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INVESTING IN EMERGING MARKETS

Motivations and Investment Decisions of Icelandic Firms

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ABSTRACT

The purpose of this thesis is to analyze the motivations and investment decisions of Icelandic firms that have invested in the emerging markets of China and India, and to compare their pattern with investment decisions of other multinational companies from small economies that have also invested in emerging markets. To the best of the author's knowledge, this is the first study to focus research on outward foreign direct investments of Icelandic firms in China and India. The research data are based on investment decisions of twenty Icelandic firms in various industries that have entered the Indian and Chinese markets, from one up to more than 10 years ago. The findings of this research provide an insight into the motivations and experience of the Icelandic firms in the Indian and Chinese markets.

As the Icelandic market is small, the main motivations of the Icelandic firms to enter China and India were to establish a long-term presence in a larger market with strong growth prospects. The research findings also revealed a resemblance with firms from the small economies of Finland, Switzerland, Australia and Sweden, when compared with the pattern of the Icelandic firms.

Being a small economy, Iceland achieved an impressive economic record over the last decade, but the country is a part of the international market and when the global market has lows that inevitably affects Iceland's economy. Activities in small economies are usually concentrated in a few sectors, and therefore it is important to diversify and take advantage of what other locations have to offer and think big; China and India have a lot to offer for firms from this small North Atlantic island.

PREFACE

The extent of investments of Icelandic firms to China and India was greater than expected before the process of this thesis began. The impact that small economies like Iceland, following their arrival in Asia, have on these markets is not as noticeable as if a US or a Japanese firm were investing. But as the number of Icelandic firms in these two markets rose, the ties and interactions between the countries extended. Business relations between Iceland and China have hitherto been stronger than those between Iceland and India. For example, the Icelandic Business Forum (IBF) was established to unite all Icelandic companies in China and to strengthen Icelandic-Chinese business and trade.

Some organizations in Iceland, such as the Central Bank, publish material and data about foreign investment from Iceland. The location factors of the Chinese and Indian markets to attract foreign investment have been well documented and published. The author therefore found it interesting to explore and combine these three economies together in a study. China and India are culturally and geographically distant markets from the Icelandic one; it was therefore with great interest that knowledge on these huge economies was extended.

The remarkable and potential growth in the Indian and Chinese market is evident, and it is no surprise that organizations and international business scholars predict that the spotlight in the international business world in the coming years will be on these two economies. The uncertainty about Iceland's economy in the coming years is perhaps greater, as it is in the midst of recovering from the impact of the global financial crisis. But the author is keen to follow the progress of these two emerging markets, and hopefully to witness further developments of Icelandic firms operating in China and India.

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1 INTRODUCTION

1.1 Background

Significant structural changes across the global market, such as the easing of restrictions and legislation, created new opportunities for foreign direct investments (FDI). Economic growth and technological developments enabled companies to have tools and freedom to expand across geographical boundaries, not only to enter new markets but to also benefit from differences in locations: these may be geographical features such as natural resources, clusters in certain locations and an abundance of low-cost factors.

Generally when a company enters a foreign market the investment is related to servicing the local market with new or improved products and/or services. But, to elaborate on the definition of foreign direct investment, the Organization for Co-operation and Development (OECD) defines FDI as investment that “reflects the objective of obtaining a lasting interest by a resident entity of one economy (direct investor) in an enterprise that is resident in another economy (the direct investment enterprise). The “lasting interest” implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises; both incorporated and unincorporated (OECD, 1999: 7-8).”

Commonly, investments of at least ten percent of total equity in a foreign firm are classified as foreign direct investments (the Central Bank of Iceland requires at least 10%). Foreign investments that are below ten percent ownership are classified as portfolio investments. Hence a foreign direct investment is considered a long-term commitment, and depends on the ownership share in the foreign entity (Central Bank of Iceland-a).

According to Peng (2006) the definition of a multinational company (MNC) is “firms that engage in foreign direct investment by directly controlling and managing value-adding activities in other countries, often have to adapt their strategies, products, and services for local markets (Peng, 2006: 5).” Hence, the term MNC will be used throughout the thesis for firms investing in foreign markets.

Foreign investment was not always considered favorable for receiving countries, and some governments hindered foreign investors from entering the country in order to defend the domestic market. But as governments of such countries as China and India sought to open up their markets the countries experienced an increasing inflow of foreign investments and today China has become one of the largest recipients of FDI. Governments and policymakers have continued to seek ways of making investment conditions in their countries more attractive. Of course debate continues on whether and how the host countries benefit from these investments.

Iceland was not a front runner as an investor in the newly opened-up markets, although there was a boom in foreign investment from Iceland in recent years. Iceland's economic growth, and foreign investments by a few Icelandic companies in European countries, did not go unnoticed in the business world. Some speculators were amazed by the swift, sharp increase in capital invested by Icelandic businesses, particularly in the UK, the Netherlands and Denmark (Hermannsdottir et al., 2007). For international comparison, Iceland made it into the top three of a top 20 rankings list on inward and outward performance indices for 2006 and 2007 listed by the United Nations Conference on Trade and Development (UNCTAD) (*World Investment Report 2008*). This success was extraordinary considering the small size of the economy.

The present thesis focuses on three countries – Iceland, China and India – and analyses of foreign direct investment of Icelandic MNCs in the two latter countries. The choice of the source country is not random; as the author is not aware of other similar studies conducted in Iceland regarding this topic it was a challenge and of interest to investigate the motivations, experience and obstacles of the Icelandic companies that have invested in China and India. The reason for choosing China and India is twofold. Firstly the size of these markets is huge, and they have been on top of the foreign direct investment receiver list in recent years among emerging markets. Also, in an UNCTAD survey for 2008 to 2010 the most attractive locations for foreign direct investment in the next three years were China in first place, and India in second (*World Investment Report 2008*). Secondly, according to the Central Bank of Iceland, foreign direct investment flows from Iceland to these markets have been increasing, especially since 2005-7. Detailed analyses of the reason for greater interest and entrance into these markets would therefore be interesting to explore.

1.2 Research Question

The research question put forward is the following:

What are the main motivations in the decision for Icelandic MNCs to invest in emerging markets and is the behavior similar to that of MNCs from other small economies with reference to similar research carried out?

1.3 Description of the research

The interest in researching emerging markets was sparked during the course “International Business in Emerging Markets” at Bifröst University, Iceland. The choice of this topic is due to the increasing role played by emerging markets in the international business world. The economic liberalization of countries like China and India has changed the scenery on the international market completely, and these countries are now being referred to as emerging markets. Firms from Iceland, like so many other companies from other countries, have recognized the potential of the emerging markets, and have therefore entered these markets in various industries. Foreign direct investment has risen substantially in past years, reflecting economic growth and strong economic performance in many parts of the world.

Iceland is no exception in this global economic growth phase, and this thesis will explore outward FDI from Iceland and other small economies in emerging markets, and augment this research with theories put forward by International Business (IB) scholars related to those topics.

1.4 The objective of the research

The objective of this thesis is to analyze and obtain more knowledge of FDI behavior of small economies in emerging markets, and in particular to focus on Iceland’s investment relationship with China and India. This study will also attempt to research the FDI behavior of Icelandic MNCs in emerging markets (China and India) and to explore the company’s future plans in the markets.

The terms “emerging market” and “small economy” require definition as an understanding of foreign direct investment and the mechanisms of how companies choose to engage in FDI. For the purpose of this research, Iceland is defined as a small economy, and India and China are emerging markets.

Many IB scholars have written about small economies, emerging markets and foreign direct investment, but few studies combine these elements. Many organizations also publish reports and data on these subjects, such as the World Bank, the Organization for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF) and the United Nations Conference on Trade and Development (UNCTAD).

The above mentioned objectives will allow for comparison with other studies on small economies and their FDI behavior in emerging markets.

1.5 Research Method

The research will be based on both quantitative and qualitative data. Quantitative data were collected through a multiple-choice questionnaire that was sent out to twenty-three Icelandic companies that have entered an emerging market, and qualitative data through an individual depth interview. Research on the internet was conducted, as well as an interview with the Secretary General of the Icelandic Business Forum (Icelandic companies in China) and correspondence through emails with the Honorary Consul General to India in Reykjavik, to establish which Icelandic companies are participating in emerging markets; this yielded a list of relevant companies, which were then asked to answer the questionnaire. In the questionnaire the representative of the company was asked ten multiple-choice questions and instructed to mark the option that applied to the company regarding motivations to enter, entry mode, benefits and experience in the emerging market. Then there was one open question where the representative was asked to assess the future developments of their companies in the market.

In summary, the research methodology consisted of both quantitative and qualitative data and will hopefully result in a clear conclusion with each method supporting the other and strengthening the research.

1.6 The importance of the research

There is a gap in the literature about outflow of foreign direct investment from Iceland to emerging markets. Past research on this topic has been dominated by study of US and Japanese investment; while a few studies address outward FDI from small economies, such as Australia, Sweden, Switzerland and Finland, but none deal with Iceland.

This research is important because, to the best of the author's knowledge, similar research has not been conducted in Iceland before. If the research indicates trends in the strategic thinking of Icelandic firms and firms from other small economies that have entered emerging markets that could potentially benefit current and future entrants into those markets, as well as Icelandic organizations that are linked to international trade. An attempt to determine FDI behavior in emerging markets will be informative, not only for managers of Icelandic firms, but also to the governments and policymakers in Asian countries that wish to attract more investments from small economies such as Iceland.

The study could also lead to a conclusion that the subject needs further exploration.

This study can contribute to research on small economies in the international business world by focusing on firms from Iceland, the smallest economy of the OECD countries, though with a significant swift and sharp increase in foreign investment in recent years.

As foreign investment continues to grow in the global market, the method of this study could possibly be useful for examining FDI behavior of Icelandic firms in other parts of the world, such as in Africa and Eastern Europe.

1.7 The structure of the thesis

The initial chapter of this thesis contains the introduction and outline of the background, the research question, and description of the research, objectives, research method and the importance of the research. The next chapter comprises a literature review on foreign direct investment theories, small economies and review of emerging markets. Reviews of other studies of small economies which have entered emerging markets will also be covered. Chapter three contains an introduction to the three markets covered in this present thesis: the backgrounds of the countries foreign direct investments and relations between the countries thus far. Following that is the outline of the methodology for this thesis, and the questionnaire which was conducted for the present thesis and the characteristics of the sample of the participating Icelandic MNCs are discussed. The next chapter provides the research findings from the data collected on the Icelandic MNCs in the questionnaire which was conducted for the present thesis. Finally are the conclusions and discussions of the thesis and suggestions for future research.

2 LITERATURE REVIEW

2.1 Foreign direct investment

IB scholars have sought to answer many questions regarding the hundred of countries, thousands of firms and millions of products and services in the world, such as: What motivates a firm to invest in another country? What benefits does the firm expect to achieve? The theory of foreign direct investment has been used to explore the ever changing answers to these and more questions, by scholars such as Hymer (1976), Dunning (1980), Vernon (1979) and Johanson and Vahlne (1977). This chapter reviews theories regarding foreign direct investment, what factors influence FDI choices, and interaction between MNCs and host countries or their governments.

2.1.1 Review of FDI theories

In the 1960s scholars from Harvard, for example, worked on the determinants of FDI by location theories, in particular decisions by the US market seeking FDI by US firms in developed countries. In the early 1970s attention switched to the behavior of the firms making the investments. From the later 1970s to the present, the so called market failure paradigm has been dominant: the internalization theory, transaction cost theory and eclectic theory (Dunning, 1998).

A number of influential theories have been propounded to analyze how firms behave regarding foreign direct investment, such as: Hymer's theory (1976), Product Life Cycle theory (1966), Internationalization theory (1975), Dunning's eclectic theory (1980), Internalization theory (1976), Transaction Cost theory (1986) and Location theory (1985). In the following chapters some of these theories will be described.

2.1.1.1 Hymer's theory

Hymer's (1976) dissertation drew the conclusion that direct investments are capital movements related to a company's international operation. The MNC's objective was to keep control of production and hence to have the ability to use its international operations to have different markets and eliminate competition, or to exploit advantages such as skilled labor, low-cost raw materials and access to advanced technology.

2.1.1.2 *Product Life Cycle (PLC) theory*

Raymond Vernon (1979) applied the product life cycle to countries instead of products; he used this theory to explain cross-border activities of US firms in the post-war period. Vernon brought up the issue of competition, as the technological capability of firms was important to enable them to upgrade their assets or create new ones; i.e. the technological gap between the firm and its competitors. In some cases competitors are able to copy the technology of the firm, but if they are not able to copy it that will give the firm a huge head-start over the competitor. That will give the firm an opportunity to produce the product at each phase of the life cycle: the question then arises of where to produce the product at each stage (Papanastassiou, 2008).

Stage one is the introduction stage, where new products are introduced to meet local demand, but the supply is more than demand so the firm exports the product to a similar country, i.e. with similar preferences, needs and incomes. The firm does not compete through price, but on the attribute of the product or the technology, so the firm needs to go to countries that have consumers that want the product. According to Vernon's study, new products that were produced in the US in the post-war period were labor-intensive, because the products were made by white-collar employees with high wages.

Stage two is the growth stage, as a copy of the product is produced in another country based on the cost of production and introduced in the home market.

Stage three is the maturity stage, as the industry contracts and concentrates; this is the stage where the lowest cost producer has the upper hand.

Stage four is the decline stage, when products have been standardized and firms compete through price only. Firms in countries such as the US can no longer compete in price so they import the product. Labor is cheaper in other countries so the product is no longer produced in the US (Papanastassiou, 2008).

Vernon's theory is not considered the most useful one in explaining FDI, but it has contributed to understanding the nature of firm's competitive advantage.

2.1.1.3 *Internationalization theory*

Much research has been conducted on the internationalization of firms, but the best-known research is arguably the study carried out at Uppsala University by Johanson and Vahlne (1977). The research showed that many Swedish firms had internationalized by following each other consecutively into new markets. Johanson and Wiedersheim-Paul's (1975) research found that a similar process could be observed for many firms from other small economies.

Johanson and Wiedersheim-Paul (1975) used the notion of psychic distance to describe the problems which could arise by entering into a new market. Examples of such problems are language and cultural differences, level of education and political system.

Johanson and Wiedersheim-Paul (1975) made the assumption that market size has an effect on decisions in the internationalization process. They argue that perhaps firms from small economies would prefer to start operations in smaller markets that have similarities with the domestic market and require less resource commitment initially.

The entry mode of Swedish firms into the foreign market usually began with an agent, and would later develop into wholly-owned firms, and in the end the firms would start their own production (Johanson and Vahlne, 1977). When firms in international business are entering a particular market in a possibly distant country, the entry mode needs to be well considered, since the company can choose between various forms of transactions. This includes choosing between firm structures: for example, creating a new firm with greenfield investment or through mergers and acquisitions. Other forms of entry include joint venture, licensing, franchising, alliances or subcontracting. Lee (1991) stresses the point that the choice of entry mode is influenced by the size of the transaction cost and the assets at stake. If, for example, a product is made and sold by a particular company and protected by a registered trademark, strong control would be more efficient. Luo (2001) points out that property rights systems are known to be weak in developing markets, and hence that factor should be considered with great caution when an entry mode is selected, as technological advantages and knowledge are crucial for a firm's competitive lead in new markets.

2.1.1.4 Transaction cost theory

The transaction cost theory was developed by Williams in 1975 and then further applied by Anderson and Gatignon (1986). This theory has been used to shed light on entry-mode decisions and especially effective in explaining vertical integration decisions.

In Peng's (2006) book on global strategy, a transaction cost is defined as costs associated with economic transactions or the cost of doing business. These may include costs of drafting and negotiating contracts, research, shipping and monitoring itself. It depends on the volume of the transaction cost whether low-control entry mode or high-control mode is chosen. If transaction cost is low then low-control mode is selected, but if a high-control mode is chosen then the decision may be premised on one of the following (Luo, 2001):

- Uncertainty of demand for the products or service is high in the foreign market
- The appeal of the foreign market is high
- The cultural distance between the home and host market is high
- There is something unique about the assets that the firm brings to the foreign investment

2.1.1.5 Dunning's eclectic theory

Last but not least is the eclectic paradigm created by Dunning (1980, 2000). This approach, the so called OLI-paradigm, states the assumption that three types of advantages influence cross-border business activities of firms: ownership (O), location (L) and internalization (I) advantages.

The first paradigm argues that a MNC will engage in FDI or increase its existing investment only if it benefits from an ownership (O) advantage over the domestic firm. Ownership-specific advantages are firm-specific assets that are reflected by the firm's size, multinational experience and the firm's ability to develop differentiated products. As stated by Dunning (2000), "the greater the competitive advantages of the investing firms, *relative to those of other firms* – and particularly those domiciled in the country in which they are seeking to make their investments – the more they are likely to be able to engage in, or increase, their foreign production" (Dunning, 2000: 164). The ownership-specific advantage specifies which transactions are gained with the operations of firms; MNCs have to have some advantages that overcome the cost of operating in

foreign markets (Peng, 2006). Examples of this are superior technology, unique product, lower costs, or organization skills.

Peng (2006) describes the second paradigm as an advantage that certain countries may bring firms operating there: location-specific-advantage. Dunning (2000) notes that some sectors (e.g. the oil and pharmaceutical sector) are more inclined to engage in FDI than other sectors (the iron and steel sector) because their needs for a location outside the home market are greater. Some firms would like to use sources (i.e. geographical, market potential, lower production costs) in foreign markets in order to make further use of their O advantage and sometimes clusters arise along the way. For example, Singapore is considered to have a location advantage, as it is an ideal stopping point for sea and air traffic connecting e.g. Europe and the Indian Ocean basin (Peng, 2006).

The third paradigm, the internalization (I) advantage, is when a MNC transforms an external market with in-house links, and as a result can reduce cross-border transaction cost and increase efficiencies (Peng, 2006). Dunning (2000) writes that internalization theory suggests that, “as long as the transaction and coordination costs of using external arm’s length markets in the exchange of intermediate products, information, technology, marketing techniques, exceed those incurred by internal hierarchies, then it will pay a firm to engage in FDI, rather than conclude a licensing or another market related agreement with a foreign producer” (Dunning, 2000: 179). Dunning (2000) further notes that in this era of globalization the primary focus is on the MNC’s capabilities to access and organize knowledge intensive assets. The MNC should also integrate, not only with its existing competitive advantages, but also with other MNCs and their complementary value added activities.

The eclectic theory offers several suggestions for international business theories on activities in the global market. It can identify variables that are most relevant in explaining the entry-mode choices of firms that are investing abroad, and behavior in FDI choices (Tahir and Larimo, 2005).

2.1.2 Motivations for foreign direct investment

A MNC seeking to invest outside the home market may have a number of specific reasons for entering a foreign market. The investment may be used to strengthen the global market position, or to acquire new sources of competitive advantage. Scholars such as Dunning (2000) mention four types of activities that MNCs can undertake in a foreign market:

1. *Market-seeking FDI*: the purpose is to satisfy a particular market or gain more market share.
2. *Resource-seeking FDI*: the purpose is to gain access to natural resources such as cheaper labor or raw material. For many years the only reason for a MNC from a developed country to look into investing in a developing country was for resource-seeking. But today the developing countries offer more reasons for MNCs to enter the emerging markets.
3. *Efficiency-seeking FDI*: the purpose is to move to a more efficient division of labor or specialization of an existing portfolio of foreign and domestic assets by MNCs. In short, MNCs take this action to reduce costs through economies of scale and scope.
4. *Strategic-asset-seeking FDI*: the purpose is to protect or increase the existing ownership-specific advantage of the firm by making the investment, and/or to reduce that of their competitors (Dunning, 2000).

These four types of activities help to explain the motivations for an investment and the decision on the location of foreign direct investment. Dunning (1994) states that the literature has indicated that the location in which FDI is preferred will depend on the motives for the investment and whether it is new or continuous. Dunning further notes that research has showed that a continuous or so called *sequential* FDI “is not only likely to be more geared to the interests of the investing company’s value activities, but is also likely to generate its own unique costs and benefits, that is, over and above those generated by the initial investment” (Dunning, 1994:5).

According to a study conducted by Ásta Dís Óladóttir (2009), the two main motives for Icelandic companies to invest abroad were market-seeking and strategic asset-seeking. In the study the motivations behind the Icelandic FDI are compared to the Slovenian market, which is a small

economy like Iceland, which resulted in the same motivations. Much first-time FDI by firms, particularly in emerging markets like China and India, has market-seeking motives.

Efficiency-seeking FDI between developed countries, and between developed and emerging markets, has been rising, as transportation costs have fallen and barriers to international trade have been lowered (Dunning, 2000).

There are more motivations to consider behind a MNC decision on a location for FDI. Michael Porter said that “anything that can be moved or sourced from a distance is no longer a competitive advantage” and that “the true advantages today are things that are sticky, that is not easily movable” (Porter, 1998: 29). There are obvious clusters among MNCs that have been formed in countries such as India (such as the IT cluster) and China (electronics), as well as network linkages in, for example, the financial sector in Tokyo, R&D in Silicon Valley and factories in the Philippines. Anything that can be replicated is no longer a competitive advantage, which means MNCs need to invest in a more cost-effective location or “sticky location” in order to gain advantage over their competitors (Papanastassiou, 2008). Choosing a location for FDI becomes a critical strategic choice for firms when considering clusters and links.

2.1.3 Foreign direct investment and countries

An investment in a foreign country can benefit the receiver by increasing the economy’s stock of capital, leading to higher productivity and higher wages. Although some of the benefits will flow back to the foreign owner, many economists advise governments in less developed countries to advocate policies that encourage investment from abroad in order to benefit (Mankiw, 1998). The question for these countries is how to best attract FDI, and for that matter the right kind of FDI they wish to attract.

In their research Narula and Dunning (2000) write that the objectives of national governments and MNCs are essentially different. No matter where the owner of a MNC is located, the aim (at least in most private enterprises) is to maximize the profit of the firm, in order to increase the owners’ return on their investment. A government would like to do the same for the citizens of

its country. Both MNCs and nations have increasingly realized that their relationship can be beneficial for both, as they seek to upgrade their resources and their efficiency. The major conflict between the two parties concerns the distribution of costs and benefits of the investment in the country. According to Narula and Dunning (2000) negotiations between the MNC and the government come down to the opportunity cost perceived by the MNC of the O advantages, and of the L advantages provided by the country where the MNC would like to invest.

Narula and Dunning (2000) note that each negotiation is different; it depends on the type of investment and economic conditions in each country. For example, conditions faced by the least developed countries and the emerging markets are very different, as are their bargaining powers at the negotiating table. With respect to the position of the MNC at the negotiating table, it can depend on the degree of governmental interference in the host country. If interference is high, a MNC would be better off entering the market in a joint venture with a local firm. This would limit the firm's risk by reducing the size of the investment and resources commitment, and give the MNC more room to exit the market if the economic conditions worsen (Luo, 2001).

What kind of competitive advantage do nations have, that give MNCs a powerful boost to start investing in foreign markets? In their study, Gugler and Brunner (2007) discuss three stages of competitive development, defined by Michael Porter that consider sources of advantages of a nation's MNC in international competition, and the nature and extent of internationally successful industries and clusters. These include:

- Factor-driven economies have an abundance of natural resources or low-cost for semi-skilled labor. MNCs mostly base their competition on prices in sectors that depend upon low technology level, or where the technology is accessible and inexpensive.
- During the investment-driven stage, the national competitive advantage is based on readiness and capability of a nation and its MNCs to use elaborated foreign process technology endowed on the world market through alliances, among other ways.
- In the innovation-driven stage, the MNC strategizes globally and focuses on international marketing for global market branding of the product. Porter emphasized that at this stage substantial foreign direct investment by MNCs has been reached.

2.1.4 The Investment Development Path

The Investment Development Path (IDP) of a nation put forward by Dunning is also relevant in relation to FDI. IDP takes countries through five stages of development, and classifies nations as outward and/or inward direct investors (Dunning & Narula, 1998).

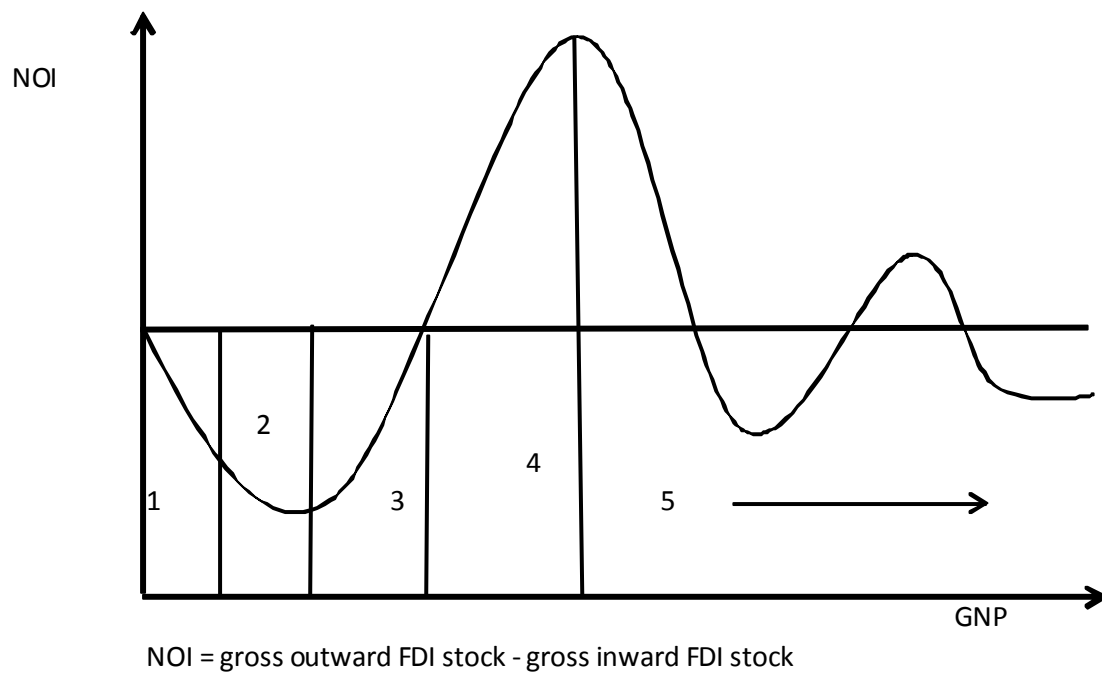


Figure 1: the pattern of the Investment Development Path

Source (Dunning and Narula, 1998)

As seen in figure 1, at stage 1 there is a negative position because it reflects countries that only receive FDI, for example developing countries in Africa. They do not have many location-bound constructed assets which emulates the limits of the domestic market. The ownership specific advantage is low but there can be a plentiful supply of raw materials that can have potential for the country. In stage 2 the countries still receive FDI, but they are closer to becoming emerging markets, such as countries in North Africa. They have infrastructure, rising educational standards and transportation systems. The inward FDI may be more in labor-intensive production. Outward investment begins at this stage for possible market-seeking reasons in a neighboring country or for strategic asset-seeking reasons in developed countries. In stage 3 economic conditions are on

the rise and looking better. This could be the stage at which European countries such as Greece, Portugal and Eastern European countries find themselves. The growth of outward investment is increasing, combined with a gradual decrease in inward investment. Domestic firms have grown stronger and are now capable of competing with foreign firms. Rising wages in the market will push manufacturing towards a higher technology level. At stage 4 and 5 outward investment is stronger than inward investment and firms can compete effectively abroad. Many EU countries are at this stage, as is Japan. Domestic firms are competitive in the home market and are also entering foreign markets. Because of their ownership-specific advantage they engage in FDI rather than give it away through activities such as franchising. Their O advantage is now less dependent on their nation's natural resources, but rather on their capability to access assets and to organize them effectively (Dunning & Narula, 1998; Papanastassiou, 2008-b).

It would be interesting to place Iceland at a stage in the investment development path for the year 2007. From reviewing figures from the Central Bank of Iceland regarding outward and inward investments, the conclusion can be drawn that in 2007 Iceland was in stages 4-5, as outward investment was larger than inward investment. In 2007 the total outward FDI was ISK 872,972 million and total inward FDI was ISK 749,000 million. In a paper published by the Institute of Business Research at the University of Iceland (Hermannsdottir et al., 2007) the authors write that foreign investment from Iceland increased considerably and that the expansion in recent years of Icelandic companies into foreign markets was remarkably swift. They further state that several Icelandic companies became leading global players in their markets in a relatively short period of time. In the paper the authors explain that several key players were expanding through acquisitions of foreign firms. Through firm acquisition Icelandic companies could not only gain control of other companies, but also acquire access to resources, improved efficiency and enhanced access to larger markets (Hermannsdottir et al., 2007).

2.2 Small Open Economies

The wealth and influence of small economies in the world has been growing as the number of these countries increases. At the beginning of the World War I there were only 62 independent countries; since then the number has risen to 195. This increase has been due to the formation of

many small economies. The main reason for this growth is the end of colonial rule, specifically in sub-Saharan Africa. Following that, the collapse of the Soviet Union gave rise to many independent countries. The economic conditions of the small economies vary greatly, but being small is no obstacle to become wealthy, as witness in the case of Luxembourg (*Little countries*, 1998): the country enjoys an extraordinarily high standard of living with a population of 486.000 and the second highest GDP (purchasing power parity) in the world, \$38.14 billion (The 2008 World Factbook, July 2008 est.)

2.2.1 Defining a Small Open Economy

The concept *small economy* is used in various ways by different authors and in diverse contexts in the literature and reports on small economies (see e.g. Hogenbirk & Narula, 1999; Merrett, 2002; Easterly & Kraay, 2000). It is widely agreed that no single definition of a small economy, exists and that there are many criteria by which one can classify the size of a country or economy. Within the International Business literature the most commonly used criteria for classifying the size of economies are; a) population and b) different measures of gross domestic product (GDP): absolute size of GDP, GDP per capita, and growth of GDP (see e.g. Merrett, 2002; Thomas & Grosse, 2001; The World Bank).

Yardsticks such as GDP and territory size have been found to be highly correlated with population; population can be concluded to be a good indicator of size, and will be used as a benchmark for the purpose of this thesis (The World Bank). Small economies may therefore be referred to as economies with an upper limit of 10 million people. Taking into consideration only sovereign developed economies, Iceland is, according to this definition, a small open economy, along with countries presented in table 1 which fall under the same definition of small, open economies.

Table 1: Small Economies and FDI outflows

Developed and Sovereign Economies with an Upper Limit of 10 million People

European Union

Country	Population (thousands)	FDI outflows 2007 (Millions of dollars)
Austria	8,205	31.437
Cyprus	793	265
Denmark	5,485	16.992
Estonia	1,308	1.531
Finland	5,245	8.623
Hungary	9,93	4.116
Ireland	4,156	20.774
Luxembourg	486	51.649
Latvia	2,245	232
Lithuania	3,565	600
Malta	404	19
Slovakia	5,455	384
Slovenia	2,007	1.569
Sweden	9,045	37.707

Other European Economies

Country	Population (thousands)	FDI outflows 2007 (Millions of dollars)
Andorra	72	-
Iceland	304	12.127
Liechtenstein	34	-
Monaco	33	-
Norway	4,644	11.168
San Marino	30	-
Switzerland	7,582	50.968

Non-European Economies

Country	Population (thousands)	FDI outflows 2007 (Millions of dollars)
New Zealand	4,173	2.840
Bermuda	67	400
Israel	7,112	7.047

Source (The 2008 World Factbook and World Investment Report 2008)

To use the upper limit of 10 million people is in line with Simon Kuznets (1960) definition of a small country. It should be noted that the specific population threshold has no particular significance. Rather, it is used as a yardstick since no single definition is likely to be fully satisfactory. Indeed, according to information from the World Bank website, “there is a continuum, with economies larger than whatever threshold is chosen sharing some or all of the characteristics of smaller countries.” This is evident when reviewing the literature on small open economies and FDI, as much of the literature identified takes examples of economies with population of 4-10 million people e.g. New Zealand, Sweden and Switzerland, but examples are also taken of countries with a population over 10 million people but with relatively small GDP. Australia is e.g. considered as a small open economy although it has a significantly larger population, of more than 20 million people, as the GDP generated is also relatively low when compared to the larger economies, such as France, Germany, UK and the US.

A relatively large population threshold is chosen here because of the economic development stage of Iceland. If one were to compare Iceland’s economy with other countries of more similar size in terms of population, most of the counterparts would be developing countries generating a significantly smaller GDP per capita than Iceland in the period under study (The World Bank).

2.2.2 Openness of economies

In today’s world, closed economies are very rare and most of the world’s economies are open to international trade. The level of openness is, however, variable. As stated by Maitland and Nicholas (2002) “the openness of an economy is usually defined in macroeconomic terms by the degree of trade in goods, services, and financial assets” (Maitland and Nicholas, 2002: 4). Accordingly, the ratio of exports of goods and services to GDP has been used as an indicator for openness (Merrett, 2002).

Small size of economies has been found to affect the level of openness (Baldur Thorhallsson, 2000). The fact that small economies rely more heavily on international trade, imports and exports, than larger economies is mainly due to the difficulty of achieving economies of scale in

the domestic markets. Many small economies are also affected by the location factor, in that they are remote or are almost completely landlocked (Easterly & Kraay, 2000).

An accepted assumption is that small open economies are price takers and therefore do not influence world prices. “Price takers” refers to the idea that prices for domestic and manufacturing products are determined by outside factors and that small economies are “open to the equilibrating effects of world prices and international factor and goods flows, which overshadow domestic forces in shaping the development of the economy” (Maitland & Nicholas, 2002: 12). Since small economies are more open to, and more dependent on, the world economy than larger economies (Baldur Thorhallsson, 2000) one might also expect their companies to behave somewhat differently when it comes to engaging in international trade or investment.

2.2.3 Globalization and Small Economies

Several milestones can be noted in the gradual development of globalization, and many small economies are threatened or could become even more isolated by this process if they do not succeed in staying ahead in globalization (Read, 2004). Read (2004) draws up a few steps of the globalization process:

- International trade became more liberalized with the strengthening of rules under the GATT (General Agreement on Tariffs and Trade) 1994.
- The liberalization of international capital flow, both short-term (portfolio investment) and long-term (FDI).
- The developing countries become more industrialized as the range of international production widens e.g. the growth of Newly Industrializing Economies in Southeast Asia. New emerging markets are opening up and are receiving the increased global output of industrial goods and services.
- MNCs play a key role as the liberalization opens up the possibility for further international capital flow (primarily FDI). Many developing countries have noticed the potential growth effects of FDI; the capital flow would enhance productivity through improved technology, labor skills and information.

Hogenbirk and Narula (1999) note; that small economies have been affected by the globalization to a greater extent than larger economies. One of the reasons is that, because of their size, the small economies are often more internationalized than larger economies, and they are often more involved in international trade and investments. Due to the limited resources in their home market, small economies seek assets and economies of scale in foreign markets in order to achieve growth targets. Because the options of small economies, in particular island economies, can be limited, they often become niche markets. For example the number of export products can be small and thus the number of targeted markets to export to will inevitably be few as well (Armstrong and Read, 2000). But specializing can bring efficiency, as in the case of the Icelandic fishing industry. Icelandic fishermen were more efficient than their Canadian counterparts and the reason was that the Icelandic government could not afford to subsidize its fishing industry. Iceland has a less diversified economy, and the smallness of the market forced it to open up and progress more than some larger economies (*Little countries*, 1998).

In Read's (2004) paper on small economies, he writes that they have more close physical union socially because smaller societies have shorter distances and deeper links between key economic players. He further states that small economies are, however, "not immune from ethnic divisions and/or rent-seeking behavior based upon family ties or clientelism; these are likely to have a greater adverse impact on growth and social cohesion in a small society" (Read, 2004: 370).

It has been argued that small economies are more affected than large ones by the so-called old boys' network; this means that in some small economies senior politicians and businessman may have known each other since school (*Little countries*, 1998). This is most certainly the case for the Icelandic market. Read says that globalization increases the external pressure on social capital, which is regarded as a significant source of competitive advantage in small economies. Social capital is claimed to be a crucial source of strength and a probable growth source for small economies (Read, 2004).

As a result of the liberalization and the opening up of new sales and production markets, MNCs are now able to enter new markets in countries that have hitherto been closed to foreign-owned firms. This development has led to strong competition for FDI among countries, as an investment from a foreign-owned enterprise has the potential to benefit the country in both production and

employment (Hogenbirk & Narula, 1999). Porter (1994) emphasized, that at that time, MNCs were starting to search in new sectors and markets for new opportunities, such as acquisition of raw material, capital and even generic scientific knowledge, and to enter a location that would offer the opportunity to tap into low-cost inputs. “Home market volume is less important than the ability to penetrate global markets (Porter, 1994: 36).”

2.3 Emerging Markets

MNCs, in their search for ways to gain and sustain competitive advantages in a growing global business environment, started increasingly to enter newly emerging markets. In this chapter the concept of an emerging market will be introduced, and which nations are regarded as belonging to that category. The growing trend of foreign direct investment into these markets will be demonstrated as economic liberalization has opened up these markets to foreign investment.

2.3.1 Defining an Emerging Market

As with the definition of a small open economy, there is a working definition for an emerging market. Many studies and definitions have been published on emerging markets by scholars and institutions and/or banks. Definitions exist from authors/organizations such as Meyer (2004), Mody (2004), Hoskisson et al. (2000), Narula & Dunning (2000) and by Goldman Sachs, Standard and Poor’s (S&P) and the International Monetary Fund (IMF).

The phrase “emerging markets” was invented in 1981 by Antoine W. van Agtmael, then deputy director of the capital markets department of the World Bank’s International Finance Corp (Knowledge@Wharton, 2008). Van Agtmael (2007) wanted to urge Western investors to invest in a fund that was dedicated to third-world equities, so he set out to rebrand the fund with more charisma, and it worked beautifully.

If a search is made on the internet for the definition of an emerging market or emerging economies various results appear:

- Rapidly growing and volatile economies of certain Asian and Latin American countries. They promise huge potential for growth but also pose significant political, monetary, and social risks. <http://www.businessdictionary.com/definition/emerging-economies.html>
- Market in a country that does not have a fully developed economy. Investments in these markets are usually characterized by a high level of risk and possibility of a high return. <http://www.infoplease.com/ipa/A0873097.html>
- A financial market of a developing country, usually a small market with a short operating history. http://www.investorwords.com/1693/emerging_market.html

According to Hoskisson et al. “emerging economies are low income, rapid-growth countries using economic liberalization as their primary engine of growth” (Hoskisson et al., 2000: 249). Another key description that has been used to describe emerging markets is transition. They can be in transition processes in manifold senses, such as fertility rates, life expectancy, and in the education system. Other transitions can also be taking place in their economic and political institutions, as well as increased cooperation with the global market (Mody, 2004).

What are the common factors of countries that belong to this category? Mody (2004) identifies five features:

- The *growth prospects* seem to be good, although not many developing countries have had higher growth rates than developed countries.
- Expectation of high *rates of return* by investors; but data show that the rates on return from emerging market securities have not proven to be much higher than the rate of return from U.S. treasury security.
- The *level of risk is high* and the market is considered to be *extremely volatile*. The risk can either be the consequence of uncontrollable factors such as natural disaster, or due to the policy framework within which MNCs have to operate in these countries.
- There is not much *history of foreign investment* in the market.
- Their *transition* to market economies, as someday they might become equal to other developed nations in the global market economy.

Some have started to question whether the term “emerging market” still makes sense, as these markets are becoming difficult to differentiate from the major markets. But Van Agtmael (2007) comments that in terms of corruption, corporate governance and investor protection, the gap between China and India, for example, and the US still exists, but is diminishing somewhat. The classification therefore still makes sense.

2.3.2 Which countries are Emerging Markets?

Many countries can fall under the definition of emerging markets, although they evolve at their own rate and with their own plan on economic development (Knowledge@Wharton, 2008). It has been recognized that the statistics on these markets may be contradictory in different reports from organizations, even sometimes within an organization (Kvint, 2008). Kvint continues to note that this mix of countries can blur the difference between emerging market and developing and underdeveloped countries. Kvint remarks that an emerging market is different from developing and underdeveloped countries in that the latter require certain attention from international aid agencies to help with starvation, diseases and political instability. Kvint ends his commentary on the importance for a clear definition of emerging markets, developing and underdeveloped countries: “It is important not only for the global business community but also for the poorest people and countries, who need special attention from political and business leaders of the world.” (Kvint, 2008)

As has been noted, various organizations and banks define and publish reports on emerging markets. The following table below shows some examples of countries that have been classified as emerging markets according to S&P, JP Morgan, Goldman Sachs and the IMF:

Table 2: Emerging Markets

S&P Emerging Broad Market Index	J.P. Morgan	Goldman Sachs	IMF
Argentina	Argentina	Bangladesh	Argentina
Brazil	Brazil	Brazil	Brazil
Chile	Chile	China	Chile
China	China	Egypt	China
Czech Republic	Colombia	India	Colombia
Egypt	Czech Republic	Indonesia	Czech Republic
Hungary	Egypt	Iran	Egypt
India	Hungary	Korea	Hungary
Indonesia	India	Mexico	India
Israel	Indonesia	Nigeria	Indonesia
Malaysia	Israel	Pakistan	Jordan
Mexico	Jordan	Philippines	Malaysia
Morocco	Korea	Russia	Mexico
Peru	Malaysia	Turkey	Morocco
Philippines	Mexico	Vietnam	Pakistan
Poland	Morocco		Philippines
Russia	Pakistan		Poland
South Africa	Peru		Romania
Taiwan	Philippines		Russia
Thailand	Poland		South Africa
Turkey	Russia		Thailand
	South Africa		Turkey
	Taiwan		Ukraine
	Thailand		Vietnam
	Turkey		

Source (Standard & Poor's, 2008; JP Morgan, 2008; O'Neill et al., 2005; IMF, 2003)

In most cases the organizations and banks agree on which countries can be classified as emerging markets. The different statistics used for the classification may explain the variations.

Goldman Sachs has in recent years greatly contributed to the name game of economies as Van Agtamael did in the 1980s. In 2001 the firm published a report naming Brazil, Russia, India and China the “BRIC” countries, and estimated that by 2010, the countries would make up more than 10% of global GDP. Each country has grown stronger since that prediction was made, and in 2007 they had already reached 15% of global GDP (Knowledge@Wharton, 2008). In 2005 Goldman Sachs (O'Neill, 2005) made another forecast on the “Next Eleven” (N-11): eleven countries that, when combined, had the potential to have a credible impact on the global

economy. The N-11 is Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam (Knowledge@Wharton, 2008).

As stated earlier, this thesis will focus on the markets in China and India which, according to various definitions mentioned, are classified as emerging markets. According to the analysts at Knowledge@Wharton (2008) these two countries have been growing rapidly, but are still not ready to be promoted out of the emerging markets group. Their national wealth is very unevenly distributed, as a high proportion of their citizens live in poverty. In addition, rules and regulations have not been properly established and followed, and it would be prudent to rely on some institutions for assistance when entering into a business contract.

2.3.3 Globalization and Emerging Markets

In the book, *Global Strategy*, Peng (2006) traces the history of globalization and emerging markets. Peng states that the current stage of globalization began after the conclusion of World War II when several major Western nations began to re-engage in global trade. But most developing and Communist countries such as China and the (former) Soviet Union were unwilling to participate, and focused on attaining self-sufficiency. Other non-Communist countries such as Argentina, Brazil, India and Mexico put all their efforts into protecting their domestic industries. But four developing countries and regions, which became known as the “Four Tigers”, stood out from this crowd and chose a different path by participating in the global economy. These “tigers” were Hong Kong, Singapore, South Korea and Taiwan. They were later recognized by the World Bank as having moved from the developing (low-income) group to developed (high income) status.

These examples motivated other emerging economies to alter their ways of approaching the global economy. The process started with China in the late 1970s, followed by Latin America in the mid-1980s, Central and Eastern Europe in the late 1980s, and then India in the 1990s (Peng, 2006). Hoskisson et al. (2000) state that, as the governments of these countries opened them up, it created more market-oriented strategic alliances with foreign enterprises. Peng (2006) explains that, as Western firms wanted to continue high growth rates, they were eager to participate in the

emerging economies and take part in the rapid growth they were experiencing. The potential market size in these countries is huge and, as Van Agtamel stated, the emerging market consumer has become more and more important, and many of the domestic companies in these markets have become world-class (Knowledge@Wharton, 2008). The faculty at the online business journal of Wharton School further states that, as these countries experienced this transition and growth period in harmony with the global economy, they started to demand a bigger slice of the pie. Some of the nations that are rich in natural resources did not want to be exploited for those resources but rather wished to be engaged in a more beneficial way by Western firms.

2.3.4 Foreign direct investment and Emerging Markets

Peng (2006) notes that as the world economy became more integrated, global trade grew immensely. Between 1990 and 2000 alone, it grew by 80%, and the total flow of FDI increased fivefold. These numbers are backed up by a tremendous change that has been witnessed in the developing countries. Their economic policies became more liberal, with privatization of State-owned enterprises and more focus on inbound FDI (Narula and Dunning, 2000).

In the opinion of Kamallakharan (2009), changed policies in the emerging markets made it easier for companies in the western part of the world to invest there, but what also initiated the increased investments in the emerging markets was more access to capital due to US Fed's low-interest policy, that made investors look for new places to invest.

According to the World Investment Report (2008), FDI flows to emerging markets in South, East and Southeast Asia and Oceania reached a record high of \$249 billion in 2007. This was an increase of 18% over 2006. They state that the growth could be traced to a combination of favorable new business opportunities, progress toward further regional economic integration, improved investment environments and country-specific factors. The forecast for FDI to this region is believed to be rising despite worries about the effects of the financial crisis. In the table below the inflows of FDI to some of the countries in this region are displayed.

Table 3: Distribution of FDI inflow among emerging markets and other developing countries

Distribution of FDI inflows among emerging markets and other developing countries (2007)	
Range	Countries
Over \$50 bn	China and Hong Kong (China)
\$10 bn to \$49 bn	Singapore and India
\$1.0 bn to \$9.9 bn	Thailand, Malaysia, Taiwan, Indonesia, Vietnam, Pakistan, Philippines, Republic of Korea
\$0.1 bn to 0.9 bn	Cambodia, Iran, Bangladesh, Sri Lanka
Less than \$0.1 bn	Bhutan, Nepal and Timor-Leste

Source (World Investment Report 2008)

As can be seen from table 3, China and Hong Kong receive the largest inflows of FDI, according to the World Investment Report (2008); the report notes that this region remained attractive to market-seeking and efficiency-seeking FDI. The high inflow to China could also be traced to a shift in MNCs strategy, from perceiving China as only a low-cost production market to viewing the country as a large and competitive market with a highly-skilled labor force, as well as the focus of the Chinese government on attracting quality FDI.

A report published by Deutsche Bundesbank (2003) states that the single most important factor in why one should invest in emerging markets the size of the market, and high profit expectations. The service sector in those markets seemed to be especially fast-growing. This report found that empirical studies suggest that an increase in private capital flows to emerging markets were due to slow GDP growth in developed countries in Europe, the US and Japan. Van Agtmael (2007) commented in an interview that as the Industrial Revolution put the US and Europe into the spotlight, now countries like India and China are being pushed out on the stage, and he predicts that in twenty-five years time, China will be the anchor economy, displacing the US.

Narula and Dunning (2000) note in their study that developing countries should attract the right kind of FDI to benefit from technological upgrading. They say that the countries should move away from resource-seeking activities to market-seeking: to break away from natural asset-based

activity and inspire MNCs to invest in activities that adds higher value to exports. This could be achieved by improving the L advantage. A good example of this would be the case of India where the software sector is the country's "niche" strategy; with this kind of specialization India upgraded its global competitiveness.

2.4 Foreign direct investment from Small Economies to Emerging Markets

In this chapter a review will be conducted on a number of research papers which describe the behavior and experience of small economies that have invested in emerging markets.

A few studies concentrate on outward FDI from small open economies to emerging markets. Studies like those of Maitland and Nicholas (2002), Gattai (2008), Lee (1991) and Tahir and Larimo (2005) concerned with well-developed small economies such as Australia, Switzerland, Sweden and Finland.

Maitland and Nicholas (2002), in their study on internationalization of Australian firms in Asia, concluded that Australian MNCs operated in different sectors from other foreign MNCs investing in Asia. The study further revealed that they sought local partners to transfer their firm-specific advantages, in order to achieve market-specific knowledge.

Gattai (2008) studied the choice of FDI by Italian, Spanish and Swiss MNCs in China. All these countries had been exhibiting a dynamic outward investment profile. Gattai's empirical findings showed that wholly foreign-owned companies and joint ventures were the preferred mode of entry into China for the firms from those countries. These were all firms with superior technology and highly-skilled labor, so the threat of knowledge spillover was the motive for their choice of total versus partial ownership.

Lee (1991) analyzed and described the development of network positions of Swedish firms in Korea. Lee conducted an empirical study, whose findings implied that the strong political and social character of networks indicated some significant feature of how foreign firms should achieve a strong position associated with successful operations in distant industrial networks.

Tahir and Larimo (2005) analyzed in a paper how Dunning's OLI paradigm affected Finnish manufacturing firms investing in Asia. Their results demonstrated, among other things, that large parent firm size, substantial international experience, large market size in the target country, low cultural distance and low labor cost increase the probability of market-seeking and efficiency-seeking FDI by Finnish firms.

2.4.1 Australian firms enter Asia

Australia can be defined as a small open economy when its GDP (purchasing power parity) and population are compared to other economies. According to the 2008 World Factbook (2007 est.) Australia's GDP was \$773 billion and its population was just over 21 million. For comparison, Germany's GDP was \$2.807 trillion and population around 83 million, Canada's GDP was \$1.271 trillion and population just over 33 million, and in France GDP was \$2.075 trillion and population about 64 million. In the study on Internationalization of Australian Firms in Asia, Maitland and Nicholas (2002b) found that the large natural resource endowments, capital flows and openness of the country have formed its industries and firms. But the country distinguishes itself from other similar countries, such as the Nordic economies, in that its FDI did not have as high a rate of return as the Nordic ones.

Similarities between Iceland and Australia can be observed in the economic histories of these two countries. Australia went through structural changes when it discontinued almost 80 years of protectionist industrial policies, privatized a number of government-owned enterprises, floated the exchange rate, removed controls on capital movements, deregulated markets (financial and labor) and opened the banking, insurance, real estate and media sectors to foreign ownership (Maitland and Nicholas, 2002b).

The Australian government encouraged firms to give serious consideration to investment in the Asian markets, which they believed to be "attractive and natural destinations for their offshore activities" (Maitland and Nicholas, 2002b: 83). Besides China, the focus was on Indonesia, as it was close geographically, and India, which was not only a sizable market but also shared Australia's British colonial heritage. Of these three countries, India was believed to represent the

closest “psychic” neighbor to Australia. The countries have legal and parliamentary systems in common, and both have English as the commercial language and similar commercial structures (Maitland and Nicholas, 2002b).

What were some of the motivations of Australian firms for entering the so-called emerging Asian dragons? Maitland et al. (1999) note in their paper that Australian firms entered the Chinese market quite soon after the Chinese market was opened to foreign investment, and before long Australia became the fourth-largest investor in China. The motive behind Australia’s investment in China was the size and growth potential of the Chinese market; they wanted to mark their presence there. Their main motive was not to enter China to seek out lower wages, as was the case from many other economies. In another study by Maitland and Nicholas (2002b), the same motives were found to be behind the FDI decision for entering Indonesia and India.

The industries in which Australian firms invested differed from those chosen by Western and Japanese MNCs, which concentrated on sectors such as microelectronics, automotive production, household electrical appliances, telecommunications equipment, office products and instrumentation, pharmaceutical and chemical industries. According to the Maitland and Nicholas (2002b) paper, Australian firms were in industries such as manufacturing, property and business services, machinery and equipment and logistics and distribution.

The entry mode of the Australian firms was predominantly by joint venture (JV) in China and Indonesia, and the dominant control being Australian. In India, Australian firms preferred wholly-owned subsidiaries to JVs, while those which entered through JVs were mostly mining companies that were forced by Indian government regulations to forge partnerships with local firms (Maitland and Nicholas, 2002b). The Maitland et al. (1999) study notes that the Australian firms entered the Chinese market through JV in order to access complementary capabilities and that this form of entry would allow more control and security than through licenses.

In their study, Maitland and Nicholas (2002b) asked the participating Australian firms to risk-assess the three markets with respect to the firms experience there. The result showed that they did not view these markets as especially risky investment locations, and no risk factor ranked higher than 3.4 on a five-point Likert scale from 1 (low risk) to 5 (high risk). The highest risk

was seen as bureaucratic barriers in China, followed by the foreign-exchange risk, inadequate infrastructure and lack of intellectual property rights protection. In India the highest risk was considered to be inadequate infrastructure. Other risk factors were host-country political uncertainty, foreign exchange and government favoritism. Maitland and Nicholas see it as peculiar that, as these economies are given to high degrees of state intervention and the level of rent-seeking by domestic firms is high, the Australian firms rate these factors as low-risk.

Maitland and Nicholas (2002b) concluded in their study that the success of the Australian firms varied in the three economies, and especially in India. They believed that the lack of success in the Indian market lay in assessing psychic distance, international experience and contract design. As mentioned above, the Australian firms saw India as the least psychic distant country, compared to the other two economies. But what the Australian firms failed to see was a country divided by unique levels of successful rent-seeking by domestic groups, which had created considerable barriers to entry for foreign firms. The way the Indian economy was constructed from the 1950s to the late 1980s by Indian politicians, policymakers and businessmen was through a web of economic controls that in fact held back the economic development of India and at the same time encouraged a system of embedded rent-seeking. The art of rent-seeking was mastered by Indian firms, having the effect of developing their skills to work against foreign MNCs. When India surrendered its large-scale economic controls in 1991 it did not change the pattern of rent-seeking; and Maitland and Nicholas (2002b) demonstrate in their study that Australian firms were oblivious to this. For instance, when the Australian firms were asked to rank the “pull” factors as to why they chose that location (India) for investment, they ranked the British colonial origins of the commercial system high on the scale, despite the transformation that the Indian market had gone through since the country gained independence.

Maitland et al. (1999) state in their paper that one of the most successful aspects of the Australian firms entry into China was new operational capabilities acquired from the business activities. Close to 70% of the firms that responded gained experience from entering into new negotiation situations and gained valuable lessons from establishing themselves in the Chinese market. That experience was then used when the firms entered other foreign markets. The mistakes mentioned above regarding the Maitland and Nicholas (2002b) study in India would become a learning experience for the Australian firms. The JV form of entry was largely avoided

in India by Australian firms, and that mistake was not made in China. In many cases the firms sought out partners enabling them to access different levels of bureaucratic and government links that would help in breaking into that market.

Maitland and Nicholas (2002b) conclude that the experience of the Australian firms in Asia had been successful in China and to lesser extent in India. The Australian MNCs were shaped by their home market, which had largely been protected from foreign control by government regulation, and historically growth would have been domestic rather than international. The data from the study shows that firms from industries such as finance, telecommunications and some areas of real-estate development were successful in pursuing international growth in the 1990s. They did not pursue entry into emerging markets in order to avoid high-cost production or to create an operation for exporting from a low-cost location. The Australian firms were seeking “large and expanding domestic markets to leverage competencies honed in Australia and acquired through prior offshore activities” (Maitland and Nicholas, 2002b: 101).

2.4.2 Nations within Europe enter China

In Gattai (2008) paper, firms from three countries (Spain, Italy and Switzerland) were studied with regard to their manufacturing operations in China. The author built a data set through survey interviews and sent a multiple-choice questionnaire to the firms that manufacture in China. The author notes with respect to the choice of these three countries that Italy and Spain are similar in terms of population, GDP, industry composition, labor market institutions and technology level. Switzerland is a small economy, but wealthier than Italy and Spain. Geographic closeness and similarity of language makes Switzerland closer to Italy. With regard to the countries experience with/in the Chinese market, they have invested substantial and similar amounts of FDI to China.

When home and host countries have a high cultural distance, they differ in many areas; a stronger control over the local investment might be preferred. Looking at this from another angle, it might also be less risky for the MNC to have a local partner when it enters a foreign and

unknown market; to have a better chance of becoming familiarized with a culturally distant market (Gattai, 2008).

The data from Gattai's (2008) study showed that the number one motive for the three countries to enter China was market size. The second was to take advantage of a good opportunity in the case of Spanish MNCs, and low labor cost for Italy, while the latter motives weighed equally for Switzerland.

The MNCs from these countries experienced some initial setbacks when entering the Chinese market, which varied between the countries. For the Swiss MNCs the most difficult part was a lack of good infrastructure, the Italians were affected most by the cultural distance and the Spanish found it difficult to handle the bureaucracy. All the countries felt also that there were language problems and a need for a transparent legal system.

The mode of entry into the Chinese market of the three countries varied. Italian and Swiss firms chose JV, while Spanish opted for wholly foreign-owned firms. According to the survey conducted by the author, reasons for choosing a local partner were: to gain local support, share risks and costs, achieve optimal size, enhance skills, and become more competitive. As has been noted earlier the cultural distance between these European countries and China is large and China was still considered a difficult market to enter, which seems to be the reason why JV entry was believed to have a higher success rate. The author writes that "the need to find a partner, well acquainted with the domestic context, able to speak and negotiate with Chinese suppliers and customers, and good at dealing with the local authorities is particularly stressed by Italian and Swiss respondents" (Gattai, 2008: 979-980).

The MNCs that chose wholly foreign-owned enterprise (mainly Spanish MNCs) required a strong control over their technological capabilities and high flexibility standards. These high-tech firms were hesitant to invest in an emerging market with which they were not familiar, and did not want to share their knowledge with a partner that had lower-skilled labor.

In conclusion, Gattai (2008) writes that the empirical findings from the study indicate that MNCs from these three countries are more likely to invest directly in China, the higher the level of valuable resources. Based on the survey data, the risk for the European MNCs of having a

knowledge spillover is the driving force in choosing between a JV and wholly foreign-owned enterprise.

2.4.3 Swedish firms enter Korea

Lee (1991), in his study on Swedish firms entering the Korean market, described and analyzed the development of network positions of Swedish firms in Korea. Although Korea is not one of the countries covered by this thesis, the country is/was defined as an emerging market by some organizations. Since not many studies have been found on the topic of this thesis from the Nordic countries, Lee's study may shed some light on how Swedish firms operated when they entered an emerging market.

In Lee's (1991) study three Swedish MNCs were chosen, that entered the Korean market between 1958 and 1982. One of them was Ericsson, the world's leading supplier in telecommunications, and this chapter will focus on that firm.

A few Swedish firms had entered the Korean market at the end of the 1950s, and in the early 1980s many firms in the industrial sector in various industries established themselves there as well. This is not surprising, as Korea rapidly developed into one of the world's most economically dynamic countries. Many of the firms that entered the Korean market counted on trade, marketing and production of rising high-technology products. The entry mode of most of the Swedish firms was initially very export-oriented, and then established agencies, sales subsidiaries and later on production plants in Korea, and JV with local manufacturers. The range of firms that entered Korea at that time included firms such as Volvo cars, Tetra Pak's packing technology and Ericsson telecommunications (Lee, 1991).

The Swedish firms encountered various problems in the process of establishing themselves in the Korean market. These problems were due to geographical and cultural distance as well as differences in expectations, educational background, international experience, economic and industrial development level and industrial structure (Lee, 1991).

In the case of Ericsson one of the motives to enter Korea rose from their chief engineer who had 15 years experience with business activities in Southeast Asia; these prompted the firm's ambition to establish their products in Korea. At the same time the Korean government encouraged an ambitious expansion program in the sustained economic boom, while the 1988 Olympics in Seoul also had an effect on the opening up of the country to foreign investments. Ericsson had not established any networks at that time with the relevant Korean government authorities or with the Korean market. Therefore Ericsson employed a former Korean government worker to be its agent in the activities in Korea. This turned out to be successful, as Ericsson was awarded contracts for about \$150 million by the Korean government. Ericsson's efforts to establish a strong network with the Korean government was rewarded, and proved to be a very efficient entry mode; i.e. to establish close personal ties with influential individuals and strong local suppliers. After this breakthrough in the Korean market, Ericsson took its entry further by investing heavily. Three major competitors were already in the market, so Ericsson had to market its products intensively if it were to catch up with the competitors. This encouraged the firm to try its best to successfully overcome the cultural distance. "Ericsson's Korean success was partly due to its understanding of the co-operative relationships between the government and private business conglomerates, and its learning about the traditional social norms in the Korean organization and society" (Lee, 1991: 17).

2.4.4 Finnish firms in Asia

In Tahir and Larimo's (2005) paper the focus was on manufacturing firms from Finland, which they described as a small industrialized country. In their research they presented empirical insight into the determinants and strategic motivation of Finnish manufacturing firms investing in ten Asian countries from 1980 to 2000. The authors' do not go into much detail about the trend of FDI from Finland, but according to the World Investment Report (2008), FDI outflows from Finland increased from \$ 4,223 million in 2005 to \$ 8,623 million in 2007. In a study published by the Confederation of Finnish Industry and Employers (Eurofound, 2003), results indicated that foreign investment of Finnish industrial companies in emerging markets demonstrated that globalization of Finnish firms had been substantially more than expected.

Figure 2 shows a considerable increase in investment in some emerging markets in the period 1997 to 2000.

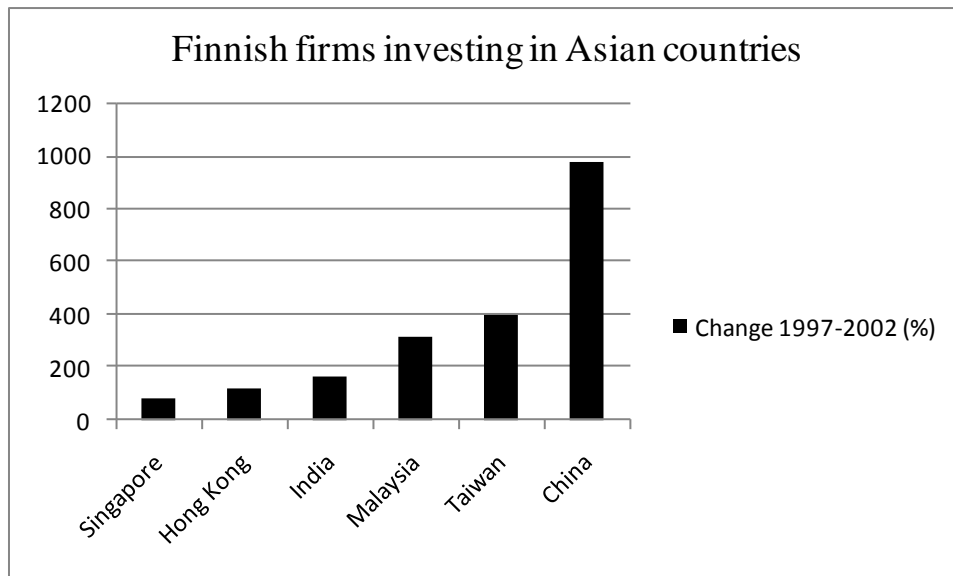


Figure 2: Finnish firms investing in Asian countries

Source (Eurofound, 2003)

The study shows that China became a popular location for Finnish labor-intensive manufacturing production and it was predicted that FDI would grow particularly in Taiwan, China and India (Eurofound, 2003).

Tahir and Larimo (2005) note that, due to the huge market potential of the Asian countries, it was considered more likely that Finnish firms would choose the so-called market-seeking and efficiency-seeking FDI. In the market-seeking FDI the investor is seeking larger market share. By gaining larger market share the manufacturing firm produces in greater quantity and can benefit from economies of scale, which, as stated above in discussion of motivations for foreign direct investment, is the goal in efficiency-seeking FDI.

In conclusion of Tahir and Larimo (2005) paper they state that “assuming that global markets are reasonably competitive, in the long run competitive forces will eliminate those firms that make FDI decisions inconsistent with value maximization.” Hence, managers should consider the relative weight of the OLI paradigm and strategic advantages when deciding on locations for FDI (Tahir and Larimo, 2005).

3 THE MARKETS

As this thesis focuses on China, India and Iceland, an introduction will follow on each country regarding its foreign direct investment and Chinese-Icelandic and Indian-Icelandic relations.

3.1 China

China is a country whose history can be traced back more than six thousand years; the country has one of the world's oldest civilizations and a population of just over 1,300 million. This Asian dragon was for centuries a leading civilization, but in the 19th and early 20th centuries the country entered a harsh era of civil crisis, famines, military defeats and foreign rule. Shortly after 1978 the country's leaders put all their efforts into changing the economy to a market-oriented one, and by 2000 output had quadrupled. This is a country that has natural resources such as coal, iron ore, petroleum, natural gas and hydropower potential. In 2008 the country was the second-largest economy in the world after the US. China's GDP (PPP) was \$7.8 trillion (2008 est.) (*The 2008 World Factbook*).

3.1.1 China and Iceland

China and Iceland established diplomatic relations in 1971 and in 1972 China opened an embassy in Iceland. It was not until about twenty years later, or in 1995, that Iceland set up an embassy in Beijing. Following the advent of diplomatic relations between the countries, China provided Iceland with support in its efforts to expand its exclusive fishing zone. On Iceland's side, the country backed China's quest to reclaim its seat at the United Nations. Trade and economic partnership between the two countries has increased over time ever since the 1980s. Two fields were especially beneficial for both parties: geothermal energy and shipbuilding. According to the Chinese Embassy in Iceland, since 1998 the two countries had signed contracts that China would build around 17 ships for Iceland (*Chinese-Embassy*).

In 2005 Iceland and China signed an agreement to begin discussions on a free-trade agreement between the two countries. No final date has been set on when the agreement will be signed, but rounds of discussions have taken place between the countries and will continue. Iceland will be the first country in Europe to negotiate such an agreement with China.

As displayed in figure 3, Iceland's foreign direct investments in China, according to the Central Bank of Iceland, do not have a long history, and amounts have been negligible until recent years.

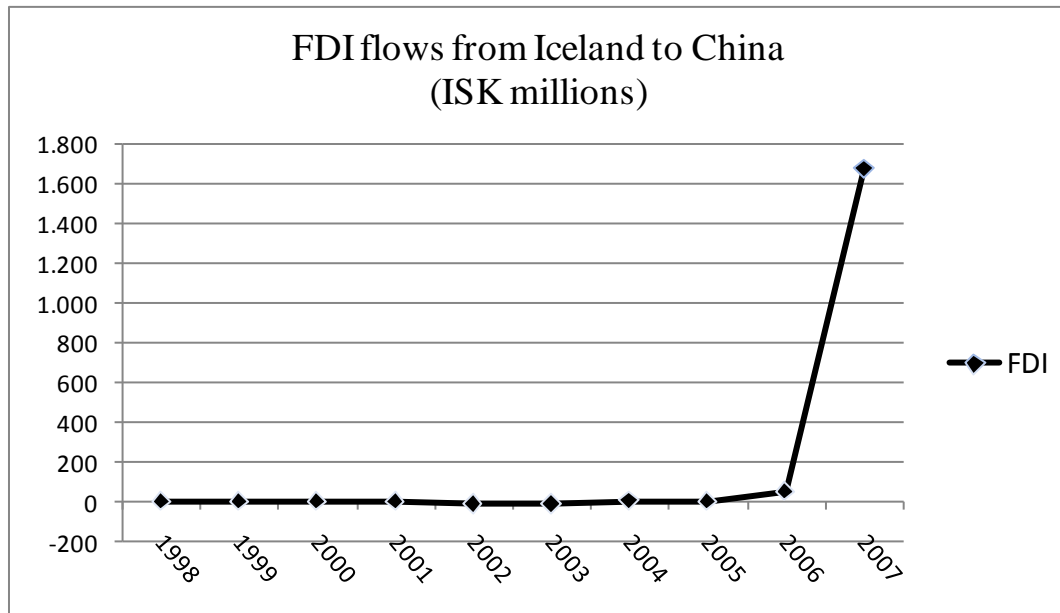


Figure 3: FDI flows from Iceland to China

Source (Central Bank of Iceland)

3.1.2 Foreign direct investment and China

As mentioned above, Chinese leaders initiated the country's "open-door" policy around 1978-9, and this led to China becoming the largest receiver of FDI of all the emerging markets (Maitland et al., 1999). According to Graham and Wada (2001), China's success story in economic development can be traced to foreign investment in the country and especially to the immense growth of exports from China. The growth in exports is attributed to foreign enterprises that were allowed to establish alliances with Chinese firms and hence transferred technology and, know-how, and manufactured products for sale to the global economy. But, as Graham and Wada (2001) state in their paper, China's success in attracting FDI has not come easily. The policy environment for FDI was/is considered to be difficult in China, and this discourages some investors. The Chinese market was only partially opened in 1979, as Chinese leaders wanted to avoid foreign competition with their domestic state-owned companies. FDI was therefore only

allowed in sectors where Chinese were not major participants (hotel development, tourism) or where Chinese firms needed foreign technology in order to progress. But, as Graham and Wada (2001) write, positive changes have taken place in China's policy since 1979, as witness China's admission to the World Trade Organization (WTO). Maitland et al. (1999) note that between 1994 and 1997 some of China's regulatory framework became more transparent, and stricter implementation of regulations for protecting intellectual property was established, as well as laws that would allow foreigners to acquire equity in Chinese state firms without joint venture (JV). The Chinese government still regulates foreign entry closely, depending on the sector. Foreign firms can be subject to conditions such as having to use local suppliers, locating firms in certain areas, or setting up a joint venture with a local partner. In an interview, Pétur Yang Li, Commercial Counselor for the Ministry of Foreign Affairs in Iceland, commented that "the Chinese government has in general encouraged FDI to China and today the country is one of the biggest recipients of FDI. But of course they have their own investment policy, some sectors are fully open, some half-open and some are closed. In some sectors foreigners can only invest by entering into a JV." Pétur Yang Li further commented that sectors closed to foreigners in China included e.g. the telecommunications and petroleum sectors.

According to the World Investment Report (2008) investment inflows to China, which rose to \$84 billion, were mainly aimed at services, high-tech industries and high-value-added activities. The increasing number of foreign-invested R&D centers (from 700 in 2004 to 1200 in 2008) in China indicates that multinational firms were viewing China more as a country of knowledgeable labor force and competitive market rather than a low-cost production base. This change in strategy by multinational firms is also attributed to the Chinese government's change in policy on attracting quality FDI.

Graham and Wada (2001) believe that there is substantial capacity for China to take in more foreign investment, as the distribution of the investments varies greatly between sectors and locations in China. The major investments are located in coastal areas of China, and sectors where firms are state-owned have not taken part in the FDI boom.

3.2 India

India is the world's second most populous country with a population of just over 1,147 million (July 2008 est.), and the largest democracy in the world. India has a large economy with a GDP (PPP) of \$3.319 trillion (2008 est.). The country is rich in natural resources such as coal (fourth-largest reserves in the world), iron ore, natural gas, diamonds, petroleum and arable land. India has been ruled and invaded by various tribes and nations, but by the 19th century the country was a British colony. In 1947 India gained independence, after largely non-violent resistance led by Mohandas Gandhi and Jawaharlal Nehru. Although India's economy has risen remarkably, the country still faces serious difficulties such as considerable overpopulation, extensive poverty and environmental damage (*The 2008 World Factbook*).

3.2.1 India and Iceland

India and Iceland established diplomatic relations in 1972, but it was not until after 2003 that the two countries embarked on close diplomatic and economic relationships (*Embassy of Iceland 2006*). As can be seen in figure 4 of data collected from the Central Bank of Iceland, direct investments from Iceland to India grew considerably in 2005; this was a consequence of closer economic ties between the two countries (*Embassy of Iceland 2007*).

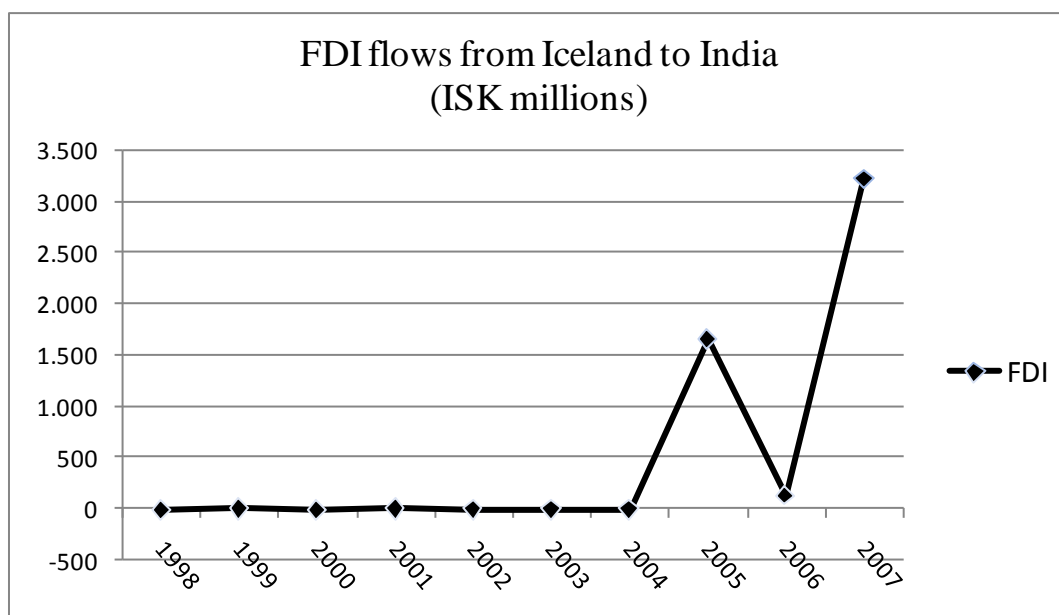


Figure 4: FDI flows from Iceland to India

Source (Central Bank of Iceland)

The Central Bank of Iceland does not reveal the break down of the FDI outflow from Iceland by country and industry, but after searching the internet for Icelandic companies investing in India in 2005 the increase in FDI is possibly due to Actavis, a generic pharmaceutical company, acquiring an Indian Contract Research Organization (*Actavis, 2009*).

3.2.2 Foreign direct investment and India

According to Singh (2005), the year 1991 was seen as a milestone in planning for changes in India's future; this was the year that the non-political economist Manmohan Singh was appointed finance minister. But the government did not define its course regarding FDI that year, as foreign investment was not viewed as an instrument for development. In 1995-6 the government started to see things differently, and defended FDI to domestic critics, as statistics and experience had revealed that the future growth of India was connected to FDI. The government stated that "fears of foreign investment swamping our domestic industry or creating unemployment are unfounded or grossly exaggerated" (Singh, 2005:7).

As the government opened the Indian market to foreign investment, some sectors were more open than others. For example, higher limits on foreign investments were approved for the telecommunication sector, but the growing market of agriculture was strictly blocked to foreign access. Political debates arose over the privatization of government-owned enterprises that remained at a halt. But India's growth in recent years has been significant, as the country has expanded production of manufactures. One of the country's assets is the large pool of well-educated people who are proficient in English; their major skills are in the software services (*The 2008 World Factbook*). Take for example the Indian companies Tata Consultancy Services, Infosys Technologies and Wipro, discussed by Khanna and Palepu (2006) in their article on emerging giants. According to Khanna and Palepu all these companies excelled in providing services and workers in the software business on the global market.

3.3 "Chindia"

Although the two countries are both emerging markets, table 4 reveals the differences between them:

Table 4: Difference between China and India

Context	China	India
Political structure	The Communist Party maintains a monopoly on political power. Local governments make economic decisions. Officials may abuse power for personal gain.	The democracy is vibrant. The government is highly bureaucratic. Corruption is rampant in state and local governments.
Civil society	The media are muzzled by the government, and there are few independent NGOs. Companies' don not have to worry about criticism, but they can not count on civil society to check abuses of power.	A dynamic press and vigilant NGOs act as checks on politicians and companies.
Modes of Entry	The government permits Greenfield investments as well as acquisitions. Acquired companies are likely to have been state-owned and may have hidden liabilities. Alliances let companies align interests with all levels of government.	Restrictions on Greenfield investments and acquisitions in some sectors make joint ventures necessary. Red tape hinders companies in sectors where the government allows foreign investment.
Workers market	Workers can join the government-controlled All-China Federation of Trade Unions. Historically there were no industrial actions, but there have been strikes at Hong Kong and Taiwanese-owned manufacturing facilities.	The trade union movement is active and volatile, although it is becoming less important. Trade unions have strong political connections.
Debt and equity	The local banking system and equity markets are underdeveloped. Foreign companies have to raise both debt and equity in home markets.	The local banking system is well developed. Multinationals can rely on local banks for local needs. Equity is available to local and foreign entities.
Accounting standards	There is little corporate transparency. China's accounting standards are not strict, although the China Securities Regulatory Commission wants to tighten disclosure rules.	Financial reporting, which is based on a common-law system, functions well.
Financial distress	Companies can use bankruptcy processes in some cases. Write-offs are common.	Bankruptcy processes exist but are inefficient. Promoters find it difficult to sell off or shut down "sick" enterprises.

Source (Khanna et al., 2005)

In Kamallakharan's (2009) view, table 4 does not entirely reveal the situation in the Indian market. The trade unions are not consistent in all industries: for example, there is no trade union in the IT sector. Kamallakharan further remarks that the banking system has traditionally not been very pro-business; the sector is highly regulated and does not have room for much flexibility. Also in many cases financial reporting is not very transparent, and usually companies

have three sets of books: one for tax purposes, one for reporting to the banks and one for the actual bookkeeping for the company.

Figure 5 displays data from the World Investment Report (2008) showing FDI inflows to China and India for the period 2005-2007.

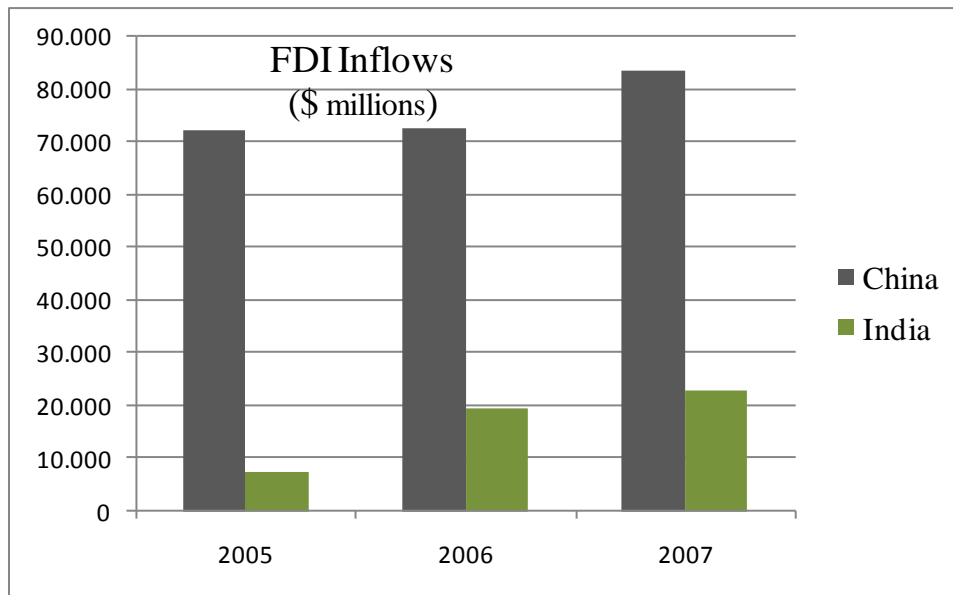


Figure 5: FDI inflows to India and China

Source (World Investment Report, 2008)

According to the World Investment Report (2008) China and Hong Kong (China) are the two largest recipients of FDI in the developing economies group, and flows to India increased substantially as the largest recipient in South Asia. The authors of the report conclude that powerful economic growth, improved investment environment, and the opening up of the Indian market for foreign investors in telecommunications, retail and other industries were the reasons for this increase of inflows to India. A similar conclusion was drawn on the increase in China: a combination of favorable business opportunities, progress towards further regional economic integration and improved investment environments.

3.4 Iceland

Iceland was settled in the late 9th and 10th centuries A.D. by Norwegian and Celtic (Scottish and Irish) immigrants. The world's oldest functioning legislative assembly, the Althing, was established in Iceland in 930. After being independent for over 300 years, Iceland was ruled by

Norway and then Denmark until a process of increasing autonomy commenced in 1874, leading to independence under the Danish crown in 1918, and the foundation of the modern Republic in 1944 (*The 2008 World Factbook*). In 1946 Iceland joined the United Nations and in 1948 became a founding member of the OECD. In 1970 Iceland joined the European Free Trade Association (EFTA), and it was a founding member of the European Economic Area (EEA) in 1994 (*Iceland History*).

3.4.1 Foreign direct investment and Iceland

The Icelandic economy is the smallest of the OECD countries, generating GDP (PPP) of \$12.97 billion (2008 est.). Iceland is not a highly-populated country, with only just over 300,000 residents, and hence the domestic market is fairly small (*The 2008 World Factbook*, July 2008 est.). But the smallness of the country did not restrain its inhabitants from aspiring to economic growth and creating a thriving community in Iceland. This success can be attributed first and foremost to Iceland's ability to promote its comparative advantage in the international division of labor, by exploiting its abundant natural resources (such as fish, hydropower and geothermal power) and human capital. New opportunities opened up for Icelandic companies when the country joined the EEA, which allowed them access to new markets (Hermannsdottir et al., 2007). With such a small domestic market, many Icelandic enterprises outgrew the home market, and so the possibility for further growth for those firms was to expand into foreign markets (Central Bank of Iceland, 2001/2002). Financing became available for the companies that wished to expand, through strong pension funds that presented capital for investment, and the privatization of the banking system created new sources as well (Hermannsdottir et al., 2007).

The Icelandic economy rested substantially on the fishing industry, which provided the lion's share of export earnings, but in the last decade the economy began to diversify into manufacturing and service industries, with new developments in software production, biotechnology, and tourism (*The 2008 World Factbook*). Iceland's FDI was mainly conducted by large seafood sales and marketing companies, while transportation and fisheries companies were also known to invest abroad but on a smaller scale. But in recent years the landscape of FDI from Iceland has been changing, and so the origin of the investments began to spread over more industries. The expansion reached such industries as real estate, financial activities and

manufacturing (Central Bank of Iceland, 2000). In figure 6 the staggering growth in FDI from Iceland in recent years can be seen:

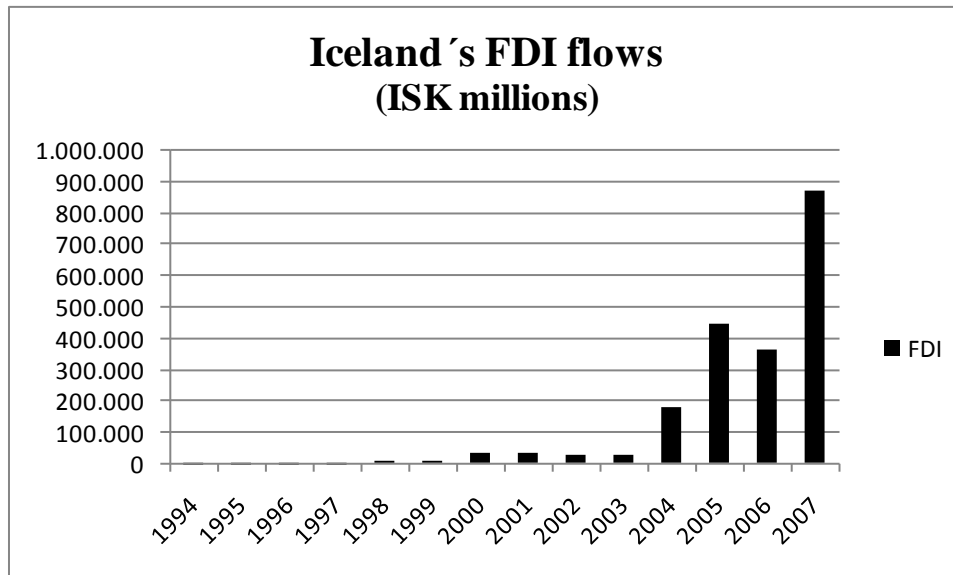


Figure 6: Iceland's FDI flows

Source (Central Bank of Iceland)

The rapid expansion of Iceland's financial sector and a boom in domestic demand accelerated economic growth in recent years. When the banking sector was privatized in the early 2000s the banks entered foreign markets vigorously, and consumers and businesses borrowed heavily in foreign-currency loans. Following the global financial crisis in 2008, three of the largest banks in Iceland collapsed (The 2008 World Factbook). These collapses will probably entail a major shift in foreign investment from Iceland as things will unfold. The words of a Danish banker are fitting for the collapse in Iceland's economy, as he reflects on the economic crisis of his country in the early 1980s: "we have been living too well on borrowed money. We are on the way to hell, but we were doing it first class." (Katzenstein, 2000:198)

4 METHODOLOGY

4.1 The Questionnaire and the sample characteristics

In this chapter, the questionnaire¹ and the sample characteristics are reviewed. An overview is provided of the data collection, and of the characteristics of the firms which received the questionnaire.

4.1.1 The Questionnaire and an individual depth interview

The data were drawn from a questionnaire sent to twenty-three Icelandic firms that were found to have engaged, or to be currently engaged, in investments in China and India. At the beginning of February 2009 the corporate headquarters were approached in an initial contact, via telephone or email, for identification of the representative who might answer the questionnaire. Subsequently the questionnaire was emailed to the designated person, and they were requested to email the questionnaire back to the author upon completion. Of the twenty-three questionnaires emailed out, twenty were returned, yielding a return rate of 86.95 percent.

The questionnaire was based on multiple-choice questions which were divided into three sections: first was contact information, the second was background information on the company and the last part was seven multiple-choice questions. The respondents could choose more than one option for each question, and they generally did so. Additionally, one open question was added, where the representative was asked to speculate about the future development of the company in the market.

The breakdown of industries in the questionnaire was constructed similarly to the industry breakdown published by the Central Bank of Iceland regarding foreign direct investments:

- Manufacturing (i.e. food products, textile, chemical, rubber and plastic products, computers, TV and communication equipment)
- Trade (products like flooring, electronics and construction material)
- Transport (i.e. land, sea and air transport)
- Financial activities (i.e. financial holding companies, insurance and monetary institutions)

¹ See Appendix 7.2

- Utilities (geothermal energy)

An individual depth interview (IDI) was conducted on January 19th 2009 with Pétur Yang Li, the Commercial Counselor for the Ministry of Foreign Affairs in Iceland and the Secretary General of the Icelandic Business Forum. The interview was semi-structured: it started with a few specific questions about the Chinese market and the Icelandic MNCs that have entered, followed by a dialogue between the interviewer and Pétur Yang Li on the topic of Chinese-Icelandic relations. There was also email correspondence with Elías Gunnarsson, Honorary Consul General to India in Reykjavik, and Bala Kamallakharan, Managing Partner of Mira Capital LLC, on questions about Icelandic firms in India and the Indian market.

4.1.2 The Sample

No list was available of Icelandic firms that have invested in China and India. Hence the author compiled a list of twenty-three relevant companies by conducting research via the internet (such as firms websites and a newspaper database), as well as interviewing the Secretary General of the Icelandic Business Forum (Yang Li, 2009), and by sending an email to the Honorary Consul General to India in Reykjavik (Elías Gunnarsson, 2009), in order to construct a list. Thus the sample is based on data on twenty-three Icelandic firms, from various industries, that have entered China or India in past years. Due to worsening economic conditions in 2008, not all the firms were able to maintain their operations in the two countries, and some were in the process of pulling out of the market the time of the questionnaire. But, due to the small size of the Icelandic market the author decided to include these firms in the sample in order to include their experiences and to have as much variety as possible between industries in the sample.

The majority of the samples are in manufacturing (thirteen), firms in financial activities (six), transportation (three), trade (one) and utilities (one). Sixteen companies in the sample had entered China, three had entered India and four had entered both markets.

5 THE RESEARCH FINDINGS

The following section provides the results of the data collected to investigate the research question.

5.1 Characteristics of the respondents

Table 5 gives a break-down of the Icelandic MNCs by industry, number of employees, and number of years since the responding firms entered the emerging markets.

Table 5: Break down of the Icelandic MNCs by industry

CHINA					
NUMBER OF EMPLOYEES	Up to 10	10-50	50 -100	100-500	More than 500
Transportation (3)	1				2
Manufacturing (11)	2	1	2	2	4
Financial activities (2)		1			1
Trade (1)	1				
Utilities (1)	1				

TIME SINCE ENTRY	< 1 year	1 -3 years	3-5 years	5-10 years	> 10 years
Transportation		1	1	1	
Manufacturing		4	5	1	1
Financial activities		2			
Trade		1			
Utilities		1			

INDIA					
NUMBER OF EMPLOYEES	Up to 10	10-50	50 -100	100-500	More than 500
Manufacturing (2)			1		1
Financial activities (3)		1			2

TIME SINCE ENTRY	< 1 year	1 -3 years	3-5 years	5-10 years	> 10 years
Manufacturing			1		1
Financial activities		2	1		

Source (Author's questionnaire, 2009-02)

Table 5 shows that the number of Icelandic MNCs in China is considerably greater than in India, and the variety of industries that have entered China is wider. The most common industry of the respondents was manufacturing (eleven), the majority of which had entered the Chinese market,

and one of those eleven had entered both markets. Only two other MNCs (in financial activities) from the respondents had entered both China and India.

Small- and medium-sized enterprises (SME) are usually defined as firms with fewer than 500 employees. FDI strategies are usually focused on large firms (employees over 500), but it has been recognized that FDI by SMEs is increasing despite the high cost and complexity of engaging in FDI (Peng, 2006). The respondents were mainly large MNCs, as most of them employ more than 500 workers. Those MNCs are mainly in manufacturing, financial activities and in transporting.

In most cases the MNCs had entered the emerging markets one to three years ago: the next most common time was three to five years ago. Exploring the timeframe, the assumption can be made that from the time of Iceland's speedy expansion in foreign investment and economic growth in 2000, and until the MNCs entered the emerging markets in 2003-2007, the Icelandic MNCs in the mean time entered other markets which were geographically closer to the home market and had fewer cultural differences (e.g. the UK and Denmark). Following that experience the MNCs then proceeded to enter more distant markets some years later. It could be concluded, therefore, that some of the Icelandic MNCs fit into the Uppsala model, where it is argued that firms from small economies may prefer to start operations in smaller markets that share similarities with the domestic market.

5.2 Location factors in FDI decisions of Icelandic firms in China and India

The motivation to operate in China and India can be driven by many purposes, but the size of the markets and lower labor costs seem to have been the dominant factors for MNCs from small economies. Several studies have showed empirical data for this, such as Gattai (2008), Maitland and Nicholas (2002) and Tahir and Larimo (2005). In the Tahir and Larimo (2005) study, the authors conclude that the probability of Finnish manufacturing firms undertaking market- and efficiency-seeking FDIs increases if the target market is large. They further state that it is arguable that MNCs expect to gain greater long-term profits through economies of scale and lower marginal costs of production in countries with larger market size. The location factors, on which the Icelandic MNCs based their investment decision, were market-, resource- and

efficiency-seeking FDIs. The table below shows the deciding location factors for choosing China and India.

Table 6: Location factors in China and India

Location factors - China					
	Transportation	Manufacturing	Financial activities	Trade	Utilities
Low labor cost		6			1
Size of domestic market	1	7			1
Strong growth prospects (market size)	2	6	2	1	1
Establish long-term presence	2	9	1		
Follow customer	1	2	1		

Location factors - India		
	Manufacturing	Financial activities
Low labor cost	1	
Size of domestic market	1	2
Strong growth prospects (market size)	1	3
Establish long-term presence		1
Forestall competitor entry	1	
Follow customer		2

Source (Author's questionnaire, 2009-02)

According to table 6, motivations to enter China for the Icelandic MNCs were primarily to establish a long-term presence in a large market with strong growth prospects, as the small domestic market would not have growth potential. The Icelandic MNCs were also seeking low labor costs in China.

The objective of the Icelandic MNCs is to gain more market share by entering a larger market due to the small size of the domestic market; hence the FDIs are market-seeking. The motive is also to seek lower labor cost which is resource-seeking FDI and to seek specialized labor force and lower cost, i.e. to reduce costs through both economies of scale and scope; hence efficiency-seeking FDI.

These results are in line with Ásta Dís Óladóttir's (2009) study which revealed that motivations behind the investment of the Icelandic MNCs were mainly market-seeking FDIs.

The low labor cost is particularly relevant for the manufacturing companies, as China is considered a highly favorable market to enter for such operations. Other location factors that manufacturing companies mentioned as favorable in China were technical know-how in the textile industry and qualified R&D labor. One manufacturing respondent commented that it is no longer all about low labor cost in China, as cheaper labor can be found elsewhere. The respondent felt that the discussion in general about low labor cost undervalued Chinese capabilities, as a foreign investor can now also gain on the infrastructure, experience, the industry manufacturing center and the R&D experience in the market.

Icelandic MNCs have been entering the growing Indian market in recent years to follow through on geothermal projects, creating a foothold through acquisitions of stakes in Indian investment companies and real-estate projects. For these MNCs it was also important to enter the Indian market, as well as the Chinese market, in order to follow their customers. The manufacturing firms' motivations for entering the Indian market were similar to those of firms that entered the Chinese market.

5.3 Problems encountered in the Emerging Markets

In table 7 is a summary of the main problems that faced the Icelandic MNCs in China and India.

Table 7: Problems encountered in China and India

	Problems encountered - China				
	Transportation	Manufacturing	Financial activities	Trade	Utilities
Bureaucracy	2	2	1		
Cultural distance	1	3	1	1	1
Legal system		1	1		
Language	1	3			
Infrastructure		1			1

	Problems encountered - India	
	Manufacturing	Financial activities
Bureaucracy	2	1
Cultural distance	2	
Legal system		1
Corruption	1	1
Infrastructure	1	2

Source (Author's questionnaire, 2009-02)

As can be seen from table 7, the problems faced in China are similar in diverse industries; they have mostly suffered from cultural distance and the bureaucracy in the country. Language problems have especially been encountered in the manufacturing industry. The manufacturing firms require a higher number of employees than the other industries, and hence communications problems are more likely to arise. If there is a problem with the language, there will consequently be a problem with understanding the culture, as can be seen from table 7: the manufacturing firms indicated cultural distance as a problem.

Bureaucracy problems were encountered in transportation, manufacturing and financial activities which could be because these industries need to file for more licenses for their operations with the government than the other industries.

One respondent commented that the problem encountered depended on where in China the investment is located. For example an investor would not face the same problems when investing in Beijing (located on the northern coast of China), which is the capital of China and a major transportation hub, and when investing in Shenzhen, which is southern China's major financial center and has the headquarters of number of high-tech companies. As Papanastassiou (2008) commented, when one discusses investing in China, the investment can be in different regions within China, and that can make the experience and problems encountered as various as the diverse regions of China.

Most of the Icelandic manufacturing firms are located in Shanghai (central eastern coast of China) and Hong Kong (southern China); the firms in financial activities are also located there. The other manufacturing firms and the transportation companies are in Guangdong province in southern China and in Shandong, a coastal province of eastern part of China. Thus the problems faced by Icelandic firms can vary greatly, depending on where they are located in China.

In India similar problems were encountered, with the exception that the Icelandic MNCs mention corruption as a problem they have faced in India. This is in line with the profile which was drawn of India in an article by Khanna et al. (2005) on emerging markets, which states that corruption is rampant in India in state and local governments.

5.4 Selection of the mode of entry

The next question in the questionnaire concerns the mode of entry chosen by the Icelandic MNCs. Table 8 displays the main findings regarding the entry mode.

Table 8: Entry Mode into China and India

	Entry Mode - China				
	Transportation	Manufacturing	Financial activities	Trade	Utilities
Joint Venture	1	1	1		1
Greenfield Investment	2	2			
Licensing	2	1			
Representative office	1	4	1		
Subsidiary		2			
Wholly foreign owned enterprise	1	5		1	
Subcontracting		1			

	Entry Mode - India	
	Manufacturing	Financial activities
Joint Venture	1	3
Greenfield Investment	1	1
Wholly foreign owned enterprise	1	1
Representative office		1

Source (Author's questionnaire, 2009-02)

According to table 8, the preferred mode of entry into China is wholly foreign-owned enterprise, followed by representative office, greenfield investment and joint venture. The Icelandic MNCs seem to want strong control of their entity by choosing a form of entry without a local partner. As Lee (1991) points out with regard to choice of entry mode and the assets at stake, it could be argued that the Icelandic manufacturing firms were reluctant to share their technological know-

how and patents with local firms. These results are consistent with what Pétur Yang Li (the Secretary General of the Icelandic Business Forum) stated in an interview. He found that the Icelandic firms liked to have control, and did not like to have to consult with a Chinese partner regarding management decisions. This may also explain the major problems the Icelandic firms encountered in China, such as the cultural distance and bureaucracy.

One of the reasons for a firm in financial activity to choose a representative office to enter China is that the financial entity needs to have a representative office for three years in the country before it can become a branch. Also, to start that kind of office does not require high capital outflow so the investment is not as risky and it gives the firm more flexibility.

In the Gattai (2008) study the Swiss companies predominantly chose the joint venture option, and in the Maitland and Nicholas (2002) study the Australian firms also chose joint ventures to enter China. According to Gattai (2008) Swiss firms chose JV because China was regarded as a difficult market to enter, so that operating in a JV seemed to be easier.

Table 8 displays that the preferred mode of entry by the Icelandic MNCs into India is joint venture, followed by greenfield investment, and wholly foreign owned, while the least chosen entry is a representative office. This is the opposite of the preferred entry into China. Khanna et al. (2005) state in their article that in India there are restrictions on greenfield investments, and restrictions in some sectors make joint ventures necessary. This may be one of the reasons why Icelandic firms are entering India by a JV. The reasons for choosing these entry modes will be discussed further in the next section.

5.5 Reasons for choosing the entry mode

The reasons for choosing a particular entry mode are displayed in the table 9.

Table 9: Reasons for Entry Mode

Reasons for Entry Mode - China					
	Transportation	Manufacturing	Financial activities	Trade	Utilities
Share risk and cost		4			1
Local support	1	2	1		1
Become more competitive	2	2			
Full property	1	3		1	
Flexibility	1	4	1		

Reasons for Entry Mode - India		
	Manufacturing	Financial activities
Share risk and cost	1	2
Local support	1	3
Become more competitive		1
Flexibility		1

Source (Author's questionnaire, 2009-02)

The reasons for engaging in an entry mode into China which would include a partnership with a local firm (JV, licensing, subcontracting) was to share risks and costs, and to gain local support. Those that chose to enter by representative office also mentioned that they found it a simpler and easier start in this new and unfamiliar market. The MNCs that chose the wholly foreign-owned entry mode were looking for flexibility, full property and to become more competitive. These results are in line with the Maitland and Nicholas (2002) study on Australian firms that entered China and Gattai's (2008) study on Swiss, Italian and Spanish manufacturing firms in China.

One of the reasons given by the Icelandic MNCs, to share the risk by entering through a joint venture, is in line with Luo's (2001) study, which states that MNCs can limit the risk by reducing the size of the investment and resources commitment. It also gives the MNC a better chance to exit the market if economic conditions worsen.

A similar pattern emerged from the answers from the Icelandic MNCs that entered India. The MNCs that operated in a partnership with local partners had chosen that entry mode in order to

share risk and costs and for local support. The ones that established a wholly foreign-owned entity wanted to have flexibility and become more competitive on the Indian market.

5.6 Competitive advantage of the Icelandic MNCs

The literature review discusses the topic of ownership-specific advantage, which is an advantage that a MNC is required to have in order to be able to compete at the international level in foreign investments. In table 10 the competencies of the Icelandic MNCs are displayed.

Table 10: Competitive advantage of the Icelandic MNCs

Competitive advantage - China					
	Transportation	Manufacturing	Financial activities	Trade	Utilities
Managerial skill		5	1	1	1
Skilled personnel		5	2		1
Product technology		9			1
Marketing and distribution skill	2	2		1	1
Brand names	2	6			
Copyright design		4			1
Patents		4			
Process and technology		4			1

Competitive advantage - India		
	Manufacturing	Financial activities
Managerial skill		3
Skilled personnel		3
Product technology	1	
Brand names		1
Process and technology		1
International access	1	

Source (Author's questionnaire, 2009-02)

Table 10 displays the sources of the competitive advantage of the Icelandic MNCs in China. Most of the firms state that their capabilities lie in product technology, followed by skills in management and personnel, and brand name. Marketing and distribution skills, copyright design, patents and process technology were of less strategic importance for the respondents that entered

China. Of the Icelandic MNCs that entered China through a wholly foreign-owned enterprise, most specified their competencies as product technology, brand names, patents and copyright design. Those that entered the market with a local partner mostly specified skilled management and personnel, brand names and product technology as their main advantages.

In India the focus was more on the capabilities of management and personnel by the MNCs in financial activities. This may suggest that the competitive advantage of the Icelandic financial firms lay in human capital, with an experience that created an advantage for the projects in the Indian market.

5.7 Motives for seeking a local partner

The respondents that chose the entry mode which would include a local partner in the markets were asked for the motives behind that decision.

Table 11: Motives for seeking local partner

	Motives for local partner - China				
	Transportation	Manufacturing	Financial activities	Trade	Utilities
Local market knowledge	2	5	2		1
Government contact		3	1		1
Cultural and social knowledge	1	5	1	1	1
Access marketing/distribution network	2	6	1		1
Past relationship		1	1		
Host government requirements		1			1
Access supply network		1			
Spread risk		1			

	Motives for local partner - India	
	Manufacturing	Financial activities
Local market knowledge	1	3
Government contact	1	3
Cultural and social knowledge	1	1
Access marketing/distribution network		2
Past relationship		2
Spread risk		1

Source (Author's questionnaire, 2009-02)

Table 11 displays the main motives of the Icelandic MNCs to seek local partners in China: the most common reasons were to have local market, cultural and social knowledge, and to have access to marketing/distribution networks. These are assets of the host-country partners that can not be easily bought or imitated by the Icelandic MNCs, but are probably critical to their operations in the emerging market. Other reasons were to have government contacts, choosing a local partner based on a past relationship, and requirements of the host government.. They also sought to access a supply network and to spread the risk of the investment. It could therefore be argued that the Icelandic MNCs sought to complement their operations with selected local partners that would provide them with an insight into the surrounding environment and perhaps to also provide them with downstream distribution connections.

Similarly, in India, the reason for seeking a local partner was to have a host-country partner that could more easily navigate through the bureaucracy of the Indian government. Probably the Icelandic firms were also inexperienced in operating in the Indian market, so they sought local market knowledge and cultural and social knowledge to lessen the gap in the cultural distance.

In the study of Maitland et al. (1999) on Australian investment decisions in China, the Australian MNCs found the most important capabilities of having a Chinese partner to be local market knowledge, government contacts, cultural and social knowledge and access to marketing and distribution networks. The Icelandic MNCs express similar motives to the Australian ones for seeking a local partner. Maitland et al. (1999) note that the Australian MNCs sought Chinese partners which were not necessarily in the core activities of the MNCs, as they were not seeking access to production know-how, but rather to minimize spillover of knowledge. Given the competitive advantages which outlined in table 7 in the previous chapter, the Icelandic MNCs

that have product technology, brand names and managerial and personnel skills did not need to access know-how for their core activities.

5.8 Risk assessment of the host country

In the final multiple-choice question the representatives of the Icelandic MNCs were asked to assess the risk for their company in China and India. The following table displays the results.

Table 12: Risk assessment of the host country

	Risk assessment - China				
	Transportation	Manufacturing	Financial activities	Trade	Utilities
Bureaucratic obstructionism	2	3			
Lack of intellectual property rights protection		3	1	1	
Profit/payment remittance restrictions	2	2	1		
Host country political uncertainty	1	1			
Government protectionism		1			
Low labor productivity		1			
Rising labor cost		5	1		1
Labor laws		1			

	Risk assessment - India	
	Manufacturing	Financial activities
Bureaucratic obstructionism	1	2
Inadequate infrastructure	1	1
Profit/payment remittance restrictions	1	1
Host country political uncertainty		1
Government protectionism		1
Low labor productivity	1	1
Rising labor cost	1	

Source (Author's questionnaire, 2009-02)

According to table 12, the Icelandic MNCs are mostly concerned about rising labor costs in China, especially the manufacturing companies, which are likely to be labor-intensive. Next the

MNCs place the risk of bureaucratic obstructionism, lack of intellectual property rights and profit/payment remittance restrictions in China.

Although China is a powerhouse of low-cost manufacturing in products such as computer parts, electrical components, toys and textiles, the Icelandic MNCs assess the greatest risk as being rising labor costs. When it comes to high-quality low-cost manufacturing, China is high on the list, if not on top, but increasingly China is also doing high-quality higher-cost manufacturing. These concerns over rising labor costs in manufacturing are consistent with published reports about the Chinese market, covered in the literature review.

As seen from table 12, the respondents believed bureaucratic obstructionism to be the single greatest risk for their companies in India. Icelandic MNCs also raised concerns regarding infrastructure and political stability in India, and low labor productivity in the case of the manufacturing firm. The explanation for the concerns of the Icelandic investors could possibly stem from India's high level of rent-seeking by domestic companies.

5.9 Icelandic MNCs future developments in the markets

In the last part of the questionnaire the representatives of the Icelandic MNCs were asked to discuss their firm future plans in India and China: whether further investments would be made; if they would hold their position or plan to reduce their operations in the market. Not all the respondents commented on this question, but a summary of the main responses will now follow.

5.9.1 China

Economic growth in China has been substantial since the transformation of the country began around 1978. According to the Chinese government, in 2007 the economy was the third-largest in the world, taking the place of Germany on the list and following Japan in second place and the US in first place (*China has overtaken Germany, 2009*). But China has, like other countries in the world, been affected by the most serious financial crisis experienced in decades. China is seeing export numbers falling especially in consumer goods to the US and other industrial nations, and the unemployment rate is rising. Iceland's turmoil in economic conditions in 2008-9, is likely to add to the challenges ahead for Icelandic MNCs in China.

The manufacturing companies in Iceland are powerful and have established themselves firmly internationally, especially in fish products and in food manufacturing. Opportunities and specialization for Icelandic companies lie also in design, research and high-tech industry, for example in bio-science, generic pharmaceuticals and in the entertainment industry. The manufacturing companies focus in China for their future plans varied, naturally, depending on the product and the balance of the company. The larger manufacturing MNCs, with more than 500 employees, were more optimistic about opportunities in China and continuing their investments there in the future. Here it can be argued that larger firms are often regarded as more able to exploit scale and scope economies more effectively than smaller ones. These MNCs agreed that the financial crisis had slowed down their growth plan; hence future growth would continue, but over a longer period. On the other hand, one respondent commented that the financial crisis had speeded up the process of entering the emerging markets.

The smaller manufacturing firms commented that, due to the world economic crisis, the strategy was to hold their position and see how the current situation would develop. There were concerns on the effects of the financial crisis on product prices, so actions were being taken to cut costs. A respondent from one company commented that in their opinion four to eight Icelandic companies would withdraw from China before the end of Q3 this year (2009). It was further stated that the economic situation in Iceland force these withdrawing companies to reorganize their operations; they would need to focus more on their core operations, and thus foreign investments by Icelandic MNCs in China would probably decline.

The Icelandic transportation companies were all in agreement on holding their position for the time being in China. There were speculations on what impact the recession would have on China, as a low-cost but distant country for Europe. Would the country be replaced for instance by India or other countries as a low-cost country?

The MNC in the industry group, utilities seems not to be altering its plans in China in spite of the financial crisis in the world. The company has planned its operations in the market until 2015, and the goal is to be the biggest district heating company in the world by that time. Future cooperation with Chinese companies is on the drawing board and they plan to utilize new areas in China and to strengthen their ongoing production there.

5.9.2 India

Although India has been somewhat in the shadow of the rise in China's economy, economic growth and purchasing power have risen substantially in India in recent years. With greater purchasing power, quality of life has increased for a higher percentage of India's people, but there is still great inequality when it comes to lifestyle. About 3% of the population belongs to a group which can afford to buy a computer and a car, around 33 million people. The next class below, the middle class, is estimated to be around 400 million people (*India at boiling point, 2008*). In this group there are many potential customers for a MNC which is considering entering the market, especially if the purchasing power of this group continues to rise.

Like other MNCs, Icelandic companies have not let the growth and potential growth of the Indian market go unnoticed, and both manufacturing firms and financial entities have entered. Despite the financial crisis in the global economy, India has not been hit as hard as many other economies, and all the Icelandic MNCs see plenty of business opportunities in the market.

One of the Icelandic MNCs is in the seafood and sustainable-energy business and with rising demand in India the need for energy was steadily increasing. With its expertise in this niche sector, the growth potential of the Indian market, and also, that many clients of the MNC were considering to enter the market, the MNC wanted to be physically present in India. Unfortunately the plan came to a halt as the recession hit Iceland with full force in the fall of 2008.

The Icelandic manufacturing firms plan to continue with their operations and ongoing projects in India. No further investments are foreseen in the market for a while, and the financial crisis is not expected to have much impact on business as much in India as in other countries.

6 CONCLUSIONS AND DISCUSSION

In this chapter the objective is to conclude and discuss the major findings from the research presented in this thesis. The main purpose of the present thesis was to examine the motivations and investment decisions of Icelandic MNCs that have invested in the emerging markets of China and India; also to analyze the process and experience of these MNCs in the markets and to explore possible similarities with MNCs from other small economies that have entered similar markets.

Small economies investing in emerging markets is not an emerging topic, so to speak, in international business, but the author was surprised that so little research had been done, e.g. in the Nordic countries. The database is very limited in Iceland, so it was with curiosity that the author began to search for Icelandic firms that had invested in China and/or India. The number of Icelandic MNCs that have entered India and China, in variety of industries, came as a surprise. Why and how they entered the markets varied, naturally, depending on the industry and the products.

Considering the challenges that many small economies face or have faced, which have been reviewed in this thesis, one may wonder how they have been able to sustain economic growth and become wealthy. Part of the reason may be because, due to their small size, these economies had to take part in globalization, by being open and competitive to progress. Protectionism had to give way to the open-market policy. The same policy, i.e. the open-door policy, enabled such markets as China and India to prosper and become major players in the global economy.

The present thesis has offered some insights into the motivations and investment decisions of Icelandic MNCs that have invested in China and India. Despite the interest in FDI and emerging markets in international business, few studies have been conducted so far to research the motives of small economies to invest in emerging markets. This thesis should therefore contribute to the literature of international business by focusing on MNCs based in Iceland, a small economy with rising foreign investment in emerging markets in recent years. To the best of the author's knowledge, this is the first study which seeks to analyze FDI decisions and motivations of Icelandic MNCs entering emerging markets. It therefore presents new insights into the determinants as well as the strategic advantages of Icelandic MNCs that engage in investments to China and India.

The research chapter of this thesis, which was based on twenty Icelandic MNCs in various industries that have invested in China or India or both, yielded informative data about the motivations and investment decisions of the Icelandic MNCs.

The first part of the research question put forward was: What were the motivations for Icelandic MNCs to invest in emerging markets? The main motives to enter China were market-seeking, as due to the small size of the domestic market the Icelandic MNCs sought to establish a long-term presence in a larger market with strong growth prospects. The motives were also resource-seeking, as some of the manufacturing companies entered due to low labor costs in China. Some MNCs were also motivated by efficiency-seeking, as the Chinese market offered a specialized labor force at lower cost. In India the main motivation was the size of the Indian market and its strong growth potential.

In the second part of the research question it was considered whether the motivations and experience of Icelandic MNCs in entering emerging markets were similar to those of other MNCs from small economies. Based on the data from the questionnaire and review of data from other small economies, the process and experience of the Icelandic MNCs in China and India have some similarities with the small economies reviewed in this thesis: Finland, Australia, Switzerland and Sweden.

In the case of the Australian MNCs, there were not many distinctive similarities. The Australian MNCs did not assess the risk of operating in those markets as high, as geographically they are closer to the markets, and thus they believed the cultural distance between Australia and e.g. India not to be high. Their main motives to enter China were similar to the Icelandic ones, except for one factor. The large size of the market and growth potential were the main location factors, but they did not seek lower labor costs unlike the Icelandic MNCs. The fact that the Australians did not seek lower wages could be due to the differences in the size of the MNCs and the experience of the Australian and Icelandic MNCs in China. The majority of the Australian MNCs entered China through a joint venture, and in India they preferred a wholly-owned subsidiary. This choice of entry mode is the opposite of what the Icelandic MNCs preferred. The difference between the Icelandic and Australian choice of entry mode may be explained by

whether the MNCs were seeking complementary capabilities of a local partner and shared risks and costs, or more control over assets. It seems that the Icelandic companies were more focused on protecting their assets and knowledge and having full control over their management decisions.

For Finnish manufacturing firms that invested in Asia, the deciding location factors were similar to those of Icelandic MNCs, i.e. market- and efficiency-seeking FDIs. The probability of the Finnish MNCs selecting that kind of FDI increased if the size of the parent company was large, if there was substantial international experience, if the target country had large market size, if the cultural distance was low, and if there was low labor cost. Although the research data of this thesis can not be entirely compared to the results of the Finnish study it is arguably likely that the Icelandic MNCs select market- and efficiency-seeking FDI in an emerging market if the size of the target market is large, and the labor cost in the market is low.

Swiss MNCs had similar motives to Icelandic companies to enter China, i.e. the size of the Chinese market and low labor cost. The preferred mode of entry for Swiss MNCs to China was through a joint venture. Their reasons for choosing JV were due to the cultural difference between the countries; hence they sought a local partner in order to gain more knowledge of the Chinese market.

There are some similarities between the Icelandic MNCs and the case of the Swedish firm that entered the Korean market, but the data from that study and this thesis are not entirely comparable. One factor in entering a foreign market is to establish networks with local suppliers and governments, and some of the Icelandic MNCs sought local partners in China and India because of past relationships and to have government contacts.

It appears that once the Icelandic MNCs had invested in the markets they remained committed to their businesses, and they intend to maintain a long-term presence. They are willing to accept the forthcoming period of low or volatile return, especially in the Chinese market, which seems to be more affected by the financial crisis than India. How the financial crisis in the world economy, and weaker economic conditions in Iceland, will affect FDI from Iceland to emerging markets

remains to be seen. Will the banks and the Icelandic government have less appetite to support FDI to emerging markets?

Icelandic MNCs have less access to capital to use in foreign investments and, with the high risk due to the financial crisis, the banks and the government may require higher rates of return on investments in emerging markets to compensate for the risk. This could be difficult for the Icelandic MNCs to achieve, since these markets tend to have volatile conditions, but it is also critical for the Icelandic MNCs to tighten the control of exposure and seek greater insurance when entering into a contract in emerging markets. The majority of the smaller Icelandic MNCs indicated that, due to the financial crisis they were unlikely to expand their investments in the short term in India or China. But the larger Icelandic MNCs noted that they took a favorable view of continuing with their investments, as the crisis is likely to have less impact in Asia than in the West.

Many new questions have arisen during the process of this thesis, and this research lays a foundation which should encourage further research on investments from small economies to emerging markets. An interesting future research topic would be to analyze further the investment decisions of e.g. Icelandic manufacturing firms in emerging markets. The Icelandic MNCs may not have much in common in terms of resources, corporate structure and strategies and the degree of internationalization. It is likely that considerable differences exist between industries.

It could also be interesting to analyze development in the ownership structure of the Icelandic MNCs in the emerging markets and to study the correlation between the ownership structure selected and the success of the business.

Another interesting future research topic would be to explore motivations for Asian countries to invest in small economies like Iceland. As it is likely that investments from Iceland will slow down due to the weakened economy, the Icelandic government should work on strengthening relations with the Asian countries, with a view to the possible investment in Iceland. The tables are being turned, as emerging markets like China and India are increasingly taking over companies in the developed countries. FDI from China will intensify, as the Chinese have one of

the biggest foreign reserves in the world, so the opportunity for investments from China is increasing. The Chinese companies are becoming stronger, and will probably want to become more involved in the international business world and become globally competitive.

Finally, many studies have been made of motivations and foreign investment decisions of firms, but there are a limited number of studies on firms from small economies like Iceland that are investing in emerging markets like China and India. Therefore, it is hoped that the data from the research and conclusions presented in this thesis will augment understanding of the FDI pattern of firms from small economies investing in emerging markets.

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Photos on cover page

Retrieved from www.flickr.com: Hong Kong; Taj Mahal, India; The Great Wall of China; Shanghai, China.

Hallgrímskirkja: from the author's photo collection.

7.1 FIGURES AND TABLES

Figure 1

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Figure 2

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Figure 3

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Figure 4

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Figure 5

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Figure 6

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Table 1

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Table 3

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Table 4

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Table 5 – Table 12

Data from the author's questionnaire sent to twenty-three Icelandic companies in February 2009.

7.2 APPENDIX



Multiple-choice questions

- Please note that the answers from these questions will be divided by industry sector, not by company name.
- There are four sections in this query; the first and second sections are about the company; in the third there are 7 multiple-choice questions, and in the fourth section there is one open question.
- Please put X in the box after the answer. One or more options can be used, as relevant for your company.
- If your company has entered both China and India, it would be greatly appreciated if two questionnaires could be returned
- It would be greatly appreciated if the questionnaires(s) could be returned before 6. February 2009.

Thank you kindly for the responses and information regarding this thesis!

Sincerely,

Sigrún M. Hallgrímsdóttir – MSc student in International Business

Email: sigrun.hallgrimsdottir@bifrost.is

Mobile number: 844-2552

I. Contact Details

Company:	
Country invested in:	

II. Questions on the Parent Company

1. Parent company industry?	
a. Transportation and communication	
b. Utilities (Electricity, gas, water, geothermal)	
c. Manufacturing (food, textile, chemical, metal, machinery)	
d. Trade and repairs	
e. Financial activities	
f. Real estate and business activities	

2. What is the size of the firm? (number of employees)	
a. Up to 10	
b. 10-50	
c. 50-100	
d. 100-500	
e. More than 500	

3. When did the company enter the emerging market?	
a. Less than 1 year ago	
b. 1 to 3 years ago	
c. 3-5 years ago	
d. 5-10 years ago	
e. More than 10 years ago	

III. Questions on the process and experience of the emerging market

4. Location factors in the FDI decision?	
a. Low labor cost	
b. Size of domestic market	
c. Strong growth prospects (market size)	
d. Follow competitor	
e. Forestall competitor entry	
f. Establish long-term presence	
g. Establish export base	
h. Follow customer	
i. Other:	

5. Major problem(s) encountered by the investor in the emerging market?	
a. None	
b. Bureaucracy	
c. Infrastructure	
d. Cultural distance	
e. Legal system	
f. Inadequate workforce	
g. Corruption	
h. Language	
i. Other:	

6. Entry mode(s) (see explanation on page 5)	
a. Joint venture	
b. Greenfield investment	
c. Licensing	
d. Representative office	
e. Subsidiary	
f. Wholly foreign-owned enterprise	
g. Subcontracting	
h. Other:	

7. Reason(s) for choosing that entry mode?	
a. Share risk and costs	
b. Achieve optimal size	
c. Enhance skills	
d. Local support	
e. Become more competitive	
f. Full property	
g. Flexibility	
h. Other:	

8. Motives for seeking local partner(s)	
a. Local market knowledge	
b. Government contacts	
c. Cultural and social knowledge	
d. Access marketing/distribution network	
e. Past relationship	
f. Host government requirement	
g. Access supply network	
h. Finance	
i. Spread risk	
j. Other:	

9. Competencies of the Icelandic multinational company	
a. Managerial skill	
b. Skilled personnel	
c. Product technology	
d. Marketing and distribution skill	
e. Brand names	
f. Copyright and design	
g. Patents	
h. Process technology	
i. International access	

10. Risk assessment of the host country	
a. Bureaucratic obstructionism	
b. Inadequate infrastructure	
c. Lack of intellectual property rights protection	
d. Profit/payment remittance restrictions	
e. Host country political uncertainty	
f. Government protectionism	
g. Low labor productivity	
h. Rising labor cost	
i. Labor laws	
j. Other:	

IV. Open question

11. How does the company foresee its future development and plans regarding its operations in the emerging market (China or India)? Is consideration being given to investing further, holding the position or withdrawing from the market? How will the financial crisis in the world economy affect future plans in the emerging market?