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Foreign Investments as a Form of Enterprise Strategy

On the Results of a Survey

by Gunter Kayser, Uwe Schwarting, Bonn*

During the course of 1980 West German enterprises and private persons were responsible for approximately DM 8.16 bn in foreign investments. The sum total of German foreign investments has now reached a level of DM 74.2 bn. Both these figures indicate the increasing internationalisation of the German economy, at the same time suggesting that a considerable wealth of experience has been acquired by German firms already resident abroad, which could facilitate entry into foreign markets for possible investors. With this in mind, a survey of German subsidiary companies in 17 countries was carried out, the aim of which was to obtain close to the market information on the problems, conditions and background details entailed in any particular undertaking abroad.

The survey revealed that primarily large-scale enterprises effectuated investments abroad: 72.6 % of the German parent companies related to the 654 subsidiaries under review have 500 or more employees. This enterprise size group was the first to recognise the need for investments abroad. Accordingly, medium-scale firms have some considerable catching-up on arrears to do in this field and there is reason to assume that, in appreciation of this fact, medium-scale industry will in future increase its efforts in foreign markets¹.

Such a development would be in accordance with the wishes of developing countries. During the 3rd UNIDO-conference in New Dehli, for example, the developing countries clearly stated that the small and medium-sized enterprises – as an alternative to the transnational enterprises – possess sufficient potential to advance the process of industrialisation in the Third World. Medium-scale enterprises have particular advantages as investors in developing countries in that

- ☐ they operate on a less capital-intensive basis than large-scale enterprises, thus enhancing their contribution to solving the unemployment problem and
- ☐ their production processes and marketing methods do not make such great demands on management qualifications.

It is interesting to note that the developing countries are also fully aware of the obstacles presented to small

and medium-sized firms which impede a more intensive investment commitment in their markets. They apparently realise that above all economic and political risks tend to prevent medium-scale enterprises from investing in developing countries.

It is for these and other reasons that – according to the results of the survey – German medium-scale industry has up to now preferred locations in neighbouring European countries, the United States and Canada. As the survey further illustrates, the lower the level of development in any particular host country, the lower the level of investment by medium-sized firms; German parent companies with a labour force of less than 500 employees account for only 13.9 % and 17.6 % of foreign subsidiaries in developing countries and newly industrialised countries respectively, whereas this percentage reaches a level of 20.7 % in the industrialised countries under investigation.

Employment through German Foreign Investors

From the host countries' point of view the activities of foreign investors are, amongst other things, of particular importance for the creation of steady employment. This attitude is already reflected to a certain extent in the investment legislation of many of the developing and newly industrialised countries. In India and Indonesia, for example, there is legal provision for a gradual substitution of German specialist personnel and German management by native workers. The survey

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¹ Cf. Auslandsengagement von Mittelbetrieben nimmt zu (Commitments Abroad by Medium-Scale Enterprises are on the Increase), in: Ifo-Schnelldienst, No. 6/1979, p. 3 f.

revealed the activities of German foreign investors towards the creation of employment to be definitely in accordance with the intentions of their host countries.

650 of the survey's 654 subsidiary companies abroad employ a total of 204,486 workers. 49.5 % (101,285) of these are in newly industrialised countries, 18.9 % (38,549) in developing countries and 31.6 % (64,652) in industrialised countries.

The German foreign subsidiaries' employment planning for the next 2-3 years shows that 448 of the 654 firms under investigation (68.5 %) intend creating new, additional jobs in the future. 169 firms (25.8 %) wish to maintain their present level of employment and only 24 firms (3.7 %) are considering a reduction of the present number of employees. These figures illustrate the firms' expectations as regards the capacity for growth in the countries concerned which can be tapped by expansive enterprise policies.

All in all 23,171 new jobs are to be created over the next 2-3 years; as opposed to this, 3,133 jobs will probably be lost, leaving on balance an increase of 20,038 jobs created by German investments abroad during the coming 2-3 years – this would correspond to a personnel increase in the order of 9.8 % of the number of workers at present employed by the firms taking part in the survey.

The effects of foreign investments on the labour market situation of the countries in question are however not limited to mere quantitative developments. Other results of the survey confirm this: the statements of the firms interviewed reveal that the setting-up of an enterprise was primarily handicapped by the lack of qualified personnel. Even up to today it has not been possible to completely eliminate this weak point. This has induced firms to implement their own personnel training on an extensive scale, either by establishing facilities for initial or continued training in the host country itself or by sending foreign employees to the German parent company for training. The quality of the work force in the host country is thus improved.

Almost two thirds (65.9 %) of the survey's 654 foreign subsidiaries indulged in labour force training. The highest percentage of training plants was to be found in the developing countries (81.1 %); the percentage in the newly industrialised countries is also above average (69.7 %), whereas the industrialised countries sink to a below average level of 58.1 %. These results demonstrate that foreign investors are most involved in training in countries in which the level of development and the standard of training are at their lowest.

For the host countries such results can be evaluated positively and for the foreign investors they stress the

Table 1
The Development of Employment in German Subsidiaries
Abroad Over the Next 2-3 Years

Change	Total		Developing Countries		Newly Industrialised Countries		Industrialised Countries	
	Enterprises							
	Number	%	Number	%	Number	%	Number	%
Increase	448	68.5	59	62.1	165	65.7	224	72.7
Decrease	24	3.7	5	5.3	13	5.2	6	2.0
No Change	169	28.5	30	31.6	69	27.5	70	22.7
No Statement	13	2.0	1	1.1	4	1.6	8	2.6
Total	654	100.0	95	100.0	251	100.0	308	100.0
Change ¹	Number of Employed							
	Total		Developing Countries		Newly Industrialised Countries		Industrialised Countries	
	Number	% ²	Number	% ²	Number	% ²	Number	% ²
Decrease (-)	3,133	1.5	2,082	5.4	948	0.9	103	0.2
Increase (+)	23,171	11.3	3,744	9.7	11,542	11.4	7,885	12.2
Balance (+)	20,038	9.8	1,662	4.3	10,594	10.5	7,782	12.0

¹ 386 of the 448 foreign subsidiaries intending to create new jobs during the next 2-3 years were able to quantify the extent of this expansion. Split up according to individual groups of countries, the figures are as follows: Industrialised Countries (190), Newly Industrialised Countries (144), Developing Countries (52). Of the 24 firms planning reduction in the number of employees, 22 were able to quantify its extent; one firm in the Industrialised Countries and the Newly Industrialised Countries respectively was unable to do so.

² as % of the present number of employed persons.

significance of early and realistic personnel planning. Qualified employees represent a definite bottleneck factor and if their significance is interpreted incorrectly this can lead to uncertainties in investment and growth calculations.

Although as a rule there is a sufficient number of workers available, the analysis of personnel recruiting indicates a lack of qualified specialists, technicians and executives. Such a lack, even more significant if restrictions hamper the employment of German specialists abroad, must be counteracted by the firm's own training.

Fringe Benefits

This result already indicates that investments in so-called low wage countries are not necessarily identical with low labour costs. As shown skilled labour is rare; one of the means of overcoming this bottleneck situation is to create one's own facilities for initial and continued training. Another way of competing for a scarce labour force is to supply fringe benefits. By doing this foreign investors try to increase the attractiveness of the jobs on offer.

Almost three quarters (73.2 %) of the German foreign subsidiaries covered by the survey grant fringe benefits which exceed the statutory ones. Altogether 91.5 % of those employed in German subsidiaries benefit as a result of this.

The fringe benefits consist mainly of the following:

- ☐ measures related to catering (e.g. setting-up of canteens, subsidisation of meals, etc.),
- ☐ measures in the field of preventive and curative health care (e.g. setting-up of clinics, (partial) payment of illness costs, etc.),
- ☐ measures towards initial and continued training (e.g. training grants, language courses, seminars, etc.),

☐ various forms of insurance,

☐ special payments (e.g. holiday money, bonus schemes, profit-sharing, etc.),

☐ other contributions (such as providing working-clothes, transport to the place of work, child care facilities, etc.).

According to the statements made by foreign investors these fringe benefits are usually made in "package form". Only 17.5 % of the firms offer only one form of fringe benefit, whereby the majority of these enterprises are resident in industrialised countries with their own particular legally binding social system. The majority (61.1 %) of subsidiaries offer a package of 2-4 fringe benefits. 20.4 % of the enterprises even offer 5 or more forms of benefit.

Motives Behind Foreign Investment

Of prime importance to a new investor is a knowledge of the aims and expectations which lie behind foreign investments. The degree of accomplishment of the investment motives registered will to a large extent determine whether or not intending investors will be able to judge the chances and possibilities of an investment abroad realistically. The survey revealed² sales-oriented and market-oriented motives as being the most important to the German foreign investors. This fact is shown by the rating order of the 10 most important motives for investment abroad (as presented in Table 2). The most important motive is the "Extension of Activities Abroad to New Markets" (No. 1 rating), followed by "Securing and Extension of an Already Existing Market" (No. 2 rating) and "Securing and Control of Marketing in the Host Country" (No. 3 rating). The significance of these three motives was regarded by 79.3 % of the enterprises as being "large" or "very large". These factors are followed in order of significance by rating No. 4, the "Political Stability of the Host Country", rating No. 5, "Creation of an Export Base for Products of the German Parent Company" and

² Cf. on this point Table 2.

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This quarterly report – compiled by the Department on Business Cycles and Statistics of the Hamburg Institute for International Economics – analyses and forecasts the economic development of the most important Western industrial nations and of the international raw materials markets.

Table 2

**Rating Order According to Significance of Motives
for Foreign Investment**

Motive	Rating			
	Total	ICs ¹	NICs ²	DCs ³
Extension of activities abroad to new markets	1	1	1	1
Securing and extension of an already existing market	2	2	2	2
Securing and control of marketing in the host country	3	3	4	3
Political stability of the host country	4	5	3	4
Export base for products of the German parent company	5	4	10	9
Overcoming of trade and export barriers	6	7	6	6
Expectation of a high investment return	7	8	5	7
Suppliers for enterprises in the host country	8	6	11	12
Low wage costs	9	12	7	5
Securing of supplies in the host country	10	10	8	8
Employment creation	11	17	9	10
Strengthening of the economic independence of the host country	12	18	12	11
Transport cost savings	13	9	19	16
Governmental promotional measures by the host country for direct investments	14	16	13	14
Production for the parent company in Germany (re-import)	15	13	14	20
Utilisation of technologies developed for the specific needs of the host country	16	15	15	18
Processing of indigenous raw materials for the host country's domestic requirements	17	19	18	13
Relocation induced by exchange rate	18	11	20	25
Supplier for a large German enterprise also operating in the host country	19	20	16	21
Low prices for raw materials and fuels	20	14	21	17
Governmental promotional measures by the Federal Republic of Germany for direct investments	21	24	17	19
Securing and extension of the raw materials base	22	21	22	15
Other reasons	23	22	23	22
Securing of energy supply	24	24	24	23
Promotional measures by international institutions for direct investment	25	25	24	24

¹Industrialised Countries

²Newly Industrialised Countries

³Developing Countries

rating No. 6, "Overcoming of Trade and Export Barriers".

Along with the factors sales and market the survey shows the motive "Political Stability in the Host Country" to be a decisive factor for the majority of German firms in deciding on an investment in any particular country. The survey shows that before undertaking investments abroad more than 60 % of the enterprises apparently viewed the political stability of the host country as being guaranteed for the foreseeable future. Their foreign commitments were therefore regarded as not being politically endangered. The motives rated 5 and 6 underline yet again that

German foreign investments tend to function as a "bridge-head", i.e. an intensification of exporting activity takes place using the new location as a base. Foreign investments thus adopt a more complementary than substitutional rôle for the enterprises and are not necessarily designed as a replacement for exporting. Furthermore it becomes evident that German investors were pushed into taking such steps in order to avoid protectionist trade barriers. If they had not carried out foreign investments they might well have had to sacrifice these export markets altogether.

Ratings No. 7 (Expectations of a High Investment Return) and No. 9 (Low Wages) are, contrary to the previous, more market-oriented motives, return-oriented and cost-oriented. Half of the enterprises regarded these as being equally decisive in the choice of a country to invest in.

Motive No. 8 (Supplier for Enterprises in the Host Country) and No. 10 (Securing of Supplies in the Host Country) express the willingness of foreign investors to adapt to the existing economic situation of the respective host country. Worth mentioning in this context is the fact that the motivational effect of existing promotional measures can hardly be ascertained. National and international incentives, as exist particularly for investments in developing countries and newly industrialised countries, occupy the lowest level of the motivational rating order.

As regards the degree of accomplishment of the motives, the market motives are seen to have a much larger chance of realisation than those geared to costs and returns. A case in point is the motive "Low Wages" and this follows up comments made above: comparisons of wage levels should not be the only determinant for the implementation of foreign investments.

Information and Advisory Services

An undertaking abroad is not viable without specific information and advice. Especially a long-term investment project which has to take the situation in the host country into account depends a great deal on the quality and availability of information and advice. For this reason the foreign investors were asked to state which information sources and advisory assistance they took advantage of during the preparatory stage of their undertaking and which of these they still employ today. The firms were also asked to rate the standard of the advice given.

In the Federal Republic of Germany there are numerous facilities for information and consultation

which are run by private and governmental institutions. In the questionnaire there was a choice of the following channels of information and consultation: Bundesstelle für Außenhandelsinformation – BFAi – (Federal Agency for Information on Foreign Trade), German Chambers of Foreign Commerce, Embassies/Consulates, Commercial Banks, Deutsche Entwicklungsgesellschaft – DEG – (German Development Society)³, development banks³, consultants, contacts to other firms, specialised literature and other sources.

The analysis of all the results obtained by the survey reveals that German foreign investors, both during the planning stage and at the present time, have a marked preference for three of the information and consultation sources: the commercial banks, “contacts to other firms” and the German Chambers of Foreign Commerce were and remain the most frequented. Broken down according to the type of country, in developing countries and newly industrialised countries the “contacts to other firms” were the most important source of information; difficult external locational factors tend to induce competitors to close their ranks. The primary source of consultation in the industrialised countries are the commercial banks, to which the most value is also attached. Accordingly, the internationalisation of the German economy is accompanied by a strengthened presence of German commercial banks abroad; a further result of this development is a realignment of the German credit institutes’ services towards activities which cater for the needs of foreign investors.

Another interesting point is that the demand for information by German foreign investors has increased over time: whereas the survey’s 654 German foreign investors took advantage of an average of 3.7 sources of information and consultation during their planning and setting-up period, the current situation reveals that each enterprise makes use of an average of approximately 4 different sources.

The purely quantitative utilisation of the individual sources of information and consultation is complemented by the foreign investors’ degree of satisfaction with the instruments used.

The ratings for the individual sources of information and consultation reveal that German foreign investors are on the whole relatively satisfied with the services employed. This service seems to be at its best in the industrialised countries; the ratings for the developing

countries and the newly industrialised countries are somewhat worse.

Of all the individual sources of information and consultation “contacts to other firms” are regarded as the most valuable. This factor is followed by the commercial banks and the Chambers of Foreign Commerce. The same applies to the newly industrialised countries and the developing countries although the Chambers of Foreign Commerce achieve the second best rating in these areas. In the industrialised countries specialised literature is highly regarded along with the afore-mentioned sources, obtaining the third best result.

Suggestions for improvement made by the firms show that there is a need for up-to-date material. Apart from being up-to-date the consultation available must – according to the firms – be able to take special requirements into account. There is a particular demand for detailed information on questions relating to location, finance, customs and legalities.

Conclusion

These partial findings of the whole survey⁴ illustrate the numerous demands made of entrepreneurial decisions-makers by foreign investments. In order to meet these demands the enterprises had, amongst other things, to bring about a re-orientation of management techniques and methods of production, i.e. the transferability of management methods and manufacturing technologies successfully employed in the Federal Republic of Germany into a foreign context can only be carried out to a certain extent. Rather, the firms’ objectives must be reformulated in the host country itself and subsequently integrated into the general plan of the enterprise, which presupposes that the investor is willing and able to adapt. One of the results of this, however, is that an enterprise operating in a foreign market has a competitive advantage. Apart from profits which are easily measurable, internationalisation creates other advantages, such as access to international capital markets, tax-induced transfer of profits, improvement of the firm’s national image (synergy-effects).

⁴ G. Kayser, H.-J. Kitterer, W. Naujoks, U. Schwarting, K. V. Ullrich: Investieren im Ausland. Was deutsche Unternehmen draußen erwartet. (Investment abroad. What German firms can expect to find there), Schriftenreihe des Deutschen Industrie- und Handelstages (ed.), Bonn 1981; by the same authors: Erfahrungen deutscher Auslandsinvestoren in ausgewählten Industrieländern. Ergebnisse einer Umfrage in Australien, Frankreich, Japan, Kanada und den Vereinigten Staaten von Amerika (Experiences made by German foreign investors in a selection of industrialised countries. Results of a survey carried out in Australia, France, Japan, Canada and the United States of America): Schriften zur Mittelstandsforschung, No. 80, Göttingen 1981.

³ The sphere of activity is confined to the newly industrialised countries and the developing countries.