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National companies or foreign affiliates: Whose contribution to growth is greater?

by
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A priori, is there a growth/efficiency justification for government programs designed to support and promote national companies (public and private) as opposed to, and in competition with, opening the doors to multinational enterprises (MNEs)? In competitive markets, there should be no difference. Where national companies close in capabilities to foreign affiliates do not exist, foreign direct investment (FDI) may stimulate development, if a country is lucky enough to attract it. But in the imperfect markets that characterize the BRICs and other emerging markets, where foreign affiliates may crowd out excellent but inexperienced national firms, the question arises as to which type of enterprise policy makers should encourage for the long run. Historically, policy makers used tariffs to promote national firms (a "race to the bottom"). Today they use investments in science and technology (a "race to the top").

National firms are likely to be the more entrepreneurial of the two types because national firms know their local markets best.[1] But foreign affiliates may have synergistic advantages from operating in more countries than the typical national firm. Still, in today's global markets, there are eight relatively new functions that normally only national firms can perform, giving them a wide edge over foreign affiliates. More specifically, without private or public nationally owned enterprises to secure home markets:

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[1] Charles Kindleberger, *American Business Abroad: Six Lectures on Direct Investment* (New Haven: Yale University Press, 1969).

- Supplying outsourcing services to developed countries is unrealistic. Outsourcers, by definition, look overseas for national firms to undertake production, especially in electronics (a US firm may establish its own affiliate as an outsourcer, but typically experienced national outsourcers are faster and more efficient).
- Establishing brand names is very difficult (a brand name is company specific, and a company usually originates in a given country that has proprietary technology).
- Dislodging a foreign legacy position in a natural resource industry like oil is undoable (to supplant a foreign concession, a domestic firm is required as demonstrated by OPEC members but not yet by Africa's new oil-producing countries).
- Reversing brain drain of top national talent is more difficult (a glass ceiling may obstruct nationals from reaching the position of CEO if a company is foreign-owned).
- The illegality of imposing local content requirements under WTO law is binding. While foreign affiliates cannot be subjected to local content regulations, national enterprises have more incentive to build their own local supply chains and state-owned enterprises can help in this respect via procurement.
- The benefits of outward FDI undertaken by foreign affiliates located in the country ultimately accrue to the parent company at home.
- Foreign affiliates conduct almost no research and development in emerging markets; so competing in high-tech industries is problematic, unless governments are able to take a hard line with foreign investors, as in India and China.
- Small and especially medium-size enterprises must be brought up to speed as subcontractors, and FDI rarely makes a large impact in this firm-size range, which is the object of numerous government programs.

There are other reasons to believe that the best national firms in the fastest growing emerging markets (for example, the Republic of Korea's Samsung, India's Infosys and Brazil's Embraer) tend to be more entrepreneurial than foreign affiliates.[2] The latter today are typically bureaucratic -- operating with relatively dense levels of management and cookie-cutting single models throughout the world. For now, when most national firms enjoy both family ownership and professional management, they display minimal bureaucracy. If a developing country relies on FDI, every "new" industry requires the entry of yet another MNE, whereas the conglomerate group, a typical national business structure in the de-colonized world, can diversify faster and at lower cost.

The thin layer of bureaucracy in national firms, due to familial relations, improves information flows. National firms are often super-quick in entering new industries and then in designing the integration of parts and components to win the global race to market. One national firm in the Indian pharmaceutical industry reached the market faster than the Indian foreign affiliate of the MNE that had invented the drug.[3] In many industries, national firms were the first movers. They diversified forcefully and fast -- the origin of the diversified business group structure.

[2] Alice Amsden, *A Rational Revolution: Developing from Role Models, Deserting Deductive Theory* (Cambridge: Harvard University Press, in process).

[3] Mona Mourshed, "Technology transfer dynamics: Lessons from the Egyptian and Indian pharmaceutical industries," doctoral thesis (Cambridge: MIT, 1999).

All this suggests that research on FDI must change. In the past, FDI was compared with no FDI, as if national enterprise had nothing to contribute. Now, the presence or absence of foreign affiliates must be compared against that of well-managed national firms. How different the results will be remains to be seen, depending on policy formulation and implementation. National firms must be nursed and nurtured to fulfill the functions that foreign affiliates are less likely to undertake. There is little substitution. For this reason, specific institutions must be built to promote national assets. Good models in Asia are the Republic of Korea and China, and in the Middle East, many OPEC members.

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The Vale Columbia Center on Sustainable International Investment (VCC – www.vcc.columbia.edu), led by Ms. Lisa Sachs, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

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