Münsteraner Schriften
zur Internationalen Unternehmensrechnung

IUR

Herausgegeben von Peter Kajüter

Thomas Poplat

Foreign Investments in BRIC Countries

Empirical Evidence from Multinational Corporations

Band 10

PL ACADEMIC RESEARCH

1 Foundation

1.1 Introduction

1.1.1 Motivation and research goals

> *"Today the changing nature of competition and the increasing pressure of globalization make investment the most critical determinant of competitive advantage."*[1]

In 1998, *Michael E. Porter* – who is one of the most-cited strategy researchers – already highlighted the importance of investment decisions within increasingly globalized economies for creating and defending competitive advantages. In 2013, globalization has entered a new phase in which the global economic power is shifting to emerging economies.[2] As a consequence, this **rebalancing of the global economy** creates new challenges for internationally operating companies.

According to the *International Monetary Fund* (IMF), 2013 is expected to be a turning point within the world economy. In this year the industrial production of emerging markets will overtake those of the developed economies[3] for the first time in history. In 2020, almost 50% of the worldwide GDP growth will be attributed to the **BRIC** countries[4]. The dynamic economic development will inevitably create emerging market multi-nationals (EMNCs)[5] which are serious competitors in their host markets. Moreover, these national champions will seek to dominate their industries on a global scale.[6]

In return, multinational corporations (MNCs) take their business overseas to the developing world in order to strengthen their positions in growth markets. However, developing markets also entail **significant risks**. In particular, BRIC investments are exposed to various challenges, as institutional voids, host governments and "national champions" dictate local business conditions for MNCs.[7] The failure of the *ThyssenKrupp* investment in a steel plant in Brazil is a current example in this respect.[8] Therefore, it seems necessary to design systematic investment decision processes to mitigate these arising risks and exploit upcoming opportunities.

---

1 *Porter* (1998), p. 431.

2 Cf. *Roberts* (2011), p. 6. The terms "emerging" and "developing" economies, markets or countries will be used interchangeably hereafter.

3 The terms "developed" and "advanced" economies, markets or countries will be used synonymously in the following.

4 The acronym BRIC means Brazil, Russia, India and China and was invented by Jim O'Neill, a chief economist at *Goldman Sachs* in 2001; cf. *O'Neill* (2001).

5 Emerging market multinational (EMNC) will be used for multinational corporations having their origin in one of the BRIC countries.

6 Cf. *Khanna/Palepu* (2006), p. 62.

7 Cf. *Holtbrügge/Baron* (2011), p. 109.

8 For a documentation of *ThyssenKrupp's* investment project in Brazil see *Blasberg/Kotynek* (2012).

Yet, investment decision-making is not solely germane to implement corporate strategies and create future performance potentials from a firm-level perspective but is also a main determinant for the overall **economic development** and **social well-being**, e.g. by creating new employment.[9] Foreign investment projects are not always positively perceived in the home country due to the associated negative consequences for domestic corporate locations, such as relocations of labor to foreign low-wage countries. But in particular **German MNCs** are able to offset or even overcompensate their domestic declining demand by strengthening their international presence in emerging economies, as it can be observed during the recent European sovereign-debt crisis. This illustrates that foreign investment projects may have positive influences on the domestic position of MNCs and their environment due to stabilizing effects from foreign activities and growth markets.

The increasing practical relevance of foreign investments in Germany is also underpinned by the significantly increasing **foreign direct investment (FDI) activity** of German firms. The total outward FDI flows of German companies rose from USD 39 billion in 1995 to its peak of USD 164 billion in 2007.[10] The cumulative outward stock of German FDI amounted to USD 1.4 trillion in 2011.[11] These numbers indicate Germany's long-term globalization process. In contrast to small and midsize companies (SMEs) from other countries, German SMEs managed to emerge as world leaders in their niche markets.[12] This tendency may explain that the country was the world export champion between 2003 and 2008.[13] Thereby, exporting generally represents a preliminary stage of internationalization with further resource commitments – such as Greenfield investment or cross-border acquisitions – as foreign market know-how increases.[14] Therefore, the number and volume of FDIs is expected to further increase in the future.

However, as opposed to foreign entry modes with lower resource commitments, FDIs involve **complex decision processes**. A variety of investment configuration decisions has to be made, e.g. the target market selection, which are not relevant for domestic investments. Due to the international dimensions further external influences, such as exchange or inflation rates, have to be controlled.[15] Process complexity and **uncertainty** are driven by multiple agency-relations, unfamiliar economic environments or cultural distances, to name just a few.[16] Surprisingly, the review of prior research indicates that foreign investment decision processes within MNCs are almost unexplored. *Swoboda* criticized that the international management literature fails to provide practical recommendations concerning the design of internationalization processes.[17] From a

9 Cf. *Harris/Raviv* (1996), p. 1139.
10 Cf. *OECD* (2010b), p. 81.
11 Cf. *UNCTAD* (2012), p. 173.
12 Cf. *Simon* (2007a), p. 11.
13 Cf. *Jeremias* (2012), p. 239.
14 Cf. *Mutinelli/Piscitello* (1998), p. 495.
15 Cf. *Becker* (2005), p. 2.
16 Cf. *Fox* (1999), p. 47.
17 Cf. *Swoboda* (2001), p. 4.

theoretical point of view, foreign investment decision processes offer a variety of interesting research aspects due to their multidisciplinary nature.

Nonetheless, prior research is biased by focusing too narrowly on the investment decision evaluation with more or less sophisticated capital budgeting techniques. However, the investigated theory-practice gap of the 1970s – between theoretically proposed and practically applied capital budgeting models – was closed by the development of computer technologies and the rise of consulting firms which accelerated the **diffusion of sophisticated capital budgeting tools**.[18] Furthermore, this work takes the view that shareholder value is not solely created by applying sophisticated capital budgeting methods, but particularly through the investment case development in creating shareholder value accumulation. For this reason, this study is primarily interested in gaining a deeper understanding of the investment decision process as well as the underlying critical success factors.[19]

Certainly, investment decisions rely on business experience and intuition. But irreversible strategic investments involving high capital expenditures (Capex) should be thoroughly reflected, prepared and decided. For instance, *Barkema et al.* identified that it is crucial to adapt management tools to the challenges of internationalization in order to create shareholder value via foreign direct investments.[20] Structured investment decision processes and sophisticated capital budgeting models are assumed to be capable of supporting these requirements. Thereby, MNCs have to balance the conflicting demands of **decision process speed** and **decision process comprehensiveness** to keep pace with the dynamic environment within the BRIC countries.

To sum up, only a few studies have been undertaken to understand unfolding foreign investment decision processes within MNCs, so that the present work intends to address this research gap. Due to the low state of exploratory research and the high practical relevance of emerging market investments, the **overall objective** is to investigate decision processes for cross-border investments into BRIC countries in its real-life context within MNCs. This general goal can be divided into three sub-goals:

- The **first sub-goal** is to describe the foreign investment decision process of multinational corporations. Therefore, a multiple case study design is applied to empirically investigate two company-specific foreign investment decision processes. A cross-company analysis intends to explain process-related similarities and differences. Subsequently, critical success factors for the design of investment decision processes are discussed against the theoretical foundation **(firm-level)**.
- The **second sub-goal** is to explore country-specific challenges related to Greenfield investment projects in BRIC countries. Based on the investigated BRIC investments within the two MNCs, country-specific challenges are described and compared by political-economic and socio-cultural aspects **(country-level)**.

18 Cf. *Haka* (2007), p. 705.
19 Cf. *Mittermüller/von Nitzsch* (2008), p. 779.
20 Cf. *Barkema et al.* (1997).

- The **third sub-goal** is to evaluate country-specific challenges along the investigated foreign investment decision processes by consolidating the firm-level and country-level results of the two preceding sub-goals. Thereby, the influence of the country-specific challenges on the identified critical success factors is discussed to draw analytical recommendations for the design of decision processes for investments in the BRIC countries **(cross-level)**.

To achieve these goals, foreign investment decision processes and their underlying success factors are empirically investigated in two German MNCs by applying a multiple case study design. Country-specific challenges for foreign MNCs are explored by focusing on interviews regarding investment projects targeting BRIC economies. This study aspires to reach **practical relevance** by identifying elements of the decision process that are critical for foreign investment strategies in BRIC countries. Country-specific challenges are evaluated according to their importance for the investment decision process.

The **theoretical relevance** arises due to the low state of research regarding foreign investment decision processes in MNCs. Furthermore, the future economic importance of the BRIC countries creates the necessity to deal with their country-specific challenges and related solutions to cope with them. Therefore, business administration – as an applied science – should deliver starting points for managers to overcome these country-specific challenges. Building on this, the **main contributions** of this study are threefold. First, this study contributes to a more **comprehensive understanding** of foreign investment decision processes in MNCs based on a broad interview database. Second, **BRIC country challenges** are explored for the first time taking a German MNCs perspective, so that results may differ compared to studies based on Anglo-American MNCs. Third, this investigation provides a **multi-perspective view** on foreign investment decision processes by analyzing interviews with managers, business developers and management accountants in order to consider the interdisciplinary character of the research object. Due to the practical barriers in business administration of gaining access to qualified interviewees, the broad and differentiated interview data base represents a strength of this study.

To sum up, this process-oriented study[21] contributes in gaining a better understanding of the dynamics in MNCs by observing sequences of events and their underlying generative mechanisms that are germane for foreign investments to be implemented in real-life contexts.[22]

---

21 A detailed description of the characteristics of process studies and theories can be found at *Mohr* (1982). One important aspect is to differentiate between a process theory and a variance theory. A process theory aims to explain how certain outcomes come about rather than to explain different variances in outcomes. Similarly, a process theory comprises a temporal order of states and phases rather than relations of dependent on independent variables without temporal structure, c.f. *van de Ven/Huber* (1990), p. 213.

22 Cf. *Tsoukas* (1989), p. 522.

1.1.2 Outline of the investigation

The outline of the investigation is depicted in Figure 1-1 showing that the present study consists of five chapters. Following the introductory elaborations on the research motivation and the underlying goals, **chapter one** continues with a presentation of the main scientific objectives and epistemological streams of business administration in order to position the present work. Subsequently, relevant terms and definitions for the further analysis are elaborated. A basic comprehension of investment decision processes within the context of shareholder-value oriented corporations is subsequently provided. Besides the illustration of a process understanding, this section serves to highlight the interdependent relationship between corporate objectives and investment decisions. The section closes with a brief description of decision parameters that have to be specifically considered within foreign investment decision processes. The investigation proceeds by explaining the background of the BRIC phenomenon and its growing importance for MNCs which represents the main selection criterion for the underlying study. Finally, a research gap is identified by reviewing prior research with respect to foreign investment decision processes.

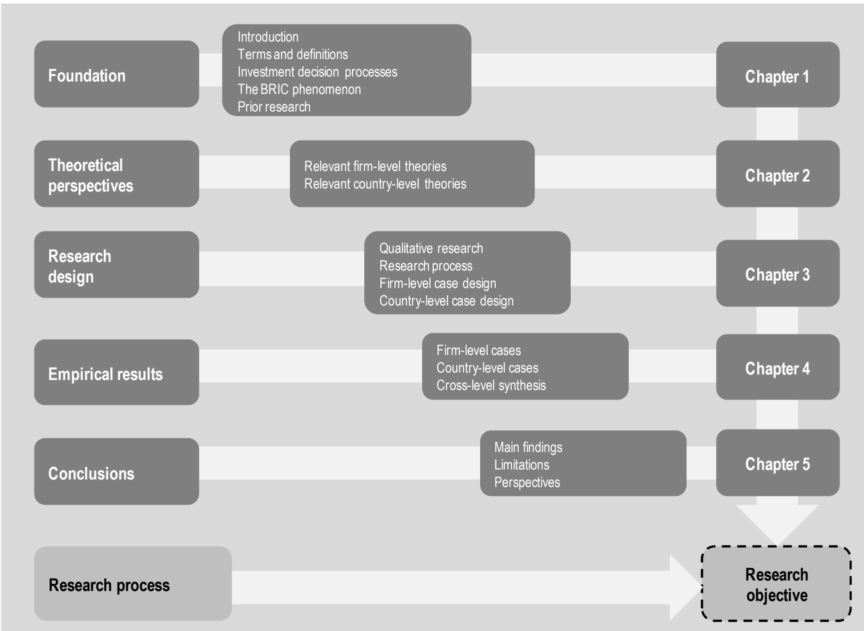

Figure 1-1: Outline of the investigation

Chapter two lays the theoretical foundation of this study. Firm-level theories in general and international firm-level theories are differentiated. The behavioral decision theory, agency theory and the promotor model have been selected as general firm-level theories. Subsequently, two international firm-level theories are introduced. The behavioral theory of *Aharoni* and the internationalization process model of the *Uppsala school* are explicitly concentrated on internationalization processes on the firm-level. This “analytical toolkit” or “theoretical lens” serves to analyze the empirical findings on the firm-level against this theoretical background. The next section presents relevant country-level theories which focus on explaining why and how country-specific challenges are related to foreign investments. Moreover, these concepts are introduced in order to highlight the influence of the internationality on the investment decision process and why country-specific challenges in the BRIC countries can be expected.

The research design of the present work is presented in **chapter three**, which is split into four major sections. In the first part, a brief overview of qualitative research and its underlying research principles is given. Characteristics of case study research are elaborated by illustrating alternative research design configurations. The selection rationale for the case study method in the present research context is disclosed thereinafter. Subsequently, the research process is revealed by describing the data collection and data analysis procedures. The specific firm-level and country-level case designs are elaborated in the last two main sections in chapter three.

Chapter four presents the empirical results in three main sections. First, the firm-level case study results are described in order to achieve the first research objective. For this, the two case studies of the German MNCs focus on delivering a detailed description of the company-specific foreign investment decisions processes. Subsequently, critical success factors of investment decision processes and company-specific process differences are discussed against the background of the introduced firm-level theories. The second section presents the empirical results on the country-level to indicate country-specific challenges for MNCs in the BRIC countries. In order to accomplish the second research objective a following cross-country discussion confronts the country-specific political-legal as well as socio-cultural challenges. Chapter four closes with a cross-level synthesis by consolidating the firm-level and country-level results to achieve the third research objective.

The detailed empirical results disclosed in the preceding chapter are briefly summarized in **chapter five**. Based on the empirical findings, managerial implications are derived for those corporations which consider investing in BRIC countries or other emerging economies. Moreover, the empirical findings shall deliver implications for invested MNCs to improve the performance of their foreign business in BRIC countries. This work has to be measured against the aspiration to achieve practical relevance or usefulness. The investigation closes with a discussion of its limitations and suggestions for further research.

1.1.3 Scientific positioning

This section serves to briefly introduce the philosophy of sciences and the underlying scientific position of the present study. Philosophy of sciences (“science of science”) involves the question of *how* scientific progress can be achieved and new knowledge can be obtained. For this reason business administration as a centerpiece of economic sciences is subject to considerations of the philosophy of science.[23] Philosophy of science can be classified as a **meta-scientific discipline** to the individual sciences because it reflects what science is and what science could be. It articulates hypotheses about the science itself. In addition, the philosophy of science deals with the term, the classification, the principles of knowledge, the methods, the languages, the assumptions, the objectives and results of the single scientific disciplines.[24]

The discussion of objectives and basic procedures of science to generate knowledge are also parts of the philosophy of science. Science is not exercised as an end in itself, but to pursue designated objectives. For science in business management **four main objectives** prevail.[25]

(1) **Descriptive target of science**: A fundamental target of sciences in business management is the precise description of the subjects under consideration. In order to create a clear communication, terms, elements and features in business management must be defined.

(2) **Theoretical target of science**: The explanation and prediction of the subjects under consideration are elements of the theoretical target. For this reason, theoretical statements must be formulated as hypotheses ("cause-and-effect-relationships").

(3) **Pragmatic target of science**: If research in business management aims to provide decision support, a pragmatic target of science is followed. Through predictive abilities of a theory, recommendations for the composition of corporate structures can be derived. The former "cause-and-effect-relationships" are transformed into instructions for achieving practical objectives.

(4) **Normative target of science**: If science claims to articulate values how a corporation *should* act in specific contexts, an exchange between practice and theory is needed. These statements are usually not based on empirical data.

This work pursues an explorative descriptive target as corporate investment decision processes are reconstructed in their real-life context and country-specific challenges are presented. Furthermore, this study aims to provide recommendation with respect to efficient decision process designs. In order to highlight *how* these new insights can be gained, the **main epistemological schools** are presented hereinafter. Highly simplified, four epistemological basic positions are identified.[26] The four epistemological schools can be roughly displayed in a two-dimensional coordinate system. *Rationalism* and *empiricism* constitute the dichotomy regarding the importance of **experiences** on the horizontal axis; while *constructivism* and *realism* are the opposites concerning **reality construction** on the vertical axis.

The classical *rationalism* has its roots in the ancient science. Knowledge is based on understanding and logical reasoning, independently of experience. Consequently, the

23 Cf. *Fülbier* (2004), p. 271; or *Kornmeier* (2007), p. 3f.
24 Cf. *Fülbier* (2004), p. 266.
25 Cf. *Schweitzer* (1978), p. 2ff.
26 Cf. *Kornmeier* (2007), p. 29.

strict rationalism is dominated by **deductive reasoning** ("from the general to the specific"). In *empiricism*, the sensory perception or experience are considered as the main source of epistemological progress. In contrast to the rationalism, the empiricism is characterized by **inductive reasoning**. For instance, an explorative investigation of decision processes without a theoretical preconception would be characterized as a purely inductive study. According to the empiricism, theories or rules are derived from a limited number of individual cases (from the specific to the general). This work combines deductive and inductive elements by developing an investment decision process model prior to the empirical investigations which is further refined within the course of the explorative case studies.

Representatives of the *realism* assume that there is an **independent reality**. Through human perception or thinking substantial parts of the reality can be reconstructed. Hence, humans can perceive things, phenomena or events without distortion.[27] The *constructivism* takes the view that reality depends on the individual subject and is a construct of the human spirit. This obviously means that a **subjectively perceived reality** differs among individuals and is not objectively describable.[28] All knowledge is constructed in as much as it is contingent on convention, human perception, and social experience.[29] Constructivism proposes new definitions for knowledge and truth that form a new paradigm based on inter-subjectivity and viability instead of objectivity and truth. Since generation of knowledge is dependent on humans, a subject independent reality cannot be described. For this reason, the value or quality of a theory is measured by the adequacy for predictions and practical recommendations for action.

But the radical positions of rationalism, empiricism, realism and constructivism are more or less outdated and seldom applied in their strictest sense in business management research.[30] Moreover, modern business management research combines elements of the four concepts. Thereby, two **predominant research programs** have been evolved in business management research.[31] The concept of critical rationalism – advanced by *Popper* – and the constructivism of the *Erlangen school* – advanced by *Lorenzen* – are the prevailing research programs in business administration in recent years.[32]

Critical rationalists hold that scientific theories should be rationally criticized, and (if they have empirical content) must be tested to falsify them. The basic assumption is that human reason is fallible, why results of rationalistic argumentation are not irrefutable.[33] Hence, knowledge can never be proven as ultimately true. Instead, knowledge is only temporarily true until it is falsified. Hypotheses must be formulated in a way that they are consistent and falsifiable by empirical testing. Not falsifiable theories are

---

27 Cf. *Frank* (2007), sp. 2012.
28 Cf. *Jonassen* (1991), p. 9.
29 Cf. *Jonassen* (1991), p. 10.
30 Cf. *Kern* (1979), p. 16.
31 Cf. *Kornmeier* (2007), p. 39.
32 Cf. *Fülbier* (2004), p. 268.
33 Cf. *Fülbier* (2004), p. 269.