

The Development Dimension of Outward Foreign Direct Investment

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Paper presented at the Third Copenhagen Conference on “Emerging Multinationals’: Outward Investment from Emerging Economies”, Copenhagen, Denmark, 25-26 October 2012

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ABSTRACT

This study examines how outward FDI supports economic development of the home economy from which the investment originates. With increasing investments by firms from developing and emerging economies being done in advanced economies, it is argued that outward FDI is an important channel of interaction and exchange with the rest of the world next to inward investment, trade and migration, creating unique opportunities for development. The study demonstrates conceptually how outward FDI can support economic development at the micro- and macroeconomic levels, and provides evidence from the literature. The urgent need for further research in this area is highlighted.

Keywords: foreign direct investment, economic development, developing country, catching up, spillovers, technology transfer

Acknowledgements:

This study originates from the author's PhD dissertation, written at the School of Oriental and African Studies (SOAS), University of London, United Kingdom. Some sentences are taken *ad verbatim* from this dissertation. The author is grateful for comments by Professor Robert Ash, SOAS.

1. INTRODUCTION

For years if not decades, researchers in their continuous search for solutions to the world's development challenges, have sought to determine and identify promising avenues through which countries can take advantage of international economic exchanges and interactions with the rest of the world to support their economic development objectives. The most notable such exchanges were found to be the movement of people across borders, the international exchange of goods and services, and the cross-border investment of capital. Referred to as migration, international trade and foreign investment, these types of interaction with the rest of the world have all been found to be relevant to economic development and at times important sources of support for developing countries (World Bank, 2008, 1999; Keller, 2004; Saggi, 2004; Andreosso-O'Callaghan & Qian, 1999). Moreover, all of these modes of exchange and interaction have an inward and an outward dimension: women and men can immigrate and emigrate, goods are imported and exported, and countries are normally faced with both inflows and outflows of capital.

The development literature has considered all these international economic exchanges in great detail and found that – for most of them – both inward and outward movements have strong potential to aid economic development, at least if circumstances are favorable (World Bank, 2008). For example, immigrants contribute to a country's economic development as an additional workforce and source of intellectual capital, while many emigrants support their country of origin through remittances of overseas earnings or by obtaining an advanced education and technological skills abroad before returning. Both immigrants and emigrants generate useful international (diaspora) networks (World Bank, 2008, pp. 122-127; Saxenian, 2005), through which various forms of information, know-how, technology and financial capital can circulate. Imports of technology-intensive capital goods and intermediate products

can improve productivity and efficiency in domestic production processes, and it is possible to reverse engineer imported technologies to improve technological capabilities of domestic firms. Exports contribute to economic development when they support the build-up of domestic industry and enhance export earnings. Finally, investment of foreign capital is important for economic development. Especially foreign *direct* investment (FDI) in a country helps create employment and contributes to the inflow of technology, the build-up of domestic infrastructure and improvement of skills among the local workforce. Inward FDI can transfer know-how, as firms set up production and research and development (R&D) centers and bring advanced technologies and equipment to support these activities.

It is interesting to note that the only aspect omitted from similar analysis has been *outward* investment, especially related to the engagement of firms from developing countries outside of their country of origin. Research down to the present day has rarely considered the possibility that the country of origin of an investment could equally benefit in developmental terms. With the exception of some very few studies that have hinted to this aspect (World Bank, 2008; UNCTAD, 2006; Zhan, 1995; Zhao & De Pablos, 2010), the literature has remained far from any systematic consideration of this issue.

To a certain extent, the lack of conceptual and empirical research on this particular angle is understandable: investing abroad involves an outflow of capital, and at first glance there would seem little reason to suppose a firm's activities in a distant country will provide significant development benefits to the country from which the investment originates. In addition, economic and business theory largely supports the view that outward investment is a *consequence* of economic development. Only when a country has reached a relatively advanced stage of development, so this theory asserts, do firms have the international competitiveness necessary to undertake investments abroad (Dunning & Narula, 1996). In

other words, companies invest overseas when their country of origin is sufficiently developed to endow them with the necessary capabilities to compete in overseas markets. *Inward* FDI in developing economies is considered to be a *facilitator* of economic development; *outward* FDI, on the contrary, is considered to be largely a *result* of economic development.

Another reason why further exploration of this development dimension of outward FDI has so far been left for future researchers to undertake lies in the fairly rare occurrence of the subject matter under consideration. Migration, trade and inward investment are all common areas of international economic activity for most developing countries, but only very few of them have so far experienced any substantial amount of outward FDI. However, this is rapidly changing. Statistics of UNCTAD show that firms from developing countries and emerging economies are rapidly intensifying their transnational activities. In 2010, FDI from developing and transition economies increased by 21 per cent, reaching a share of 29 per cent of global outward FDI flows (UNCTAD, 2011, pp. 6-8).¹ Notable firms that have invested in advanced economies are Companhia Vale do Rio Doce from Brazil, Geely, Haier, Huawei, Lenovo and ZTE from China, Tata Motors and Tata Steel from India, Gazprom, Lukoil and MMK from Russia (Kalotay & Sulstarova, 2010), Mabe from Mexico and Arçelik from Turkey (Bonaglia, Goldstein & Mathews, 2007). Apparently paradoxically, many developing countries have now emerged as net capital exporters, with capital flowing from poorer to richer economies (UNCTAD, 2008a, p. 51).

Given these new trends in international investment flows from the South, I argue in this study in favor of a more profound investigation of the impact of outward FDI on the home economy of the investing company. My point of entry is to argue that it may be short-sighted to regard outward FDI merely as a consequence of economic development. In accordance with this view, the purpose of this study is to explore whether outward FDI is not only a consequence

of economic development, as most literature asserts, but also functions as a cause – or facilitator – of development. The basic ambition is to conceptualize and assess the role of outward FDI in contributing to economic development of the country of origin of an investment.

Similar to previous studies (De Mello, 1997; Crespo & Fontoura, 2007; JBICI, 2002; Saggi, 2002; Fan, 2003; Görg & Strobl, 2001; Lim, 2001), I conduct this analysis in the form of a survey. There is a wide range of theoretical and empirical research that examines phenomena which are relevant to outward FDI and development. However, no study has so far examined the available evidence comprehensively or developed an appropriate theoretical foundation. The purpose of this study is to fill this gap. Within this study, I will refer to the term “development” to characterize areas in which outward FDI can benefit the home economy of an investment. For some emerging economies, however, this terminology may arguably be inapplicable and, in order to address this contention, the terms “growth” and “catching up” could be considered as alternatives or complements. I will begin with some initial theoretical considerations; then I will examine microeconomic and firm-level effects before turning to the macroeconomic impacts of outward FDI on home economy development. On the basis of these findings, I propose a conceptual framework appropriate for examining outward FDI and economic development in a discussion section. A final section concludes.

2. THEORETICAL CONSIDERATIONS

The potential for outward FDI to create additional development benefits is supported by FDI theory. Recent research has gone beyond the traditional view that firms only invest abroad in order to exploit their competitive (i.e., “ownership” or “proprietary”) advantages (Hymer,

1976; Kindleberger 1969; Caves, 1971, 1974; Dunning, 2001a,b), suggesting that they also engage in FDI to secure valuable assets that can create these advantages for them. This finding has major implications for outward FDI from developing countries, especially in terms of opportunities such investment offers for sourcing desired assets and advantages abroad.

“Asset-seeking” FDI is driven by a foreign firm’s desire to gain access to valuable assets which are available on better terms to firms operating in the host country than the investing firm’s home country (Wesson, 1999, p. 2; Wesson, 1993). Firms undertake asset-seeking FDI by placing themselves in proximity to the holders of desired assets in foreign locations. By this means, companies create proprietary assets that confer an identifiable advantage. Asset-seeking is particularly beneficial to the investing firm if it manages to combine the acquired assets with those that it already owns in such a way as to create additional value added. Firms may even undertake asset-seeking FDI from a position of disadvantage vis-à-vis firms in the host economy, helping them to overcome these disadvantages (Wesson, 1999). Today, some have come to see asset-seeking as the actual reason and rationale for FDI activity (Dunning, 2001b, p. 45), while most suggest that asset-seeking is usually undertaken in parallel or in combination with the exploitation of existing ownership advantages (UNCTAD, 2006, pp. 142-143; Dunning, 1995; Dunning, 1998; Wesson, 1999, p. 3; Dunning, 2000; Dunning, 2001a, p. 183). Additionally, it is usually argued that investing firms already have to possess some ownership advantages, which enable them to acquire assets and successfully absorb and learn while they undertake foreign operations (so-called “asset-augmenting”) (Dunning, 2001a, p. 183; UNCTAD, 2006, p. 142).

Today there is ample evidence, including survey evidence (Dunning, 1996), for the existence of asset-seeking behavior by foreign investors (UNCTAD, 2006, pp. 141-168; Child &

Rodriguez, 2005; Knörich, 2012), and firms are found to find it increasingly important (Dunning, 1996; Cantwell *et al.*, 2004). For example, Almeida (1996) found that firms in the semiconductor industry used their production facilities in the United States to improve technological capabilities in areas of activity in which they were domestically weak. Shan and Song (1997) confirmed the existence of asset-seeking as a motivation for engaging in equity participation in American biotechnology firms. Taking into account the advanced nature of the US biotechnology industry, they suggested that such activity by foreign firms was guided by the objective to tap into specific advantages possessed by firms in the host location. Ivarsson and Jonsson (2003) revealed that in-house R&D conducted by foreign companies in West Sweden and technology-related contacts with local companies provided benefits for the foreign companies' global economic activities in many sectors, ranging from manufacturing to services. Globerman *et al.* (1996) found that outward FDI by Swedish multinationals supported technology transfer to Sweden. Kuemmerle (1999) found that firms engaging in overseas R&D activity did so for both asset-exploiting and asset-augmenting purposes.

In specific accounts of developing country firms, Makino *et al.* (2002) found that Taiwanese firms favored investments in more advanced economies for both asset-exploiting (i.e. market-seeking) and also asset-augmenting purposes. Lecraw (1993) confirmed that such a dual approach also motivated FDI by some Indonesian firms. Asset-seeking has continuously been a motivation for Chinese firms investing abroad (including in advanced economies), and has often been undertaken from a position of weakness (Deng, 2008, p. 27; Deng, 2007, p. 77; Child & Rodrigues, 2005, p. 388; Yang, 2005, pp. 49-58; Wu, 2005, pp. 8-9; Ash, 2008, p. 199; Knörich, 2012, 2010). Case studies provide evidence that Chinese firms were undertaking asset-seeking FDI as early as 1992 (Young *et al.*, 1996, pp. 301, 312). Beausang (2003, p. 35) suggests that developing country multinationals have succeeded in creating

ownership advantages through asset-seeking FDI in advanced economies. And Moon and Roehl (2001, pp. 198-199) have also argued that despite a lack of ownership advantages, firms from developing countries do invest abroad, and they suggest that this can be explained by asset-seeking activities, or, in the words of the authors, unconventional investments.

All this evidence suggests that asset-seeking is a useful analytical tool for researchers to better understand the benefits of (outward) FDI to the investing firms beyond the benefits of firm expansion and financial gains. But how can firms concretely seek assets and advantages abroad, and how does it benefit the home economy? The following sections will provide more detailed consideration of these questions.

3. FIRM-LEVEL EXAMINATION

Research has long been concerned with the nature and type of impact that investment by foreign firms can have on development and growth in a *host* country. *Inward* FDI is considered as important for economic development, especially FDI originating from advanced economies and destined for developing countries. The literature on this issue is extensive, but the focus is entirely on the impact of *inward* FDI on development.² Fortunately, this literature promises to provide a solid analytical foundation for examining *outward* FDI and development, and the analytical thrust of this study will be that on the basis of the literature on *inward* FDI and development, inferences can be made about how *outward* FDI can benefit the *home* economy in terms of economic development, growth and catch-up. This section considers spillovers, theories of the firm, organizational learning behavior, and some prerequisites that have to be in place for any pursuit of assets and transfer of capabilities to be successful.

(a) "Reverse" spillover effects

A majority of the studies on foreign investment have focused on the central role of spillover effects in facilitating economic development. The theory suggests that investors from a more advanced economy than the host country of investment will bring in technology and other know-how that has not been familiarized yet in the country of investment. This know-how will eventually diffuse into the host economy, not only via direct technology transfer, but also through various horizontal and vertical linkages, and labor turnover, leading to economic development. The literature has mostly confirmed the existence of such dynamic effects for investments from advanced into developing economies, but no examination has to date considered their applicability to outward investment from developing to advanced economies. However, further analytical reasoning, as detailed below, will lead us to the conclusion that all these spillover effects will be present in the latter scenario as well.

The spillovers described below differ from those discussed by the theories on inward FDI because the main beneficiaries are the foreign investing firms rather than local firms. Quite early, the possibility had been tentatively suggested that multinational corporations investing overseas could transfer technologies obtained through spillovers in a foreign country back to the home economy (Blomström & Kokko, 1998, pp. 22-25). This accorded with the increasing recognition, mentioned above, that ownership advantages might be less important if FDI involves knowledge sourcing (Fosfuri & Motta, 1999, p. 617; Driffied & Love, 2003, pp. 659-660). But only more recently has research set out to examine this kind of spillovers in further detail, analyzing advanced economy firms and applying the term "reverse spillovers" (Driffield & Love, 2005, 2003). The concept of "reverse spillover" was coined and gained currency after the discovery of its relevance in a study of FDI in the manufacturing sectors of

the United Kingdom (Driffield & Love, 2003; Driffield & Love, 2005; De Propris & Driffield, 2006). Like all other investors, firms from developing countries benefit from various kinds of reverse spillovers when they operate overseas.

First of all, developing country firms investing abroad benefit from horizontal linkages.³ Especially when based in an advanced economy, they become exposed to local competitors with advanced knowledge and capabilities. Healthy competition is usually good for all involved, inducing improvements in technology, management, organizational efficiency, production processes and other business practices. Exposure to competition in advanced economies pushes developing country investors to adjust and enhance their performance in order to maintain competitiveness, perhaps by upgrading their products and processes and ameliorating methods of management and organization. This process is referred to as “competition effect” in the literature on inward FDI (Crespo & Fontoura, 2007, p. 412; Saggi, 2002; JCIBI, 2002). For example, many subsidiaries of Chinese firms in advanced economies already function as “listening posts” for their parent firm (Knörich, 2012; von Zedtwitz, 2005), monitoring the advanced economy market and the moves of their competitors, including technological developments and new products.

The variety and sophistication of technologies in an advanced economy are usually greater than in a developing country. “Demonstration effects” occur when developing country firms improve their production and other capabilities through exposure to advanced knowledge when they invest in advanced countries. One way of achieving this is to imitate the technologies of local firms. More generally, the developing country firms benefit from an extension of the variety of technologies available to them. In most business situations, proximity among firms facilitates greatly any capabilities transfer or learning process between them. For firms from developing economies, investing overseas thus means enhancing

opportunities for organizational learning, generating additional benefits compared to staying at home.

Developing country firms can also obtain knowledge through vertical linkages in the advanced economy where they invest. Local vertical linkages tend to evolve over time, and there are many ways by which they can facilitate the transfer of knowledge. The concept of vertical linkages can be subdivided into forward and backward linkages, because an enterprise from a developing country operating in advanced economies benefits from contacts with both customers and suppliers. *Forward* linkages are captured in a developing economy firm's relations with *customer* firms in the advanced host country (whether final consumers or firms purchasing intermediate goods). The procurement process allows developing country firms to obtain know-how and receive training from their customers in areas such as procurement optimization, production processes, zero defect procedures, industry best practices, management and organization, etc.⁴ Procedures put in place by the advanced economy firms to assess and develop their suppliers are important in this context – since local enterprises will wish to ensure that their suppliers' products are of high quality, it is in their own interest to provide technological and managerial consulting services to developing country suppliers.

Backward linkages refer to relations with *suppliers*; here, potential for organizational learning exists in the area of sales and marketing, and further benefits to developing country firms can be made when they procure advanced producer goods and other high-quality inputs from local suppliers.⁵ The scale of reverse spillovers resulting from vertical linkages differs, depending on circumstances. Factors such as the relative technological capabilities of firms in the advanced economy, the absorptive capacity of the investing firm (see below), the degree to which the investing firm sells intermediate goods to local firms and the size of the host

country market affect to some extent the organizational learning and technology transfer potential of such forward and backward linkages.

Finally, in order to sustain an investment, most foreign investors have to employ individuals from the host economy. In fact, if the investment is a merger and acquisition (M&A), these employees may already be present in the acquired subsidiary. Local employees hired in an advanced economy can be high-skilled workers who possess valuable know-how. Since an employee assumes complete ownership of his or her individual knowledge and has no obligation to impart it to others (Liebeskind, 1996, p. 100), the employing investor must provide sufficient incentives and motivations for employees to share their know-how with colleagues from overseas. Employees from the developing country parent company benefit from working with their high-skilled counterparts in a technologically sophisticated environment, and can receive training from these local employees in the advanced economy. Labor turnover is beneficial when host country employees enter the firm and bring new types of knowledge, thereby enhancing opportunities for organizational learning.

Companies from developing countries investing in advanced economies sometimes focus their attention in areas that enhance their technological and organizational capabilities. Chinese firms, for example, have been quite active in setting up research and development (R&D) centers in advanced economies. Van Pottelsberghe de la Potterie and Lichtenberg (2001) found that outward FDI in advanced economies with intensive R&D activity raises productivity in the home economy of the investment. Another possibility, though still rather rare among developing country firms, is to acquire an advanced economy firm, or form a merger or joint venture. In such a cooperative arrangement, the internal knowledge and assets of the firms involved, including technologies, production processes, and organizational and managerial know-how, will become accessible to the partner firms (Inkpen, 1998). As access

to know-how through such alliances is more direct than through spillovers from greenfield investments, the M&A approach is particularly promising.

(b) Theories of the firm

Two essential schools in strategic management – the Resource-Based View (Barney, 1991) and the Knowledge-Based View (Kogut & Zander, 1993; Hedlund, 1994; Grant, 1996) – provide further theoretical backing for the above analysis. These two “theories of the firm” form part of organization theory, emphasizing the distinctive characteristics of individual firms (Nelson, 1991; Barney & Hesterly, 1996) and their role in supporting the creation of competitive advantage and (knowledge) resources (Liebeskind, 1996; Nahapiet & Ghoshal, 1998).

The Resource-Based View assumes that firms differ in their endowments of resources and capabilities, which may be categorized as financial, physical, human and organizational resources. A firm performs better than others if its resources or capabilities are valuable, rare, costly to imitate, and difficult to substitute (Barney & Hesterly, 1996, pp. 133-134). It is possible that firms in weak strategic situations invest abroad to acquire such resources, which they need to compete successfully (Grant, 1996, p. 18). Accordingly, Deng applied the Resource-Based View to examine outward FDI by Chinese enterprises (Deng, 2008).

The Knowledge-Based View, most likely an outgrowth of the Resource-Based View (Grant, 1996, p. 110), explains the existence of a firm by its possession of a unique set of knowledge resources, which distinguish it from other firms, allow the maintenance of some competitive advantage, and enable a firm to innovate. Thus, while the Resource-Based View emphasizes a whole set of resources which firms can use to enhance their performance and outcompete

other firms, the Knowledge-Based View identifies knowledge as strategically most important and the critical resource in achieving competitive advantage.

An important distinction is that between explicit and tacit knowledge (Anh *et al.*, 2006, p. 465; Liebeskind, 1996, p. 94; Polanyi, 1966). Explicit knowledge is information or “know-what” that can be codified and made accessible through linguistic means, while tacit knowledge, or “know-how”, is hard to communicate and entrenched in the processes and routines of firms and their workers (Nahapiet & Ghoshal, 1998, p. 246; Kogut & Zander, 1992, p. 386-388). Because explicit knowledge is more easily obtained and used, tacit knowledge is more valuable. A further distinction can be made between knowledge that is *compatible* and therefore similar to that possessed by other firms, and knowledge that is *complementary*, describing needed knowledge that is possessed only by other firms (Shenkar & Li, 1999, p. 136). The transfer of knowledge, as well as other resources, refers to their movement from the firm that possesses them to the firm seeking them. This includes technology transfer. Knowledge acquired through such means “does not have to be newly created, only new to the organization” (Anh, Baughn, Hang, & Neupert, 2006, p. 465).

Mergers and acquisitions (M&As) have been mentioned as a promising strategy for building up knowledge capabilities relatively swiftly compared to continuous in-house innovation. It has been argued that, “a primary driver of many acquisitions has also been the desire to obtain valuable resources, including technologies and capabilities possessed by target firms” (Ranft & Lord, 2002, p. 420; Ahuja & Katila, 2001). Acquired companies may possess knowledge that can be directly transferred to the acquiring parent firm. The acquiring firm normally assumes ownership of these technologies and assets, and can set conditions favorable to technology transfer through contractual arrangements. This may explain the rising occurrence of M&As in global FDI trends, particularly in knowledge-intensive industries in advanced

economies (Dunning, 1998). In situations where a developing country firm acquires an advanced economy firm, any gains in knowledge capabilities may well have a positive effect on the competitiveness of developing country firms and, ultimately, the home economy. The main constraint of the M&A approach is that a suitable advanced economy firm must be available for purchase or willing to cooperate with a developing country firm. This is less likely when target firms possess advanced or cutting-edge technologies, but more feasible when firms are struggling or belong to industries that are ailing in the host economy. Attention has also been paid to the nature of post-acquisition knowledge transfer and organizational learning activities (Inkpen, 1998; Ranft & Lord, 2002; Ahuja & Katila, 2001; Bresman, Birkinshaw, & Nobel, 1999). Given that the nature of knowledge possessed by target firms in acquisitions is often “tacit, socially complex, and idiosyncratic” (Ranft & Lord, 2002, p. 423), the transfer of such knowledge resources to the parent firm is complicated and difficult. Further obstacles remain in integrating the two firms after the acquisition, which is known to be a problematic phase in most M&As. Finally, if the acquisition is cross-border in nature, additional difficulties resulting from cultural differences and communication barriers may complicate any transfer of knowledge resources.

(c) Absorptive capacity and social dimensions

Regardless of whether an investment is an M&A, a greenfield investment or an R&D center, certain mechanisms need to operate effectively to make obtaining any resources and knowledge through outward FDI a success. Most important is the level of a firm’s absorptive capacity. The literature suggests that a firm’s absorptive capacity is determined by the degree to which prior knowledge, related to the knowledge aspired to from external sources, exists within the firm. Such possession of prior related knowledge enhances “the ability of a firm to

recognize the value of new, external information, assimilate it, and apply it to commercial ends” (Cohen & Levinthal, 1990, p. 128). Makino *et al.* (2002), for example, found that successful asset-seeking FDI by Taiwanese firms was contingent on the investing firm’s possession of technological capabilities or prior experience in strategic asset-seeking, demonstrating the necessity of absorptive capacity.

The concept of *relative* absorptive capacity can be used to understand what is required for a “student” firm to learn from its partner, the “teacher” firm. The organizational characteristics of both firms and the nature of the relationship between them will influence the student firm’s relative absorptive capacity with respect to the teacher firm. Research in this area shows that a firm’s capacity to learn from another is contingent on the existence of similarities between both firms along various organizational learning dimensions, including the way in which within-firm knowledge is utilized and processed (Lane & Lubatkin, 1998).

A useful distinction is between passive, active and interactive learning. “Passive learning” refers to the appropriation of codified knowledge that exists in the public domain in written or other easily accessible format, such as in publications or through external advice from consultants. “Active learning” occurs through monitoring of rivals and competing firms in the market in order to obtain knowledge. Both passive and active learning have their limitations, since knowledge obtained by these means is publicly available to all firms and so not a unique capability or skill. By contrast, “interactive learning”, which may occur in an alliance between two firms, allows the student firm access to the teacher firm’s more valuable knowledge, i.e. capabilities that have the potential to generate a genuine competitive advantage. But transfer of this type of knowledge requires social interaction, to allow the student firm access to socially embedded knowledge of the teacher firm (Lane & Lubatkin, 1998, pp. 462-463).

The key question is whether developing country firms have sufficient absolute and relative absorptive capacity or prior relevant know-how to ensure effective transfer of knowledge. To benefit from opportunities for organizational learning, developing country firms must be able to recognize the value of foreign knowledge for their own businesses, adjust the knowledge to their own processes and routines, and exploit it in the home economy or international markets. In specific contexts, such as learning alliances, the developing country (student) firm should be sufficiently “similar” to an industrialized country (teacher) firm in terms of organizational and knowledge structure.

Another challenge is how to transfer acquired knowledge from the subsidiary in the advanced economy back to the parent firm in the developing economy. In general, social relationships function as a facilitator of organizational learning and innovation, and the firm as a social community is suitable for the quick and efficient creation and transfer of knowledge (Kogut & Zander, 1996, p. 503). Referring to the concept of social capital, one strand of the business literature introduces three relevant dimensions: the structural dimension, referring to the structure of ties and connections among individuals in a firm; the relational dimension, describing the nature of these personal relationships within the firm, such as the level of trust or mutual obligations; and finally, the cognitive dimension, referring to shared meanings and mutual understanding among individuals working in the firm (Nahapiet & Ghoshal, 1998; Nahapiet & Ghoshal, 1997). If a firm is strong in these dimensions, a high degree of exchange and combination of resources within a firm is facilitated, which, according to theory, contributes to value creation and innovative capacity (Tsai & Ghoshal, 1998, p. 466). In foreign investments where knowledge is acquired in a subsidiary, positive interaction between home economy headquarters and the advanced economy subsidiary must be maintained, not only formally (the structural dimension), but also in terms of cultivating good relationships

(relational dimension) and establishing a joint way of thinking (cognitive dimension).⁶ In addition, for the effective acquisition of external knowledge, these dimensions will also be important in a subsidiary's interaction with partner firms in the host economy.

A summary of this section's discussion is provided in Figure 1, which depicts the process of knowledge transfer through outward FDI, comparing it with inward FDI. In this figure, technology transfer can be said to already have been successfully completed once knowledge obtained abroad has been transferred back to developing country headquarters. However, there is still potential for further knowledge diffusion from these headquarters to other companies in the home economy. This will occur through normal competition and demonstration effects, backward and forward linkages, and labor turnover.

Figure 1 goes about here

When firms from developing economies manage to improve their firm-level capabilities by investing abroad, development in the home economy is being supported. This is because the subsidiary companies of such investments will transfer some of these newly acquired capabilities and technologies back to parent companies. Ideally, the eventual result is the expansion of the production possibilities frontier, technological catching-up, enhanced competitiveness of firms and industries, structural change and industrial upgrading.

4. MACROECONOMIC EXAMINATION

Beyond the above firm-level considerations, outward FDI can support development of the home economy at a more macroeconomic level. In contrast to firm- and industry-levels, where dynamic effects are most apparent, static effects predominate at the macroeconomic level. Static effects are usually quantifiable and capture the impact of FDI on income, productivity, employment and exports, while dynamic effects are difficult to measure and capture qualitative aspects, such as technology transfer, linkages and structural change (Chai, 1998, p. 163). The two macroeconomic areas of primary significance for outward FDI are financial flows and resource flows.

It was pointed out above that outward FDI initially involves an outflow of capital, crowding out investment (and employment) that might have otherwise taken place in the home economy and constraining domestic fixed capital formation. It is only through returns on investment (ROI) that the home economy will eventually benefit from outward FDI. ROIs may be quite substantial, but they may also fluctuate over time (UNCTAD, 2006, p. 179). Outward FDI often generates financial returns by facilitating the engagement in international commerce for national firms (market-seeking investments). This enhances export activity and associated financial earnings, especially when firms in the home economy function as suppliers to the foreign invested entity. Increased domestic production for exports and other activities supporting the foreign investment also have the potential to enhance home economy employment. But the scale of this effect is likely to be limited and will depend on the nature of the investment (UNCTAD, 2006, pp. 178-182).

Developing countries can also benefit from the inflow of resources, especially raw materials, and this benefit is particularly significant if these resources are unavailable or scarce in the home economy. Specific types of outward FDI allow a high degree of control over resources, especially those securing exploration and exploitation rights for raw materials (resource-

seeking investments). Given availability uncertainties and the international price volatility of commodities, sole reliance on the market to obtain natural resources threatens to make domestic firms and the home economy more dependent internationally. If firms exercise at least some control over globally available commodities, they and the home country can gain an important economic and strategic advantage. Additionally, inputs for domestic production could become cheaper.

It is especially this recognition of macroeconomic gains from outward FDI that will prompt governments to incentivize outward FDI. For example, outward FDI was a component of China's development strategy from the early reform era, alongside the existing development-inspired goal of attracting inward FDI for development. Already from the mid-1980s, the Chinese government sought more consistently to promote outward FDI in areas such as the sourcing of raw materials to assure stable supplies of commodities that were scarce in China, the generation of export opportunities, and the transfer of advanced foreign know-how, managerial skills, technology and equipment to the home economy (Zhan, 1995; Guo, 1984; Zhang, 2003; Tan, 2001). Outward FDI promised to enhance international cooperation, strengthen emerging foreign trade links and raise China's influence in the world (Wu & Chen, 2001).⁷ Some of these aspects were also important parts of the rationale behind China's initiation of a going global policy (McGregor, 2005), which, after the turn of the century, further facilitated direct and indirect support to Chinese companies investing abroad.

5. DISCUSSION

In light of the arguments made so far, how important is the development dimension of outward investment? This section will discuss this question, examining the specific role

outward FDI can play in contributing to development, and comparing it with a country's other channels of interaction with the rest of the world. Finally, a conceptual framework on outward FDI and its development contribution is introduced.

(a) The importance of outward FDI

In spite of the theoretical arguments and the empirical examples provided, uncertainties remain about the magnitude and importance of the impact that outward FDI has on the home economy. In this context, it should be noted that the literature struggles more generally in determining the development impact of FDI. There is a rich literature on the effects of *inward* FDI on economic growth and development, but it also remains inconclusive and ambiguous, both theoretically and empirically (Crespo & Fontoura, 2007; Fan, 2003; Moran *et al.*, 2005; Shan, Tian & Sun, 1999; Young & Lan, 1997). One general analytical constraint is that spillovers and other knowledge flows are not directly measurable and do not leave a paper trail (Saggi, 2002, p. 208; Krugman, 1991, p. 53). A favorable outcome may depend to a significant extent on the specific conditions of the host country. Common criticisms are that inward FDI will be followed by capital outflows, when companies repatriate their profits to the home economy. The technology brought in by foreign investors is often more dated and at times unsuitable to the needs of domestic consumers, while the employment of expatriates in key positions could reduce potential skills transfer to local employees (Sornarajah, 2004, pp. 51-55). Dependency theory even argues that inward FDI is harmful to economic growth in developing countries (Fan, 2003, p. 35). Latin American in origin, the theory argues that multinational enterprises act according to the interests of their headquarters and shareholders in advanced economies, thereby conferring the greatest benefit on their countries of origin in the developed world (Sornarajah, 2004, pp. 57-58). It even argues that developed countries

increase their prosperity by extracting resources and labor from developing countries (Fan, 2003, pp. 35-36). It is also important to note that a positive impact at the firm level may indeed not necessarily benefit development of the economy as a whole, as the interests of a firm do not always coincide with those of overall society and are not always conducive to sustainable economic development (UNCTAD, 2006, pp. 170, 175).

Given these uncertainties in analyses of inward FDI and development, there is no reason to expect more certainty about the impact of outward FDI on home economy development. For various reasons, the spillover effects generated by outward FDI are likely to be less evident, compared with those forthcoming from inward FDI (Hejazi & Safarian, 1999, p. 498). The scope of organizational learning and knowledge transfer may be reduced by the additional steps involved in the process, involving the engagement of a relatively small number of firms from the home economy in relevant activities. Outward FDI could constrain home economy investment and fixed capital formation, replace exports from the home economy and reduce employment as a result of “crowding out” effects (UNCTAD, 2006, pp. 180-182). Tentative evidence suggests, however, that the effect on exports and employment at home is more likely positive (Lipsey, 2004; Lipsey, 2002; Lipsey & Weiss, 1981).

Nevertheless, although these considerations appear to make outward FDI less promising for development, there are also particular advantages of outward FDI. The possibility of securing access to natural resources overseas is quite unique to outward FDI, and can hardly be achieved by other means. This allows firms to obtain cheaper or required inputs for production at home. Other assets, such as certain technologies or brand names, can also only be obtained through overseas investment. Outward FDI enables firms to expand into international markets, generating revenue which is often repatriated to the home economy. In fact, even dependency theory would indirectly support this approach: since proponents of this

theory emphasize that FDI benefits primarily the multinationals themselves and their home economy, the multinationals and shareholders from developing countries, as well as the entire economies of which they are part, should be able to benefit substantially from outward FDI in other economies.

Another important advantage is that foreign firms investing abroad can be proactive in their strategy on how to pursue foreign assets, technologies and know-how.⁸ For example, they have some leverage in determining appropriate investment locations – such as in advanced economies or in the vicinity of technological leaders – or in deciding on the appropriate entry mode (e.g. greenfield investment vs. M&As) and on suitable foreign companies for acquisition. In other words, these firms can seek to select or develop know-how and technologies overseas that are most appropriate for production conditions in their home economy and compatible with indigenous technologies there. In addition, outward investing firms may also secure access to the specific raw materials they – and other home economy firms – need for production. Overall, therefore, outward FDI offers greater flexibility in pursuing whatever goals investing firms set themselves. The larger degree of control over the process raises the prospects of gaining access to valuable technologies, assets and resources that are important for development. However, there is also a price to pay for such elevated leverage and control: investing firms have to incur the financial burden and investment risks. Not only do they need to secure sufficient funds to invest overseas, but also the means of hedging against failure in fulfilling their investment goals. They must deal with an unfamiliar environment and political risk, and have to learn about the idiosyncrasies of host countries. The liability of foreignness (Zaheer, 1995; Child & Rodrigues, 2005, p. 385; Tang *et al.*, 2008, p. 39) may be a heavy burden, especially for firms from developing countries. For many

relatively weak firms, these burdens may be too large to shoulder, and valuable opportunities may, in consequence, be missed.

It is possible to deduct from the above that the benefits obtained at the firm-level from investing abroad may eventually have a positive economic impact on entire domestic industries in the home developing country. As firms investing overseas gain access to a larger pool of knowledge, skills and resources, including cheaper inputs and scarce raw materials, so should the industries located around the headquarters of the investing firm benefit from improvements in industrial competitiveness and industrial upgrading. Spillovers, linkages and competition effects from the internationalizing firm may benefit domestic firms which have not yet internationalized, and help them move up the value chain. These domestic firms could also acquire needed inputs for production at lower prices from the overseas investing firm. Because they are “local” in origin, outward investing firms with headquarters in the home economy have stronger domestic linkages and greater local embeddedness than foreign inward investors. This is because ties between the domestic players have been established long before companies made decisions to invest overseas. Domestic firms also commonly have similar characteristics and capabilities. Thus, spillovers and linkages among these firms will be more intensive, maximizing domestic diffusion of know-how that some firms have obtained abroad. One possible hindrance in this process, however, will be the need to transfer foreign knowledge obtained abroad back to headquarters and convert it into domestic knowledge. As illustrated above, this might involve a complex process of absorption and communication in which much can get lost. Since this responsibility of access and transfer rests with a small number of firms, i.e. only those domestic companies that decide to invest abroad, the possibilities for industry-wide effects in the home economy are reduced.

(b) Outward FDI and other transmission channels

The above discussion proves that there is a need for greater acknowledgement and recognition of outward FDI as a channel through which development can occur, not only in comparison to inward FDI, but also next to the other channels mentioned in this study's introduction. The commonly applied framework of national innovation systems (NIS) is useful for further illustration. This concept suggests that innovation and technology development are the result of a complex set of relationships among actors, which includes the movement of information and technology among individuals, firms and institutions (OECD, 1997, p. 7). An analysis of a country's NIS usually would focus on interactions among domestic players, but especially for developing countries, there is also the possibility to obtain technological capabilities from overseas sources, which then become an important component of the NIS.

This interaction of a country's NIS with the rest of the world is shown in Figure 2, which is constructed on the basis of similar depictions available in the literature (World Bank, 2008, p. 8; Andreosso-O'Callaghan & Qian, 1999, p. 128). Outward FDI is added as an explicit separate transmission channel next to exports, imports, emigration, immigration and inward FDI. The modified graph illustrates how a NIS is linked to foreign technological know-how through these six transmission channels. It further highlights the necessity of a domestic "technological absorptive capacity", comprising an appropriate institutional and legal environment, a sufficient level of education and technological skills and supportive policymaking. With sufficient quality of domestic labor and other economic and legal fundamentals in place (World Bank, 2008, pp. 127-150; Mowery & Oxley, 1995, pp. 68-80), enterprises in the home economy will be better able to absorb the overseas technologies and then adjust and utilize them successfully. Spillover effects also play an important role in this process of technology adoption. If successfully implemented, this process can set the stage for

further technological achievements, promote economic development and support the establishment of a knowledge-based economy. A study by the Norden Nordic Innovation Centre demonstrated that activities of firms abroad can transfer knowledge into the national innovation system of Nordic home economies (Herstad & Jónsdóttir, 2006).

Figure 2 goes about here

The modified graph suggests that outward FDI is important enough and also sufficiently different from the other transmission channels to deserve separate consideration, in particular as the other channels exhibit limitations in their ability to transfer technology and know-how. For example, technology gains from imports of capital goods are limited by the difficulties in discerning tacit or non-codified elements of products through activities such as reverse engineering. Similarly, when developing country firms or original equipment manufacturers (OEM) receive technology from foreign firms to improve their products for export, only a limited range of technologies is transferred, and arguably less advanced ones, to the developing country manufacturer. Even firms investing in a developing economy will limit technology transfer, maintaining control over the technologies they bring to the host country by keeping them within the confines of their own factory or plant. Foreign companies tend to avoid transferring core technologies and use less advanced technologies in overseas locations. As inward investors are often unwilling to transfer advanced know-how voluntarily, most actual transfer of know-how to local entities occurs through spillover effects. In addition, because of the differences in the nature of technologies used, the know-how brought into a country by foreign investors may not match well with domestically developed technologies.

Licensing agreements are also fairly limited in their potential to transfer know-how, as licensing firms are usually reluctant to use such agreements for advanced technologies with inherent proprietary value. Last but not least, technology transfer through international migration and overseas (diaspora) networks is constrained by the “brain drain” (World Bank, 2008, pp. 122-123; Docquier, 2006; Adams, 2003). A large proportion of migrants may not return to their country of origin after completing their education and training, opting instead to work in overseas companies and universities. Furthermore, it remains an open question to what extent these individuals are able to carry or transfer much complex and tacit technological know-how back to their country and effectively use it in home country industries. Finally, high-skilled immigrants from advanced economies quite rarely settle in developing countries.

It is therefore worthwhile to consider whether outward FDI, by its nature, can overcome some of these limitations and complement the other transmission channels. The recent increase in investments from developing countries in advanced economies indicates that some developing country firms recognize the possibilities offered by outward FDI. As discussed above, outward FDI allows more independence from decisions made by foreign firms and more freedom of choice in deciding where to invest, what know-how to seek, and how to seek it. This may result in more immediate and direct opportunities to access advanced and tacit know-how. Outward FDI also allows the acquisition of assets and capabilities beyond technological or managerial know-how, such as brand names, distribution networks, and natural resources. In light of these considerations, explicit attention to the unique benefits and shortcomings of transferring technology and other capabilities through outward FDI is overdue, in particular given the previous almost exclusive focus in the literature on the other transmission channels.

(c) An analytical framework

In order for increased consideration of the development dimension of outward FDI to go forward, a conceptual framework is needed. In the following, a framework is presented that is suitable in capturing the mechanisms that need to be in place if outward FDI is to have a positive effect on the home economy, making explicit the various ways in which outward FDI benefits economic development. The framework has three basic tenets.

The first tenet refers to conditions in the home economy that act as inducements to undertake overseas investment. These include: deficiencies in firm capabilities such as branding and technological sophistication, resulting in a need for technological catch-up; a lack of domestic availability of certain commodities and raw materials, resulting in a need to obtain them from overseas; and a saturation of the domestic market resulting in a need to expand commerce by entering foreign markets. In other words, outward FDI can promote economic development if it helps mitigate domestic scarcities, bottlenecks and constraints.

The second tenet describes how outward FDI can make such a contribution. It is arguably the most important element of the analytical framework, since it attempts to characterize the inherent purpose behind outward FDI activity. It is argued that firms invest in other countries in pursuit of assets and advantages that may, at least to a certain degree, be required in order to overcome aforementioned shortages, bottlenecks and constraints.⁹ For example, investment in overseas exploration and extraction of natural resources can have a beneficial impact by reducing domestic natural resource bottlenecks. Technological deficiencies can be addressed by engaging in overseas acquisitions of technologically advanced companies or by establishing R&D facilities abroad.

Finally, the third tenet of the analytical framework suggests that gaining access to assets or advantages overseas will generate returns that are transferred back to the home economy. These returns can be beneficial to economic development in the home country, in various ways helping to reduce its prevalent shortages, bottlenecks and constraints. Some returns are more effective in fulfilling this function than others. Returns take various forms: for example, technologies that help promote the catching-up processes of firms from the home economy, natural resources that reduce energy shortages and serve as inputs in production processes, or financial flows generated from gaining access to overseas markets, to mention a few. Therefore, returns can occur within the firm (e.g. technology transfer) or through the economy (e.g. natural resource flows). Different kinds of returns differ in their impact on economic development. Figure 3 depicts the three tenets of this analytical framework.

Figure 3 goes about here

Some may wonder why this study finds it necessary to introduce yet another analytical framework on FDI. What does this additional perspective add to the existing literature? At least three points can be made in favor of this framework. First, the analytical framework introduced here makes it possible to explicitly analyze outward FDI in the context of economic development. Other analytical perspectives proposed in the literature reveal clear shortcomings in this regard, especially since most literature on FDI that deals with economic development is concerned with the impact of FDI on the host economy where the investment takes place rather than on the home economy from which it originates.

Second, the framework advocated here can facilitate assessments of what types of outward FDI activity produce what kinds of economic outcomes. Such assessments would identify which assets and advantages generate which kinds of returns, and how effective these returns are in facilitating home economy development. They will make it feasible to distinguish between more or less beneficial types of outward FDI. Valuable lessons can be learnt for countries in the process of development and technological catching-up from a better understanding of the precise mechanisms through which outward FDI can improve domestic economic development.

Third, adoption of such a perspective will help develop our understanding of the role of ownership advantages as a prerequisite for successful foreign investment. While firms frequently possess such advantages before they invest, it need not necessarily be so, especially when firms from developing countries undertake outward FDI. In looking at the problem from the perspective of home country economic development, one may expect to encounter cases where firms invest abroad even though they do not seem to possess a particular competitive edge vis-à-vis host economy firms, or are, at least in terms of international competitiveness, not entirely ready to become global players. The strength of the analytical framework presented here is that it does not place too much emphasis on the role of firm competitiveness in FDI activity. Rather than applying the orthodox narrative, describing how firms exploit their competitive advantages through FDI, this study articulates a different narrative, focusing on what is available in overseas countries that is important for home economy development. This latter narrative is more suitable for understanding the development dimension of outward FDI.

6. FINAL REMARKS

This study has examined how outward FDI can support development of the home economy. Conceptually, it argued that outward FDI constitutes a pursuit of assets and advantages in other countries, where the returns generated from this pursuit promise to provide various benefits to the home economy. Such benefits will be most conducive to economic development if they contribute effectively in easing shortages, bottlenecks and constraints which confront the home economy, or in meeting other development needs. On the basis of the reasoning provided in this study, there should be little doubt that this development dimension of outward FDI exists – even if the magnitude of this dimension is unknown. The framework is not exclusive – other dimensions still have to be considered in parallel, as firms obviously also contribute economically to host economies, where development benefits accrue as well.

Economic progress makes firms increasingly competitive and hence promotes outward FDI; but at the same time, outward investment can, in turn, facilitate economic development. Returns from outward FDI are not only financial in the form of profits that are repatriated, but also enhance the broader development trajectory of the home economy. It is in this respect that outward FDI undertaken by firms from developing countries differs from that of firms from other advanced economies. Early outward FDI projects from the United States (for instance, those in the 1960s) were mainly geared towards efficiency- and market-seeking activities in countries that were less developed than the United States itself. As a result, the only real gains for the home economy were in terms of financial returns from low-cost production, market expansion and profits generated overseas. Given the global economic supremacy of the United States, its further *development* depended on its own efforts and could not be promoted by undertaking outward FDI in other countries. The developing countries

today, however, stand to benefit *developmentally* from investing abroad and in advanced economies.

The logic of this argument is that there exists a hierarchy of different types of outward FDI, measured in terms of their contribution to development of the home economy. Investment that leads only to the generation of financial profits will only be indirectly beneficial to development, while other types of investment generates concrete returns, such as technological gains, improvements in firm capabilities, higher productivity and efficiency. The more closely the returns from the pursuit of assets and advantages match development needs at home, the more suitable and effective will be the contribution of outward FDI to development. Thus, South-South investment in market- and efficiency-seeking activities may be less beneficial to development of the home economy than asset-seeking South-North investment.

One important constraint is that outward FDI requires the availability of capital, which will be less abundant in countries with low levels of development. Firms from these countries also have less absorptive capacity and international competitiveness. Hence, emerging economies are likely to benefit the most from outward FDI. Nevertheless, there are also encouraging aspects for poor countries. Some investments, especially in small R&D facilities, require only modest amounts of capital (Knörich, 2012). By setting up R&D centers in advanced economies at relatively low cost, firms from developing countries can benefit from proximity to and cooperation with other holders of knowledge, including major firms in the same industry, universities and research institutes. The developing country firm could, for example, choose to engage in research that is especially relevant to the specific circumstances of the home economy, such as in agricultural, environmental or pharmaceutical areas. The fact that this research is undertaken within the organizational setting of the firm, rather than through

the more common method whereby individuals are sent overseas for study and research, will alter the nature of the research that is pursued and the kind of knowledge that is generated, thereby promising to transfer some unique research outcomes. Similar to offering scholarships to students from developing countries, advanced economies could call for the submission of R&D projects, for which they would provide the necessary funding support.¹⁰ Other types of outward FDI projects could also be supported, for example by assisting with the establishment of incubation centers.

For governments formulating economic policies in developing countries, consideration of the development dimension of outward FDI is necessary, as governmental support of outward FDI could be an important means of improving economic conditions in the home country. If policymaking on inward FDI and in many other areas of the economy is guided by the concern for economic development, why should policymaking on outward FDI not be pursued to the same ends? While firm-level activity, depending on the specific type of outward FDI, may not always be conducive to economic development goals, governments will be inclined to support firms whose activities promise to provide a larger benefit to the home economy. In view of the framework presented in this study, government should promote investments whose returns serve to minimize domestic shortages, bottlenecks and constraints. Just as governments frequently create incentives to attract inward FDI, they also have the means to use tax incentives, financial support, and information provision to make certain kinds of outward FDI more attractive. Governments have a unique ability to encourage, supervise and direct national firms towards activities and sectors where the benefits of their investments abroad can most effectively address domestic development needs. What the government views as desirable outward FDI can be encouraged, while undesirable overseas investments can be restricted, with the beneficial impact on economic development being an

important criterion for desirability.¹¹ In this way, outward FDI could become an important component of a country's industrial policy and development strategy.¹² More research is necessary to determine what type of government involvement in outward FDI activity generates a positive economic outcome, and this study's analytical framework can be of assistance in such research.

This study's findings help explain why firms from developing countries increasingly enter the sophisticated and complex markets of advanced economies, despite potentially higher risks. Outward FDI in advanced economies offers firms access to assets and advantages that are less obviously available or not available at all in developing countries, but which promise to help achieve capability improvement of the investing firm and thereby promote catching-up and development of the home economy. Created assets, such as technologies, brand names and know-how, are more accessible in advanced economies. Developed countries can thus contribute to economic development by hosting foreign investors from developing countries. This explains why outward FDI may occur even if the investing firm lacks competitiveness in international markets.¹³ If one of the goals of an overseas investment project is improvement of a firm's capabilities, the possession of competitive advantages may be of secondary importance.

In conclusion, in order to understand the development dimension of outward FDI, it is important to focus attention on what the investing firm is seeking.¹⁴ The adoption of this perspective facilitates consideration of the implications for economic development in the home economy. It makes it possible to identify different types of assets and advantages pursued in overseas locations and compare them in terms of their degree of contribution to home economy development. Traditional theories that focus on asset-exploitation are less powerful for understanding the potential impact on economic development in the countries

from which FDI originates, even though they may be better for other analytical purposes. In other words, the particular perspective introduced in this study is meant to offer a convenient and useful way of exploring how firms from developing countries can benefit most effectively from outward FDI, granted that many of them may already have substantial ownership advantages. Indeed, a general hypothesis could be formulated to the effect that any kind of outward FDI, regardless of whether it originates from a developing or advanced economy, is an endeavor to pursue assets and advantages in overseas locations. For example, firms from the United States and Europe have a long tradition of investing in Africa for natural resources and in China to access low-cost labor.¹⁵ The main difference between these examples and outward FDI from developing countries is that the latter can be analyzed in the context of development economics. It is this aspect to which this study wishes to draw attention, and it is hoped that future research, possibly through application of the conceptual framework formulated in this study, will gradually develop a body of literature that examines in greater detail how outward FDI can best support development in the home economy.

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¹ The literature to a large extent remains focused on FDI among advanced economies, or from advanced to developing economies, no doubt because they have been and still are predominant in global FDI flows. A separate branch of literature has addressed the activities of multinationals from developing countries (Lecraw, 1977; Wells, 1983; Lall, 1983; Beausang, 2003). But studies on outward FDI from developing countries are still limited.

² For a selection of surveys on the existing literature, see JBICI, 2002; Saggi, 2002; Fan, 2003; Moran *et al.*, 2005; and De Mello, 1997.

³ For the traditional uses of the terms labor turnover, horizontal and vertical linkages together with their subcategories, see Crespo & Fontoura, 2007; JCIBI, 2002; Saggi, 2002, 2004. The present study adapts the concepts developed there to identify similar effects for outward FDI.

⁴ In the traditional literature on inward FDI, local firms in developing countries benefit from procuring to foreign firms that entertain *backward* linkages by purchasing from their local counterparts (Saggi, 2002, p. 213; Crespo & Fontoura, 2007, p. 412). By contrast, in the case of outward FDI in advanced economies, the learning entity is the foreign investor, not the domestic firm, with gains from procurement to more advanced firms made through *forward* linkages with local buyers.

⁵ In the traditional literature on inward FDI, *forward* linkages refer to domestic firms purchasing from foreign investors locating in the developing country (Crespo & Fontoura, 2007, pp. 412-413; JCIBI, p. 60). By contrast, in the case of outward FDI in advanced economies, beneficial contacts to suppliers in the advanced host economy represent *backward* linkages.

⁶ This may prove especially difficult if the foreign subsidiary has many employees from the host economy, as is often the case in M&As.

⁷ In 1995, Zhan described Chinese outward FDI as inward looking (Zhan, 1995, pp. 81, 94).

⁸ This may be preferable to passive reliance on the readiness of inward investing firms to transfer technologies, skills, resources etc.

⁹ An *asset* may be thought of as something concrete and tangible, such as a natural resource, low-cost or skilled labor, a capital good or a specific technology. An *advantage* may refer to something less concrete, such as

networks or markets, dynamic capabilities and externalities found in the form, for example, of technological and managerial know-how. The distinction between both is not clear-cut. Advantages may take a longer time to acquire than assets.

¹⁰ There might be a possibility so set such expenditure against the development assistance budget.

¹¹ There is a possibility that such government involvement will be criticized for distorting international competition, giving some firms an unfair advantage. However, if the result is a positive impact on economic development, there may be a justification in favor of some government support for altruistic reasons.

¹² This is a previously unexplored opportunity for governments to proactively influence how interaction with the rest of the world forms the domestic development process. Developing countries are often responsive to decisions made in advanced economies that are likely to affect their economic development, such as the decision of an advanced economy firm to invest in a developing economy, or that of a government to extend development aid. The success of this approach during the last half-century has been mixed. The possibility to promote outward FDI in the interests of development expands a government's "policy space" (UNCTAD, 2004, 2008b). It may also help that governments have more influence and control over domestic rather than foreign firms.

¹³ For example, one UNCTAD survey suggested that Chinese firms investing abroad have a relatively low level of competitiveness (UNCTAD, 2006, p. 152).

¹⁴ This is in line with the proposition made by Yang (2005, p. 46) that the literature on FDI should not only focus on the supply side (i.e., exploitation of proprietary advantages, with the investor as the supplier of capital and other benefits to the host economy) but also take a demand side perspective (i.e., focusing on asset-seeking and highlighting the gains from FDI for the firm itself and the economy of which it is part).

¹⁵ It can even be argued that as far back as colonial times, Western enterprises invested in the colonies to pursue assets and advantages there, fuelling the needs of manufacturing industries in their home economies, and thereby advancing the economic progress in countries like the UK.

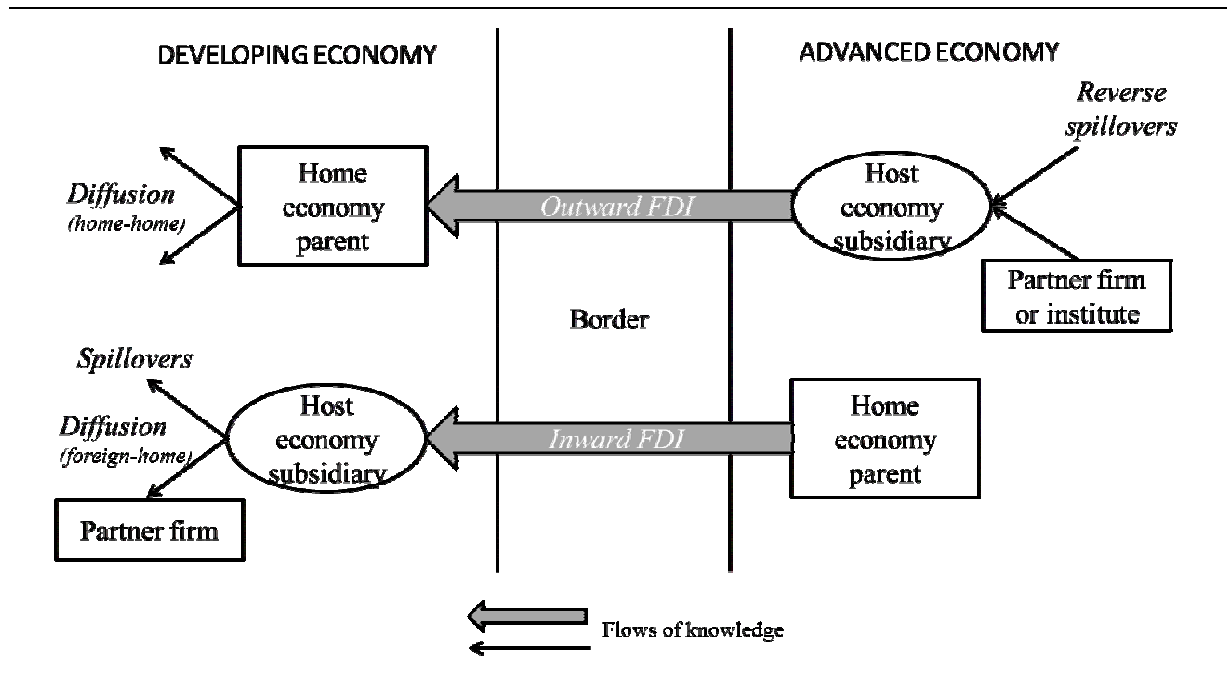
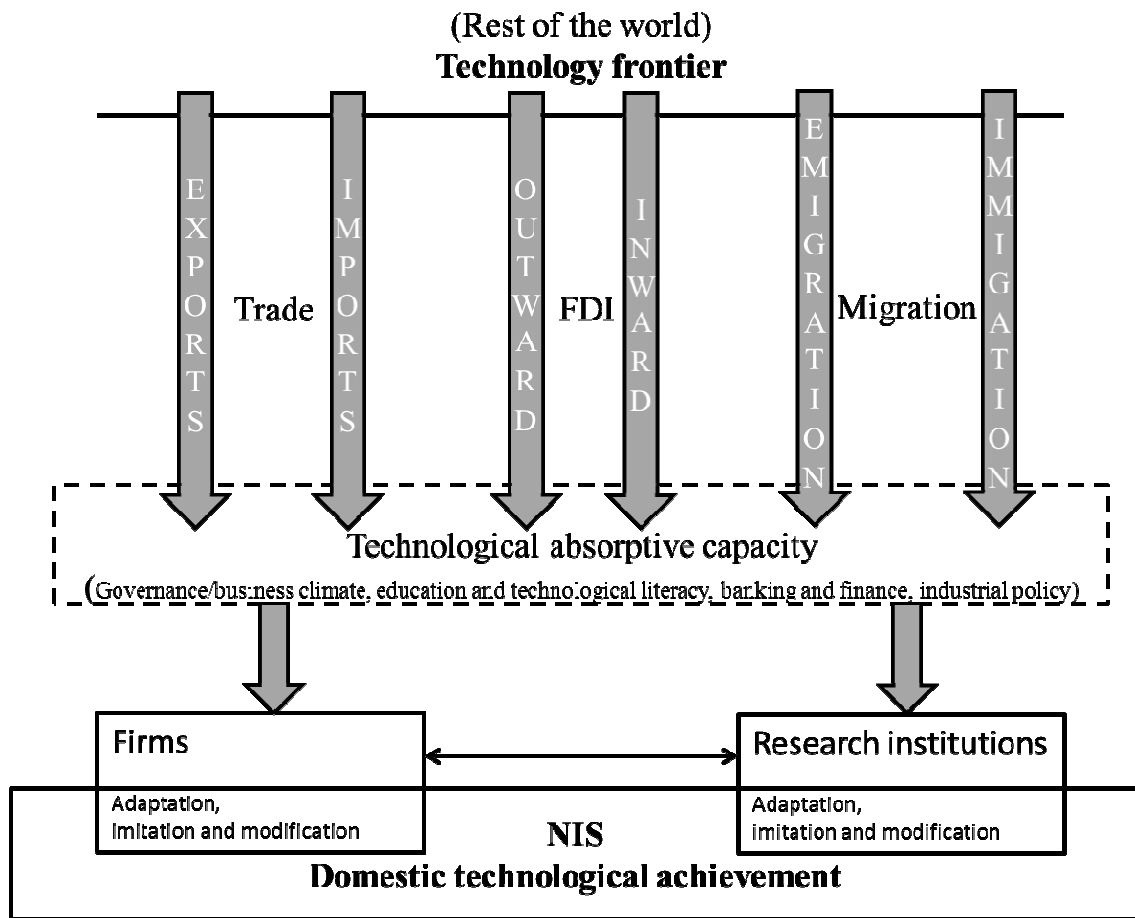


Figure 1. Cross-border knowledge transfer through outward and inward FDI



Sources: World Bank (2008: 108); Andreosso-O'Callaghan & Qian (1999: 128).

Figure 2. National innovation system's interaction with the rest of the world

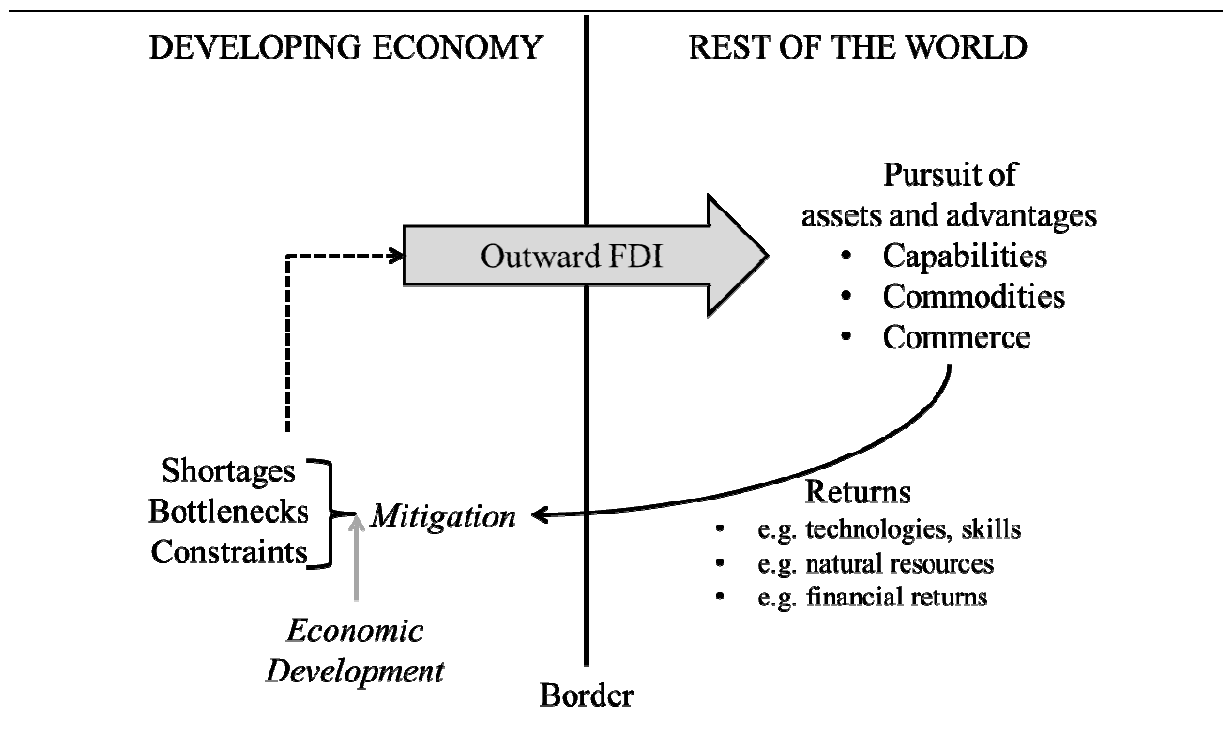


Figure 3. The development dimension of outward FDI: An analytical framework