see if RH Form has a competitive advantage or not. One could argue that because of the patents the company has it can protect its products and thereby possess a sustainable competitive advantage. However, the patents do not stop other firms from starting to produce chairs that are ergonomically designed. RH Form might have a competitive advantage now, but it is not certain that this advantage is sustainable. From a theoretical perspective this is supported by the fact that the market RH Form is operating within has many competitors. Hymer (1960) and Kindleberger

[9] subsequently also referred to as RH Form

(1969) argue that if a firm has a competitive advantage this will push smaller competitors out of business.

RH Form has in the last few years started to focus more on the international markets. The firm has increased its exports and has opened up subsidiaries in other European countries. RH Form is using several retail dealers, both domestically and internationally, to get its products on the market. Most of the international subsidiaries are meant to function as local sales departments, who in turn establish its own network of retail dealers. These types of investments have been made in Denmark, Norway, Finland and France. Mr. Lundmark (personal communication, 2005-12-05) explains that the investments in the Nordic countries were not very capital intense, but was seen as a cheap and effective way for RH Form to establish a physical presence in the markets. The larger scaled foreign direct investments conducted have been made in England and Holland. These investments have been more capital intense and have been centered on obtaining smaller manufacturing and assembly facilities in these countries. Mr. Lundmark (personal communication, 2005-12-05) says that England was a very important market to gain access to and the demand for the products was present. It had a high level of competition and in order to compete successfully in the market it was imperative that the company established productive capacity in the country. The company made a green-field investment and started the new subsidiary with the help of previous contacts in the country. From there RH Form had a base of operations in the country, and the subsidiary acted as a hub towards the network of suppliers. A similar approach was used in Holland were the company acquired an existing company in order to exploit an existing web of suppliers. The Dutch market had great potential and investments were made to capitalize on these.

Li and Clarke-Hill (2004) present three main motives for a firm to undertake foreign direct investments. The motive for RH Form to be active internationally has been to seek new markets. RH Form has in its more capital intense investments been looking for markets that are large and have great potential. The company has in its goal to enter the English and Dutch markets used two different types of FDI. In England the company already had some contacts and customers so the need to acquire an existing firm with a customer base was not so great. The company therefore chose to do a green-field investment. To undertake a green-field investment can be beneficial for the firm, since it can construct a site that is modern and adjusted for the company (Griffin & Pustay, 2002). In Holland RH Form lacked contacts and knowledge so instead of building a site from scratch the firm acquired an existing company. This is theoretically supported by Buckley (1981) who explains that an acquisition type of entry mode is suitable when a firm wishes to gain an instant understanding of the culture and business environment within the host country.

It is our opinion that RH Form has mostly been seeking new markets due to the fact that the home market is highly satiated. In RH Form's attempts to stay profitable the firm has been pushed into international markets. RH Form has initially started to seek new markets close to its home market and the firm seems to follow the sequential process identified by Johanson and Wiedersheim-Paul (1975) and Johanson and Vahlne (1977).

Mr. Lundmark (personal communication, 2005-12-05) argues that the only risks a company face when investing in countries in Europe is the financial risk of project failure and low profitability. There are no political risks when investing in the aforementioned countries and RH Form is looking at the investments in the long-run, and therefore it does not view currency risks as a factor.

We can only concur with the arguments of Mr. Lundmark (personal communication, 2005-12-05), that the currency risk involved should balance out in a longer perspective. Other risks hold no real importance on the decisions the company has made.

## 4.6 Comparative Analysis

When conducting interviews with the selected respondents, all companies claimed to possess a competitive advantage compared to their competitors. We argue that several of the companies lack a sustainable advantage. The two companies that we have identified as having competitive advantages are IDAB and Petterssons, since they are technological leaders within their respective industries. An interesting point in this discussion is that these companies are the only ones that can be regarded as operating in an industry characterized as at least an oligopoly. This would support the classic FDI theories developed by Hymer (1960) and Kindleberger (1969) that companies with a competitive advantage are operating within an oligopoly. These theories also state that a company must have an advantage in order to successfully compete in foreign markets. However, the three respondents in this thesis that lack a competitive advantage have also been successful in their international operations. This led us to the conclusion that even though a competitive advantage is of great importance and beneficial when possessed, it may not be a fundamental pre-requisite when investing abroad.

Li and Clark-Hill (2004) have identified several motives for a company to conduct a foreign direct investment. We have in our study found that most of the respondents invested abroad in order to enter certain targeted markets, in fact four out of five have stated that this was the primary investment motive. What differ between the companies are the determinants sought in the host countries. The four companies with market seeking motives have all identified the size of the market as an important determinant in the host country. Some firms invest in specific regions or countries because they see a potential for growth in the market. One company stated that industrial linkages were an important factor, since it followed its customers into a new market. One thing that the companies have in common is that they have all identified multiple factors that were important in their decision. Although they initially state the overall motive of investing they often look for several different factors that need to be present in the host country. One of the respondents had dual motives for investing abroad. Carlfors had a combined desire to access a market and to acquire resources.

The choice of which type of FDI to employ when conducting the investment is more diverse. In our study we have not found one single type of investment which is more preferred than others. The type of entry mode is usually a reflection of company- and country specific factors. In this thesis two companies have opted to invest abroad through joint ventures. These investments have been made in countries that are considered relatively risky, in terms of political and financial risks. Joint ventures are not only less capital intense but also a good way to gain knowledge of the local market conditions, and thereby decreasing the perceived risks. Two of the respondents have chosen to enter markets through green-field investments; however the reasons behind the choice of entry mode differ. In Pettersons' case this type of investment was ultimately seen as the best option as the firm wanted to have control and set up a new production system. For RH Form the choice was based on the fact that the firm already had some contacts and customers in the country, and therefore seen as a cost-effective way of establishing itself in the market. Acquisitions have been made in European countries, which we argue may be a result of the perceived low risks and attempts to gain knowledge of the local market. Although acquisitions can be the most costly type which carry a certain amount of financial risk, countries in Europe are considered to be similar to the home market and therefore less risky.

Out of the five companies studied, four have been influenced by pull factors in their decisions to invest abroad. They have seen opportunities in international markets which have created incentives for the companies to conduct a foreign direct investment. The firms mentioned push factors as well such as fierce competition and high production costs, these were however not the decisive factors. Only one company, RH Form, has experienced that changes in the business environment has been the most influential factor when deciding to invest abroad.

It is our opinion that the companies have not viewed risk as an important factor when investing abroad. The companies are aware of the risks of cross-border investments and attempts are made to limit some risks. Risks have not however been a factor which has deterred firms in their decisions to invest.

# 5 Conclusions and General Discussion

*This chapter will present the conclusions drawn from the research, and will ultimately answer the purpose of the study. Critique of the study will also be introduced and the chapter will end with suggestions for further studies.*

## 5.1 Conclusions

The purpose of this study was to describe the reasons and factors behind a foreign direct investment undertaken by medium-sized manufacturing firms in the Jönköping region. We argue that by answering the following research questions the purpose has been fulfilled.

***What are the main motives behind a decision to conduct a foreign direct investment for medium-sized companies in the Jönköping County?***

Since four out of five selected respondents have stated the same main motive for an investment abroad, we believe that we have a foundation for making a generalization about the underlying motive. We have found in our study that companies in the Jönköping region most likely conduct foreign direct investments in order to enter certain targeted markets. That is, FDIs are made primarily for market seeking reasons. Determinants that companies look for in the host country are mainly market size and growth.

***What factors are important when medium-sized companies in the Jönköping County choose type of FDI?***

Although the main motives behind the investment are similar for the respondents, the choice of type differs in some cases. We have identified that companies mainly base their decision of type on the following factors: quick entry, market knowledge, existing customer base, and risks. Joint ventures are preferred when companies face risks and have limited knowledge of the market. If the companies have had market knowledge and an existing customer base, a green-field investment has been made. Acquisitions have been made in order to quickly establish the companies in the market and acquire a customer base. Further, acquisitions have been made exclusively in European countries where companies perceive the risks to be low.

***Are the factors in the domestic or host market most influential in the company's decision to conduct an FDI?***

We have found that the factors in the host markets are most influential in the decision to invest abroad. Foreign direct investments have been made in order to benefit from opportunities that exist abroad. The only push factor we have identified is competition in the domestic market, but we do not see it as the main reason for investing in other countries.

***How are the risks involved an important factor when deciding to conduct an FDI?***

The respondents in this study have not viewed risks as an important factor when choosing location. Companies are aware of the risks of investing in certain locations, but do not seem to discard certain locations because of the risks. Instead, companies try to minimize the country-specific risks by selecting the appropriate type of FDI. After the investment the respondents actively work in various ways to handle and limit the risks.

## 5.2 General Discussion

Before conducting this study we had a notion of why Swedish companies invested abroad. Like many others, we thought that the tax system and high wages more or less forced companies to move production abroad in order to stay profitable. The general discussion in the media about FDI is usually focused on companies moving to low-cost countries to cut production costs. Therefore, the results of this study were quite surprising to us. The fact that none of the companies identified efficiency seeking motives for conducting an FDI is interesting. Even though some companies have invested in low-cost countries the main motive has been to enter the market, and low factor costs have just been a positive side effect. One reason for this outcome is, as we see it, that all the companies still have production in Sweden. When firms invest based on efficiency seeking motives they usually close production in the home country. We believe that there are a few additional reasons why the companies have chosen not to move their production in the first place. First of all, companies in this region are somewhat reluctant to move their production, since they feel that they have a certain social responsibility. It is not rare that companies in smaller communities are the largest employer and a corner-stone in the local society. Also, companies might experience that high production costs can be dealt with by increasing the productivity through technological solutions.

Another result that differed from what we expected was how companies viewed the risks. After reviewing the theories of FDI we learned that many authors see risks as an important factor when companies choose location. The reason for including risks in this study was based on the idea that the country-specific risks would affect the decision to invest or not. However, the results we got did not support this, since the respondents did not discard locations because they were seen as too risky.

There are a few theoretical aspects in this thesis we think is interesting to mention. When looking at the classical theories of Hymer (1960) and Kindleberger (1969) and what we concluded in the comparative analyses, we believe that these theories have lost some of its explanatory features and should be revised. Firms without a sustainable competitive advantage can also be successful in their investment abroad. Another theory that we want to discuss is the Uppsala school. We only found one firm that seem to be following the sequential process identified by Johanson and Wiedersheim-Paul (1975) and Johanson and Vahlne (1977). We do not want to generalize this too far and claim that the theory holds no importance, but a lot has happened in Europe since the 70s and maybe some aspects of the process are different now. When this theory was introduced only a few countries were mentioned as being similar to Sweden, and would therefore be the first step in a firms aim at becoming international. However, since EU has evolved Sweden has become less alienated to Europe and we argue that most of the countries within the union can in many ways be seen as similar to Sweden. Further, becoming international today might not be as remarkable as it was then, and therefore companies do not have the same need to be cautious and move in incremental steps. We find that the critique which has been introduced towards the sequential process in the frame of reference is in our study warranted. These theories have in our view evolved from explaining the entire process to explaining the aspects of internalization. By this we mean that when looking at figure 3.1 one can get an understanding of all the parts, rather than explaining how companies go about internationalizing.

We believe that there are certain theories that are size related. In this thesis transaction cost theories have been included in the theoretical framework, but have proven to be of no real significance for companies in their decisions. In retrospect, we argue that these theories are more applicable to larger companies since they would have the financial strength to purchase smaller suppliers. Medium-sized companies might find it hard to acquire a company of relatively the same size for transaction cost reasons. Also, when reviewing the OLI-paradigm we find that it might be a useful tool to analyze the strengths of the company. It is not however very useful when trying to explain why SMEs undertake FDIs since these companies often lack real ownership advantages.

## 5.3 Critique

The theoretical aspects mentioned in the section above can also be seen as critique of our choice of theoretical framework. If we were to conduct the study again we would discard certain theories and focus more on others. The problem is that few theories exist on foreign direct investments done by smaller companies and our frame of reference has been based on general FDI theories. These theories have often been developed through studies of large corporations and therefore we saw the need to develop a wide frame of reference which would capture SME aspects as well.

In this study we have chosen not limit the research to one particular manufacturing industry. Some decisions made by companies when investing abroad may be industry specific. For instance, some industries are raw material dependant and often invest abroad in order to acquire or secure supply of these assets. This might mean that it can be hard to compare the decisions made by companies in different industries. However, we argue that if one is aware of these differences and think about them when analyzing the results, it is possible to make a comparison. If one views the results in this study where five different industries are represented, it is fairly obvious that the industry specific aspects have little meaning. This conclusion can be made since four companies from different industries have had the same reason for investing abroad. We can not guarantee that the results would be the same if the research would be made using different respondents, and therefore the reliability may be questioned. However, this problem is common in qualitative studies.

## 5.4 Further Studies

During the course of this study we have encountered some questions that would be interesting to investigate further. These queries could form the basis for other studies within the field of FDI. The questions we found were:

- What are the reasons and determinants for foreign owned firms to invest in the Jönköping region?
- What would the results be if our study were carried out using a quantitative method?
- Would our results be different in another part of Sweden, e.g. in one of the larger cities?
- What would the results be if we had limited our study to one industry?

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# Appendix A: Interview Guide

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## General Questions

Please tell us about the company, in terms of:

- History
- Industry
- Products
- Employees
- Turnover

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## Foreign Direct Investment

1. How would you characterize the competition in the company's markets?
   - ✓ Does the company have a competitive advantage?
   - ✓ How does the company protect this?

2. In what countries is the company currently operating?
   - ✓ How is the company operating in these countries, exports, manufacturing etc?

3. In what countries has the company made foreign direct investments?
   - ✓ What factors did the company look for in the host country?

4. What reasons did the company have to conduct a foreign direct investment?
   - ✓ How has the business environment in Sweden affected the company's decision to invest abroad?

5. How did the company choose location?
   - ✓ What type of business has the company had in the country prior to the investment?

6. How did the company conduct the foreign direct investment?
   - ✓ Acquisition, green-field or joint venture?
   - ✓ What was the process of the investment?

7. What types of risks did the company identify?
   - ✓ Financial or political?
   - ✓ How did the company handle the risks identified?