FOREIGN INVESTMENT DECISIONS
OF WESTERN CANADIAN FIRMS

by

ABDUL WAHAB

M.B.A., University of Karachi, 1964
M.B.A., Indiana University, 1967

A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF
THE REQUIREMENTS FOR THE DEGREE OF
DOCTOR OF PHILOSOPHY

in

THE FACULTY OF COMMERCE AND BUSINESS ADMINISTRATION
(Marketing Division)

We accept this thesis as conforming

to the required standard

THE UNIVERSITY OF BRITISH COLUMBIA
December, 1977

© Abdul Wahab, 1977
In presenting this thesis in partial fulfilment of the requirements for an advanced degree at the University of British Columbia, I agree that the Library shall make it freely available for reference and study. I further agree that permission for extensive copying of this thesis for scholarly purposes may be granted by the Head of my Department or by his representatives. It is understood that copying or publication of this thesis for financial gain shall not be allowed without my written permission.

Department of Marketing

The University of British Columbia
2075 Wesbrook Place
Vancouver, Canada
V6T 1W5

Date December 9, 1977
ABSTRACT

An earlier study of the foreign investment decision process of U.S. firms by Aharoni had suggested the dominance of behavioural characteristics over criteria based on economic theories in determining such decisions. His research did not however, provide strong analytical proofs and part of the intellectual derivation for this study was the search for such proof. This was combined with the effort to bring into the field of knowledge some information about an under-reported sub-sample of foreign investors, namely firms from Western Canada.

The main structure of the research model consisted of six identified stages in the foreign investment decision process. In turn, six sets of variables were developed which corresponded to each of these stages: awareness through initiating forces, investigation, commitments, negotiations, uncertainty, and the final decision.

To test the research model five hypotheses were developed. The first hypothesis corresponding to stage one contended that endogenous initiating forces are more important in creating awareness of foreign direct investment opportunities than exogenous initiating forces. The second hypothesis relating to stage two claimed that those who conduct a sequential investigation will judge the subjectively estimated cost of that investigation to be significantly higher than those who do not conduct a sequential investigation.

The third hypothesis concerning stage three stated that the extent of investigation and the degree of commitments are positively related. The fourth hypothesis relating to negotiations in stage four and
uncertainty in stage five said that there exists a positive relationship between the extent of negotiations and the amount of uncertainty. The fifth hypothesis corresponding to stage six claimed that in those cases where the decision has been made to invest abroad, there will be strong initiating forces, more investigation, greater degree of commitments, greater extent of negotiations, and smaller amount of uncertainty than in those cases where the decision has been made not to invest abroad.

The hypotheses were tested against data collected on 89 decisions. The data supported all the hypotheses excepting the first part of the last hypothesis which said that the initiating forces will be stronger in the case of positive decisions. This was explained in terms of the presence of intervening variables such as investigation, commitments, negotiations, and uncertainty.

The research has implications for home and host country and the theory of the firm. Profit is shown as an important consideration in the investment decisions. Resource-based firms are led by the location of resources and they have a desire to internalize the source of supply and demand.

Some of the areas for further research are: a comparison of foreign and domestic investment decisions and a study of buying and financing practices of Canadian firms that invest abroad.

J. W. C. Tomlinson
# Table of Contents

## I. INTRODUCTION

A. The Importance of Foreign Direct Investment
   - Page 1

B. The Meaning of Foreign Direct Investment
   - 1. Control
   - 2. Flow of Funds and Direct Investment
   - 3. Technology and Management
   - 4. Initial and Ongoing Direct Investment
   - Page 2

C. Historical Growth and Distribution of Direct Investment
   - 1. Portfolio Investment
   - 2. Foreign Direct Investment
     - (a) Size and Growth
     - (b) Geographical Distribution
   - Page 5

## II. A SURVEY OF FOREIGN DIRECT INVESTMENT THEORIES

A. The Issues in Foreign Direct Investment
   - Page 18

B. The Maximization Theories
   - 1. The Classical Economic Theory
   - 2. Investment Theories
     - (a) Rate of Interest or Cost of Capital
     - (b) Capacity Utilization Theory
   - 3. The Theory of Growth of the Firm
   - 4. The Monopolistic Advantage Theory
   - 5. Exchange Risk and Securities Markets Imperfections Theories
     - (a) The Exchange Risk Theory
     - (b) The Securities Markets Imperfections Theory
   - Page 21

C. The Satisficing Theory
   - Page 39

D. The Product Life Cycle Theory
   - Page 43
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The Background</td>
<td></td>
</tr>
<tr>
<td>2. The Assumptions</td>
<td></td>
</tr>
<tr>
<td>3. The Theory</td>
<td></td>
</tr>
<tr>
<td>4. The Explanatory Power of the Theory</td>
<td></td>
</tr>
<tr>
<td>E. The Modern Imperialism Theory</td>
<td>52</td>
</tr>
<tr>
<td>III. THE RESEARCH MODEL</td>
<td>57-75</td>
</tr>
<tr>
<td>A. Aharoni's Research Design</td>
<td>58</td>
</tr>
<tr>
<td>1. The Sample</td>
<td></td>
</tr>
<tr>
<td>2. The Scope of Research</td>
<td></td>
</tr>
<tr>
<td>3. Research Methodology</td>
<td></td>
</tr>
<tr>
<td>B. Aharoni's Research Findings</td>
<td>61</td>
</tr>
<tr>
<td>C. Weaknesses in Aharoni's Theory</td>
<td>72</td>
</tr>
<tr>
<td>IV. THE RESEARCH DESIGN</td>
<td>76-88</td>
</tr>
<tr>
<td>A. Objectives of the Study</td>
<td>76</td>
</tr>
<tr>
<td>B. The Hypotheses</td>
<td>77</td>
</tr>
<tr>
<td>C. The Operational Definitions</td>
<td>77</td>
</tr>
<tr>
<td>D. The Sample</td>
<td>85</td>
</tr>
<tr>
<td>E. The Methodology</td>
<td>86</td>
</tr>
<tr>
<td>V. THE RESEARCH FINDINGS</td>
<td>89-123</td>
</tr>
<tr>
<td>A. Initiating Forces and Awareness of Foreign Direct Investment Opportunities</td>
<td>89</td>
</tr>
<tr>
<td>1. Initiating Forces</td>
<td></td>
</tr>
<tr>
<td>(a) Endogenous Initiating Forces</td>
<td></td>
</tr>
<tr>
<td>(b) Exogenous Initiating Forces</td>
<td></td>
</tr>
<tr>
<td>2. The Relative Importance of Individual Initiating Forces</td>
<td></td>
</tr>
<tr>
<td>3. A Comparison of Endogenous and Exogenous Initiating Forces</td>
<td></td>
</tr>
<tr>
<td>B. Sequential Investigation and Subjectively Estimated Cost of Investigation</td>
<td>93</td>
</tr>
</tbody>
</table>
1. The Sequential Investigation
2. The Cost of Investigation
3. A Comparison of Sequential Investigation Cost with the Cost of Non-Sequential Investigation

C. Relation between Intensity of Investigation and Degree of Commitments 98
   1. Investigation Variables
   2. Commitment Variables
   3. The Test of the Hypothesis

D. Relation between Extent of Negotiations and Amount of Uncertainty 107
   1. The Negotiation Variables
      (a) Negotiations with Host Country Government
      (b) Negotiations with Host Country Banks
      (c) Negotiations with Partners
   2. The Uncertainty Variables
   3. The Relation between the Extent of Negotiations and Amount of Uncertainty

E. Relation between Positive and Negative Decisions in Terms of Initiating Forces, Investigation, Commitments, Negotiations, and Uncertainty 116
   1. Initiating Forces
   2. Investigation
   3. Commitments
   4. Negotiations
   5. Uncertainty

VI. COMPARISON OF RESEARCH FINDINGS WITH OTHER STUDIES 124-145
   A. Initiating Forces and Awareness of Foreign Direct Investment Opportunities 124
   B. Sequential Investigation and Subjectively Estimated Cost of Investigation 133
   C. Relation between Intensity of Investigation and Degree of Commitments 135
   D. Relation between Extent of Negotiations and Amount of Uncertainty 137
E. The Comparison of Positive and Negative Decisions  

<table>
<thead>
<tr>
<th>E. The Comparison of Positive and Negative Decisions</th>
<th>144</th>
</tr>
</thead>
</table>

VII. CONCLUSIONS, SUMMARY, IMPLICATIONS, AND AREAS FOR FUTURE RESEARCH  

<table>
<thead>
<tr>
<th>VII. CONCLUSIONS, SUMMARY, IMPLICATIONS, AND AREAS FOR FUTURE RESEARCH</th>
<th>146-175</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Conclusions</td>
<td>146</td>
</tr>
<tr>
<td>1. Contribution of the Present Study</td>
<td></td>
</tr>
<tr>
<td>2. Areas of Differences</td>
<td></td>
</tr>
<tr>
<td>3. The Validity of the Behavioural Model</td>
<td></td>
</tr>
<tr>
<td>B. Summary of the Study</td>
<td>154</td>
</tr>
<tr>
<td>1. The Research Model</td>
<td></td>
</tr>
<tr>
<td>2. The Hypotheses</td>
<td></td>
</tr>
<tr>
<td>3. The Sample and Methodology</td>
<td></td>
</tr>
<tr>
<td>4. The Research Findings</td>
<td></td>
</tr>
<tr>
<td>C. Implications</td>
<td>160</td>
</tr>
<tr>
<td>1. Implications for Host Countries</td>
<td></td>
</tr>
<tr>
<td>2. Implications for Home Country</td>
<td></td>
</tr>
<tr>
<td>3. Implications for the Theory of the Firm</td>
<td></td>
</tr>
<tr>
<td>D. Areas for Further Research</td>
<td>174</td>
</tr>
</tbody>
</table>

Appendix                                                                 |
Bibliography
ACKNOWLEDGEMENTS

Many thanks are due to Dr. J. W. C. Tomlinson, who, as chairman of my dissertation committee, guided me from the beginning of this dissertation. Without his useful suggestions my dissertation would not have been completed. Dr. Tomlinson spent several weekends in minutely reading my drafts. I very much appreciate his assistance.

The other members of my committee, namely, Dr. Merle E. Ace, Dr. Herbert D. Drechsler, and Dr. S. M. Oberg were very helpful in offering useful comments and suggestions. I sincerely thank them for their assistance. The suggestions of Dr. G. B. Hainsworth and Dr. Vance F. Mitchell, as members of my oral examination committee, were useful in clarifying the concepts I have used in this dissertation. Thanks are also due to Mrs. Sylvia Willie for offering her assistance.

I sincerely thank the presidents and vice-presidents of the firms in British Columbia who spent their valuable time in answering my questions. I am very grateful to them for the information they provided about the foreign direct investment decisions of their firms.

I also want to thank the Division of International Business Studies and the Faculty of Commerce and Business Administration for the financial assistance which enabled me to complete my dissertation.

My children, Wasim, Baber, and Shazia also deserve thanks for not putting demands on my time and for praying for my success.

Abdul Wahab
dedicated to

Razia

(whose prayers, patience and love made this possible)
I. INTRODUCTION

A. The Importance of Foreign Direct Investment

One of the most significant and dramatic world trends of the post-war period has been the rapid and sustained growth of foreign direct investment. According to an IMF estimate, the total foreign direct investment at book value in 1974 was $216 billion, more than the combined gross national product of two-thirds of the countries of the world. The annual average rate of growth of foreign direct investment has been estimated to be 10 to 20 percent. Foreign direct investment is proving to be one of the most important means of transfer of technology, efficient managerial practices and capital across national boundaries.

An important measure of the significance of foreign direct investment is its contribution to foreign production. During 1971, foreign production was estimated at $330 billion. The total exports of market economies for the same period was $311 billion. Thus foreign production as a percentage of export reached the high figure of 105.8.

The unprecedented expansion of foreign direct investment has evoked a strong interest in the motives underlying the decision process. While some information and understanding has been gained from this surge in interest, the complexity of the decision-making process and the controversy that surrounds it require more attention for its analysis.

1 International Monetary Fund, Balance of Payments Yearbook, Volume 26 (Washington D.C. 1974).


B. The Meaning of Foreign Direct Investment

A business firm thinking of going abroad can do so by export, licensing, or direct investment. The selection of a strategy for each market may vary and depends on a number of factors which will be discussed in this dissertation.

1. Control

The essential feature of foreign direct investment is control over the decision making process of the business enterprise in the host country by investors who are not citizens of that country. The extent of control may vary according to equity participation. According to Kindleberger, the extent of desired control is determined by the amount of monopolistic advantages enjoyed by a firm. The bigger the advantage, the higher the probability of avoiding sharing of control with locals. The possibility of clash of interests over policies regarding dividends, reinvestment of earnings, and transfer pricing may also determine the extent of control desired. Government regulations in the host country also play an important role in determining the extent of control. The government in India, for example, requires foreign corporations, as a condition of entering, to undertake to sell as much as 30 percent of their equity to local investors.

Control is sometimes used in the legal sense. The U.S. government defines direct investment as an ownership interest in foreign enterprises.

---


of at least 10 percent. This definition was used by the U.S. government in 1968 to restrict foreign investment.

In portfolio investment ownership interest is present, but there is no managerial control. Even if a business firm owns the equity of a foreign enterprise by 100 percent, the investment will not qualify as direct investment unless the investor exercises control over the decision-making process.

Control has political implications too. According to Kindleberger, "The control aspect of direct investment, which economists have been inclined to dismiss, is increasingly assuming political significance. In part this is the result of an unresolved conflict in international law; in part the result of what we may loosely characterize as pure nationalism. On the first score, for example, the United States assumes that it has the right to require parent companies to direct the operations of their subsidiaries in ways that conform to American purposes, while foreign governments, sovereign over the territory where these subsidiaries are located, deny the existence of such a right."⁶ The controversy over control has strengthened economic nationalism.

2. Flow of Funds and Direct Investment

Historically, economists considered foreign direct investment as an international flow of funds. In the case of the United States, the capital movement part of direct investment remained significant and was a cause of concern due to balance of payments problems. In February 1965 voluntary controls were imposed. These were made mandatory in January 1968. As economists discovered later, direct investment did not necessarily involve an outflow of funds from the investing country. Investors who acquire

control of an enterprise would borrow in the local capital market in the host country or they could borrow in the international capital markets. Direct investment is also possible through the exchange of assets such as technology, patents, or machinery without any exchange of funds through the foreign exchange markets. Direct investment may also be financed by reinvesting earnings. This also does not involve a flow of funds from the investing country.

3. Technology and Management

Flow of funds may not be necessary for direct investment, but it usually carries with it valuable knowledge in the form of research and development, technical guidance, production technology, entrepreneurship, marketing skills, or managerial expertise. These rarely accompany portfolio investment. It is because of the involvement of these factors that a multinational enterprise is regarded as a vehicle for the dissemination of superior inputs. Most of the direct investment is channelled through multinational corporations.

4. Initial and Ongoing Direct Investment

Foreign direct investment may be classified as initial direct investment i.e. the decision to invest direct in a market for the first time. This involves an analysis of motives of the investing enterprise. Direct investment may also be seen as ongoing i.e. an enterprise had already invested in a market, it is merely repeating the decision.

In the words of Richardson, "An important theoretical distinction must be drawn between this initial decision and the ongoing investment decision which is made periodically for an established foreign affiliate."
In principle the initial decision is discrete and has no backdrop of resources already committed to the foreign market."  

Thus, foreign direct investment involves control of varying degrees. It may or may not accompany a flow of funds from the investing country, but it usually accompanies some superior inputs in the form of technology, management, entrepreneurship and marketing. Foreign direct investment involves formation or acquisition with ownership of production facilities in a host country. Direct investment decisions may therefore be initial investment decisions or ongoing investment decisions.

C. Historical Growth and Distribution of Direct Investment

1. Portfolio Investment

Prior to the First World War, 90 percent of all long term international capital movements consisted of portfolio investment in the form of foreign securities and bonds acquired by individuals or institutions. The period from 1864 to 1914 was uniquely favourable to free movement of capital. The world could easily be divided into capital exporting and importing countries. The U.K. was the leading creditor country followed by France, Switzerland and Germany. The countries in North America (U.S.A. and Canada), Latin America, Oceania (Australia and New Zealand), Asia and Africa clearly being debtors. There were few exchange problems because

---


the currencies of almost all countries were pegged to gold. Trade between creditor and debtor countries was growing.

The upheaval following the First World War changed the positions of debtor and creditor countries. The U.S. emerged as the prime creditor country during the war. By 1919 she had invested $6.5 billion abroad, excluding the large war loans to her Allies. In 1930, the United States investment rose to $15.7 billion, about two-thirds of the world total of new investment.9

Continental Europe was transformed from a net creditor to a net debtor area. Most countries in Europe liquidated a large share of their foreign investment during the war. The U.K. sold 15 percent of her foreign investment, while France disposed off more than half of her foreign assets. Germany not only gave up all her foreign investments, but she became the largest borrower after the war. During this period, the U.S. had loaned as much as $7.5 billion to Germany. By 1930, the U.K., France, the Netherlands, Switzerland, Belgium and Sweden had recovered their lost positions and again became lenders.

But this recovery was short lived because the Great Depression changed the entire situation. Dunning says, "... the depression which followed constituted the dividing line in the history of investment. Not only were its immediate effects far more serious than anything which had occurred before - as shown by the wholesale defaults of debtor countries and sales of assets by creditor countries. The crisis itself was but a prelude to a series of events which were cumulatively disastrous for the international savings/investment process as it was then organized."10

9 Ibid., p. 60.

Exchange controls replaced the gold standard and free convertibility of currencies. Free trade was replaced by import restrictions and bilateral trading. Portfolio investment, for all practical purposes, was halted. At the end of the Second World War, when foreign investment resumed, its character was completely changed.

2. Foreign Direct Investment

The post World War II period was dominated by foreign direct investment channelled through the multinational corporations. Similarities in spirit and institutional set up of foreign direct investment could be found in the seventeenth century when three powerful groups of Italian financiers established agencies in Rome, Lyon, Bruges, Paris, Antwerp, London and other centres throughout Europe.\footnote{Endel J. Kolde, \textit{International Business Enterprises, Second Edition}, (Englewood Cliffs: Prentice-Hall, Inc., 1973), p. 3.}

The emergence of nation states in Europe resulted in the subordination of commerce and finance to the nationalistic aspirations of the state. The individuals and companies were rewarded for their support and cooperation by exclusive rights which led in the beginning of seventeenth century to the rise of commercial monopolistic enterprises like British East India Company, the Levant Company, the Dutch East India Company and the Hudson Bay Company.

The monopolistic colonial enterprises were basically concerned with trade and raw materials exploitation in the colonies. However, on a small scale, they manufactured goods locally, which did not compete with the goods manufactured in mother countries. The colonial monopolies dominated world
trade until the late eighteenth century. Their influence was eroded by the advent of the Industrial Revolution.\footnote{Arvind V. Phatak, \textit{Evolution of World Enterprises} (American Management Association, 1971), p. 5.}

The Industrial Revolution brought inventions, technology, specialization and concentration of production in the factories. Cottage industry was replaced by the new factory system. Government functions were taken away from the companies. Attitudes of nations changed from self-sufficiency and protectionism to free trade. Great philosophers like John Locke supported the laissez faire movement. Adam Smith advocated free trade.

It was during this period that direct investment was made by England, France and Holland on a small scale, in their colonies in Asia, Africa and America. The investment took the form of subsidiary operations of metropolitan trading or manufacturing companies in need of raw materials - both agricultural and minerals. These colonial subsidiary arrangements of the nineteenth century metropolitan firms were forerunners of the modern multinational corporation. The similarity between the two consists in the transfer of capital, know-how, skilled managers, and technicians for permanent operations in overseas areas.

There were two major differences in the companies that operated during the colonial period and the modern multinational corporations. First, the companies operated in a colonial area or a sphere of influence of the mother country compared to the present day multinational corporations that operate in sovereign states. Second, the direct investment of those companies was production oriented compared to the direct investment of modern multinational corporations which is market oriented. The output of subsidiaries in the colonies or spheres of influence was for further
processing. The modern multinational corporation's basic purpose is to manufacture and market the parent company's products in the host country, though goods may be exported to other countries including the home country.

It was in the latter half of the nineteenth century that several of the modern multinational corporations started manufacturing abroad, on a small scale, by setting up subsidiaries. Singer established its first foreign subsidiary in Glasgow in 1867 to assemble sewing machines, followed by another assembly plant in Montreal in 1873. In 1879 Westinghouse started a shop in Paris to manufacture brakes. The General Electric Company, soon after its incorporation in 1892, acquired all the stock of the Thomson Houston International Company, which mostly consisted of foreign direct investment. In 1897, Wyeth and Company, a pharmaceutical firm, opened a manufacturing plant in Canada. By 1889, Eastman Kodak incorporated in London the Eastman Photographic Materials Company to manufacture films. In 1879, Standard Oil of Ohio made its first investment in a refinery in Galicia.

In Europe the first breakthrough was made by the Swedish inventor and industrialist Alfred Nobel who founded the first foreign branch plant in Hamburg in 1866. Lever and Nestle also started setting up foreign manufacturing plants in the same period. Following the example of Lever and Nestle, a large number of such companies as Imperial Chemical, Philips and Royal Dutch Shell appeared on the horizon with a global outlook.

Thus, by the start of 1890's, leading American and European inventors, manufacturers, and marketers were concerned with foreign direct investment, though on a small scale. American and European manufacturers of sewing machines, harvesters, typewriters, elevators, printing presses, boilers, electrical appliances, drugs, explosives, films, petroleum,
margarine, soaps, coffee and insurance already had investments outside their respective countries. In the words of Wilkins, "The U.S. triumph abroad was one of ingenuity, new products, new methods of manufacturing and new sales and advertising techniques."\(^\text{13}\)

Prior to the First World War direct investment in foreign markets was made by Ford, G.M., Studebaker and Computing Scale Company, the predecessor of IBM. Despite the appearance of the firms that were going to grow into multinationals of the present day, foreign direct investment remained a small part of the total investment because the U.S. market was big enough to attract most of the attention of American investors.

After the Second World War the composition of long term international capital flows was completely changed. Most of such flows consisted of direct investment, foreign aid, loans by international agencies, and only 5 percent portfolio investment. Direct investment dominated the scene.

(a) Size and Growth

The stock of foreign direct investment, as given in Table 1, shows that the United States remained the major investing country followed by the United Kingdom, Germany, Switzerland, France, Japan, Canada, Italy and the Netherlands. The eight countries owned 90 percent of foreign direct investment in 1974.

A comparison of the share of these countries in the stock of direct investment shows that the U.S. share declined from 55 percent in 1967 to 47.9 in 1974. The U.K. and Italy also experienced a decline in their shares. The countries that remarkably increased their share during this

Table 1. Stock of Foreign Direct Investment of Market Economies at Book Value.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Billions of US $</td>
<td>% Distribution</td>
<td>Billions of US $</td>
<td>% Distribution</td>
<td>Billions of US $</td>
<td>% Distribution</td>
</tr>
<tr>
<td>United States</td>
<td>59.5</td>
<td>55.0</td>
<td>86.0</td>
<td>52.0</td>
<td>103.5</td>
<td>47.9</td>
</tr>
<tr>
<td>U.K.</td>
<td>17.5</td>
<td>16.2</td>
<td>24.0</td>
<td>14.5</td>
<td>31.5</td>
<td>14.6</td>
</tr>
<tr>
<td>France</td>
<td>6.0</td>
<td>5.5</td>
<td>9.5</td>
<td>5.8</td>
<td>11.4</td>
<td>5.2</td>
</tr>
<tr>
<td>Germany, FR</td>
<td>3.0</td>
<td>2.8</td>
<td>7.3</td>
<td>4.4</td>
<td>13.7</td>
<td>6.3</td>
</tr>
<tr>
<td>Switzerland</td>
<td>4.3</td>
<td>3.9</td>
<td>6.8</td>
<td>4.1</td>
<td>12.0</td>
<td>5.6</td>
</tr>
<tr>
<td>Canada</td>
<td>3.7</td>
<td>3.4</td>
<td>5.9</td>
<td>3.6</td>
<td>7.6</td>
<td>3.5</td>
</tr>
<tr>
<td>Japan</td>
<td>1.5</td>
<td>1.3</td>
<td>4.5</td>
<td>2.7</td>
<td>8.7</td>
<td>4.0</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.3</td>
<td>2.1</td>
<td>3.6</td>
<td>2.2</td>
<td>5.7</td>
<td>2.6</td>
</tr>
<tr>
<td>Sweden</td>
<td>1.5</td>
<td>1.4</td>
<td>3.5</td>
<td>2.1</td>
<td>4.3</td>
<td>1.9</td>
</tr>
<tr>
<td>Italy</td>
<td>2.1</td>
<td>1.9</td>
<td>3.4</td>
<td>2.0</td>
<td>4.0</td>
<td>1.8</td>
</tr>
<tr>
<td>Belgium</td>
<td>2.0</td>
<td>0.4</td>
<td>3.2</td>
<td>2.0</td>
<td>3.7</td>
<td>1.7</td>
</tr>
<tr>
<td>Others</td>
<td>4.9</td>
<td>6.1</td>
<td>7.4</td>
<td>4.6</td>
<td>10.3</td>
<td>4.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>108.2</strong></td>
<td><strong>100.0</strong></td>
<td><strong>165.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>216.4</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>


1972-74: Computed from International Monetary Fund, Balance of Payments Yearbook, Volume 26, Washington, 1974-75. The figures for 1974 are provisional.
period were Japan (from 1.5 percent in 1967 to 4.0 percent in 1974), Germany (from 2.8 percent in 1967 to 6.3 percent in 1974) and Switzerland (from 3.9 percent in 1967 to 5.6 percent in 1974).

An analysis of the total size of foreign direct investment shows an increase of 70.9 percent from 1967 to 1971, the annual average growth being 14.2 percent. The same high rate of growth could not be maintained during 1971-74 because this was the period of financial, economic and political crises. The direct investment during 1971-74 increased by 31.1 percent only, the annual average growth rate being 7.7 percent.

The book value measure of direct investment has inherent limitations because it does not take care of the tremendous increase in the value of assets due to the high rate of inflation. Thus the total value of direct investment is highly understated. If the assets are valued in terms of their market price, the figures of direct investment will increase by three or four times.\footnote{See Stefan H. Robock and Kenneth Simmonds, \textit{International Business and Multinational Enterprises}, op.cit., Chapter 3.}

(b) Geographical Distribution

Over two-thirds of the estimated book value of direct investment is located in the developed market economies where the advanced economic level and similarities in institutional and social structures have facilitated the spread of multinational corporate systems.\footnote{United Nations, \textit{Multinational Corporations in World Development}, op.cit., p. 8. See also Tables 11 and 12 in the Annex II of the same book.} A study of the geographical distribution of the direct investment of the United States, still the biggest investor, illustrates the concentration of direct investment in developed countries.
Table 2. Geographical Distribution of Foreign Direct Investment of USA 1965-73.

(Million US $)

<table>
<thead>
<tr>
<th>Year</th>
<th>UK</th>
<th>Other Western Europe</th>
<th>Japan</th>
<th>Canada</th>
<th>Latin American Rep. &amp; Other W. Hemisphere</th>
<th>Other countries</th>
<th>Institutions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>566</td>
<td>1,247</td>
<td>70</td>
<td>1,435</td>
<td>597</td>
<td>858</td>
<td>123</td>
<td>4,896</td>
</tr>
<tr>
<td>1966</td>
<td>574</td>
<td>1,665</td>
<td>80</td>
<td>1,626</td>
<td>616</td>
<td>648</td>
<td>50</td>
<td>5,259</td>
</tr>
<tr>
<td>1967</td>
<td>423</td>
<td>1,285</td>
<td>112</td>
<td>1,036</td>
<td>428</td>
<td>998</td>
<td>317</td>
<td>4,599</td>
</tr>
<tr>
<td>1968</td>
<td>583</td>
<td>853</td>
<td>180</td>
<td>1,356</td>
<td>928</td>
<td>913</td>
<td>354</td>
<td>5,167</td>
</tr>
<tr>
<td>1969</td>
<td>435</td>
<td>1,568</td>
<td>168</td>
<td>1,556</td>
<td>720</td>
<td>888</td>
<td>264</td>
<td>5,602</td>
</tr>
<tr>
<td>1970</td>
<td>878</td>
<td>1,980</td>
<td>251</td>
<td>1,706</td>
<td>1,003</td>
<td>1,035</td>
<td>477</td>
<td>7,330</td>
</tr>
<tr>
<td>1971</td>
<td>943</td>
<td>2,148</td>
<td>336</td>
<td>1,272</td>
<td>1,041</td>
<td>1,403</td>
<td>738</td>
<td>7,881</td>
</tr>
<tr>
<td>1972</td>
<td>433</td>
<td>2,291</td>
<td>342</td>
<td>1,609</td>
<td>809</td>
<td>1,359</td>
<td>456</td>
<td>7,299</td>
</tr>
<tr>
<td>1973</td>
<td>1,486</td>
<td>4,741</td>
<td>335</td>
<td>2,315</td>
<td>1,650</td>
<td>1,580</td>
<td>496</td>
<td>12,517</td>
</tr>
</tbody>
</table>


The figures in the IMF Balance of Payments Yearbook up to 1970 were given in US $, while those for the remaining years were in SDRs. For the sake of consistency, the SDRs were converted into the US $. The following exchange rates were computed from the exchange rates given in the IMF Balance of Payments Yearbook:

1971: US $ = SDR 1
1972: = SDR 0.98
1973: = SDR 0.85
The United States direct investment was concentrated in Western Europe followed by Canada, Latin American Republics and the United Kingdom. Only 15.9 percent of direct investment during 1965-73 went to other countries of Asia, Africa and Oceania. Canada remained the most important single country from the U.S. investors' point of view by taking a record of 22.9 percent of total U.S. investment during this period.

The geographical distribution of direct investment by Canada shows a concentration in the United States followed by the UK and other (non-OECD) countries. Canada's direct investment in other OECD countries seems to have levelled off after 1968. In 1973, direct investment in this region showed a decline from the previous year's $30 million to $12 million.

A look at the geographical distribution of West Germany's direct investment shows large increases in all areas except the United States and Canada, where it shows a modest increase.

As discussed before, Japan is showing the fastest rate of growth in her foreign direct investment. The highest concentration of Japan's direct investment is in the third world countries. As Japan is not rich in natural resources, she is investing in the third world countries to develop their natural resources so that she can have dependable sources of supply of raw materials.

An interesting feature of the distribution of direct investment of the UK, France, Italy, Belgium and the Netherlands reflects the importance of former colonial ties. More than two-thirds of the French and Belgium direct investment was in Africa, mostly in French speaking countries. The investment of the UK was concentrated in Commonwealth countries.
Table 3. The Geographical Distribution of Canada's Foreign Direct Investment.

<table>
<thead>
<tr>
<th>Year</th>
<th>USA</th>
<th>UK</th>
<th>Other OECD Countries</th>
<th>Other Countries</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1968</td>
<td>42</td>
<td>1</td>
<td>45</td>
<td>38</td>
<td>126</td>
</tr>
<tr>
<td>1969</td>
<td>265</td>
<td>7</td>
<td>31</td>
<td>39</td>
<td>342</td>
</tr>
<tr>
<td>1970</td>
<td>208</td>
<td>15</td>
<td>37</td>
<td>38</td>
<td>268</td>
</tr>
<tr>
<td>1971</td>
<td>181</td>
<td>26</td>
<td>31</td>
<td>64</td>
<td>302</td>
</tr>
<tr>
<td>1972</td>
<td>122</td>
<td>32</td>
<td>30</td>
<td>181</td>
<td>366</td>
</tr>
<tr>
<td>1973</td>
<td>353</td>
<td>108</td>
<td>12</td>
<td>98</td>
<td>571</td>
</tr>
</tbody>
</table>


(c) Composition of Direct Investment by Industry

During 1946-58 most direct investment was made in extractive industries particularly in petroleum in the Middle East, Canada and Latin America. From 1958 onward, the emphasis shifted to manufacturing of consumer goods, mostly durables. The direct investment during this period was dominated by automobiles, electric appliances, food, chemicals and petrochemicals.

Direct investment industries are dominated by large size multinational corporations. The subsidiaries in the natural resources sector appear to be three to four times larger than in manufacturing. The industries in which

*The figures in IMF *Balance of Payments Yearbook* for 1968 were given in Canadian dollars. For the sake of consistency these were converted into US dollars by using US $1 = CN $1.0728. The figures for 1969 and 1970 were in US dollars. The figures for 1971, 1972, and 1973 were in SDRs. These were converted into US dollars by using the exchange rates discussed at the bottom of Table 2 of this paper.*
Table 4. The Geographical Distribution of Germany's Foreign Direct Investment.

<table>
<thead>
<tr>
<th>Year</th>
<th>US &amp; Canada</th>
<th>EEC</th>
<th>Other OECD Countries</th>
<th>Other Countries</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td>44</td>
<td>83</td>
<td>61</td>
<td>76</td>
<td>264</td>
</tr>
<tr>
<td>1968</td>
<td>54</td>
<td>140</td>
<td>117</td>
<td>85</td>
<td>396</td>
</tr>
<tr>
<td>1969</td>
<td>83</td>
<td>208</td>
<td>149</td>
<td>109</td>
<td>549</td>
</tr>
<tr>
<td>1970</td>
<td>103</td>
<td>242</td>
<td>178</td>
<td>163</td>
<td>686</td>
</tr>
<tr>
<td>1971</td>
<td>136</td>
<td>232</td>
<td>227</td>
<td>76</td>
<td>671</td>
</tr>
<tr>
<td>1972</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1973</td>
<td>141</td>
<td>585</td>
<td>455</td>
<td>458</td>
<td>1,640</td>
</tr>
</tbody>
</table>

Source: IMF, Balance of Payments Yearbooks, 1967-73. For conversions of SDR figures for 1971, 1972 and 1973 into US dollars, see note on Table 2 of this paper.

The following table shows the geographical distribution of direct investment in Japan:

Table 5. The Geographical Distribution of Foreign Direct Investment of Japan.

<table>
<thead>
<tr>
<th>Year</th>
<th>USA</th>
<th>Canada</th>
<th>Other OECD Countries</th>
<th>Finland, Australia, New Zealand, and South Africa</th>
<th>Other Countries</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td>16</td>
<td>0</td>
<td>3</td>
<td>5</td>
<td>53</td>
<td>77</td>
</tr>
<tr>
<td>1968</td>
<td>67</td>
<td>0</td>
<td>16</td>
<td>7</td>
<td>54</td>
<td>144</td>
</tr>
<tr>
<td>1969</td>
<td>1</td>
<td>0</td>
<td>9</td>
<td>18</td>
<td>106</td>
<td>134</td>
</tr>
<tr>
<td>1970</td>
<td>20</td>
<td>0</td>
<td>41</td>
<td>39</td>
<td>161</td>
<td>261</td>
</tr>
<tr>
<td>1971</td>
<td>114</td>
<td>27</td>
<td>4</td>
<td>88</td>
<td>145</td>
<td>150</td>
</tr>
<tr>
<td>1972</td>
<td>70</td>
<td>16</td>
<td>162</td>
<td>27</td>
<td>246</td>
<td>521</td>
</tr>
<tr>
<td>1973</td>
<td>585</td>
<td>63</td>
<td>436</td>
<td>49</td>
<td>735</td>
<td>1,868</td>
</tr>
</tbody>
</table>

Source: IMF, Balance of Payments Yearbooks, 1967-73. For conversions of the SDR figures for 1971, 1972 and 1973 into US dollars, see note on Table 2 of this paper.
direct investment is being made are dominated by a few firms in each country. For the United States, 250 to 300 firms account for over 70 percent of direct investment. In case of the United Kingdom, over 80 percent of the total is controlled by 165 firms. For the Federal Republic of Germany, 82 firms control over 70 percent and the nine largest foreign investors alone control 37 percent of the total. In the case of Japan, although there are some giant firms active abroad, many small firms appear to have participated in foreign direct investment activities.\textsuperscript{16}

Summarizing the above discussion, the following conclusions can be drawn about foreign direct investment after the Second World War:

1) Direct investment became the major form of investment replacing portfolio investment.

2) More of the direct investment is being made in the developed market economies of the world, particularly in Western Europe after the formation of the European Economic Community in 1958. The share of the developing countries is declining.

3) The emphasis has shifted from extractive industries to manufacturing.

4) About 90 percent of the stock of direct investment is owned by nine countries viz., the U.S.A., the U.K., Germany, Switzerland, France, Japan, Canada, Italy and the Netherlands. The shares of the United States and the U.K. are declining, while those of Germany, Japan and Switzerland are increasing.

5) The multinational corporations are the most important channels of foreign direct investment.

II. A SURVEY OF FOREIGN DIRECT INVESTMENT THEORIES

A. The Issues in Foreign Direct Investment

The rapid growth in foreign direct investment after the Second World War raised many issues in the minds of all those who were in any way concerned with it - economists, international trade theorists, financial experts and government policy makers, both in home and host countries. Some of these issues were the effects of foreign direct investment on the balance of payments, the threat to the sovereignty of host countries, its contribution to economic development of host countries, the impact of foreign direct investment on the employment level in the home country and economic nationalism. These macro issues are not within the scope of this research which is concerned with the determinants of foreign direct investment.

The issues at the micro level can be briefly stated as follows:

1) What factors, internal and external, motivate a business firm to expand its operations across national boundaries?

2) What factors determine the form of going abroad i.e. why some firms expand their operations in foreign markets by means of export, others by means of licensing and still others choose direct investment by acquiring or building production facilities in foreign markets?

3) Why do firms prefer to make direct investment in certain countries and regions and not in others? Particularly, why is foreign direct investment concentrated in developed countries compared to developing regions?

4) Why is foreign direct investment concentrated in certain industries rather than others?

5) Why is it that some firms in the same industry invest abroad, while others decide to stay home?
6) Why does the two way flow of foreign direct investment take place between developed countries even in the same industry?

A comprehensive theory of foreign direct investment should offer a satisfactory explanation of these issues. As foreign direct investment is a new phenomenon in terms of its size and growth, no comprehensive theory has yet developed to provide acceptable answers to these issues. The foreign direct investment decision theory is still in its infancy. Mostly theories and concepts borrowed from economics, investment theory, international trade theory and organizational behaviour are being applied to explain the determinants of foreign direct investment and its pattern.

The lack of a comprehensive theory can be attributed to the difficulties encountered in interpreting the motives of corporations which have grown tremendously in size and complexity. The officials of the Office of International Investment in the U.S. Department of Commerce faced the same problem when they tried to investigate the causes and effects of U.S. direct investment abroad. They admitted in the report that "Sorting out the motives underlying either individual or collective behavior is a very complex process not readily amenable to quantification or to facile generalizations. Yet criticism of the motives underlying activities of multinational companies by certain industry and labour groups have tended to oversimplify the motives for investing abroad or have implied invidious motives to specific investments."

Another difficulty in probing the determinants of foreign direct investment lies in the fact that on a number of occasions behaviour is

---

influenced not by one, but by several motives. In the words of Dunning, "Since foreign direct investment represents the territorial expansion of business activities, it may be assumed that, in principle at least, it is undertaken to advance the interests of the investing institution - whatever these interests may be. It is true that most firms are influenced in their behaviour by more than one objective and sometimes different values are placed on the same objectives. Moreover, not all firms view their overseas investments in the same light as their domestic investments."\(^2\)

The theories explaining foreign direct investment can be grouped into: the maximization theories, the satisficing theory, the product life cycle theory and the neo-imperialism theory. The maximization theories include the classical economic theory, the interest rate differential or cost of capital theory, the capacity utilization theory, the theory of the growth of firm, the monopolistic advantage theory and the capital market imperfections theory. The emphasis in all these theories is on maximization of economic goals of the firm such as profit, interest, utilization of capacity, sales, return from monopolistic advantages, and the avoidance of the risk of capital depreciation.

In the satisficing theory, greater attention is paid to noneconomic goals and less attention is given to purely rational decisions. The product life cycle theory relates the location of production to the stages in the life cycle of a product. The neo-imperialism theory stresses the collaboration between the imperialist powers and the multinational corporations to achieve the political goals of the former.

B. The Maximization Theories

1. The Classical Economic Theory

The emphasis in classical economic theory is on profit maximization, which is held to be "the strongest, the most universal, and the most persistent of the forces governing entrepreneurial behaviour." Milton Friedman says, "Few trends could so thoroughly undermine the very foundation of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."

Caves introduces the idea of overall maximization. "... the maximization of profit can safely be assumed to be the prevailing motivation of the firm, multinational or not. Indeed, the available evidence supports the view that the multinational maximizes profits from its activities as a whole, rather than, say, telling each subsidiary to maximize independently and ignoring the profit interdependencies among them. But overall maximization by the multinational can lead its subsidiary to behave differently from an independent firm. ... A subsidiary might pass up an otherwise profitable local use of funds if the expected yield would be higher elsewhere in the global corporation, whereas a local firm would make the local commitment. Another difference arises because the multinational firm almost automatically spreads its risks, and could therefore behave quite differently in an uncertain situation from an independent having the same risk ...."
According to the classical economic theory, the firm is assumed to be composed of a single, omniscient economic man. All problems, their alternatives and consequences of each alternative are known to him. Firms cannot grow beyond a certain size because management is indivisible. Each firm in the market is very small and their number is infinitely large. This assumption was relaxed and oligopoly and monopolistic competition were added. Profit maximization is achieved at the level where marginal revenue equals marginal cost.

The optimizer tries to formulate corporate goals in quantitative terms and to combine them into a single measure of overall corporate performance. He may not succeed completely, but he usually manages to translate some vaguely formulated qualitative objectives into more precise quantitative terms. The optimizer tends to ignore goals that he cannot quantify. He either tries to minimize the resources required to obtain a specified level of performance or to maximize the performance that can be attained with resources that are available. He may also try to obtain the best balance of costs and benefits.  

When applied to foreign direct investment, the classical economic theory answers some of the issues. A business firm is motivated to expand its operations in foreign countries because of its desire to maximize profit. Profit maximization will partly determine the form of going abroad, i.e. export, licensing or direct investment. The types of industries and

---

6 See for a brief discussion of the classical economic theory, Yair Aharoni, Foreign Investment Decision Process, Chapters 1 and 10 (Boston: Division of Research, Graduate School of Business Administration, Harvard University, 1966). See also Russell L. Ackoff, A Concept of Corporate Planning, Chapter 1 (Toronto: Wiley Interscience, A Division of John Wiley and Sons, 1974).

markets are also selected on the basis of their profit potentials. Some firms in the same industry decide not to invest abroad because they see more profit opportunities in the domestic market. However, the theory does not provide a good explanation of the two-way flow of direct investment.

The classical theory has been criticized on several grounds. It is said that the theory is too simple, vague and nonoperational. Profit maximization in the short-run appears to make some sense, but in the long run it creates many problems in view of risks and uncertainties pertaining to costs and revenue in the future. Another objection to profit maximization is that a person is also motivated by non-pecuniary motives such as job security, leisure, freedom from worry and retention of control.

Profit maximization in the modern complex organization is seen more as a constraint subject to which other goals can be followed rather than as the sole motivating force. "In teaching the theoretical model-building, the modern large corporation is ignored. An entrepreneur is assumed. To most economists, even today, entrepreneur still means only the owner-manager, usually by implication, of a small manufacturing business."\(^7\)

In fact, the earnings of modern organizations are much less compared to owner-manager type of firms. Monsen, Chiu and Cooley have compared for twelve years from 1952 to 1963 the earnings of large firms in which there is full management control with those in which there is substantial ownership interest. The return on the invested capital for the management controlled firms was substantially and consistently lower.\(^8\)


The explanation offered by the classical economic theory of foreign direct investment, despite its limitations, has several advantages. It is a fully integrated theory of investment, production and distribution. The theory gives a strong power of prediction for foreign direct investment because it can be subjected to mathematical manipulations. The most important reason for not ignoring the classical economic theory is that the investment incentives of many countries, particularly those of developing countries are based on profit maximization.

2. Investment Theories

(a) Rate of Interest or Cost of Capital

Similar to the classical economic theory with its emphasis on profit maximization is the rate of interest or cost of capital theory of investment. Contributions to this theory were made by Ricardo, Hume, Mill and Iverson. Historically, the purpose of this theory was to explain the international flow of capital for portfolio investment. "Thus, the immediate cause which calls forth capital movement is usually a difference between the interest rates of two countries, which is large enough to outweigh the costs of transfer occasioned by the obstacles to such capital flows."9

The main reason for the lower rates of interest in the home country is abundance of capital. As investors are maximizers, they invest in countries where they get a higher return for their investment. John Stuart Mill speaking of the mobility of capital in response to interest rates differences said, "Capital is becoming more and more cosmopolitan; there is so much greater similarity of manners and institutions than formerly, and so

much less alienation of feelings, among the more civilized countries, both population and capital now move from one of those countries to another on much less temptation than heretofore.\textsuperscript{10}

When applied to interpret foreign direct investment, the explanation of the theory appears to be somewhat like this: Direct investment in foreign countries is made because the rate of interest in the domestic market is much lower while in the foreign countries it is much higher.

According to this theory, businessmen calculate the rate of return from an investment and compare it with the rate of interest. The calculation is then adjusted for risk and the required rate of interest is raised by the risk factor. While doing so it is being assumed that the exact probability distribution of risk is known. Knight\textsuperscript{11} distinguished between risk and uncertainty. According to him, risk is a situation where the probabilities of alternative outcomes are known. Thus risk can be insured. An exact probability distribution of uncertainty is not known, therefore, it cannot be insured. Economists take uncertainty into account by saying that what is maximized is the expected return. The most recent profit experience is used as a measuring rod for expectations. Thus calculation of return on investment is in fact precarious if not impossible. As mentioned earlier, this theory was developed to explain the flow of funds during the mid-nineteenth and early twentieth century. It does not explain much of the foreign direct investment which is not always accompanied by a flow of


funds. The theory does not say anything about why control is desired by the investing firm and why the movement of capital, if any, uses the firm as a medium rather than the organized and efficient international capital markets. It also fails to explain the simultaneous inflow and outflow of foreign direct investment. The geographical distribution of foreign direct investment is also not explained by this theory. Moreover, empirical studies show no apparent relationship between the rate of interest and investments. As this model was too simple, changes were made to include variables other than interest rates. Also this theory does not take into consideration the strong preference of management for financing investments out of internally generated funds in the form of retained earnings.

(b) Capacity Utilization Theory

According to this theory, at full employment the change in capital stock is strictly proportional to the positive rate of change in output. The 'rate of change' was substituted by 'level of output.' Also changes were made by introducing various lags, created both by delays in reaching a decision and by the period between capital goods production and the start of operations using these goods called 'gestation lag.' The majority of studies undertaken by Moose, Popkin, Severn and Stevens support the capacity utilization or 'accelerator principle' of investing overseas, which U.S. economists have found to be dominant with respect to domestic

---

investment, but as yet data are not sufficiently disaggregated on an industrial basis for conclusions of any practical value to be drawn.  

The limitation of the capacity utilization theory is that it tries to explain induced investment or 'ongoing investment' to maintain capacity of existing plants. It does not explain autonomous investment, i.e. investment associated with innovation. Also the theory can be used only if past experience is available. It offers no guidance for action for initial foreign direct investment.

3. The Theory of Growth of the Firm

Contributions to this theory were made by Baumol, Rothchild, and Galbraith. According to this theory, profit is considered a constraint subject to which other goals are sought. Going beyond the minimum level of earnings necessary for survival may mean inviting increased risk of loss. Once this level is achieved, the firm has a choice with regard to goals. Overwhelmingly, this choice is to achieve the greatest possible rate of corporate growth as measured in sales. Expansion of output means more jobs with responsibility and hence more promotion and more compensation. Growth of the firm is also desired by management as protection against

---


contraction. In large corporations men work in groups and whole groups cannot be discharged. Growth as an objective is also selected because it is consistent with economic growth which is the most desired social goal. Capacity for growth depends very largely on capacity for innovation. The growth theory was also supported by the findings of Mikesell.¹⁷

When applied to explain foreign direct investment, the theory of growth of the firm answers some of the issues. A firm invests abroad because it wants to grow. Markets and areas are selected for direct investment because of their growth potential. Beyond this, the theory does not offer any explanation of the issues. It does not say why a firm chooses direct investment compared to other forms of going abroad. However, the theory implies that after achieving a minimum level of earnings, the choice of objectives will be determined by the self-interest of management.

4. The Monopolistic Advantage Theory

This major theory was originally propounded in 1960 by Stephen H. Hymer while writing his doctoral dissertation on "The International Operations of National Firms: A Study of Direct Investment" under the supervision of Charles P. Kindleberger at the Massachusetts Institute of Technology. Later, it was refined and extended by Kindleberger in his "American Business Abroad: Six Lectures on Direct Investment." Unlike other theories discussed so far, this was specially developed to explain foreign direct investment.

According to Hymer, direct investment belongs more to the theory of industrial organization than to the theory of international capital movements. If a higher rate of return was the only issue then capital would move through organized capital markets rather than through firms that specialize in the production and distribution of goods. The classical capital-flow theory assumes perfect competition for goods and factor markets. Hymer's theory is based on the imperfections in goods and factor markets.

A foreign investor has many disadvantages in the host country. Besides the political disadvantage of being a foreigner, he has to bear additional costs such as travel, transportation, communication and delays in communicating information and decisions. The local firm does not suffer from any of these disadvantages. To overcome these disadvantages the foreign firm must have an advantage over existing or potentially competitive firms in the host country. This advantage should be transferable from one country to another at no extra cost. The local firm should be unable to acquire it. If there was perfect competition in the factors market, the foreign market will be served by local firms only. In a world of perfect competition for goods and factors, direct investment cannot exist. To meet the additional costs, the foreign investing firm must earn a higher return in the market where it is operating compared to what local firms earn.

To reduce the weight of the argument that foreign direct investment is undertaken because production costs may be lower in the host country due to favorable wage rates, raw material prices, interest rates and reduction in the cost of transportation, distribution, inventory and servicing, Kindleberger remarked, "In the present view, cheaper costs
abroad than at home are not enough. What must be explained is why the production abroad is not undertaken by local entrepreneurs, who have an inherent advantage over foreign investors. There must be a more than compensating advantage on the part of the foreigner before direct investment will be called forth.18

These advantages in a goods market, which is imperfect, may include product differentiation, special marketing skills, retail price maintenance and administered pricing. Product differentiation is the main reason for the prevalence of foreign direct investment in branded products such as automobiles, tires, electric appliances, electric components, farm machinery, office equipment, cosmetics, pharmaceuticals, soft drinks and specialty foodstuffs. Foreign direct investment is not made in standardized goods such as textiles, clothing, flour milling and distribution. This answers the question relating to the concentration of foreign direct investment in certain types of industries.

Product differentiation in oligopolistic industries also explains the two-way flow of foreign direct investment. There is an urge in such industries for each firm to get a foothold in each important or potentially important market irrespective of the rate of profit available in absolute terms. The main purpose of facing the competitors in their own territories is to prevent any of its few competitors from obtaining a substantial advantage which it could put to use over a wider area. The best defence is offence in the market of the firm threatening to enter into the home market.

---

The foreign firm may enjoy an advantage in the factor markets which includes patented or unavailable technology, access to capital, differences in the skills of managers organized into firms rather than hired in competitive markets. The function of patents and restricted technology is to limit entry. The decision to license or undertake foreign production is determined by which of these two methods causes the foreign firm to realize the full rent of the monopolistic advantage. If the license fee fails to capture the full rent inherent in technical superiority, the advantage lies in direct investment. Licenses tend to bring in a lower return, but are less expensive in capital, time and energy. This explains the form of expanding abroad.

Though direct investment does not necessarily involve a flow of funds in industries that need large amounts of capital, a foreign firm will have an advantage over a domestic firm because of its superior credit standing. The international capital market is not perfect, and though capital markets are joined, different rates are charged to borrowers of different credit standing. Many borrowers cannot command the large sums of money necessary for capital intensive investments.

Hymer's theory of monopolistic advantage, as refined by Kindleberger and Caves, answers many of the issues raised in foreign direct investment. It provides a satisfactory answer to the question relating to the motives of firms expanding their activities abroad. According to this theory, firms go abroad because they have advantages in factors or goods markets. As these advantages are transferable from one country to another, the firms enjoying these advantages want to get the maximum return on them.

When domestic markets are well served and sales reach the point of saturation, a firm will try to go abroad to exploit these advantages.

According to this theory, firms select foreign direct investment rather than licensing because licensing may not bring full return of the monopolistic advantages enjoyed by the firm. Foreign production may also be selected due to the desire to ensure supply of goods and adapt the product to local needs.

The theory of monopolistic advantage also offers an acceptable answer to the question of concentration of foreign direct investment in certain industries and the types of firm that undertake foreign direct investment. Direct investment requires larger and riskier fixed costs than exporting or licensing. Given the presence of lender's risk or outright imperfections of capital markets, direct investment becomes the province of the large firms with substantial internally generated funds to finance the initial fixed charges. On a probabilistic basis, the requirement of large size for the investing firm implies that foreign investment will occur principally in industries where sellers are few in number. One may expect to find direct investment in manufacturing industries marked by differentiation and fewness of sellers or "differentiated oligopoly." 20

Firms also engage in what is called "defensive" direct investment, i.e. investment that produces a less than average return, but where the difference between the gross returns plus the loss that would have resulted from exclusion gives the necessary rate of return on a marginal

basis. Direct investment may also be undertaken in raw materials and minerals due to vertical integration, i.e. the ownership and control of production process backwards to ensure supplies of raw materials and to restrict the entry of competitors.

The theory of monopolistic advantage is superior to many other theories because it offers acceptable answers to most of the questions raised in foreign direct investment. It does not however, give reasons for the recency in exploitation of monopolistic advantages by firms, i.e. it does not explain why the firms started using their monopolistic advantages on such a large scale after the Second World War. The theory also does not throw much light on the geographical distribution of foreign direct investment. It does not say much about foreign direct investment through takeovers. Despite these limitations, it is a powerful tool for explaining foreign direct investment.

5. Exchange Risk and Securities Markets Imperfections Theories

(a) The Exchange Risk Theory

The exchange risk theory was propounded by Aliber in a seminar on the international corporation at the Massachusetts Institute of Technology in the spring of 1969. According to Aliber, "the key factor in explaining the pattern of foreign direct investment involves capital market relationships, exchange risks and the market's preferences for holding assets denominated in selected currencies." Direct foreign investment involves the acquisition of plant and equipment for production in a customs area or

in a currency area other than that area in which a firm is located. The European Economic Community, as an example, is one customs area and several currency areas. The central question is whether foreign direct investment is better explained as a customs-area phenomenon or a currency area phenomenon.

Aliber's argument proceeds on the assumption that the home country firm has a monopolistic advantage which he calls a "patent." Whatever is said about this advantage, can also apply to other monopolistic advantages enjoyed by the firm. The firm has a choice between exploiting the patent within the country and exporting or licensing the patent. According to Aliber, one of the major weaknesses of licensing is that a firm which licenses a patent must police its use and prevent infringement. In a world of separate customs areas and a unified currency area, tariffs affect where a patent will be exploited to meet demand in each customs area. If customs areas are unified while currency areas remain separate, interest rates on similar assets denominated in different currencies may differ because exchange rates might be changed. The change in the interest rates relationship affects the relationship between capitalization ratios. Thus the decision to invest abroad or not depends on national differences in capitalization ratios and not on the height of the tariff.

The income stream of home country firms may be capitalized at a higher rate than those of host-country firms for many reasons such as rapid economic growth and increasing share of profits in national income. The difference in capitalization rates may reflect that the assets are denominated in different currencies and that the capitalization rate of assets with certain income streams in the two countries differs. The pattern of direct foreign investment reflects that home
country firms capitalize the same stream of expected earnings at a higher rate than host country firms. This difference in capitalization rates results because the market attaches different capitalization rates to income streams denominated in different currencies. The differences in capitalization rates determine which country will be the host and which the home country.

The market applies different capitalization rates to assets denominated in different currencies because the market demands a premium for bearing uncertainty about exchange risks and as a result of that the difference between interest rates on fixed price assets denominated in different currencies may exceed the expected change in their exchange rates. This difference may be called a currency premium. Thus the two factors necessary in understanding foreign direct investment are schedules of currency premiums and the fact that the market applies a higher capitalization rate to the same income stream generated in the host country when received by a home country firm than by a host-country firm.

Thus, according to Aliber, "the advantages of U.S. firms are inherent in investor preferences for assets denominated in dollars. U.S. firms by definition are identified with dollar equities, just as British firms are identified with sterling equities, and German firms with deutsche marks. A firm cannot change the currency denomination of its equity without changing its identity and firms almost never change their nationality."^{22}

---

The theory of exchange risk is an attempt to offer explanations of a number of issues in foreign direct investment. The geographical pattern of foreign direct investment is interpreted in terms of the dispersion in capitalization rates for equities denominated in different currencies. According to this theory, the United States is the largest net source of foreign investment because capitalization rates for U.S. firms are higher than those of foreign firms. Higher capitalization rates attached to U.S. equities reflect a preference by the markets for having assets denominated in dollars; the currency premium on dollar denominated assets exceeds that on assets denominated in other currencies.

The cross-haulings in foreign direct investment are explained partly in terms of historical premiums on the currencies of the Netherlands, Switzerland and Britain. Investment by these countries were made when their currencies were stronger than the dollar. "Foreign firms invest in the United States to reduce their borrowing costs in dollars and to secure a higher price for their equities once a larger proportion of their earnings is in a preferred currency like the dollar. Thus, British Petroleum purchased a part of Sinclair and also invested extensively in Alaska so as to be able to borrow dollars on more equal terms with U.S. petroleum firms. Moreover, British Petroleum also anticipated that investors would pay a higher price for its shares if a larger part of its total earnings were in dollars, and preferred currency."\(^{23}\) Aliber's example is over-simplified and ignores all other factors contributing to foreign direct investment decisions.

\(^{23}\) Robert Z. Aliber, The International Money Game, op.cit., p. 188.
The theory does not help much in explaining the continued dominance of foreign direct investment by U.S. firms even during 1971-74 when the dollar was a weak currency compared to German mark, Swiss Franc, Japanese yen and Canadian dollar. Kindleberger, while introducing Aliber's paper perhaps rightly remarked, "the theory encounters difficulties in explaining cross investments in the same industry ... In many formulations exchange risk has nothing to do with long-term foreign investment, since it cancels out both numerator and denominator in the ratio of profit to assets. Aliber's paper is provocative. It may be right."\(^{24}\)

(b) The Securities Markets Imperfections Theory

This theory was developed in 1973 by Giorgio Ragazzi, an economist in the International Monetary Fund. The main cause of the foreign direct investment of U.S. firms in Europe, according to this theory, is the imperfections in securities markets in Europe. "Imperfections in markets for securities may be an important determinant of direct foreign investment abroad. Even in the absence of oligopolistic behavior or of technological advantages, direct investment may be attracted towards areas where average rates of profit are higher when such rates are not equalized internationally by portfolio capital flows due to inefficiencies in securities markets. This argument seems to be relevant in explaining the expansion of U.S. direct investment abroad, particularly in Europe."\(^{25}\)

---


The lack of information about a company's financial affairs is an important inefficiency or weakness of the capital markets in most of the European countries. This makes the holding of portfolio shares in European companies unattractive for Americans because it increases the risk of possible deviations from expected rate of return. The direct investor, being in the control of the company, has immediate and direct access to all information; his risk is limited to the normal industrial risk.

Another weakness of the European securities markets, according to Ragazzi, is the smaller size of these markets compared to the United States. This may cause larger fluctuations in stock prices, which may cause concern in the minds of portfolio investors because they are interested in the day-to-day prices of stocks as opposed to direct investors who are interested in the medium and long term profitability of the company. These two factors result in foreign direct investment by U.S. firms in Europe and portfolio investment by Europeans in the United States. The U.S. financial market is so efficient that there is no additional advantage in control stocks over portfolio stocks. In Europe, institutional factors result in substantial additional advantages of control over portfolio stocks.

This theory offers an explanation which is limited to U.S. foreign direct investment in Europe. It ascribes the foreign direct investment of U.S. companies to the inefficiencies of European securities markets. This explanation should be seen more as a part of the monopolistic advantage theory. Ragazzi has simply pointed out another advantage enjoyed by American firms. The same may apply to English, French and Japanese firms.
C. The Satisficing Theory

The emphasis in this theory is not on maximization of economic goals, but on satisficing. "... the satisficing man is one whose problem solving is based on search activity to meet certain aspiration levels rather than a maximizing man whose problem solving involves finding the best alternatives in terms of specified criteria."26

The useful term "satisficing" was coined by Herbert A. Simon to represent efforts to achieve a certain level of satisfaction, but not necessarily to exceed it. To satisfice means to do "well enough," but not necessarily "as well as possible." The level of attainment that defines satisfaction is one that the decision maker is willing to settle for. The satisficer sets goals and objectives that are considered feasible, desirable and simple. He tends to use only available knowledge and understanding of the system; the satisficer seldom engages in research designed to expand such knowledge and understanding.27

Like most of the other theories discussed so far, the satisficing theory was not developed to explain foreign direct investment. The behaviouristic school of economic analysis led by Boulding, Simon and March developed it as a reaction to the classical profit maximization theory. The underlying idea of the theory from a decision making point of view is that the decision makers prefer to sacrifice some of the rewards of a

---


maximization solution in order to reduce the pains incurred in searching for it. The rationality of the "satisficer" is deliberately bounded because the feasible set of alternatives he could explore would be so great, the information he would need to evaluate them so vast that even an approximation to objective rationality is hard to conceive.

Yair Aharoni, generally agreeing with the basic assumptions of the satisficing theory regarding "bounded rationality", developed his theory of foreign direct investment. According to him, the foreign direct investment decision processes cannot be explained in terms of pure economic rationality. Aharoni does not believe in a perfect rational behaviour in organizations because they are composed of individuals and groups belonging to a certain culture, are faced with uncertainty, operate on the basis of incomplete information, and are constantly pressed by servicing demands of ongoing activities. Under these circumstances one simply cannot believe in a rational way as this term is defined in economic theory - even though executives pretend that they are behaving as rational beings.

In elaborating his views further Aharoni says, "In Western civilization rationality is considered a supreme virtue. Executives like to be considered sophisticated people. They feel that they are expected to be always absolutely logical and never humanly emotional. In order to maintain a pretense of sophistication, rationality, and total absorption with the task at hand without any regard to feelings, they work hard to present in a written report an orderly and logical presentation of problem-definition, rational ordering of alternatives and consequences, and interpretation of verifiable facts. However, the mental decision process itself - although not necessarily the final written version of it - is actually a cooperative
social process, through which commitments are made under the cumulative weight of small acts."  

According to Aharoni's theory, the decision to recognize foreign direct investment as a legitimate problem is a major breakthrough in the normal course of a company's affairs. Many companies do not consider foreign direct investment as a legitimate problem because "there are ample investment opportunities in the home market," or because "we do not invest abroad," or simply because "foreign direct investment is too risky." For the potential investor, foreign direct investment is full of unknowns, which create uncertainty. The recognition that investment abroad is an opportunity to be pursued and examined is called by Aharoni "the decision to look abroad."

In order to attain the major breakthrough of the decision to look abroad some external and internal initiating forces are necessary. The external initiating force may be an outside proposal that comes from a source that cannot be easily ignored, fear of losing a market, the bandwagon effect, or strong competition from abroad in the home market. The internal initiating forces include the interest and drive of a high ranking executive. Besides these two categories of initiating forces there are auxiliary forces, such as creation of markets for components and other products, utilization of old machinery, capitalization of know-how, spreading of research and development and other costs, and indirect return to a lost market through investment in a country that has commercial agreements with those lost territories.

---

Thus the decision to look abroad is undertaken as a result of a chain of events. Environmental forces, organizational factors, personal traits and sheer accidents are all blended in disrupting the balance of forces in the organization and bringing about such a decision.

The decision to look abroad leads to collection of information. However, "Sometimes the decision is made before the investigation begins and the investigation is carried out with the specific aim of finding an optimal way of implementing it."\(^{29}\) According to Aharoni, during the process of investigation commitment is created which represents a state of mind, a feeling that guides action, not a legal obligation. Commitments are also made through the process of individual adjustment to social positions e.g. having once claimed to be a certain kind of person, one may find it necessary to act, as far as possible, in an appropriate way."\(^{30}\)

The concept of commitment, according to Aharoni, has significant implications for the investing firm. The very fact that an organization is making an investigation creates new commitments. Some of these emerge because money and time are spent; executives apparently find it difficult to look at this investment of scarce resources as a sunk cost. They resist the idea of abandoning the project. They feel an urge to persist and to find ways to overcome difficulties. Commitments are not only created by financial investments, but they also emerge because of a psychic or social investment. Similarly, the creation of an international division within an organization generates an internal force which strongly stimulates an

\(^{29}\) Ibid, p. 122.

\(^{30}\) Ibid, pp. 123-124.
organization towards making direct investments abroad. The creation itself is a kind of commitment to the idea and the process of going abroad.

Aharoni suggests that if economic theory is going to be a predictor of behaviour and a theoretical basis for policy formulation, it must include concepts such as management time as a scarce resource and the cost of information. When these concepts are recognized, it can be seen that organizations are satisficers and not maximizers.

The theory of foreign direct investment decision process propounded by Aharoni helps immensely in understanding the complex process of decision making. His theory appears to be near to reality, though in his enthusiasm for modifying classical economic theory, he has gone a little farther than was needed. His concepts of initiating forces, social influences, satisficing and commitment are of practical value in understanding the attraction of foreign direct investment towards a specific country. His emphasis on subjective preferences and cultural and political similarity also help in understanding the geographical distribution of foreign direct investment.

D. The Product Life Cycle Theory

1. The Background

This theory was developed by Raymond Vernon and his colleagues at the Harvard School of Business in 1966. For many years it was suspected that a close relationship existed between technology, international trade and foreign direct investment. Louis T. Wells Jr., Seev Hirsch, Robert B. Stobaugh, William Gruber, Dileep Mehta, F. Michael Adler, Yoshihiro Tsurumi,
Sotirios Mousouris and Jose R. De La Torre, Jr., all contributed to the refinement of this theory through empirical studies.32

The inadequacy of classical and neoclassical theories in explaining international trade became obvious with the publication of the important study of U.S. trade conducted by Leontief in 1953. He showed that the United States export industries were more labour-intensive than the industries which would replace American imports. Leontief's conclusion appeared to contradict the factor proportions theory or Heckscher-Ohlin theory, which claims that a country will export those products which use in its production the abundant factor. This startled the international trade theorists because according to the commonly believed factor proportions theory the U.S. should export capital intensive goods as it is well endowed with capital and poorly endowed with labour.

An important factor contributing to the development of this theory was the concept of lag in technological innovation, which was developed to explain the pattern of international trade during the persistent world-wide shortage of dollars soon after the Second World War. The product life cycle theorists incorporated into their theory many of the concepts of the lag in technological innovation.

2. The Assumptions

The underlying assumptions in the product life cycle theory relate to production function, economies of scale, consumption patterns and transmission of knowledge.

According to this theory, production functions change over the life cycle of a product. In the early part of the life cycle, the product is more skilled-labour intensive. In the later stages, production functions in all countries tend to be identical. More capital is used in the later stages and whatever labour is used is mostly unskilled.

The frequent design changes that occur in the early stage of a product lead to short production runs, which require a greater input of skilled labour compared to capital. The manufacturing process is not broken down into simple tasks to the extent that it will be later in the product's life cycle. Special skills are needed for constructing pilot models, engineering changes in designs and manufacturing tools and dies many of which, due to design changes, will be discarded before they are worn out. As there are not many economies of scale in the early part of the life cycle, the cost of production per unit is high. There is no mass production because consumer desires have not been fully identified.

As consumers' desires become well known through exploitation of alternative product forms, standardization begins to take place. Production functions tend to be identical and economies of scale appear. The manufacturing process is broken down into parts. A higher degree of automation can be introduced which increases the use of capital and skilled labour is mostly replaced by unskilled labour. The per unit cost of production is considerably reduced. This facilitates the production of the product in those areas where labour is cheap. Economies in the cost of production become necessary because competition increases.

Potential demand plays a critical role in the theory of life cycle because whosoever provides funds for the commercial production of the new product must be assured of sufficient potential demand and profits. The
entrepreneur will think of production in a market with which he is familiar and is able to make a forecast of expected profits. This means that in all likelihood the production of a new product will start near the market where sufficient potential demand and profit opportunities exist.

During the early part of a product's life cycle, most buyers are unable to compare prices of different versions directly because performance measures have not appeared. The price elasticity of demand facing a single producer is not as great as it will be later when the buyer can be turned to a competitor's product which is clearly cheaper than that of another firm. The relative inelasticity of demand facing a firm leads to a skimming pricing policy. The shorter production runs result in costs and prices that are higher early in the cycle than they will be later.

Those who buy the product in its early phase will have higher incomes compared to those who will purchase it in the later stages in its life cycle. According to marketing literature, the innovators, who buy a product in its early phase, are generally younger, more educated, earn higher incomes and are mobile. In the later phase of life cycle, the product filters to the lower segments of the market.

The assumption regarding scientific knowledge that exists in physical, chemical and biological sciences is that the entrepreneurs in all the advanced countries of the world have almost an equal access to this kind of knowledge and have an equal capacity to comprehend scientific principles. The difference lies in application. "It is a mistake to assume, however, that equal access to scientific principles in all the advanced countries means equal probability of the application of these principles in the

---

generation of new products. There is ordinarily a large gap between the knowledge of a scientific principle and the embodiment of the principle in a market place. An entrepreneur usually has to intervene to accept the risks involved in testing whether the gap can be bridged."\(^{34}\)

According to the assumptions made in the product life cycle theory, knowledge is not a free good, nor does it flow freely across national boundaries. This leads to three important conclusions: First, innovations of new products and processes are more likely to occur near a market where there is a strong demand for them than in a country with little demand; second, a businessman is more likely to supply risk capital for the production of the new product if demand is likely to exist in his home market than if he has to turn to a foreign market; and third, a producer located close to a market has a lower cost in transferring market knowledge into product design changes than one located far from the market.\(^{35}\)

3. The Theory

According to this theory, the three stages in the life cycle of a new product are: new product, maturing product and standardized product.\(^{36}\) The production function, the economies of scale and the consumption patterns in each of these stages have already been discussed earlier. The phases in the life cycle of a new product determine its location of production,

\(^{34}\) Raymond Vernon, "International Investment and International Trade in the Life Cycle", ..., op.cit., p. 191.


direction of international trade and timing of foreign direct investment. The initial empirical studies were based on U.S. manufacturing and international direct investment. Under the assumptions discussed previously, the United States is more likely than other countries to initiate production of new products which appeal to high income consumers or are labour saving. The two important advantages enjoyed by the United States are: the higher per capita income of American consumers and the highly skilled labour and relatively unrationed capital compared with practically all countries.

The theory can be further classified into six phases depending on the stage in the life cycle of a new product. These phases describe location of production, direction of international trade and foreign direct investment.

In the new product stage of the life cycle of the product, all production is concentrated in the United States because of high income and potential demand. As incomes in foreign countries grow and prices in the United States begin to fall due to economies of scale and information about the new product travels abroad, potential demand is created for the new product outside the United States, particularly in Western Europe. The American firm(s) satisfy this demand through export. Thus the United States start exporting the new product to Western Europe and on a small scale to less developed countries.

After a certain time, the markets abroad expand, particularly in Western Europe, till they reach the point where local production becomes feasible. The length of the time period is determined by tariffs, transportation costs, income elasticity for the new product, economies of scale, income levels and size of the market. One local production
starts, the U.S. exports to Western Europe either cease to grow or decline. The U.S. exports to less developed countries, however, continue.

At this stage in the life cycle when foreign production becomes feasible, a most important question for direct foreign investment arises: who will manufacture in Western Europe, an American firm(s) which was exporting to this market previously or a local entrepreneur? According to Vernon, "As long as the marginal production cost plus the transport cost of the goods exported from the United States is lower than the average cost of prospective production in the market of import, United States producers will presumably prefer to avoid an investment."\(^{37}\)

However, the fear of production by a local firm is enough of a threat to the established position of the U.S. exporter to take action. "Threat in general is a more reliable stimulus to action than opportunity is likely to be. In the international field, threats appear in various forms once a large scale export business in manufactured products has developed. Local entrepreneurs located in the countries which are the target of these exports grow restive at the opportunities they are missing. Local governments concerned with generating employment or promoting growth or balancing their trade accounts begin thinking of ways and means to replace the imports. An international investment by the exporter, therefore, becomes a prudent means of forestalling the loss of a market. In this case, the yield on the investment is seen largely as the avoidance of a loss of income to the system."\(^{38}\)

---


\(^{38}\) Ibid, p. 200.
The decision to produce abroad by a U.S. firm starts a series of reactions. "... other major producers in the United States sometime see it as a threat to the status quo. They see themselves as losing position relative to the investing company, with vague intimations of further losses to come. Their share of the market is imperilled, viewing share of the market in global terms." 39 This results in further foreign direct investment in the same industry. The original investor may maintain his lead over his competitors from the United States or from the local market through product differentiation or technological improvements in the product.

In the third phase, the manufacturing plants in Western Europe grow in size and attain the economies of scale which reduce their per unit cost of production. Moreover, the cheaper cost of inputs in these countries help further in reducing the per unit cost of the new product. The cost of transportation from the United States to less developed countries is higher for many regions. Because of these factors the U.S. export to less developed countries is displaced by export from Western Europe.

Foreign production in Western Europe reaches sufficient scale that costs are low enough to overcome the transportation and tariff protection of the American manufacturer. The countries in Western Europe start exporting to the United States. Thus the United States becomes a net importer of the product.

As the product becomes highly standardized, assembly line production makes longer production runs possible. Most labour used in this stage in the cycle is unskilled. With an increase in competition, profit and price margins are considerably reduced. Thus reducing the cost

of production becomes very necessary. As labour costs are extremely low in less developed countries, the location of production shifts to these areas. Due to low cost production, the less developed countries start exporting to the United States.

4. The Explanatory Power of the Theory

The theory provides a powerful tool for explaining the relationship between technological changes, international trade and foreign direct investment. The empirical studies conducted to test the theory tend to confirm it. The emphasis on technology, defensive and preemptive motives in direct investment bring it nearer to reality.

The major contributions of the theory lie in the areas of geographical distribution of foreign direct investment and the industries which will make direct investment. The stages in the product life cycle very much correspond to the phases described in the theory. Much of the U.S. direct investment during 1950s and 1960s followed this pattern. The United States dominates foreign direct investment because of the huge research and development expenditures by American firms. Though the theory uses the United States as the source of innovation for illustration purposes, it equally applies to any country innovating a product. The increasing European and Japanese direct investment abroad may be explained in terms of this theory. By relating stages of a product in its life cycle to location of production, direction of international trade and foreign direct investment, the theory gives an analyst strong power of prediction.

The theory suffers from certain limitations. It does not explain direct investment in non-manufacturing sectors such as extractive industries

---

and agriculture. Even in the manufacturing sector it applies only to high technology consumer durables and office equipment. The theory also does not say why firms do not consider licensing for defending their positions or preempting competition. Moreover, the theory may be losing its significance in view of the emergence of global corporations, which skip or short-cut some of the phases in life cycle because they think in global terms. The product life cycle theory also does not throw much light on the two-way flow of direct investment.

E. The Modern Imperialism Theory

Another interpretation of foreign direct investment may be found in the modern imperialism theory, which originally was developed by Lenin in his book "Imperialism: The Highest Stage of Capitalism", in April 1917, a few months before the Russian Revolution.  

This theory explains foreign direct investment in terms of surplus capital and the desire for control. The opportunities for profitable investment in capitalist countries reach a point of saturation due to constant exploitation of the masses and concentration of wealth in fewer


hands. At this stage the capitalists look abroad for profitable investment opportunities for their surplus capital. "The necessity for exporting capital arises from the fact that in a few countries capitalism has become over ripe and (due to the backward stages of agriculture and the impoverished state of the masses) capital cannot find profitable investment."\textsuperscript{44}

According to Lenin, modern imperialism has the following features:

1) The concentration of production and capital development to such a high stage that it creates monopolies which play a decisive role in economic life.

2) The merging of bank capital with industrial capital and the creation, on the basis of this finance capital, of a financial oligarchy.

3) The export of capital, which has become extremely important, as distinguished from the export of commodities.

4) The formation of international capitalist monopolies which share the world among themselves.\textsuperscript{45}

The desire for control by a capitalist government, using multinational corporations as its main agents, means uninterrupted supply of essential raw materials, food, markets for its manufactured exports and profitable locations for the investment of capital. Uninterrupted supply means that it should be free from effects of political uncertainties, competitive manipulations and imperfections of the market. "Thus modern capitalist imperialism comprises a complex of private corporate policies, supplemented by induced government support, seeking to develop secure

\textsuperscript{44} V. I. Lenin, \textit{Imperialism} ..., op.cit., p. 140.

\textsuperscript{45} Ibid, p. 195.
sources of raw materials and food, secure markets for manufactures and secure outlets for both portfolio and direct capital investment." Control is achieved without physically occupying the country as was done during the colonial era. The country thus penetrated apparently retains its political freedom, but the real power lies in the hands of giant enterprises and foreign modern imperialist powers. According to this theory, the United States has emerged as the biggest modern imperialist power after the Second World War.

The small size of direct foreign investment as a percentage of gross national product should not reduce its importance for an imperialist power. One should look into the importance of the investment for the economy. Magdoff illustrates his point by showing the importance of certain raw materials for the U.S. economy. "The availability of such supplies at any moment of time thus enters as a determinant into the heart of the productive processes of the capitalist economy. For one illustrative example, consider the modern jet engine. The series of technical innovations that produced this item have made its production absolutely dependent on columbium, chromium and cobalt—all commodities whose consumption in the United States is totally dependent on imports. Or consider that in 1966 net imports of iron ore equaled 43 percent of domestic United States production." The modern imperialism hypothesis comes into conflict with the fact that most of the foreign direct investment is concentrated in

---


47 Magdoff, op.cit., pp. 50-52. See also Wolff, op.cit., p. 226.
developed countries rather than the politically and economically weak developing countries. Magdoff's comments on this conflict is "Nowadays it is frequently said that the greater involvement by the United States capital in Western Europe, as contrasted with investments in the underdeveloped countries, is evidence of a departure from imperialism. This view of course is untenable if one recognizes that antagonism between unevenly developed industrial centers is the hub of the imperialist wheel ... The higher standard of living and the great amount of capital accumulated in Western Europe are rooted in past and present advantages obtained by the latter area through exploitation of colonial and neo-colonial countries. By penetrating the metropolitan centers of Europe, U.S. capital skims off part of the cream: it benefits from (a) the enlarged consumer markets of Western Europe and (b) the opportunity to trade through channels developed by the metropolitan centers in their relations with their dependencies." 48

In view of the importance of multinational corporations and foreign direct investment as an agent of modern imperialism "... today it is business that is expected to serve the needs of national policy. The problem is how to stimulate private investment abroad. Private foreign investment is considered such a necessary tool of national policy that various forms of investment guaranty programs have been designed to protect foreign investors against losses due to confiscation, wars and the uncertainties of currency convertibility." 49

However, it is also true that the United States, the U.K., and France

48 Magdoff, op.cit., p. 16.

49 Ibid, pp. 175-176.
on a number of occasions restricted foreign direct investment due to balance of payments problems.

The modern imperialism theory does contain some elements of truth in it, but most of it highly exaggerates the facts. The proponents of the modern imperialism theory forget that foreign direct investment flows in both directions among the developed countries. The U.K., Japan, Germany and France are also investing in the United States. If the theory is true, it means that the United States, which is pictured as the biggest modern imperialist power, is a "colony" of these smaller countries.

As observed above, the theory has some truth in it. The multinational corporations have used the assistance of their governments, in all possible ways, to safeguard their interests. The days of sending gun boats and marines to protect property abroad may be gone, but the same ends are achieved through other means, e.g. CIA and tied loans.
III. THE RESEARCH MODEL

A theory is a systematic statement of relationships among variables of certain observed phenomenon which has been verified to some extent. Theories are used to reveal reality and to serve as instruments for explaining the past and the present, and for predicting and controlling the future.

One of the major weaknesses of most of the theories of foreign direct investment is that they explain the phenomenon by using only one variable, e.g. profit maximization, cost of capital, capacity utilization, growth, exchange risk, technology, imperialism, etc. Another important weakness of these theories is that they explain foreign direct investment by emphasizing mainly economic variables. The third major weakness of these theories is that they do not treat foreign direct investment decisions as a process that goes in stages. It appears that these theories were not concerned with this particular aspect.

The advantage in using Aharoni's behavioural theory of foreign direct investment is that it is considerably free from the weaknesses of the major theories that explain foreign direct investment. His theory is comprehensive because it emphasizes more than one variable. Aharoni explains foreign direct investment by using economic and social variables, although there appears to be greater emphasis on behavioural variables. Perhaps the best thing about Aharoni is that he explains foreign direct investment as a process – analyzing it into stages. It is for these reasons that Aharoni's basic approach to foreign direct investment decisions is being used as the research model for our study.
Aharoni developed his theory of foreign direct investment in 1961 while working for his doctorate at Harvard. He was distressed by the apparent failure of the less-developed countries to attract United States manufacturing investments. To analyze the situation, he decided to study the way foreign investment decisions were made by United States manufacturing firms. Because of his familiarity with Israel as a less-developed country in 1960, he chose to carry out his research among a sample of firms that either had invested or had considered investment in Israel.

A. Aharoni's Research Design

1. The Sample

To develop a sample, Aharoni chose 44 business firms from a list of 300 corporations which were known to have either invested or considered investment in a manufacturing enterprise in Israel.

The sample of 44 firms was clustered into subgroups of 30 firms that actually invested in manufacturing in Israel and 14 firms which investigated the possibility of investment but rejected it. The actual investors also included those who had subsequently disposed of their investments. The firms in the sample ranged in size from very small closely-held enterprises to giant corporations.

Although Aharoni had chosen his sample from a list of those who had invested or considered investment in Israel, the interviews were not confined to the experiences of the respondents in Israel alone. The interviews were concerned with a wide range of countries. The total number of

1 Yair Aharoni, The Foreign Investment Decision Process, op.cit. The description of Aharoni's model is adopted from this book.
investment decisions studied in the firms was 105. Out of these occasions for investment decisions, 12 cases were studied in considerable depth. Also included in the sample were 12 "outsiders" selected from among the Israeli Government officials and the U.S. consultants who were involved in these decisions.

2. The Scope of Research

The scope of Aharoni's research included an investigation into the causes of failure of Israel's law for Encouragement of Capital Investments to attract U.S. direct investment into Israel. He was testing the basic economic premise that tax incentives make otherwise unpromising investments attractive because they permit a higher rate of return. The conferral of tax benefits is intended to induce foreign investors to initiate investigations which they would not otherwise have taken. Later, the scope of the study was broadened to ascertain the way in which a decision to invest or to reject an investment opportunity abroad was made, and to get insight into the impact of the policies of foreign governments on this decision.

In his field research, Aharoni tried to find answers to the following issues:

(a) The way foreign direct investment opportunities were brought to the attention of management in different types of organizations.

(b) The nature of the organizational hierarchy.

(c) The processing of information at different stages.

(d) The cost of collecting additional information.

(e) The communication and utilization of such information.

(f) The important variables in the decision process.
(g) The importance assigned by management to various factors through the decision process.

(h) The evaluation of foreign government's concessions.

(i) The practical deterrents to an increased stream of direct foreign investments in less developed countries.

These questions were presented at the end of the open-ended part of the interview if they were not touched upon by respondents themselves.

3. Research Methodology

Aharoni used the case study method to collect his data. It consisted of extensive open-ended interviews with key individuals (managers and above) who were involved in various phases of the foreign direct investment decision process. In these interviews, the nature of the research was explained and the respondents were asked to discuss their experiences. Toward the end of the interviews, various hypothetical situations were presented orally to the respondents, and they were asked to tell the writer how they would decide in such a situation and why.

The data collected through interviews was compared with theories of investment and decisions. It was also compared with public addresses of corporate executives. Supplementary data on other foreign investment decisions were received through interviews conducted by several case writers at the Harvard Graduate School of Business Administration. Aharoni also used the corporations' files containing information on investment decisions.

Aharoni justifies his research methodology in these words: "One of the criticisms of my research may be that the suggested variables are unmeasurable and therefore my basic framework is not fully substantiated. I certainly must agree that no way to measure the variables mentioned has
been suggested, and that any research based on case studies may be attacked as not well substantiated. However, although my contribution is not offered as a definitive solution, it is claimed that the analytical framework suggested in the book fits the data on which it was developed and presents a meaningful and operational way of analyzing organizations. I see the aim of scientific research not necessarily as constructing a theory that is validated under all circumstances, but as accumulating a body of empirically verifiable generalizations. I do not think that a hypothesis 'proved' at a 5% level of significance has more claim to be true than one proved by a large series of case studies. In both cases, the hypotheses may be plausible, but there is still a probability that they may not be correct.  

B. Aharoni's Research Findings

Aharoni did not find any simple relationships between tax incentives and investment decisions. He discovered that investment decisions embody a wide range of components. It was impossible to reduce these decisions to a neat mathematical explanation. His findings were inconsistent with the classical economic theory of profit maximization. Aharoni discovered that the irrational behaviour (i.e., behaviour inconsistent with economic theory) was not confined to Jews or to consideration of investments in the Holy Land. He found no distinct differences in the elements of the decision process when Israel or any other country were scrutinized, though less-developed countries were considered much more risky, and therefore less attractive than the developed countries.

2 Aharoni, op.cit., p. xii.
According to Aharoni's findings, the simplifying assumptions of classical economic theory represented so gross a departure from reality that the theory was an extremely inefficient frame of reference from which to observe, project, and prescribe on the subject of foreign direct investment. What was needed, instead, was to look for the elements in the baffling complexity of the organizational system that could explain the behaviour and the inter-relationship between the variables.

The decision process that he described involved a group of individuals with time pressures, limited information, operating under conditions of uncertainty, interaction of social influences and creation of commitment.

Aharoni divided the foreign direct investment decision process into four distinct interrelated stages: First, the decision to look abroad; second, the investigation of an investment opportunity; third, negotiations with the host country government; and fourth, the final decision to invest or not to invest.

Stage I. The Decision to Look Abroad

"The decision to look abroad", is an arbitrary point, chosen by Aharoni, in the continuous process of organizational activities from which a description of a decision to invest abroad is made. The decision to look abroad is the recognition by the decision makers of a firm that an investment abroad is an opportunity to be pursued and examined. This means that management becomes willing to examine the possibility of a specific foreign investment on its own merits and will not "kill" it a priori because it is not interested in foreign investment or because of the notion that foreign investment is too risky.

The forces that bring the opportunities of foreign direct investment to the attention of management and that lead some individuals in a company
to focus attention on the possibilities of investment abroad in terms of devoting time and other resources for its investigation are called "initiating forces" by Aharoni.

According to Aharoni, the decision to have a look at the possibilities of foreign direct investment is a major breakthrough in the normal course of a company's affairs. The most crucial decision is taken when the first venture abroad is considered. At this stage, the organization has had no experience whatsoever in the complicated field of foreign investment. Quite a strong push is needed for making the decision to look abroad. When subsequent foreign investment decision processes are carried through, the company will benefit from its experience in previous investigations.

The forces leading a firm to investigate direct investment opportunities abroad were classified by Aharoni into two categories: exogenous and endogenous. In the exogenous or environmental forces he included an outside proposal from a credible or influential source (e.g., a representative of a foreign government, a distributor of the firm in a foreign country, a customer of the firm, a close friend, a bank in home or foreign country); fear of losing a lucrative export market (due to prohibitive increase in tariff rates or quota imposition or a total ban on imports of products being exported by a company); the band wagon effect (very successful activities abroad of a competing firm in the same industry or a general belief that investment in a certain area is a must e.g., EEC); strong competition from abroad in the home market; and saturation in the home market.

The endogenous or internal forces include the keen interest of a high ranking executive of the firm in a particular foreign country due to
personal reasons (need for prestige, extensive travel abroad, aspiration to contribute to the economic development of other countries or desire to live in a country) or through perceiving direct investment as a means for growth of the firm; opportunities for the utilization of old or semi-obsolete machinery; capitalization of patents or technical know-how; the desire to create a market for components (e.g., supplying car parts to foreign assembly plants); and spreading of research and development and other fixed costs.

According to Aharoni, these forces can disrupt the existing state of affairs in a corporation, and if these forces are strong, the decision process enters into the next logical stage of investigation.

Stage II. Investigation of An Investment Opportunity

In this stage the firm gathers information that serves as a basis for a decision. The decision to investigate is made in terms of a specific project in a specific country. According to Aharoni, companies do not investigate possibilities of investment in several countries in order to find the best alternative. Opportunities are weighed on their own merits and are rarely compared with other investment alternatives.

The strength of the initiating forces determines the extent to which unfavourable circumstances are ignored or certain stages in investigation, which will be described later, are skipped.

The investigation, according to Aharoni, is carried out in three distinct phases: collection of information on general economic and political indicators, on-the-spot investigation into the country where investment is being considered, and presentation of report.
The factors peculiar to foreign investment are those stemming from the differences in legal, social, economic, and political environments between a foreign country and the investing country. Other factors are similar to those considered in a domestic investment e.g., market size, distribution system, production method and cost of production, selling expenses, capital requirements, method of financing, and plant location.

The purpose in using general indicators in the first phase is to form an opinion on the risk and uncertainties involved, to measure the market size, and to find out possible conflicts of the suggested project with existing company policies and resources. The first phase is largely carried out at the company's office. Depending on the strength of initiating forces and data obtained in this preliminary screening, the investigation may be terminated due to high risk and uncertainty, small size of the market or conflict with existing policies of the company e.g. if company policy is 100 percent ownership of the capital, any indication of sharing ownership with the locals will tend to terminate investigation.

If the result of preliminary investigation is positive or if the initiating forces were strong, investigation is carried out by one or several executives in the prospective host country in the second phase. Companies with previous experience in the area may ask even their area manager or other personnel with knowledge of or contacts in the area to carry out investigation. This investigation is expensive and time consuming compared to preliminary screening.

Specific information is gathered on those product characteristics that are deemed most important according to the way the problem was initially defined or those regarded as most crucial for success or failure.
Inquiries are made into the character and financial standing of proposed partners or other associates. A check is made into the problems of imports, regulations governing them, and transportation facilities. Often check lists containing as many as 300 questions are used to collect information.

According to Aharoni, executives in an organization have different motives, backgrounds, and needs. The goals of management vary with the motivational patterns of the men who make the managerial ranks. They identify with the goals of the organization, but they have to fit their personal goals into the picture. They are also influenced by the general beliefs and moral values of the society in which they live. In their decisions, they must consider the needs and work patterns of other institutions with which they deal.

The investigation of these organizational factors can be seen in the third phase when a report on a foreign investment proposal is presented to higher echelons in the company. The higher the echelon the more "accurate flavour" the report has. There is a strong tendency to forget the statistical limitations of the figures and the assumptions behind them and to present them as the truth. Ranges of possibilities are replaced by definite figures. An outcome which was first considered as one of many possibilities is treated as the only possible one. Sometimes, the investigator adds contingency allowances, often of unspecified size, and these allowances are treated as reality or another layer of allowances is added by another executive.

Aharoni suggests these reasons for the elaborate use of figures. First, when a report has to be sent to a higher echelon, the investigator tries to make it look rational. Secondly, quantification gives a feeling
of certainty. Third, quantitative analysis is often prescribed in the company's standard operating procedure.

All reports are influenced - sometimes unconsciously - by the personal feelings of the writer toward the project and its impact on him personally. For instance, if the investigator believes that if the project is approved he will be asked to serve as its local manager, the tone of the report is influenced by his attitude toward this possibility.

The hypotheses formulated by Aharoni were:
1) The stronger the impact of initiating forces, the further the investigation may be carried through different phases before it is stopped due to general indicators showing signs of risk and uncertainty or other unsatisfactory conditions.
2) Investigation is carried out in a sequential way due to cost of investigation.
3) The report is influenced both by the beliefs of the investigators about the country and investment and by their perception of the thinking of their boss.
4) The creation of commitment during investigation strengthens the decision to invest.

Aharoni defines commitment as a state of mind, a feeling that guides action. A commitment is created when an individual, by his own previous action, has put himself in a position in which his decision with regard to some particular line of action has consequences for other interests and activities not necessarily related to it. A series of small acts creates individual commitments. Acts of individuals may also create organizational commitments. A form of institutionalized commitment is the creation of an international division in an organization. The creation of such a division
means that a group of persons are formed into a decision-making unit which has vested interests in promoting and developing the international operations of an organization.

Stage III. Negotiations

Once the highest management echelon approves the project, it enters into the negotiation stage. The purpose of negotiation is to reduce the amount of a company's own capital investment, search for local partners, injection of flexibility into the investment programme and bargaining with the foreign government for concessions to reduce risk and uncertainty. One of the important purposes of negotiations is to attempt to minimize risk.

The negotiations are carried with foreign governments, potential local partners, bankers in the host and home country. Aharoni suggests that a typical risk reducing preference is to borrow required capital funds in the money markets of host countries to avoid exchange losses due to devaluation.

Several years may elapse between the beginning of investigation and the first official approval of a project by the highest authority in the company. Further time may be taken between final approval and actual approval of the plant. Aharoni found in his field research that the time taken between on-the-spot investigation and the actual physical preparations (buying of land or erection of plant) was from one to seven years, with an average of two years.

The time element makes it more imperative to give important weight to risk and uncertainty factors, and to efforts to reduce their impact. The long period of decision stems partly from the involvement of many people, both inside and outside the organization. Trying to mould a final
programme that will satisfy so many interests necessitates many modifications in the investment programme.

The failure of a first venture abroad may be an obstacle to consideration of subsequent opportunities, while its success often results in an expansion of foreign operations. Gradually, organizations may evolve into multinational corporations, vigorously looking for investment opportunities abroad.

Repeat investment decisions, according to Aharoni's findings, are much more expeditious and the proposals are processed much more rapidly. The local manager of an existing subsidiary tends to be an initiating force for new investments and to push for approval of his suggestions. Information is much more readily available. Head offices of firms are more confident of the estimates arising out of investigation.

The creation of an international division creates several important institutional as well as individual commitments. The creation of such a division is a commitment by the board of directors to consider foreign direct investment as an integral part of the company's total activities. It is more than an act of faith in the possibilities of opportunities in the international field. When a firm allocates capital and manpower resources to some activity, it expects results. The employees of the international division feel they must seek and find opportunities for foreign direct investment. The top management is now committed to consider these projects on their own merit, and not to reject them on general policy grounds such as "the company is not interested in foreign investment." Thus the creation of an international division represents a major change in a company's strategy. It is a recognition that the company sees as part of its goal the search for opportunities for manufacturing purposes overseas.
Aharoni points out that every investor is a member of a social system or a number of social systems. An important variable affecting the decisions may be the sentimental attachment of top executives to a given country. This variable, he found, was very significant in the case of American Jews' investment in Israel. But this sentiment had to be rationalized by the Jews themselves in terms of more business-like motivations. Aharoni also mentions the case of Henry Ford's investment in Ireland as an attempt to create "a great factory rising in the land of his ancestors like a creative monument to his achievements."

General values and beliefs may also be important. The belief that it is unpatriotic to invest abroad; the feeling that Africa, for example, is too risky; the inference from the nationalization of a public utility that every business in the same country will be expropriated; the interpretation of governmental controls as encroachments on private enterprise—all these beliefs stem from the social and cultural environments in which executives operate.

The attitudes of stockholders and bankers toward foreign direct investment also influence the foreign direct investment decision. The desire of an executive and his wife to live or not to live in a country can affect their attitudes towards a decision. The vigorous opposition of many Americans to partnership proposals with an agency of a foreign government, which can partially be explained in terms of a strong belief in a free enterprise system, is another typical decision-influencing attitude in this context.

Thus the decision process may be described as a bargaining process among the various participants. Decision making in complex organizations is a long social process, not solely an intellectual exercise. This process
is composed of many small acts, carried out by different people at different points of time. Participants in the decision process are a part of a social system. The rationale of a decision process are a part of a social system. The rationale of a decision process can be seen only when the totality of all forces influencing the decision makers is taken into account.

In view of the complexities in decision making, Aharoni concludes that it is virtually impossible to find out at what point and by whom a decision to invest was made. Even in those cases in which a point can be defined, the decision to invest is not necessarily the last in a chain of decisions nor is it always the outcome of the related investigation process. Sometimes the decision is effectively made before the investigation begins, and the latter is carried out with the specific aim of finding an optimal way of implementing a pre-determined decision.

Conclusions:

Aharoni draws the following conclusions from his empirical research based on the case method:

1) Foreign governments' announcements of investment incentives to attract direct investment do not trigger managements' decision to investigate foreign investment opportunities in the respective countries.

2) One of the important reasons why developing countries are less attractive to foreign direct investors is because of the high cost of information collection about these countries.

3) Initiating forces trigger a firm's decision to investigate and negotiate foreign direct investment opportunities abroad.

4) Investigation of foreign direct investment opportunities is carried out in a sequential way.
5) A firm's decision to invest abroad is influenced by the attitudes of stockholders, bankers, investigators, and executives towards foreign direct investment and the country where direct investment is being considered.

6) Prior commitments and the ones created during investigation and negotiation strengthen the decision to invest.

7) It is difficult to point out when and by whom the actual decision to invest was made due to involvement of large numbers of persons and the complex nature of decision making.

C. Weaknesses in Aharoni's Theory

Aharoni has been criticized for basing his conclusions on an unre­presentative sample. Weigel\(^3\), for example, tested a related hypothesis (the relation between government economic policy and direct investment in developing countries). He disagreed with the lack of emphasis on profit maximization in Aharoni's findings.

Weigel also questioned some of Aharoni's contentions such as "search for new direct investment seems biased," "some people push certain undesirable projects because their goals are different from the firm's" and "creation of commitment during the process of investigation." According to him, much of the substance of Aharoni's points is consistent with the maximization of the value of a firm under uncertainty. Weigel concludes that Aharoni's behavioural approach is not really that different from profit maximization under uncertainty.

Weigel suggests that if the risk-adjusted expected returns from search are less than the costs, then it does not pay to invest in search. Costs of search may be particularly high for small companies, which do not have access to established and low-cost sources of information, and this may be especially true for proposed projects in foreign countries. Also, there are likely to be decreasing costs of search per unit of investment, as the proposed scale of the investment increases. Thus, it may be more profitable for all but the largest firms to eschew the search for foreign investments unless some favourable information arises without cost, such as from an unsolicited proposal.

Another major weakness in Aharoni's theory is that he creates the impression that the first decision to invest abroad is most often the result of negative forces - fear of losing an export market, strong competition from abroad, saturation in the home market, bandwagon effect, or waiting for an outside proposal. The only positive force is the "drive of a high ranking executive." This weakness is consistent with his findings that firms are not maximizers but satisficers. However, a business firm, according to his theory, becomes active in searching opportunities for foreign direct investment when it creates an international division.

Despite these weaknesses in Aharoni's theory, it still remains a useful model for research because it describes in detail the various stages in the decision making process. It also remains superior to other theories because it explains the foreign direct investment decision process by including behavioural as well as economic variables.

As mentioned earlier, the research model used in this study was basically patterned after Aharoni's behavioural theory. Certain variables, as explained in detail in the body of this report, mentioned by Aharoni
were dropped and other variables found significant during the research were added in the model. The basic design of Aharoni's model, however, remained unchanged. The stages in the decision making process, the sets of variables with the list of variables in each set, and the direction of influence of each set of variables is shown in the following table:
Table 6. The Research Model

<table>
<thead>
<tr>
<th>Stage One (Awareness)</th>
<th>Stage Two (Investigation)</th>
<th>Stage Three (Commitments)</th>
<th>Stage Four (Negotiations)</th>
<th>Stage Five (Uncertainty Evaluation)</th>
<th>Stage Six (Final Decision)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initiating Forces (IV)</td>
<td>Initiating Forces (IV)</td>
<td>Investigation (IV)</td>
<td>Investigation (IV)</td>
<td>Commitments (IV)</td>
<td>Negotiations (IV)</td>
</tr>
<tr>
<td>Investigation (DV)</td>
<td>Commitments (DV)</td>
<td>Negotiations (DV)</td>
<td>Uncertainties (DV)</td>
<td>Final Decision (DV)</td>
<td></td>
</tr>
</tbody>
</table>

**Initiating Forces (IV):**

**Exogenous:**
1. An outside proposal
2. Growing demand for product
3. High prices for commodities
4. Unfavourable political environment in the home country
5. Fear of losing an export market
6. Successful direct investment operations of one's competitors abroad

**Endogenous:**
1. Keen interest of a high ranking executive
2. Desire to internalize source of supply
3. Desire to internalize demand
4. Export experience in the host country
5. Capitalization of patents or technical know-how

**Investigation:**
1. Creation of international division
2. Stabilize demand
3. Stabilize profit
4. Desirability of retaining an export market

**Commitments:**
1. Creation of International division
2. Stabilize demand
3. Stabilize profit
4. Desirability of retaining an export market

**Negotiations:**
1. Repatriation of dividends
2. Repatriation of capital
3. Applicable rates of taxation
4. Environmental or pollution control
5. Special depreciation or depletion allowances

**With Host Governments:**
1. Demand for product
2. Inflation
3. Local competition
4. Corruption
5. Devaluation
6. Government intervention
7. Availability of minerals
8. Red tape
9. Labour unrest
10. Nationalization
11. Cultural differences
12. Change in government through democratic process
13. Expropriation
14. Military coup
15. Civil war
16. War with another country

**With Host Banks:**
1. Relied on information in published sources
2. Inquired about general credit climate
3. Made inquiries about loans for specific project
4. Submitted application for loan
5. Established a credit line

**With Partners:**
1. Just discussion
2. Negotiations for type of joint venture
3. Lawyers were involved in negotiations
4. Preparation of a draft agreement
5. Signing of the final draft

---

**Initiating Forces (IV):**

**Investigation (IV):**
1. Library research + investigation + report
2. Published material
3. Outside consultant
4. Proposal from outside
5. Export experience
6. Internal sales records
7. Capital cost calculation
8. Information from host government departments

**Type of Information:**
1. Market size
2. Price behaviour
3. Information about partners in the host country
4. Competition
5. Consumer taste
6. Cost of production
7. Market share
8. Availability of minerals

---

**Final Decision (DV):**

Yes/No
IV. THE RESEARCH DESIGN

A. Objectives of the Study

The main objective of the research was to find out how the Canadian firms, which have their head offices in British Columbia, make their foreign direct investment decisions. The emphasis in the research was on identification of variables that make a firm aware of direct investment opportunities abroad. An effort was made to explain foreign direct investment as a process rather than as an end product.

The research also focussed on making a comparison of subjectively estimated cost of search between those firms that conduct sequential research and those which do not conduct sequential research.

Other areas of emphasis were measurement of relationships between extent of investigation and degree of commitment, extent of negotiations and amount of uncertainty, and a comparison of positive decisions to invest with negative decisions in terms of strength of initiating forces, extent of investigations, degree of commitments, extent of negotiations, and amount of uncertainty.

As Aharoni's behavioural theory of foreign direct investment was used as a research model, the role of behavioural variables in the decision making process was emphasized. Aharoni's research findings were mainly based on the case method. An attempt was made in this research study to quantify the variables that play an important role in decision making. The hypotheses were tested by using statistical techniques.
B. The Hypotheses

To test the behavioural theory, the following hypotheses were developed:

H1 Endogenous initiating forces are more important in creating awareness of foreign direct investment opportunities than exogenous initiating forces.

H2 Those who conduct a sequential investigation will judge the subjectively estimated cost of that investigation to be significantly higher than those who do not conduct a sequential investigation.

H3 The extent of investigation and degree of commitments are positively related.

H4 There exists a positive relationship between the extent of negotiations and amount of uncertainty.

H5 In cases where the decision has been made to invest abroad, there will be stronger initiating forces, more investigation, greater degree of commitments, greater extent of negotiations, and smaller amount of uncertainty than in those cases where the decision has been made not to invest abroad.

(For questions based on these hypotheses, please see Appendix A).

C. The Operational Definitions

H1 Initiating Forces

Initiating forces are those independent variables that bring the opportunities of foreign direct investment to the attention of management and that lead some individuals in a company to focus attention on the possibilities of direct investment in terms of devoting time and other resources for its investigation.
Initiating forces are classified into two categories: exogenous and endogenous. The exogenous or environmental forces include: an outside proposal from a credible or influential source (e.g. a representative of a foreign government, a distributor of the company in a foreign country, a customer of the company, a friend, a banker etc.), fear of losing a lucrative export market due to prohibitive increase in tariff rates or quota limitations, a total ban on import of products being exported by a company, the bandwagon effect (very successful activities abroad of a competing firm in the same line of business or a general belief that investment in some area is a must), strong competition from abroad in the home market, and saturation in the home market.

The endogenous or internal forces may include: the keen interest of a high ranking executive of the firm in a particular foreign country due to personal or perceived economic reasons, opportunities for the utilization of old or semi-obsolete machinery, capitalization of patents or know-how, the desire to create a market for components and other products, the liquidity position of a company, unabsorbed or under utilized managerial resources.

**Initiating Forces: Exogenous**

**An Outside Proposal:**

A proposal is a written document or a verbal discussion that suggests a firm should consider making direct investment abroad. It tends to contain information on product, market, initial investment levels, expected rate of return, host government policies on foreign investment etc. The proposals can be classified according to their sources e.g. government, distributor, customer, banker, friend or a foreign competitor. Importance attached to the proposal by executives of the firm is a subjective matter, but it can
be measured for each proposal by obtaining a scaled response on say a seven or five point scale ranging from "critical" to "not even considered".

Fear of Losing a Market:

This assumes that the company was serving the market through export. Such a market may be lost as a result of a total ban on import of the company's products or due to imposition of prohibitive tariffs on the company's products. When such situations occur, they are usually a matter of record and often public documentation; as such they should present fewer problems in obtaining objective measurements. It is also useful to supplement this level of measurement with subjective assessments of importance by respondents.

Strong Competition from Abroad in the Home Market:

When a foreign competitor enters into the domestic market with a better product, an aggressive promotional programme, a lower price or better channels of distribution, companies feel threatened. One of the retaliatory measures they may consider is direct investment in the country of origin of "the intruder" as part of a balance of power or potential influences strategy. The time of entry of foreign competitors is usually a known phenomenon, while their success and, therefore, a true measure of the threat, can be determined from their respective market share performance over time. Examples of such products are bicycles, typewriters, radios, and cotton textiles from Japan or Western Europe into North America.

Saturation in the Domestic Market:

A long term levelling-off in industry sales in the domestic market is a feature of saturation in the domestic market. This may be an important initiating force for a firm to seek opportunities abroad for making direct
investments in foreign markets. Any levelling-off of industry sales in Canada is measurable objectively through examination of figures for industry sales in the domestic market which are available in published sources.

**Band Wagon Effect:**

Band Wagon or "follow the leader" means that when several companies in the same industry invest abroad, other firms feel a strong urge to do the same to maintain their relative size, rate of growth and market share. Many firms invested in the European Economic Community because other big firms in the industry had done so.

**Other Exogenous Initiating Forces**

Besides the above initiating forces mentioned by Aharoni, the respondents in the present study suggested high prices of a commodity, unfavourable political environment in the home country, and growing demand for the product in the host country as exogenous initiating forces. High prices of a commodity mean an increase in the prices of commodities considered above the normal or traditional level of prices for those commodities. This commonly happens in the mining and other resource-based industries. For example, in December 1974, when the price of gold reached close to $200 per ounce, this increase was considered much above the normal or traditional level of gold prices.

Unfavourable political environment in the home country refers to changes in federal and provincial government policies which may affect adversely the profits of companies. Any criticism of firms by federal or provincial government leaders, which threatens the existence or operations or expected profit levels of these firms, is also considered an unfavourable political environment in the home country.
Growing demand for the product in the host country obviously means a continuous increase in sales in units of a product either being exported from Canada or being manufactured in a host country.

**Initiating Forces: Endogenous**

**Keen Interest of a High-Ranking Executive:**

The keen interest of a high-ranking executive in looking abroad for direct investment opportunities may be due to such factors as: the need for prestige gained in the domestic market from manufacturing abroad, the desire to see the world, an aspiration to contribute to the economic development of other countries, some favourable personal experience in a particular foreign country, and extensive travel abroad.

**Utilization of Old Machinery:**

Machinery, which has scrap value for a firm in the domestic market because it was fully depreciated may well be good and usable in a developing country. Sometimes such equipment is sold to subsidiaries for exorbitant prices.

**Capitalization of Patents or Know-how:**

Foreign direct investment may also be in the form of patents or technical or managerial know-how. Such companies receive shares in consideration of patents, know-how, and blueprints.

**Markets for Components and Parts:**

This is an important by-product of a foreign direct investment. Export markets are created for components or other products. For several years, a foreign subsidiary may not produce all the components because it is only an assembly plant, the required components being exported by the
parent company. For example, car manufacturing is essentially an assembly
operation in the beginning, and a long time usually passes before a sub-
sidiary can produce engines.

Spreading R and D and Other Fixed Costs:

A foreign subsidiary gives a company an opportunity to spread its
R & D and other fixed costs over a larger number of units of a product
manufactured at home and abroad.

Other Endogenous Forces

Other endogenous forces mentioned by respondents in the present
study were the desire to internalize the source of supply, the desire to
internalize demand, and export experience in the host country. The desire
to internalize a source of supply means backward integration. Instead of
putting itself to the risks of disruptions in supply, a firm internalizes
the source of supply by acquiring the source or by forming a joint venture.
Thus the firm has complete control over the source of supply.

The desire to internalize demand refers to forward integration.
Through acquiring controlling interests, outright purchases, or forming
joint ventures with firms that were buying or potentially could buy a
firm's products, the firm internalizes demand.

Export experience in the host country apparently means the knowledge
a firm acquires as the result of operating in the host country as an ex-
porter.

H$_2$ Sequential Investigation

Sequential investigation means that a firm first conducts a library
research, followed by field research (if the library research results were
positive), and preparation of a written report.
Subjectively Estimated Cost

The reasons why actual cost of investigation was avoided and subjective estimates of cost were sought were that the size of actual cost varies with the location of investment opportunity (distance from B.C.), number of days spent in the host country, and the position of the investigators. A comparison of the actual cost due to these variations may not be meaningful. Another reason for not asking the actual cost of investigation was the fear that the firms may be reluctant to release this information.

Extent of Investigation

Investigation of a foreign direct investment opportunity can be carried out in three phases: library research, field investigation, and writing a report. Library research refers to the use of information available in published sources. This research is largely carried out in the head office of the investigating firm. Field research refers to on-the-post investigation in the host country. Writing a report implies processing of information through the perceptual process, organization of material and presentation.

Extent of investigation refers to the phases covered by a firm in the investigation process. A firm may effectively end its investigation of an opportunity after library research. Intensity of investigation refers to the measurement of perceived cost of investigation.

Commitments

A commitment is a state of mind or feeling that guides action. A commitment is created when an individual, by his own previous action, has put himself in a position in which his decision with regard to some
particular line of action has consequences for other interests and activities not necessarily related to it.

Examples of commitments are creation of an international division, serving a market through export, money and time spent on investigation, negotiations etc.

H4 Extent of Negotiations

Once the top management of a firm approves in principle a foreign direct investment project, the firm enters into negotiations with government, bankers, and potential partners in the host country to minimize uncertainty. The firm's representatives bargain with the host country government on concessions relating to income taxes, tariffs on raw materials, protection against imports, remittance of profit etc.

The purpose of negotiations with host country banks is to reduce the amount of a company's own capital by borrowing from them in local currency. Local partners also spread the risk of investment by providing part of the capital and local contacts.

H4 Uncertainty

Uncertainty refers to a situation in decision making when the probability distribution of alternative outcomes is not known. Thus, uncertainty is not directly measurable and cannot be insured. The uncertainty variables used in this study were demand for a product in a host country, inflation, local competition in the host country, corruption, devaluation, government intervention, availability of minerals, red tape, labour unrest, nationalization, cultural differences, change in government through democratic process, expropriation, military coup, civil war, and war with another country.
Truitt has distinguished between expropriation and nationalization. According to him nationalization refers to the transfer of an entire industry or sector of economy from private to public ownership, with no discrimination against those firms that are foreign owned. Expropriation is takeover of a foreign owned company by the host country government. If no compensation is paid, Weekly calls it confiscation.

D. The Sample

The population for this research study consisted of foreign direct investment decisions made by firms which have their head offices in British Columbia. The B.C. firms selected were either entirely owned by Canadians or the latter had controlling shares in them. Finance firms, including banks, and service firms (e.g. consultants) were excluded because the nature of their business does not make them comparable with manufacturing or mining companies.

A list of 25 firms was prepared in April 1976 from files of the Division of International Business Studies, University of British Columbia, the Financial Post Survey of Industrials (1975), the Financial Post Survey of Mines (1975), and British Columbia Directory of Manufacturers (1975). The selection criteria were: foreign direct investment, Canadian ownership or control, head office in British Columbia, and manufacturing or mining.

---


The 25 firms were contacted by telephone in the last week of April 1976 and basic information was obtained about their eligibility in meeting the criteria. The list was revised in September 1976 after the availability of 1976 editions of the above publications. The firms were contacted again to obtain the latest information about their eligibility. As a result of the information obtained on telephone and from published sources, the list was reduced to 20 firms. Information was also obtained on the names and positions of the key executives responsible for foreign direct investment decisions in each firm.

To get maximum cooperation, the Chairman, Division of International Business Studies, wrote letters in December 1976 to the top executives who had final responsibility for foreign direct investment decisions in each firm. The letter explained the purpose of the survey and introduced the interviewer.

Out of the 20 firms contacted, 16 firms from mining, forestry, seafood, and manufacturing industries cooperated. Two of the four firms, which did not cooperate, had quite small foreign direct investments, one had moved its head office out of British Columbia and the fourth firm had become inactive.

Information was obtained on 89 foreign direct investment decisions from the 16 firms. These 89 decisions covered 95 percent of the known and significant foreign direct investment decisions made by firms in British Columbia.

E. The Methodology

Executives (managers and above) involved in foreign direct investment decisions were interviewed in January and February 1977. A structured
questionnaire, containing questions about the background of firms and each decision and 12 questions relating to the hypotheses, was used to interview the respondents. The questionnaire was not mailed to the respondents because it had a sequence. All the interviews were conducted in the offices of the executives concerned.

Following the general practice in social sciences and considering the needs for this research, an alpha level of .05 was chosen.

Hypotheses $H_1$, $H_2$, and $H_3$ were tested by using $t$-tests. $H_1$ involved a comparison of the strength of endogenous variables versus exogenous variables in causing awareness of foreign direct investment opportunities. In $H_2$ the comparison was between those who conduct sequential investigation in relation to the subjectively estimated cost of investigation. The main concern in $H_3$ was measurement of the strength of initiating forces, extent of investigation, degree of commitments, extent of negotiations, and amount of uncertainty between positive decisions to invest and negative decisions.

The main interest in these hypotheses was location of strength of the mean for each group. $T$-tests were considered most appropriate for testing these hypotheses. As the variable in these hypotheses were measured on an assumed interval scale, it was possible to use the operations of arithmetic (adding, dividing, finding the means, etc.) on the scores. This is one of the essential conditions for the use of $t$-tests. The observations in the survey were independent. That is, the selection of any one case from the population for inclusion in the sample did not bias the chances of any other case for inclusion. The other major condition for use of $t$-tests, that is, the observations be drawn from a normally distributed population, was assumed to be true.
The remaining two hypotheses $H_3$ and $H_4$ were tested by using canonical correlation because the main interest in these hypotheses was finding a relationship between two sets of variables i.e. extent of investigation and degree of commitment in case of $H_3$ and extent of negotiations and amount of uncertainty for $H_4$. The basic strategy of canonical correlation analysis is to derive a linear combination from each of the sets of variables in such a way that the correlation between the two linear combinations is maximized. Canonical correlation analysis was considered very appropriate for testing these two hypotheses because Pearson's product moment correlation coefficient deals with only two variables, that is, it is bivariate.
V. THE RESEARCH FINDINGS

Hypothesis No. 1

A. Initiating Forces and Awareness of Foreign Direct Investment Opportunities

1. Initiating Forces

(a) Endogenous Initiating Forces

An analysis of the responses in the present study showed that important endogenous initiating forces mainly consisted of keen interest of a high ranking executive in foreign direct investment, capitalization of patents or technical know-how, the desire to internalize the source of supply, the desire to internalize demand, and export experience in the host country.

Other endogenous initiating forces mentioned infrequently (less than three responses) by respondents in this survey were: partnership in a project, minimizing tariff and transportation costs, the desire for greater control in management, and the desire for diversification.

(b) Exogenous Initiating Forces

The set of exogenous initiating forces consisted of an outside proposal, fear of losing an export market, successful direct investment operations of one's competitors abroad, growing demand for the product in the host country, high prices for the commodity, and unfavourable political environment in the home country.

Other exogenous initiating forces mentioned infrequently in this research were: problems with custom officials, delays in delivery due to long distances, depressed domestic market conditions, plane failure in X country, pressure from a lobbyist, low cost of mining conditions outside Canada, better grade of ore south of Canada, fast growing pines in Alabama,
high cost of transportation, and access to the European Common Market. The number of responses for each of these initiating forces was less than three.

2. The Relative Importance of Individual Initiating Forces

In his research, Aharoni was not concerned with the relative strength of the initiating forces. As he was doing pioneering work in the area of behavioural determinants of foreign direct investment decisions, Aharoni was mainly interested in listing the significant variables causing awareness of foreign direct investment opportunities.

In the present study an effort was made to measure the strength of the initiating forces in terms of an interval scale ranging from 0 to 4. The following table gives the relative importance of these variables in causing awareness of foreign direct investment opportunities.

Table 7 shows that within exogenous initiating forces, an outside proposal was the most important variable in causing awareness of foreign direct investment opportunities followed by growing demand for product, high prices for commodities, unfavourable political environment in the home country, fear of losing an export market, and successful direct investment operations of one's competitors abroad.

In the set of endogenous variables, keen interest of a high ranking executive was most significant, followed by the desire to internalize the source of supply, the desire to internalize demand, export experience in the host country, and capitalization of patents or technical know-how.

3. A Comparison of Endogenous and Exogenous Initiating Forces

The main interest in this part of the study was measurement and comparison of variables relating to the sets of exogenous and endogenous variables. The endogenous variables mainly consist of behavioural
Table 7. The Rated Importance of Initiating Forces in Causing Awareness of Foreign Direct Investment Opportunities, Relative to the 89 Investment Decisions.

<table>
<thead>
<tr>
<th>Initiating Forces</th>
<th>Degree of Importance</th>
<th>Total No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Critical</td>
<td>Very important</td>
</tr>
<tr>
<td>Exogenous</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. An outside proposal</td>
<td>32</td>
<td>3</td>
</tr>
<tr>
<td>2. Growing demand for the product</td>
<td>15</td>
<td>1</td>
</tr>
<tr>
<td>3. High prices for commodities</td>
<td>12</td>
<td>1</td>
</tr>
<tr>
<td>4. Unfavourable political environment in the home country</td>
<td>11</td>
<td>2</td>
</tr>
<tr>
<td>5. Fear of losing an export market</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>6. Successful direct investment operations of one's competitors abroad</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Endogenous</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Keen interest of a high ranking executive</td>
<td>25</td>
<td>17</td>
</tr>
<tr>
<td>2. The desire to internalize the source of supply</td>
<td>17</td>
<td>3</td>
</tr>
<tr>
<td>3. The desire to internalize demand</td>
<td>15</td>
<td>3</td>
</tr>
<tr>
<td>4. Export experience in the host country</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>5. Capitalization of patents or technical know-how</td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>
variables while the exogenous variables mostly consist of economic variables. Unfortunately, Aharoni had not made a quantitative comparison of these two sets of variables, so there were no figures to compare with the results of this study. Nevertheless, a comparison is useful because Aharoni had emphasized the endogenous variables.

The hypothesis formulated to compare endogenous and exogenous initiating forces was as follows:

H₁ Endogenous initiating forces are more important in creating awareness of foreign direct investment opportunities than exogenous initiating forces.

The findings with regard to the above hypothesis are presented in the following table:

Table 8. The Relative Strength of Endogenous and Exogenous Initiating Forces.

<table>
<thead>
<tr>
<th>Initiating Forces</th>
<th>No. of Cases</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>t-value</th>
<th>One-tail Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Endogenous</td>
<td>89</td>
<td>0.81</td>
<td>0.606</td>
<td>-1.67</td>
<td>0.05</td>
</tr>
<tr>
<td>Exogenous</td>
<td></td>
<td>0.62</td>
<td>0.538</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

To eliminate the bias of unequal number of variables in each set (endogenous having five variables and exogenous having six variables), the score of each set was divided by the number of variables in it i.e. endogenous variables' score was divided by five and the score of exogenous variables was divided by six. The null hypothesis (H₀) was that U₁ (mean of endogenous variables) = U₂ (mean of exogenous variables). The alternative hypothesis (H₁) stated that U₁ > U₂. The level of significance, as mentioned earlier, for all hypotheses was set at .05.
As indicated in Table 8, the null hypothesis ($H_0$) is false because $U_1(.81) \neq U_2(.62)$. The alternative hypothesis ($H_1$) is true because $U_1(.81) > U_2(.62)$. As the one-tail probability of .05 meets the condition of this research, it can be said that these results are statistically significant. The null hypothesis ($H_0$) was rejected and the alternative hypothesis ($H_1$) was accepted.

The acceptance of the alternative hypothesis indicates the relative strength of endogenous variables, which mainly consist of behavioural variables as initiating forces - a result which supports Aharoni's findings.

Hypothesis No. 2

B. Sequential Investigation and Subjectively Estimated Cost of Investigation

1. The Sequential Investigation

According to Aharoni, strong initiating forces lead to investigation of foreign direct investment opportunities. However, as Robinson says, "The decision to investigate a foreign project is not to be taken lightly, for such a decision in itself may mean the investment of a substantial amount of company resources."\(^1\) Stigler also considers the cost of search as one of the major constraints.\(^2\) Perhaps for this very reason, Aharoni emphasized that investigation of foreign direct investment opportunities was sequential. The first step in investigation is library research or use of general indicators. If the results of this phase are favourable or if the initiating

---


forces were strong, the search enters into the second phase of on-the-spot investigation. The third and the last phase is presentation of the report to the top executives of the firm.

The types of investigation of foreign direct investment opportunities as found in the present study are given in the following table:

Table 9. The Types of Investigation of Foreign Direct Investment Opportunities.

<table>
<thead>
<tr>
<th>Serial No.</th>
<th>Type of Investigation</th>
<th>No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Library Research $\rightarrow$ Field Investigation $\rightarrow$ Report</td>
<td>37</td>
</tr>
<tr>
<td>2.</td>
<td>Export Experience $\rightarrow$ Feasibility Study $\rightarrow$ Report</td>
<td>20</td>
</tr>
<tr>
<td>3.</td>
<td>Export Experience $\rightarrow$ Field Investigation $\rightarrow$ Report</td>
<td>10</td>
</tr>
<tr>
<td>4.</td>
<td>Export Experience $\rightarrow$ Proposal $\rightarrow$ Feasibility Study $\rightarrow$ Report</td>
<td>5</td>
</tr>
<tr>
<td>5.</td>
<td>First FDI Experience $\rightarrow$ Industry Sales Analysis $\rightarrow$ Report</td>
<td>4</td>
</tr>
<tr>
<td>6.</td>
<td>Proposal $\rightarrow$ Library Research $\rightarrow$ Field Investigation $\rightarrow$ Report</td>
<td>3</td>
</tr>
<tr>
<td>7.</td>
<td>Proposal $\rightarrow$ Library Research $\rightarrow$ Report</td>
<td>2</td>
</tr>
<tr>
<td>8.</td>
<td>Partnership $\rightarrow$ Library Research $\rightarrow$ Report</td>
<td>2</td>
</tr>
<tr>
<td>9.</td>
<td>First FDI Experience $\rightarrow$ Proposal $\rightarrow$ Report</td>
<td>1</td>
</tr>
<tr>
<td>10.</td>
<td>Proposal $\rightarrow$ Internal Evaluation $\rightarrow$ Report</td>
<td>1</td>
</tr>
<tr>
<td>11.</td>
<td>Information from Government $\rightarrow$ Lease of Property $\rightarrow$ Test Drilling $\rightarrow$ Report</td>
<td>1</td>
</tr>
<tr>
<td>12.</td>
<td>Experience with Supplier $\rightarrow$ Field Investigation $\rightarrow$ Report</td>
<td>1</td>
</tr>
<tr>
<td>13.</td>
<td>Experience of Director $\rightarrow$ Loss $\rightarrow$ Disinterested $\rightarrow$ Acquisition</td>
<td>1</td>
</tr>
<tr>
<td>14.</td>
<td>Information from Friend $\rightarrow$ Field Investigation $\rightarrow$ Report</td>
<td>1</td>
</tr>
</tbody>
</table>
A detailed investigation of the 37 sequential decisions in Table 9 showed that these were either the first foreign direct investment decisions in the life of a firm, or they were first decisions in a country with which the firm had no previous contact.

In those cases where these two conditions were not met a different sequence was followed. If a firm had previous export experience in a market, the management already possessed the basic and necessary amount of information available from library research or general economic indicators. Similarly, other kinds of experiences such as foreign direct investment experience in a country, experience with a supplier, experience of a director, etc., also make redundant the need for library research.

2. The Cost of Investigation

In the case of sequential investigation the management of a firm has to carry out a more extensive search for information as compared to other types of investigation where the management either possesses part of the needed information because of previous experience, or the management is supplied with some information almost free of cost as in the case of a proposal.

Search for information in the case of sequential investigation, as explained by Aharoni, means incurring cost for the collection of information. Thus, according to Aharoni's reasoning, the cost of sequential investigation is much higher compared to the cost incurred by those who do not conduct sequential investigation (in Aharoni's sense). This is an important finding because the high cost of sequential investigation tends to discourage a firm from adequate investigation of all or even most of the possible alternatives. As the cost of sequential investigation in developing countries is much
higher (according to Aharoni) than its cost in developed countries, because of insufficient or non-existent data, this tends to discourage firms from probing foreign direct investment opportunities in such countries.

The responses of the executives with regard to the cost of investigation in relation to the size of the project are presented in the following table:

Table 10. The Cost of Investigation in Relation to the Size of the Project.

<table>
<thead>
<tr>
<th>Subjective Estimate of Cost of Investigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Expensive</td>
</tr>
<tr>
<td>----------------</td>
</tr>
<tr>
<td>3</td>
</tr>
</tbody>
</table>

The responses in Table 10 indicate that in 56 out of 89 cases the subjective estimate of the cost of investigation was not expensive. In 22 cases the response was expensive followed by somewhat expensive (8 cases), and very expensive (3 cases).

3. A Comparison of Sequential Investigation Cost with the Cost of Non-Sequential Investigation

To compare the cost of sequential investigation with the cost of non-sequential investigation, the following hypothesis was formulated:

\[ H_2 \] Those who conduct a sequential investigation will judge the subjectively estimated cost of that investigation to be significantly higher than those who do not conduct a sequential investigation.
There were several reasons for comparing the subjectively estimated cost rather than the actual cost of investigation. First, there was a realization that obtaining figures of actual cost would be difficult because the executives did not like to disclose the information or they did not know it or remember it. Second, a comparison of actual cost of investigation might not be meaningful because comparing the actual cost of investigation of a direct investment opportunity, say, in Washington State with that in Australia would obviously weigh against Australia.

The results of the t-test performed on those cases where sequential investigation was conducted against those cases where sequential investigation was not followed are reported in Table 11.

Table 11. A Comparison of the Subjectively Estimated Cost of the Cases Involving Sequential Investigation Against the Cases where Sequential Investigation was not Carried Out.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Groups</th>
<th>No. of Cases</th>
<th>Mean*</th>
<th>Standard Deviation</th>
<th>t-value</th>
<th>One-tail Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subjectively Estimated</td>
<td>Cases where sequentially investigated were</td>
<td>37</td>
<td>2.84</td>
<td>.800</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of Investigation</td>
<td>carried out</td>
<td></td>
<td></td>
<td></td>
<td>3.64</td>
<td>.0005</td>
</tr>
<tr>
<td></td>
<td>Cases which did not involve sequential</td>
<td>42</td>
<td>2.19</td>
<td>.840</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>investigation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* The mean is based on the scores obtained for subjectively estimated cost of investigation.
The null hypothesis \((H_0)\) was that \(U_1\) (the mean of those cases where sequential investigation was carried out) was equal to \(U_2\) (the mean of the cases where sequential investigation was not followed). The alternative hypothesis \((H_1)\) was that \(U_1 > U_2\). The level of significance remained unchanged at .05.

The results of the t-test presented in Table 11 show that the null hypothesis \((H_0)\) was not supported because \(U_1(2.84) \neq U_2(2.19)\), therefore, the null hypothesis was rejected. The alternative hypothesis was accepted because \(U_1(2.84) > U_2(2.19)\), the one-tail probability of .0005 indicating that these results are statistically significant. This confirms the hypothesis.

Hypothesis No. 3

C. Relation between Intensity of Investigation and Degree of Commitments

Aharoni has emphasized the creation of commitments during investigation. Commitments are created because money and time are spent on investigation and executives find it difficult to look at this investment of scarce resources as a sunk cost. As investigation gets deeper and deeper, more and more commitments are created and ceteris paribus the reluctance to back off becomes correspondingly greater.

1. Investigation Variables

The investigation variables mentioned by Aharoni were grouped under general environmental variables affecting uncertainty, market related variables, and variables pertaining to the sources of information. The frequency distribution of the responses relating to the sources of information as obtained during the present research, is given in the following table:
Table 12. Rated Importance of Eight Sources of Information on the 89 Investment Decisions.

<table>
<thead>
<tr>
<th>Sources of Information</th>
<th>Critical</th>
<th>Very Important</th>
<th>Important</th>
<th>Unimportant</th>
<th>Not Even Considered</th>
<th>Total No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Published material</td>
<td>30</td>
<td>11</td>
<td>0</td>
<td>0</td>
<td>48</td>
<td>89</td>
</tr>
<tr>
<td>2. Outside consultant</td>
<td>30</td>
<td>5</td>
<td>0</td>
<td>0</td>
<td>54</td>
<td>89</td>
</tr>
<tr>
<td>3. An outside proposal</td>
<td>28</td>
<td>3</td>
<td>0</td>
<td>1</td>
<td>57</td>
<td>89</td>
</tr>
<tr>
<td>4. Export experience</td>
<td>11</td>
<td>14</td>
<td>0</td>
<td>0</td>
<td>64</td>
<td>89</td>
</tr>
<tr>
<td>5. Internal sales records</td>
<td>9</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>80</td>
<td>89</td>
</tr>
<tr>
<td>6. Capital cost calculation</td>
<td>8</td>
<td>11</td>
<td>0</td>
<td>0</td>
<td>70</td>
<td>89</td>
</tr>
<tr>
<td>7. Cost of acquisition</td>
<td>8</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>79</td>
<td>89</td>
</tr>
<tr>
<td>8. Information from host government</td>
<td>5</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>83</td>
<td>89</td>
</tr>
</tbody>
</table>

It is obvious from Table 12 that the most important source of information used by firms in British Columbia for the investigation of foreign direct investment opportunities was published material. This source was almost always used by mining companies because their decision to invest abroad is basically determined by the geology of the area, provided other factors are also favourable. Geological information is available in books, magazines, and special reports published by numerous organizations. The firms making their first direct investment decision also very frequently used this source of information.

Other important sources were: outside consultants, proposals from outside the firm, export experience, internal sales records (frequently used in expansion decisions) and capital cost calculations. Aharoni had not discussed direct investment through acquisition of existing companies in
the host countries. In the present study about 12 such cases were mentioned.

Some other sources of information mentioned by respondents were: a friend informed the firm about the opportunity, availability of a commodity, information from the Canadian International Development Agency (CIDA), information from the Department of Industry, Trade and Commerce, and using previous foreign direct investment experience. These responses were not shown in Table 12 because the number of responses in each case was only one.

During the interviews, the following market related variables were mentioned by respondents as being important considerations:

Table 13: Rated Importance of Nine Market Related Investigation Variables on the 89 Decisions.

<table>
<thead>
<tr>
<th>Market Related Investigation Variables</th>
<th>Critical</th>
<th>Very Important</th>
<th>Important</th>
<th>Unimportant</th>
<th>Not Used</th>
<th>Total No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Market size</td>
<td>38</td>
<td>14</td>
<td>1</td>
<td>0</td>
<td>36</td>
<td>89</td>
</tr>
<tr>
<td>2. Price behaviour</td>
<td>38</td>
<td>8</td>
<td>3</td>
<td>0</td>
<td>40</td>
<td>89</td>
</tr>
<tr>
<td>3. Information about partners in host country</td>
<td>27</td>
<td>12</td>
<td>2</td>
<td>0</td>
<td>48</td>
<td>89</td>
</tr>
<tr>
<td>4. Competition</td>
<td>19</td>
<td>10</td>
<td>3</td>
<td>1</td>
<td>56</td>
<td>89</td>
</tr>
<tr>
<td>5. Consumer tastes</td>
<td>19</td>
<td>6</td>
<td>3</td>
<td>0</td>
<td>61</td>
<td>89</td>
</tr>
<tr>
<td>6. Cost of production</td>
<td>18</td>
<td>27</td>
<td>9</td>
<td>2</td>
<td>33</td>
<td>89</td>
</tr>
<tr>
<td>7. Market share</td>
<td>10</td>
<td>22</td>
<td>2</td>
<td>0</td>
<td>55</td>
<td>89</td>
</tr>
<tr>
<td>8. Availability of minerals</td>
<td>9</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>80</td>
<td>89</td>
</tr>
<tr>
<td>9. Dealer survey</td>
<td>1</td>
<td>5</td>
<td>1</td>
<td>1</td>
<td>81</td>
<td>89</td>
</tr>
</tbody>
</table>
Table 13 shows that the most important market related investigation variable was market size. This could be understood in terms of the small market in Canada (population 22 million). According to one executive of the Vancouver Board of Trade, the tendency in Canada is to look to the immediate south for export or direct investment. Because of the large area of Canada and its scattered population it is natural on the part of Canadian executives to investigate markets for their products in the nearest state in the United States.

The managing director of a Vancouver manufacturing firm, while discussing the constraints imposed by the small size of the market in Canada said, "How can we ignore California which is much closer to us than many Canadian provinces and this one state in terms of population is almost equal to the whole of Canada and if you consider income, the size of the market is much larger than Canada." *

The second important investigation variable mentioned by respondents in the present study was price behaviour. This variable was almost always mentioned by the executives of mining firms. As the prices of commodities rise, the search for them is intensified not only in British Columbia and the rest of Canada, but many firms start looking for properties outside the country. As reported by the executive of a mining firm, often the mining firms know of properties which are rich in certain minerals, but they neither exploit them (because of low prices) nor do they let others know about them. As soon as the prices start moving up, these properties become very attractive.

* See also Alfred Powis, "Public Policy and the Mineral Industry," Address before the Mining Association of Canada, November 24, 1976.
Another important investigation variable in Table 13 was information about partners in the host country. This was important in the case of joint ventures. The total number of joint ventures in the present study were 48. In 27 decisions this information was considered critical. The number of respondents saying that this information was very important was 12. Thus out of 48 joint ventures 81 percent considered information about local partners either critical or very important. In the remaining cases the partners were already well enough known to the executives because their export experience or else as old friends, so that further information was no longer perceived as necessary.

Other important variables mentioned by the executives were: competition, consumer tastes, cost of production, market share, and availability of minerals. Certain other variables, which were not mentioned in Table 13 because the number of responses was insignificant (one or two responses), were: terms for acquiring plant, infrastructure, real estate prices, labour problems, and attitudes of a host country government towards foreign direct investment.

2. Commitment Variables

In his research, Aharoni emphasized the creation of an international division as a major indication of commitment to the consideration of foreign direct investment opportunities. Other commitments mentioned by him were psychic or social, i.e. the concern about corporate image once investigation is being carried out, the desire to retain an export market, and friendship. It was realized that measuring the impact of friendship through a direct questionnaire would be difficult because very few executives would admit that the direct investment was mainly due to friendship. Therefore,
this variable was not included in the questionnaire. The responses relating to commitment are shown in the following table:

Table 14: Rated Importance of Four Commitment Variables for the 89 Investment Decisions

<table>
<thead>
<tr>
<th>1. Creation of international division</th>
<th>Critical</th>
<th>Very Important</th>
<th>Important</th>
<th>Unimportant</th>
<th>Not Even Considered</th>
<th>Total No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>51</td>
<td>14</td>
<td>0</td>
<td>0</td>
<td>27</td>
<td>89</td>
</tr>
<tr>
<td>2. The desire to stabilize demand</td>
<td>30</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>57</td>
<td>89</td>
</tr>
<tr>
<td>3. The desire to stabilize profit</td>
<td>18</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>71</td>
<td>89</td>
</tr>
<tr>
<td>4. The desire to retain an export market</td>
<td>10</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>79</td>
<td>89</td>
</tr>
</tbody>
</table>

It is obvious from Table 14 that concern about corporate image as a commitment variable is missing because it was not considered a commitment by any respondent. Two new variables, the desire to stabilize demand and the desire to stabilize profit, appear in the above table. The desire to stabilize demand can be seen as a form of forward integration. It can be illustrated with a real example without naming the firm or the country concerned.

A certain firm in British Columbia was exporting a semi-finished product to another firm in a developed country. This product was used as a basic ingredient in the product manufactured by the latter firm. The semi-finished product exported from British Columbia was bulky and
consequently transportation costs were high giving a competitive disadva-
tagge to the British Columbian firm. The semi-finished product was also exported by other countries located quite close to the importing country. The exports by the British Columbian firm fluctuated widely from year to year. The fluctuation in export demand was a constant cause of concern for the management of the firm. The B.C. firm lost no time in acquiring the controlling shares of its customer firm when shares became available.

By internalizing demand, the British Columbia firm not only sta-
ibilized export, but it used this experience as the basis for further acquisi-
tions until it became a pattern for stabilizing exports. Stabilizing demand is different from Aharoni's desire to retain an export market because, according to his interpretation, the desire to retain an export market through direct investment is aroused as the result of some action (e.g. a total ban on imports or restrictions on imports) taken by the government of a country to which a firm was exporting its products.

The desire to stabilize profit as a commitment variable reflects the concern of management to increase or maintain a level of profit achieved before and considered satisfactory by the stockholders. The most important commitment variable, as emphasized by Aharoni, was creation of an inter-
national division.

3. The Test of the Hypothesis

To determine the relationship between the intensity of investigation and the degree of commitment, the following hypothesis was formulated: $H_3$ The intensity of investigation and degree of commitment are positively related.
The intensity of investigation and the degree of commitment were measured in terms of weighting or scores obtained on each variable depending on the responses given by an executive for each decision. The null hypothesis ($H_0$) said that $R_c$ (canonical correlation coefficient) = 0 and the alternative hypothesis ($H_1$) stated that $R_c > 0$.

The results of the canonical correlation analysis are given in the following table:

<table>
<thead>
<tr>
<th>Table 15. The Relationship Between Intensity of Investigation and Degree of Commitments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eigenvalue</td>
</tr>
<tr>
<td>------------</td>
</tr>
<tr>
<td>0.497</td>
</tr>
</tbody>
</table>

The hypothesis was tested by using canonical correlation analysis, which takes as its basic input two sets of variables, each of which can be given theoretical meaning as a set (extent of negotiations and amount of uncertainty in the case of the present study). The basic strategy of canonical correlation analysis is to derive a linear combination from each of the sets of variables in such a way that the correlation between the two linear combinations is maximized. Many such pairs of linear combinations, called canonical variates, may be derived.

Both principal-component analysis and canonical correlation analysis produce linear combinations of the original variables. Canonical correlation analysis does so, not with the object of accounting for as much
variance as possible within one set of variables, but with the aim of accounting for a maximum amount of the relationship between two sets of variables. The first pair of canonical variates are selected so as to have the highest intercorrelation possible, given the particular variables involved. A second set of canonical variates is then selected to account for a maximum amount of the relationship between the two sets of variables left unaccounted for by the first canonical variates, and so forth.  

As can be seen in Table 15, the null hypothesis \( H_0 \) cannot be accepted because \( R_c = 0.705 \) is greater than zero. Therefore, the null hypothesis \( H_0 \) is rejected and the alternative hypothesis \( H_1 \) is accepted. This conclusion is supported by other values of statistical measures in Table 15. The eigenvalue, which is a measure of the relative importance of the function, is 0.497. This value is obtained by squaring the canonical correlation coefficient. The eigenvalue indicates the proportion of variance in the function explained by the two sets of variables, namely, intensity of investigation and degree of commitment. The eigenvalue 0.497 in Table 15 indicates 50% of the variance in the two sets of variables is held in common.

The value of Wilk's lambda in Table 15 is 0.281. This indicates that considerable reliance could be placed on the canonical correlation coefficient because the smaller the value of lambda, the higher the confidence in the canonical correlation coefficient. The value of lambda (0.281) is quite small, therefore, the rejection of the null hypothesis \( H_0 \)

---

is justified. The high value of chi-square (98.973) also shows a strong relationship between intensity of investigation and extent of commitment.

The P value of $R_c$ in Table 15 is 0.007 which is much smaller than the alpha level of .05 considered acceptable for this research. This further justifies the rejection of the null hypothesis.

On the basis of the above discussion, it can be concluded that there exists a statistically significant positive relationship between the intensity of investigation and the degree of commitment.

**Hypothesis No. 4**

D. Relation between Extent of Negotiations and Amount of Uncertainty

1. The Negotiation Variables

Favourable investigation and commitments created during investigation lead to negotiations with the host country government, the host country banks, and the potential partners in the host country if it is a joint venture. The purpose of negotiation is to reduce the amount of uncertainty perceived by the management of a firm in the case of a foreign direct investment opportunity.

(a) Negotiations with Host Country Government

Federal, provincial or state and local governments can play a very important role in attracting or discouraging foreign direct investment. If the role of governments is so important, one can ask about the issues on which a potential direct investor would like to negotiate with host country governments. As mentioned earlier, Aharoni was mainly interested in his research in measuring the effectiveness of incentives offered by less developed countries, particularly Israel, in attracting direct investment from the United States.
The most widely used issues in negotiations with host country governments, according to Aharoni, were income tax exemptions, accelerated depreciation for tax purposes, tariff protection, and relaxation or restriction of import duties.

The following table shows the responses of executives in the present study with regard to negotiations with host country governments:

Table 16: Rated Importance of Five Negotiation Variables for the 89 Investment Decisions.

<table>
<thead>
<tr>
<th>Negotiation Variables</th>
<th>Critical</th>
<th>Very Important</th>
<th>Important</th>
<th>Unimportant</th>
<th>Not Even Considered</th>
<th>Total No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Remittance of dividends</td>
<td>25</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>62</td>
<td>89</td>
</tr>
<tr>
<td>2. Repatriation of capital</td>
<td>1</td>
<td>18</td>
<td>5</td>
<td>1</td>
<td>64</td>
<td>89</td>
</tr>
<tr>
<td>3. Applicable rates of taxation</td>
<td>2</td>
<td>6</td>
<td>17</td>
<td>3</td>
<td>61</td>
<td>89</td>
</tr>
<tr>
<td>4. Environment or pollution control</td>
<td>7</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>82</td>
<td>89</td>
</tr>
<tr>
<td>5. Special depreciation or depletion allowances</td>
<td>1</td>
<td>2</td>
<td>4</td>
<td>6</td>
<td>76</td>
<td>89</td>
</tr>
</tbody>
</table>

Table 16 indicates that the most important issue in negotiations with the host country governments was dividends. The importance attached to repatriation of dividends in negotiations with government shows the concern of B.C. firms with profit. The second most important issue was repatriation of capital. The importance given to repatriation of capital shows that the business firms were aware of the possibility of misjudgement in the case of an investment and the consequent need for repatriation of
capital. Another important issue was the applicable rate of taxation. Environment or pollution control and special depreciation or depletion allowances were other issues.

A close look at Table 16 reveals that the number of positive responses (critical, very important, important) for none of the issues were more than 26. This figure matches the total number of direct investment decisions of B.C. firms in developing countries. An examination of individual cases also confirmed that the positive responses in Table 16 regarding remittance of capital, repatriation of capital, applicable rates of taxation, and special depreciation or depletion allowances applied to developing countries. This was most probably due to the fact that in developing countries these issues are negotiable on an individual (i.e. firm by firm) basis depending on the importance of the particular direct investment for the country concerned. This in no way implies that there are no rules in developing countries regarding these issues. The only implication here is that the developing countries are flexible with regard to these rules.

The seven direct investments, where negotiations were held with host country governments on the issue of environment or pollution control, were all in developed countries and the products were potentially hazardous to human health.

(b) Negotiations with Host Country Banks

The purpose of negotiations with host country banks is to reduce the size of investment due to perceived risks. Five variables were used to measure the extent of negotiations with host country banks. These stages in the process were: relied on information in published sources,
inquired about general credit climate, made inquiries about availability of loans, and established a credit line.

The following table summarizes the responses of the executives in the present study:

Table 17. Extent of Negotiations with Host Country Banks for Each of the 89 Investment Decisions

<table>
<thead>
<tr>
<th>Extent of Negotiations</th>
<th>No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Relied on information in published sources</td>
<td>1</td>
</tr>
<tr>
<td>2. Inquired about general credit climate</td>
<td>5</td>
</tr>
<tr>
<td>3. Made inquiries about availability of loans for a specific project</td>
<td>10</td>
</tr>
<tr>
<td>4. Submitted an application for loan</td>
<td>1</td>
</tr>
<tr>
<td>5. Established a credit line</td>
<td>72</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>89</strong></td>
</tr>
</tbody>
</table>

The figures in Table 17 give full support to Aharoni's findings that firms reduce the size of their foreign direct investments due to perceived risks. The number of decisions in the above table, where a credit line was established, were 72 (81%) out of 89. An examination of the original responses disclosed that the remaining 17 responses in Table 17 related to those decisions where the firms decided not to invest.

(c) Negotiations with Partners

Aharoni considers a joint venture another frequently used device to reduce the impact of uncertainty, although he thinks that joint ventures are a mixed blessing because executives weigh the desire to reduce financial risk and the benefits of association with local groups who "know the ropes" against the desire to maintain control over management.
The firms in British Columbia appear to be quite willing to enter into joint venture type of arrangements. The following were the responses of executives with regard to negotiations with local partners:

Table 18. The Extent of Negotiations with Potential Partners in Host Countries for the 48 Joint Ventures.

<table>
<thead>
<tr>
<th>Negotiations with Partners in Host Countries</th>
<th>No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Just discussion</td>
<td>5</td>
</tr>
<tr>
<td>2. Negotiations for type of joint venture</td>
<td>7</td>
</tr>
<tr>
<td>3. Lawyers were involved in negotiations</td>
<td>0</td>
</tr>
<tr>
<td>4. Preparation of a draft agreement</td>
<td>4</td>
</tr>
<tr>
<td>5. Signing of the final draft</td>
<td>32</td>
</tr>
<tr>
<td>Total</td>
<td>48</td>
</tr>
</tbody>
</table>

Table 18 shows that the total number of the proposed joint ventures in the sample was 48. In 32 decisions, the final draft of agreement was signed by both the partners in the proposed joint ventures. The remaining cases involved negotiations short of signing the final draft.

During the interviews, the respondents emphasized the importance of this stage in the decision process. The failure of the proposed joint ventures was ascribed to insistence either on "seed money" by government officials in case of joint ventures involving minerals or the failure of negotiations was due to lack of consensus on the terms of agreement.

2. The Uncertainty Variables

Uncertainty is a situation where the individual does not know the probability distributions connecting behaviour choices and environmental choices. A firm may perceive a number of uncertainties when it becomes
aware of a foreign direct investment opportunity in a foreign country. The purpose of investigation and negotiations is to minimize the uncertainties faced by a firm. A list of 16 uncertainty variables was prepared from the type of uncertainties mentioned by Aharoni. The responses of executives in the present study are summarized in the following table:

Table 19. Rated Uncertainty of Sixteen Uncertainty Variables for the 89 Investment Decisions

<table>
<thead>
<tr>
<th>Uncertainty Variables</th>
<th>Very High Uncertainty</th>
<th>High Uncertainty</th>
<th>Uncertain</th>
<th>Somewhat Uncertain</th>
<th>Insignificant Uncertainty</th>
<th>Total No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Demand for product</td>
<td>36</td>
<td>10</td>
<td>8</td>
<td>5</td>
<td>30</td>
<td>89</td>
</tr>
<tr>
<td>2. Inflation</td>
<td>24</td>
<td>18</td>
<td>7</td>
<td>2</td>
<td>38</td>
<td>89</td>
</tr>
<tr>
<td>3. Local competition</td>
<td>14</td>
<td>7</td>
<td>5</td>
<td>2</td>
<td>61</td>
<td>89</td>
</tr>
<tr>
<td>4. Corruption</td>
<td>13</td>
<td>8</td>
<td>4</td>
<td>0</td>
<td>64</td>
<td>89</td>
</tr>
<tr>
<td>5. Devaluation</td>
<td>12</td>
<td>11</td>
<td>2</td>
<td>2</td>
<td>62</td>
<td>89</td>
</tr>
<tr>
<td>6. Government intervention</td>
<td>12</td>
<td>5</td>
<td>2</td>
<td>1</td>
<td>69</td>
<td>89</td>
</tr>
<tr>
<td>7. Availability of product (minerals)</td>
<td>11</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>77</td>
<td>89</td>
</tr>
<tr>
<td>8. Red tape</td>
<td>8</td>
<td>12</td>
<td>4</td>
<td>0</td>
<td>65</td>
<td>89</td>
</tr>
<tr>
<td>9. Labour unrest</td>
<td>8</td>
<td>4</td>
<td>1</td>
<td>1</td>
<td>75</td>
<td>89</td>
</tr>
<tr>
<td>10. Nationalization</td>
<td>7</td>
<td>3</td>
<td>0</td>
<td>2</td>
<td>77</td>
<td>89</td>
</tr>
<tr>
<td>11. Cultural differences</td>
<td>5</td>
<td>8</td>
<td>2</td>
<td>1</td>
<td>77</td>
<td>89</td>
</tr>
<tr>
<td>12. Change in government through democratic process</td>
<td>5</td>
<td>2</td>
<td>4</td>
<td>0</td>
<td>78</td>
<td>89</td>
</tr>
<tr>
<td>13. Expropriation</td>
<td>3</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>84</td>
<td>89</td>
</tr>
<tr>
<td>14. Military coup</td>
<td>2</td>
<td>3</td>
<td>5</td>
<td>2</td>
<td>77</td>
<td>89</td>
</tr>
<tr>
<td>15. Civil war</td>
<td>2</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>81</td>
<td>89</td>
</tr>
<tr>
<td>16. War with another country</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>87</td>
<td>89</td>
</tr>
</tbody>
</table>
Table 19 indicates that the most significant uncertainty variable was demand for product. All these decisions related to direct investments in developed countries. "When we introduced a new product in X country, we thought we would set the world on fire," said the vice-president of a firm, "but when the harsh realities dawned upon us after two years failure in that market, we realized that the number one uncertainty was demand for the product."

Due to the very high rate of failure of new products and new brands (80 to 90 percent) in North America the management is uncertain about the fate of their direct investment. This uncertainty prevails in varying degrees despite forecasts and data collection.

The second most important uncertainty related to inflation. This was in all likelihood due to the fact that 52 (58.4 percent) foreign direct investment decisions in the present study were made during 1971-75. This was the period when very high rates of inflation prevailed in all the developed countries.

Another important uncertainty variable was local competition in the host country. The responses in Table 19 were related to some of the developed countries. The firms going to developing countries did not face competition because either there was no competition or it was insignificant.

Corruption was another important variable. This variable was generally valid in the case of developing countries. The respondents told numerous stories about corruption. "The guys were postponing the signing of the agreement for one or the other excuse. We had spent a considerable amount of money on investigation. As the agreement was not signed, I left the country. After a few months, they asked for negotiations and signing of the agreement."
"I went again to the country, but on arrival I found that they were using the same tactics. Two days before my planned departure, I was asked to see Mr. X, a consultant, who was working as an agent for government officials. After the breakfast, he introduced me to an attractive girl. 'She is a very fast and accurate typist,' he said, 'we can draft the agreement according to your terms and she can type it in one hour, but to please the officials, your company has to give $400,000.' As the mining concessions were not worth the money being asked for, I left in utter disgust. Since then they have been writing us to re-open the negotiations. We receive their letters and throw them in the wastepaper basket. See (picking a letter from the basket) here is a letter I received this morning. We do not even acknowledge their letters."

Another executive narrated his story thus: "When we went into country X, we took very expensive equipment with us for exploration. As we were extremely disappointed due to corruption and poor prospects for what we were looking for, we decided to discontinue our efforts and take back our sophisticated equipment. We were told to pay a certain amount of bribe to custom officials. We refused because it was very close to the value of the new equipment. They refused to give customs clearance for loading our equipment on the ship and sent us a notice for payment of import duty, which according to the notice, we should have paid when the equipment was brought in. As the amount of duties was twice the value of the equipment, we decided to give the equipment to the government as a gift."

"We love you North Americans for your gifts to our country," said one official, "but you have to pay gift taxes which will come to the same amount as custom duties." In utter disappointment the company officials
hired a boat, loaded the equipment on it, took the boat to deep water and dumped the sophisticated equipment in the sea in the presence of a custom official. "We returned empty handed but full of bitter memories," said the official.

Devaluation, government intervention, availability of product, and red tape were other important variables. An interesting remark about red tape in a certain country in Latin America was, "The (naming the citizens of that country) are super in red tape. The amount of paper work they require shows that they invented paper before Egyptians and Chinese."

It appears from Table 19 that the B.C. firms were not very much concerned about political uncertainties such as war with another country, civil war, military coups, expropriation, and change in government. The most probable reason for this lack of concern was that 63 out of 89 decisions of B.C. firms were in developed countries. The remaining 26 decisions in developing countries were made in countries enjoying relative political stability.

3. The Relation between the Extent of Negotiations and Amount of Uncertainty

The purpose of negotiations, as stated earlier, is to reduce uncertainty. To measure the relationship between the extent of negotiations and the amount of uncertainty, the following hypothesis was formulated:

$H_4$: There exists a positive relationship between the extent of negotiations and amount of uncertainty.

The results of canonical correlation analysis are given in the following table:
Table 20. The Relation Between Extent of Negotiations and Amount of Uncertainty.

<table>
<thead>
<tr>
<th>Eigenvalue</th>
<th>Canonical Correlation Coefficient ((R_c))</th>
<th>Wilk's Lambda</th>
<th>Chi-square</th>
<th>Degrees of Freedom</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.827</td>
<td>0.909</td>
<td>0.008</td>
<td>372.34</td>
<td>112</td>
<td>0.000</td>
</tr>
</tbody>
</table>

The null hypothesis \((H_0)\) stated that \(R_c = 0\) and the alternative hypothesis \((H_1)\) said that \(R_c > 0\). The null hypothesis \((H_0)\) cannot be accepted because \(R_c > 0\). As \(R_c > 0\), the null hypothesis \((H_0)\) is rejected and the alternative hypothesis \((H_1)\) is accepted.

The acceptance of the alternative hypothesis \((H_1)\) was also supported by the eigenvalue and the extremely low values of Wilk's lambda. The chi-square in Table 20 is very high. The level of significance in the above table is much lower than the .05 level of significance considered acceptable for this research.

Hypothesis No. 5

E. Relation between Positive and Negative Decisions in Terms of Initiating Forces, Investigation, Commitments, Negotiations, and Uncertainty

So far, the five sets of variables, namely, initiating forces, investigation, commitments, negotiations, and uncertainty were either compared with subsets in the same group of variables, for example, endogenous initiating forces were compared with exogenous initiating forces, or two sets of variables were compared with each other for strength of relationship.

The purpose of analysis in this section was to compare the strength of the five sets of variables for positive direct investment decisions with
the negative decisions. For this comparison, the following hypothesis was formulated:

\( H_5 \) In cases where the decision has been made to invest abroad, there will be stronger initiating forces, more investigation, greater degree of commitments, greater extent of negotiations, and lower amount of uncertainty than in those cases where the decision has been made not to invest abroad.

To test the above hypothesis, five t-tests were used on the five sets of variables. The results of the t-tests are summarized in Table 21.


<table>
<thead>
<tr>
<th>Variable Sets</th>
<th>Type of Decisions</th>
<th>No. of Cases</th>
<th>Mean</th>
<th>Standard Deviations</th>
<th>t-value</th>
<th>One-tail Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initiating Forces</td>
<td>Yes decisions</td>
<td>72</td>
<td>7.58</td>
<td>2.555</td>
<td>-1.40</td>
<td>0.083</td>
</tr>
<tr>
<td></td>
<td>No decisions</td>
<td>17</td>
<td>8.53</td>
<td>2.294</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investigation</td>
<td>Yes decisions</td>
<td>72</td>
<td>20.14</td>
<td>5.989</td>
<td>1.98</td>
<td>0.025</td>
</tr>
<tr>
<td></td>
<td>No decisions</td>
<td>17</td>
<td>16.94</td>
<td>5.932</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commitments</td>
<td>Yes decisions</td>
<td>72</td>
<td>4.14</td>
<td>1.427</td>
<td>2.50</td>
<td>0.007</td>
</tr>
<tr>
<td></td>
<td>No decisions</td>
<td>17</td>
<td>3.24</td>
<td>0.664</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Negotiations</td>
<td>Yes decisions</td>
<td>72</td>
<td>8.97</td>
<td>4.335</td>
<td>0.13</td>
<td>0.448</td>
</tr>
<tr>
<td></td>
<td>No decisions</td>
<td>17</td>
<td>8.82</td>
<td>3.486</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uncertainty</td>
<td>Yes decisions</td>
<td>72</td>
<td>25.68</td>
<td>6.867</td>
<td>4.72</td>
<td>0.0005</td>
</tr>
<tr>
<td></td>
<td>No decisions</td>
<td>17</td>
<td>36.94</td>
<td>14.686</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
1. Initiating Forces

To compare the strength of positive decisions against the negative decisions in terms of the set of initiating forces, the null hypothesis \( H_0 \) stated that \( U_1 = U_2 \) and the alternative hypothesis \( H_1 \) was that \( U_1 > U_2 \). The chosen level of alpha remained unchanged at .05. As shown in Table 21, \( U_1 \neq U_2 \) and \( U_1 < U_2 \), therefore, on the basis of strength of the means of positive and negative decisions both the hypotheses should be rejected. Unfortunately, the null hypothesis cannot be rejected because the one-tail probability is .083, which is larger than .05, the level of alpha considered necessary for this research.

The alternative hypothesis cannot be accepted because \( U_1 < U_2 \). This means that despite somewhat weaker initiating forces the decision to invest abroad may be positive. In other words, strong initiating forces do not necessarily guarantee a positive decision. This finding is not in agreement with Aharoni's emphasis on initiating forces. This may be due to the fact that Aharoni had not quantified his variables. Had he quantified the set of variables, which he called initiating forces, Aharoni might have ended up with the same results. Another probable explanation of slightly weaker initiating forces in cases of positive decisions and somewhat stronger initiating forces in cases of negative decisions may be the presence of intervening variables such as investigation, commitments, negotiations, and uncertainties. The initiating forces in cases of negative decisions may be somewhat stronger but if the results of investigation are not favourable, less commitments are created, negotiations are not successful, and uncertainties are higher, then the strong initiating forces may not produce positive direct investment decisions.
2. Investigation

If the initiating forces are sufficiently strong, they lead the decision makers in a firm to investigation. The set of investigation variables, as discussed before, consisted of seventeen variables relating to sources of information and type of information collected. The hypothesis that was being tested stated that in cases of positive decisions to invest abroad more investigation will be done than in cases of negative decisions.

The t-test performed on the set of seventeen investigation variables gave mean values of 20.14 and 16.94 for positive and negative decisions respectively. The null hypothesis ($H_0$) said that the mean of positive decisions ($U_3$) was equal to the mean of negative decisions ($U_4$), or symbolically stated, $H_0: U_3 = U_4$. The alternative hypothesis ($H_1$) stated that the mean of positive decisions ($U_3$) is greater than the mean of negative decisions ($U_4$), or $H_1: U_3 > U_4$.

The null hypothesis ($H_0: U_3 = U_4$) can be easily rejected because $U_3$ (20.14) is not equal to $U_4$ (16.94). The alternative hypothesis ($U_3 > U_4$) is very much acceptable because $U_3$ (20.14) is considerably larger than $U_4$ (16.94). The one-tail probability .025 in Table 21 for the set of investigation variables is smaller than .05, which is the level of alpha considered necessary for this research.

The acceptance of the alternative hypothesis ($H_1: U_3 > U_4$) supports Aharoni's contention that in the case of positive foreign direct investment decisions the level and effects of investigation are stronger than in the cases of negative decisions.
3. Commitments

The set of commitment variables consisted of four variables, namely, creation of an international division, the desire to stabilize demand, the desire to stabilize profit, and the desire to retain an export market. The hypothesis to be tested stated that there will be greater degree of commitment in those cases where the decision has been made to invest abroad.

The null hypothesis \( H_0 \) stated that the mean of those cases where a decision was made to invest abroad \( (U_5) \) was equal to the mean of those cases where the decision was not to invest abroad \( (U_6) \). The alternative hypothesis \( H_1 \) said that the mean of positive decisions \( (U_5) \) will be stronger than the mean of negative decisions \( (U_6) \). The results of the t-test in Table 21 show that the mean of positive decisions \( (U_5) \) was 4.14 and the mean of negative decisions \( (U_6) \) was 3.24. The null hypothesis \( H_0 \) was rejected because the mean of positive decisions \( (U_5 = 4.14) \) was not equal to the mean of negative decisions \( (U_6 = 3.24) \). The alternative hypothesis was accepted because the mean of positive decisions \( (U_5 = 4.14) \) was greater than the mean of negative decisions \( (U_6 = 3.24) \) or symbolically, \( H_1: U_5 > U_6 \). The one-tail probability in Table 21 for commitments was .007, which was smaller than the .05 level of alpha considered acceptable for this research.

The acceptance of this alternative hypothesis supports Aharoni's contention that commitments are stronger in those cases where the decision was made to invest.

4. Negotiations

The main concern in this section was about the set of negotiation variables concerning the issues on which negotiations took place between
the prospective direct investor and the government, the banks, and the potential partners in the host country. The hypothesis stated that in cases where the decision has been made to invest abroad, there will be a greater extent of negotiations than in those cases where the decision has been made not to invest abroad.

The null hypothesis (H₀) said that the mean of the extent of negotiations for positive decisions (U₇) will be equal to the mean of the extent of negotiations for negative decisions (U₈) or in symbolic terms

\[ H₀: U₇ = U₈ \]

The alternative hypothesis (H₁) stated that the mean of the extent of negotiations of positive decisions (U₇) will be greater than the mean of the extent of negotiations of negative decisions (U₈). In symbolic terms this is represented as

\[ H₁: U₇ > U₈ \]

The results of the t-test, as given in Table 21 show that the mean of the extent of negotiations for positive decisions (U₇) was 8.97 and the mean of the extent of negotiations for negative decisions (U₈) was 8.82. If the hypothesis is tested simply on the basis of the strength of the means of positive and negative decisions, the null hypothesis (H₀: U₇ = U₈) can be rejected because the mean of extent of negotiations for positive decisions (U₇ = 8.97) was not equal to the mean of the extent of negotiations for negative decisions (U₈ = 8.82).

The problem in testing a hypothesis is that the two-tail or one-tail probability in a t-test must meet the requirement of the level of significance considered necessary for that research. The one-tail probability for the set of negotiation variables in Table 21 was .448, which was larger than the .05 level of alpha considered acceptable for this research. This conclusion cannot be compared with Aharoni's findings.
because he had not quantified his research. Moreover, he did not treat negotiation with banks and potential partners as a process. In the present research, as shown in Tables 17 and 18, negotiations with host country banks and potential partners were treated as a process.

5. Uncertainty

The set of uncertainty variables consisted of sixteen variables as shown in Table 19. The hypothesis to be tested stated that there will be a lower amount of uncertainty in those cases where the decision was made to invest abroad than in those cases where the decision was not to invest abroad.

The null hypothesis (H₀) said that the mean of the set of uncertainty variables for positive decisions (U₉) will be equal to the mean of the set of uncertainty variables for negative decisions (U₁₀) or in symbolic terms H₀: U₉ = U₁₀. The alternative hypothesis (H₁) stated that the mean of the set of uncertainty variables for positive decisions (U₉) would be smaller than the mean of the set of uncertainty variables for negative decisions, or H₁: U₉ < U₁₀.

The results of the t-test, as given in Table 21 for the set of uncertainty variables, show the mean of the set of uncertainty variables for positive decisions (U₉) as 25.68 and the mean of the set of uncertainty variables for negative decisions (U₁₀) as 36.94 and the null hypothesis (H₀: U₉ = U₁₀) was therefore rejected. The rejection was also supported by the one-tail probability of .0005 given in Table 21 which was much smaller than the .05 level of alpha considered acceptable for the present study.
The alternative hypothesis \((H_1: U_9 < U_{10})\) was accepted because the mean of the set of uncertainty variables for positive decisions \((U_9 = 25.68)\) was smaller than the mean of the set of uncertainty variables for negative decisions \((U_{10} = 36.94)\) at our appropriate level of significance.

It appears, therefore, as emphasized by Aharoni, that one of the most important considerations before the management of a firm is the amount of uncertainty in a given situation. If the perceived uncertainties in the case of a foreign direct investment opportunity are very high, the investment decision is negative.

In hypothesis number five \((H_5)\) an effort was made to compare the relationship between positive and negative decisions in terms of initiating forces, investigation, commitments, negotiations, and uncertainty. The five t-tests performed on the above sets of variables showed that in cases where the decision was made to invest abroad, there was more investigation, greater degree of commitments, greater extent of negotiations, and lower amount of uncertainty than in those cases where the decision was made not to invest abroad.

Initiating forces were found to be slightly weaker in the case of positive decisions and somewhat stronger in the case of negative decisions. The slightly stronger initiating forces in the case of negative decisions were explained in terms of lack of quantification of the set of initiating forces by Aharoni and the presence of intervening variables such as investigation, commitments, negotiations, and uncertainty. In the light of above discussion it could be concluded that the results of the t-tests generally provided support to hypothesis number five.
VI. COMPARISON OF RESEARCH FINDINGS WITH OTHER STUDIES

In the previous chapter an attempt was made to test the five hypotheses relating to five sets of variables, namely, initiating forces, investigation, commitments, negotiations, and uncertainty. In this chapter an effort will be made to compare the findings in the present study with the findings of other studies.

A. Initiating Forces and Awareness of Foreign Direct Investment Opportunities

Some of the initiating forces found in the present study were similar to Aharoni's list while others were different. The following two tables compare Aharoni's initiating forces with those found in the present study:

Table 22. A Comparison of Aharoni's Exogenous Initiating Forces with the Present Study.

<table>
<thead>
<tr>
<th>Aharoni's Initiating Forces</th>
<th>Initiating Forces in the Present Study</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exogenous Initiating Forces</strong></td>
<td><strong>Exogenous Initiating Forces</strong></td>
</tr>
<tr>
<td>1. An outside proposal</td>
<td>1. An outside proposal</td>
</tr>
<tr>
<td>2. Fear of losing an export market</td>
<td>2. Fear of losing an export market</td>
</tr>
<tr>
<td>3. Successful direct investment operations of one's competitors abroad</td>
<td>3. Successful direct investment operations of one's competitors abroad</td>
</tr>
<tr>
<td>4. Strong competition from abroad in home market</td>
<td>4. Growing demand for the product in the host country</td>
</tr>
<tr>
<td>5. Saturation in the domestic market</td>
<td>5. High prices for the commodity</td>
</tr>
<tr>
<td></td>
<td>6. Unfavourable political environment in the home country</td>
</tr>
</tbody>
</table>
The comparison in Table 22 shows that in the set of exogenous variables the first three variables, an outside proposal, fear of losing an export market, and successful direct investment operations of one's competitors abroad, were common to Aharoni's list and the present study. The two other variables in Aharoni's list, namely, strong competition from abroad in the domestic market and saturation in the domestic market, were not mentioned by any respondent in this study as variables causing awareness of foreign direct investment opportunities.

The most probable reason for the difference in the two studies relating to strong competition in the domestic market was that the firms in the present sample were motivated more by endogenous forces, as will be discussed later. Also it appeared that the firms in the present study were aggressive enough not to wait till their competitors enter the domestic market and create an environment of strong competition. Most of the firms in this sample were leaders in their industries.

Saturation in the domestic market was not an initiating force in the present study for the simple reason that most of the firms preferred to look towards the south rather than waiting for saturation of the domestic market and then starting to look for markets abroad.

Three additional variables, growing demand for the product, high prices of commodities, and unfavourable political environment in the home country, were important in the present study as causes of awareness of foreign direct investment opportunities. Growing demand for the product as an exogenous initiating force is typical of firms that enter into foreign markets in stages. High prices of commodities was an important motivating

---

force because 80 percent of the decisions in the present study were related to resource-based firms. It appears that such firms are activated by increases in the prices of commodities. An unfavourable political environment in the home country reflects the concern of firms (particularly mining companies) regarding changes in attitudes and taxation laws in Canada in the early 1960s. These concerns of Canadian firms were also reflected in a recent report prepared for the U.S. Congress by Arthur D. Little Inc. on "The Reasons and Outlook for Foreign Direct Investment in the United States."

In this report emphasis was laid on unfavourable Canadian domestic environment (e.g. taxation and government regulations). Other important variables were small domestic markets and labour unrest in Canada. The report was based on an interview survey of Canadian executives involved in direct investment in the United States.³

Litvak and Maule also highlighted the role of unfavourable conditions in the domestic market "... firms undertake direct foreign investment so as to escape from unfavourable conditions in their domestic markets, such as saturation of the domestic market, taxation, anti-trust policy, and union militancy."⁴ The importance of an unfavourable domestic environment was also emphasized by Cottrel. He stated that one of the major reasons for London's success as a financial centre of the world was the unfavourable political environment in Western Europe. "Merchants and financiers were

---

driven out of Europe by the disruption of war, and were attracted to London, which offered political stability and profitable opportunities with the rapid growth of British overseas trade.  

Table 23. A Comparison of Aharoni's Endogenous Initiating Forces with the Present Study.

<table>
<thead>
<tr>
<th>Aharoni's Initiating Forces</th>
<th>Initiating Forces in Present Study</th>
</tr>
</thead>
<tbody>
<tr>
<td>Endogenous Initiating Forces*</td>
<td>Endogenous Initiating Forces</td>
</tr>
<tr>
<td>1. Keen interest of a high ranking executive in foreign direct investment</td>
<td>1. Keen interest of a high ranking executive in foreign direct investment</td>
</tr>
<tr>
<td>2. Capitalization of patents or technical know-how</td>
<td>2. Capitalization of patents or technical know-how</td>
</tr>
<tr>
<td>3. The desire to create a market for components abroad</td>
<td>3. The desire to internalize the source of supply</td>
</tr>
<tr>
<td>4. The desire to utilize abroad old machinery</td>
<td>4. The desire to internalize demand</td>
</tr>
<tr>
<td>5. The desire to spread R &amp; D and other fixed costs</td>
<td>5. Export experience in the host country</td>
</tr>
</tbody>
</table>

The two lists of endogenous variables shown in Table 23 indicate that the variables, keen interest of a high ranking executive in foreign direct investment and capitalization of patents or technical know-how, are common to Aharoni's list and the present study. The desire to create a market for components abroad, the desire to utilize old machinery abroad, and other fixed costs.

---


*Keen interest of an executive was the only variable listed by Aharoni as an endogenous variable. Other variables were termed by him as auxiliary forces, which were included in the present study in the list of endogenous variables because logically they belong to this group.*
and the desire to spread R and D and other fixed costs were not mentioned by any respondent as causing awareness of foreign direct investment opportunities. Most probably these initiating forces were not mentioned because of lack of innovative R and D in British Columbia.

Three other variables, the desire to internalize the source of supply, the desire to internalize demand, and export experience in the host country, were mentioned in the present study as causing awareness. Coase, Hymer, and Brown have emphasized internalization of operations by firms due to imperfections of markets. Kindleberger, while commenting on the internalization of operations by a firm, went to the extent of saying that "Even when there are no economic advantages in coordinating production at various stages, or of coordinating new investments at different levels of production to carry through innovation, companies may feel safer with assured access to sources of inputs and to outlets for products." A striking example of internalization of operations by acquisition given by Kindleberger was that of Alcan Aluminium Limited of Canada. This company purchased a half interest in the government owned Aardal og Sunndal Verk (A.S.V.) aluminum smelter in Norway to expand its aluminum capacity by about 20 percent and to eliminate a source of price competition that had

---


vexed the entire industry. Numerous cases (see Table 1) of internalizing supply and demand were found in the present study.

Other endogenous variables mentioned infrequently (less than three responses) by respondents in this survey were: partnership in a project, minimizing tariff and transportation costs, the desire for greater control in management, and the desire for diversification.

Tomlinson and Himmelsbach in a survey of foreign direct investment decisions of 52 European and 57 Canadian firms found the preference or experience of senior executives a very important determinant of foreign direct investment decisions. Sixty-one percent of Canadian respondents stressed that this was an important factor in foreign direct investment decisions. 10

According to Tomlinson and Himmelsbach "The most common preferences or experiences of the senior executives, who replied to this question, included specific knowledge of certain foreign markets, education and international travel. In some cases proficiency in the host country's language or ethnic origins accentuated these preferences and influenced the decision making to some extent. In other cases, especially in the mining and oil industries, such experiences consisted merely of the knowledge of certain geological formations." 11 This description matches almost exactly the variable, keen interest of an executive, as emphasized in the present study.

10 Ibid, p. 22.


Another variable, where the findings of Tomlinson and Himmelsbach and the present study were similar concerned patent or technical know-how. As can be seen in Table 23, in the group of endogenous variables, patents or technical know-how were the least significant. Tomlinson and Himmelsbach also reached the same conclusion. With regard to patents or technical know-how "the majority of executives stressed that their products were rather unsophisticated and were not originally invented or developed in Canada."\textsuperscript{13}

Table 23 shows that in the set of exogenous variables successful direct investment operations of one's competitors abroad was an insignificant variable. Only two respondents considered it critical and one thought it was very important. Contrary to this, Tomlinson and Himmelsbach found 59 percent of European executives attaching various degrees of importance and 52 percent Canadian respondents considering this variable important.

The most important reason for the difference in the two findings in this respect was that the two studies were based on different samples. The sample of Tomlinson and Himmelsbach contained 36 firms from Ontario, the most industrialized region in Canada, followed by 14 firms from Quebec, the second most important industrialized province. The manufacturing firms in those regions are more conscious of what their competitors are doing. Compared to this, the firms involved in foreign direct investment in British Columbia are highly specialized by product, they are resource-based, and most of them are leaders in their own industry. Hence the question of following others or the bandwagon effect does not arise.

\textsuperscript{13} Ibid, p. 40.
Knickerbocker, who was studying the tendency of following one's competitors in foreign direct investment, excluded resource-based firms because he found that "in no instance did two or more U.S. parent firms belonging to the same industry establish competing manufacturing subsidiaries in the same country in the same overseas industry."\(^{14}\)

When all the twenty-one variables in the Tomlinson-Himmelsbach survey were subjected to factor analysis by Tomlinson and Willie, the five components of the foreign investment decision identified were: market development, ready-made opportunity, corporate position, governmental incentives, and profitability.\(^{15}\) Market development (or market related variables, as called in the present study) supports the contention in this study that the small market in Canada in itself is an important motivating force for foreign direct investment. Ready-made opportunity (or an outside proposal as called in the present study) was also the most important exogenous variable in the present study (see Table 23). The background material collected on the firms in the present study supports what Tomlinson and Willie found under the heading "corporate position" in terms of a corporation's financial, oligopolistic or international status. (Please see Appendices A-E).

With regard to governmental incentives, the findings in the present study are in agreement with the findings of Tomlinson and Willie. The home country influence on foreign direct investment was minimal in both the

\(^{14}\) Frederick T. Knickerbocker, *Oligopolistic Reaction and Multinational Enterprise*, op.cit., p. 42.

studies as was the influence of political stability. The importance of profitability as a motive is also common in both the studies.

The conclusion of the relative strength of endogenous variables in the present study partly contradicts the hypothesis presented by Robinson. His hypothesis states that "The investment decisions of the MNCs are less likely to be stimulated by an internal market survey and more likely to be the result of external pressure on the firm." However, his hypothesis was not based on an empirical study and thus it was not tested. Despite this difference in emphasis on exogenous variables in Robinson's work, he agrees with the major finding in this study, that is, he agrees with the importance of the keen interest of an executive in foreign direct investment decisions. "Throughout the decision-making process personal interest on the part of key members of management is likely to play a larger role than in the domestic case precisely because of the greater number of imponderables in assessing a foreign market opportunity."

Basi in his study of the determinants of U.S. direct investment in foreign countries collected data from 160 American foreign investors. He found such exogenous variables as potential size of the market, political stability, and favourable host government attitudes important determinants of the decision to invest abroad. Basi used a mail questionnaire which requested the executives to rate the importance of fifteen investment determinants along a three point scale. As all the fifteen variables were exogenous the question of endogenous variables did not arise.

---

17 Ibid, p. 22.
Daniels, who collected data on the foreign direct investment decisions of business firms investing in the United States, found a combination of exogenous variables (such as host country government pressure to produce locally and natural advantages of local production) and endogenous variables (such as the desire for diversification) to be important. He did not however, compare the strength of exogenous and endogenous variables. While adding to the body of knowledge concerning the foreign investment decision process therefore, the work of neither Basi nor Daniels provides a realistic ranking of the importance of internal versus external determinants. They do not therefore, weaken the present findings concerning the primacy of endogenous variables but add further recognition of their importance.

B. Sequential Investigation and Subjectively Estimated Cost of Investigation

The cost of search makes it necessary to investigate foreign direct investment opportunities in a sequence. The responses of the executives in the present study, as shown in Table 9, confirmed this sequential process and were in turn also supported by the findings of Margolis. "Important decision problems are broken down into a sequence of lesser component decisions. Only the most pressing of these component decisions are made immediately. Others in the sequence are treated only as necessary, in the light of the latest available information." 


Simon applied marginal analysis to the cost of information. "There is one way in which the formation of expectations may be reincorporated in the body of economic theory; by treating information gathering as one of the processes of production, so to speak, and applying to it the usual rules of marginal analysis. Information, says price theory, should be gathered up to the point where the incremental cost of additional information is equal to the incremental profit that can be earned by having it."\(^{21}\)

According to the findings of the present study, as shown in Table 9, 14 types of investigation patterns were found as compared to only one pattern discussed by Aharoni. Table 9 shows further that only 37 out of 89 decisions followed the sequence mentioned by Aharoni. This means that his sequential investigation generalization was valid only in the case of the first foreign direct investment decision in a country with which the firm had no previous contact. It seems therefore that he was describing the investigation process for the first direct investment decision in a country. Aharoni was perhaps assuming that the firm had little or no previous knowledge of the potential host country at the time of this first decision. If he had included export experience, proposals, information from government, experience with suppliers, information from friends and partnership with the potential investors in a project, he might have reached the same conclusions as the ones found in this study.

The findings of H\(_2\) in the present study are also supported by the analysis of Helliwell. "... the preparation and analysis of investment proposals itself is a costly undertaking. Since the collection and analysis of information requires some of the same management skills required for

successful current operations, there may be a high shadow price attached to
the use of scarce management skills (including the efforts of architects, en-
gineers etc.) in the collection and analysis of information for decisions.\textsuperscript{22}

C. Relationship between Intensity of Investigation and Degree of
Commitments

The findings in $H_3$ in the present study related to investigation vari­
ables which consisted of sources of information and type of information and
commitments created during investigation. The creation of commitments during
investigation, as found in the present study, is similar to the situation
described by March and Simon. According to them "the process of commitment
is generally sequential. An initial commitment is a commitment primarily
to undertake search activity. The outcome of initial search becomes itself
a major determinant of how rapidly and with what resources the activity will
continue to be pursued."\textsuperscript{23} Selznick also places greater stress on the crea­
tion of commitments during investigation. His emphasis on the role of
leadership (keen interest of a high ranking executive in the present study)
also compares well with the findings in the present study.\textsuperscript{24}

The validity of the market related variables described in Table 13
is supported by the findings of Kobrin, who investigated the relationship
between the flow of foreign direct investment from the United States and
various aspects of economic, political, and socio-cultural environments.
He reached the conclusion that "Market related variables appear to be the

\textsuperscript{22} John F. Helliwell, Public Policies and Private Investment (Oxford:

\textsuperscript{23} James G. March and Herbert A. Simon, Organizations, op.cit., p. 186.

\textsuperscript{24} P. Selznick, Leadership in Administration (New York: Harper and Row,
1957).
overriding factor in the allocation of manufacturing foreign direct investment.  

The results of Table 12 are comparable with the work of Tomlinson and Himmelsbach. According to their findings, in the Canadian sample 24 percent of the respondents attached various degrees of importance to a proposal as compared with 34 percent in the present study. The experiences of executives as a source of information was used by 30 percent of the respondents in the Tomlinson-Himmelsbach survey. In the present study the export experiences of executives accounted for 28 percent of the responses.

In the Tomlinson-Himmelsbach study only 2 percent of the respondents used Canadian Government departments as a source of information. The number of respondents using government sources in the present study was less than 2 percent. The president of a company, who had used one of the government agencies as a source of information, spoke very bitterly about his experience. "We stay away from government as far as possible, using it as a last resort. Once we used the facilities of X (a Canadian government agency) for Y (a country in Latin America). The results were extremely disappointing."


D. Relation between Extent of Negotiations and Amount of Uncertainty.

In $H_4$, an effort was made to define a relationship between negotiation variables, which consisted of negotiations with host country governments, banks, and local partners (if it was going to be a joint venture) and sixteen uncertainty variables.

The purpose of negotiations, according to Aharoni, is to reduce the amount of uncertainty perceived by the management of a firm in the case of foreign direct investment opportunities. Similar views were expressed by Radford, "To reduce uncertainty, many organizations endeavour to negotiate an environment in which they can operate."$^{27}$ Cyert and March also concluded that firms strive to avoid uncertainty by trying to create negotiated and controllable environments.$^{28}$

Kapoor emphasized the growing importance of negotiations with host country governments for the simple reason that the governments of many developing countries are playing a growing role as regulators and participants in the economic affairs of their countries, resulting in greater interaction between MNCs and host governments.$^{29}$

The southern states of the United States are attracting direct investment on a large scale from the North including Canada. "It appears that the richly-endowed South of the U.S. exerts a magic appeal to


investors and corporations from both areas within its borders and foreigners ... The incentives the South offers attract the capital which not only helps reduce the historically-high unemployment, but allows these states to acquire sufficient technology to make them economically independent of the North.

"Among incentives offered are such powerful arguments in favor as: low wages, a large pool of easily trainable workers, low corporate taxes, taxation holidays, good transportation, communications, and industrial revenue bond financing (up to $5 million) with low interest rates."  

Another success story in attracting considerable direct investment is that of New Hampshire in the United States. According to Lawrence D. Maloney, associate editor of the U.S. News and World Report, the State is virtually being flooded by companies ranging in size from small operations employing a handful of people to Digital Equipment Corporation, which is building two huge facilities that will employ some 3,100 workers. Executives cite these reasons for the State's appeal to business: low taxes (no sales and state income tax), skilled labor at reasonable prices and a fiscally conservative government that has put out the welcome mat.


Green, who did empirical work on political instability as a determinant of U.S. foreign investment, found that negotiations with foreign governments were increasing in importance because "Political phenomena exert a major influence on the overseas operations of U.S. firms. The magnitude of that influence is explained partly by the direct control that the governments of most foreign firms exert over their economic system, a much greater degree of control than that exerted by the U.S. government over the economy of the United States." 32

The issues found significant in the present study in negotiations with governments were remittance of dividends, 33 repatriation of capital, applicable rates of taxation, environment or pollution control, and special depreciation or depletion allowances. These are similar to the findings of Behrman who prepared a detailed list of criteria used by governments in Latin American countries to evaluate foreign direct investment from official proclamations and views expressed in several countries. 34

32 Robert T. Green, Political Instability as a Determinant of U.S. Foreign Investment (Austin, Texas: Bureau of Business Research, Graduate School of Business, The University of Texas, 1972), p. 3.


"Decision 24" was a ruling adopted by the Andean Pact nations restricting remittances of profit by foreign companies to 14 percent of registered capital. According to an amendment, the limit was raised to 20 percent of the registered capital.


Tomlinson and Himmelsbach (1973) in their study of foreign trade and investment decisions of Canadian firms also mentioned repatriation of dividends and repatriation of capital as important issues in negotiations with host country governments.

The concern of the U.S. government over pollution is well known. The Japanese government is also becoming increasingly concerned about pollution. It has made it mandatory for industry to invest in the prevention of pollution of air and water.35

Potential investors also negotiate with banks in the host country for loans to minimize risks. The findings in the present study showed that in 72 percent of these decisions the firms in the sample established a credit line with banks in the host country. This compares well with the findings of Aharoni. In his research, Aharoni found that all the companies interviewed held equity commitments down and used higher debt to equity ratios in their foreign direct investments than they did at home.36

None of the companies in his sample felt that the higher debt ratios increased the risk of loss or jeopardized the operations of the company. Local borrowing was also conceived as a hedge against potential exchange losses.

Aharoni had not discussed negotiations with banks as a process. He had simply mentioned the final act of establishing a credit line. It


36 See also Robert W. Korthals, "Project Financing and How It Affects Credit Ratings," Address Presented to the Bar Association Seminar on Corporate and Commercial Financing, February 25–26, 1975, Toronto. Korthals is the Vice President of the Toronto Dominion Bank.
was realized that as this research was treating foreign direct investment
decisions as a process, negotiations with banks should also be treated as
a process. The home country banks were not discussed because most of the
firms preferred to borrow in the host country to minimize currency risks.

Negotiations with partners is another way of minimizing uncertainty
and reducing risks of investing in a foreign country. Root suggested that
in a highly volatile political situation, a licensing or a joint-ownership
arrangement should probably be considered, since either would decrease the
amount of assets the firm risks. Furthermore, the existence of a local
partner would reduce the potential of hostility toward the enterprise and
provide possible communication with current and future governments. 37

In the set of uncertainty variables in the present study those
found to be significant were demand for the product, inflation, local
competition, corruption, devaluation, government intervention, availability
of product (minerals), red tape, labour unrest, nationalization, cultural
differences, change in government through democratic process, expropriation,
military coup, civil war, and war with another country. These were called
uncertainty variables because each case from the firm's point of view was
unique and full of unknowns, as Knickerbocker has said, "each new market
represented something of terra incognita." 38 This fits into the definition
of uncertainty given by March and Simon. "Uncertainty is a situation

37 Franklin R. Root, "Toward an Enterprise Theory of International Mar-
ketig," Unpublished paper, University of Pennsylvania, Wharton School
of Finance and Commerce, Department of Marketing, p. 13.

38 Frederick T. Knickerbocker, Oligopolistic Reaction and Multinational
Enterprise, op.cit., p. 22.
where the individual does not know the probability distributions connecting behavior choices and environmental choices."  

The importance of lack of demand for the product was also emphasized by Root. Lamont analyzed the decisions of U.S. firms that had succeeded or failed in the South of Italy. He found that an overwhelming number of American firms, which had started operations there because of special Italian government benefits granted to them had, in general, overvalued special government benefits and improperly evaluated local demand and distribution factors.

The lack of concern for political uncertainties was also emphasized by Tomlinson and Himmelsbach in their study of foreign direct investment decisions of Canadian firms. Only 30 percent of the respondents attached various degrees of importance to political risk in their survey. The usual comments made by respondents were: "We can't do anything about political risks anyway, so we neglect this aspect entirely." "The only country where we were ever expropriated is Canada, so why should we worry about risks in foreign countries."

Another explanation of lack of concern for political risks is provided by Robock. "Political activities which do not significantly alter

---


the business environment do not represent political risks.\(^{43}\) Kobrin's findings support Robock. "... the data and empirical findings are consistent with the conclusion that only the market matters. Factors, such as violent political protests, governmental instability, rebellion, and subversion do not appear to directly influence the FDI decision process."\(^{44}\)

The findings of Bauer, Poole, and Dexter also suggest that political instability receives only a superficial evaluation.\(^{45}\) Zink suggests to the headquarters management not to be concerned unnecessarily even about developing countries. According to him the headquarters management of some of the companies interviewed were reacting too strongly to short-range political conditions in their frequent unwillingness to make new investments or to explore possible modes of accommodation because this was causing them to bypass potentially profitable opportunities.\(^{46}\)

The lack of concern of Canadians with expropriation in foreign countries is based on their experience. Though in the case of U.S. firms there were numerous cases of expropriation, no purely Canadian firm has so far gone through this bitter experience.\(^{47}\)


\(^{44}\) Stephen J. Kobrin, The Environmental Determinants of Foreign Direct Investment: An Ex Post Empirical Analysis, op.cit., p. 22.


E. The Comparison of Positive and Negative Decisions

The $H_5$ was concerned with the comparison of positive and negative decisions in terms of strength of initiating forces, extent of investigation, degree of commitments, extent of negotiations and amount of uncertainty.

The findings in the case of initiating forces was not in agreement with the findings of Aharoni. The finding in the present study was that initiating forces can be fairly strong even in the case of negative decisions. This may be due to the fact that Aharoni had not quantified his variables. Had he quantified the set of initiating forces, he might have ended up with the same result. Another probable explanation of slightly weaker initiating forces in the case of some positive decisions and slightly stronger initiating forces in the case of some negative decisions may be due to the presence of intervening variables. The initiating forces in the case of negative decisions may be somewhat stronger but if the results of investigation are not favourable, less commitments are created, negotiations are not successful, and uncertainties are higher, then the strong initiating forces may not produce positive investment decisions.

The results concerning extent of investigation were consistent with Aharoni's findings that in the case of positive decisions more investigation will be carried out, while less investigation will be done for negative decisions. The findings that there were greater commitments in the case of positive decisions and less commitments are developed when the result is a decision also confirmed Aharoni's analysis.

The last part of $H_5$ related to the set of uncertainty variables. The finding in the present study with regard to the set of uncertainty variables was in conformity with the findings of Cyert and March:
"Organizations avoid uncertainty by avoiding situations in which future actions depend on uncertain future events."\textsuperscript{48}

VII. CONCLUSIONS, SUMMARY, IMPLICATIONS, AND AREAS FOR FUTURE RESEARCH

A. Conclusions

1. Contribution of the Present Study

Despite the growing importance of direct investment by Canadians in other countries little attention has been paid so far to its study.* One obvious reason for this apparent lack of interest is the size of foreign direct investment in Canada and the increasing concern of Canadians about the controversies surrounding it. Most of the work done by Safarian,¹ Reuber,² Levitt,³ Beige⁴ and others was related to foreign direct investment in Canada.

This work is one of the few empirical studies on direct investment made by Canadians in foreign countries. In British Columbia this is the first study of its kind and can be called a pioneering work.

* One of the earliest work having references about direct investment by Canadians in the United States was done by Herbert Marshall, Frank A. Southard, Jr., and Kenneth W. Taylor, Canadian-American Industry: A Study in International Investment (New Haven, Conn.: Yale University Press, 1936).


The present study made several elaborations upon the work done by Aharoni. The first improvement was in ordinal level quantification of the variables and the use of statistical techniques to test the hypotheses. Aharoni himself was aware of this weakness in his research when he wrote "Another criticism (of my work) may be that the suggested variables are unmeasurable, and therefore my basic framework is not fully substantiated. I certainly must agree that no way to measure the variables mentioned has been suggested, and that any research based on case studies may be attacked as not well substantiated."\(^5\) The quantification of variables in the present study helped in substantiating the research findings.

The second contribution of this research was the ranking of all those variables which were mentioned by Aharoni and also those which were found to be relevant in the present study. This added to the refinement of the research findings and enhanced confidence in interpretation. All variables in the sets of initiating forces, investigation, commitments, negotiations, and uncertainty were ranked in the present study according to their relative explanatory strength.

The third important improvement in the present study over Aharoni's work was the addition of a number of new variables not mentioned by Aharoni. In the set of initiating forces, growing demand for the product in the host country, high prices for the commodity, unfavourable political environment in the home country, the desire to internalize the source of supply, the desire to internalize demand, and export experience in the host country were some of the important variables added to the list of initiating forces.

Similar additions were made in the pattern of investigation. As mentioned before, Aharoni had emphasized only one pattern, but thirteen other investigation patterns were added during the present study. Aharoni had discussed some of them in very broad terms. The uncertainty variables, discussed in a general manner by Aharoni, were clearly listed and ranked. Perhaps the most important addition was in the area of commitment variables. Aharoni had mentioned creation of an international division, desirability of retaining an export market, and some social commitments such as concern about company image once investigation started. Two important additions in this area were a firm's commitments to stabilize demand and profit.

2. Areas of Differences

In two respects the present study is different from Aharoni's findings. The first area of difference is the lack of emphasis upon profit motivation in Aharoni's research. In this study the respondents repeatedly emphasized that profit was an important consideration in foreign direct investment decisions. The most important reflection of profit as an important consideration in foreign direct investment decisions could be seen in the area of commitments, where stabilizing profit and demand were explicitly mentioned by respondents as commitments. An extreme comment made by the president of the subsidiary of one big company in Vancouver was that "Any talk of minimizing the importance of profit is nonsense, such talk can be afforded at universities only and reflects the desire on the part of such persons to gain cheap popularity and attention by saying something which is radically different from the traditional and accepted practices." The vice president
of another firm three times repeated that there was absolutely no truth in
theories which spoke of something other than profit.

The emphasis on profit as an important consideration in the foreign
direct investment decisions does not however, appear to be profit maximiza­
tion, as this term was explained by March and Simon (1963). There was no
evidence in the present study that the firms tried to investigate all the
alternatives. The perceived cost of search is so high that none of these
firms ever conducted a fully comprehensive search. For example, as stated
by the vice president of one firm, the cost of preliminary investigation for
oil exploration on a small scale costs from 1.5 to 18 million dollars.
Over twenty years ago C. Shannon demonstrated the physical limitations of
alternative evaluations, by calculating that a machine capable of evaluating
each path in a millionth of a second would take 1095 years to examine all
the paths in a chess game to decide on the first move. 6

With respect to the emphasis on profit as an important consideration
in the foreign direct investment decisions, this research is supported by
the numerous empirical studies listed by Stevens. 7 Some of the important
studies in this list emphasizing profit were done by Berlin, 8 Billsborrow, 9

1950), pp. 48-51.

7 Guy V. Stevens, "Determinants of Investment," in John H. Dunning, ed.,
Economic Analysis and the Multinational Enterprise (London: George Allen

Department of Commerce, Office of Foreign Direct Investments, 1971).

9 R. E. Billsborrow, The Determinants of Fixed Investment by Manufacturing
Corporations in Colombia, Unpublished Doctoral Thesis, Michigan University,
1968.
Horst, Knickerbocker, Kopits, Reuber, and Richardson. Kindleberger goes to the extent of saying that "In addition to earning more abroad than at home, the investing firm must be able to earn a higher return in the market where it is investing than local firms earn (because) there are costs of operating at a distance, cost not only of travel, communication, and time lost in communicating information and decisions, but also costs of misunderstanding that leads to errors."

Kindleberger's remarks clearly imply an element of profit maximization in the foreign direct investment decisions. The behaviour of the firms in the present study in respect to the importance attached to profit approximates the behaviour of firms studied by Stobaugh. "Rather than taking bold leaps forward into new situations that promised high returns, the managers in our firms took small steps that represented a low-risk route in the
normal course of their firms' evolution. They resembled more Caspar Milquetoast than Sir Francis Drake.16

The second important area of difference between the present study and Aharoni's findings is in the passive role he assigned to firms in responding to foreign direct investment opportunities before the creation of an international division or before recognition of foreign direct investment as a legitimate problem area. His hypothetical Mr. John Smith, Executive Vice President of ABC Manufacturing Corporation, while commuting from his home, learns from the financial pages of the New York Times that the government of Zambia has offered a number of incentives to attract foreign capital. According to Aharoni, Mr. Smith will in all likelihood do nothing unless his company happens to be already very active abroad, including Africa.

The present study showed that firms are not only receivers of information in the form of proposals, news clippings etc., but they are also seekers of information. In other words, firms are constantly in search of opportunities. The real (unlike the hypothetical Mr. Smith) president of a medium size mining company in British Columbia was seen underlining a news item on the financial pages of a local newspaper about the discovery of gold in a Central American country. The president told the writer of this report, who had gone to interview him at 9:00 a.m., about the news item and said that he was going to investigate the possibility of a joint venture for the exploitation of the gold deposit. The company was not very active

16 Robert B. Stobaugh, Nine Investments Abroad and Their Impact at Home: Case Studies on Multinational Enterprise and the U.S. Economy (Boston: Division of Research, Graduate School of Business Administration, Harvard University, 1976), p. 187.
The president of another small mining company went to Australia after reading an article about the mining boom in that country.

The two examples quoted above show that even a news item may play the role of an initiating force. The very fact that executives read the financial pages of the local newspapers demonstrate that they seek information. The mining companies and other resource-based firms are often activated by the news of discoveries of resources. These comments in no way imply that a firm will necessarily pursue each and every lead, merely that it is in fact constantly scanning the environment for attractive opportunities.

3. The Validity of the Behavioural Model

The basic premise in Aharoni's behavioural theory was that foreign direct investment decisions may best be explained in terms of complex organizational behaviour rather than as a rational economic review of alternatives. The findings of the present study are generally in agreement with Aharoni's conclusion. Foreign direct investment decisions are initiated by a number of exogenous and endogenous forces. Investigation is sequential, though there are many patterns of investigation, negotiations are conducted to minimize uncertainties and decisions are taken after the final assessment of uncertainties.

The complexities of organizational behaviour are manifested in the variety of initiating forces, investigation, creation of commitments, negotiations and perception of uncertainties. Although the search for profit was shown in the present study to play an important motivational role in the foreign direct investment decision process, it is only one of the considerations involved. The keen interest of a high ranking
executive, the desire to internalize the source of supply and demand, the political environment in the home country etc. all play an important role in focussing a firm's attention upon foreign direct investment opportunities and in influencing its decisions.

It appeared that the high ranking executive(s) of firms in the present sample exercised greater influence over the decision process than the situation described by March and Simon. According to them the behaviour of the firm is the product of the interaction of several groups, so rather than being predictable from profit or growth considerations alone, behaviour is an uncertain and shifting compromise among the several interest groups. The high ranking executives of the firms in the present study appeared to dominate the decision process. In this particular aspect the findings of the present study appeared to be closer to Selznick (1957) who emphasized the role of leadership in the decision-making process.

The behavioural model, as discussed in the present study and by Aharoni, was also validated by an interesting study of eight foreign direct divestment decisions by U.S. multinational firms, though unfortunately this study was also entirely based on case studies. After the case studies, Torneden concluded that "In general this study supports Yair Aharoni's contention that classical economic theory is not particularly helpful in understanding organizational decision-making. Organizational and personal characteristics are more important in investment and divestment decisions than is the objective application of concepts that attempt to maximize corporate profits." 17

Helliwell's study also provides support to the behavioural model. As his study progressed "it became obvious that we could not rely on a theoretical framework based merely on the explicit capital budgeting rules used by the firms."18

B. Summary of the Study

1. The Research Model

The purpose of this study was to find out how the Canadian firms, which have their head offices in British Columbia, make their foreign direct investment decisions. The research model consisted of six stages because the foreign direct investment decisions were being studied as a process. The six sets of variables, corresponding to each stage, were initiating forces, investigation, commitments, negotiations, uncertainty and final decision.

In the first stage a business firm becomes aware of foreign direct investment opportunities through exogenous and/or endogenous initiating forces. If the initiating forces are strong, the firm enters into the second stage of investigation, which in itself is internally sequential. The third stage is that of commitment created during investigation. In the fourth stage favourable investigation and strong commitments lead the firm to negotiations with host country government, banks and local partners (if the operation is going to be a joint venture). After investigation, creation of commitments, and negotiations the firm enters into the fifth stage of final assessment of uncertainties. The sixth stage is that of final decision.

---

As the research model depicts a process, it is difficult to draw a clear-cut line of demarcation to separate each stage, therefore, they should be seen more as approximations rather than as finally defined isolated stages.

2. The Hypotheses

To test the research model five hypotheses were developed. The first hypothesis corresponding to stage one of the model contended that endogenous initiating forces are more important in creating awareness of foreign direct investment opportunities than exogenous initiating forces.

The second hypothesis relating to stage two claimed that those who conduct a sequential investigation will judge the subjectively estimated cost of that investigation to be significantly higher than those who do not conduct a sequential investigation.

The third hypothesis concerning stage three stated that the extent of investigation and degree of commitments are positively related. The fourth hypothesis relating to negotiations in stage four and uncertainty in stage five said that there exists a positive relationship between the extent of negotiations and amount of uncertainty.

The fifth and last hypothesis corresponding to stage six of the research model claimed that in those cases where the decision has been made to invest abroad, there will be strong initiating forces, more investigation, greater degree of commitments, greater extent of negotiations, and smaller amount of uncertainty than in those cases where the decision has been made not to invest abroad.
3. The Sample and Methodology

To test the hypotheses data were collected through interviews from the executives of 16 firms using a structured questionnaire. The unit of study was the individual foreign direct investment decision as made by these firms. The total number of decisions on which data were collected was 89, out of which 44 decisions related to mining, 17 decisions were concerned with forestry, 10 decisions pertained to marine resources, and the remaining 18 decisions were in manufacturing. In terms of host countries, 63 decisions related to developed countries and 26 decisions to developing countries.

4. The Research Findings*

The data supported the first hypothesis that the endogenous initiating forces were more important in creating awareness of foreign direct investment opportunities than exogenous initiating forces. The means of endogenous and exogenous initiating forces according to the t-test were .81 and .62 respectively.

In the set of endogenous initiating forces the variables causing awareness of foreign direct investment opportunities in order of importance were: keen interest of a high ranking executive, the desire to internalize the source of supply, the desire to internalize demand, export experience in the host country, and capitalization of technical know-how.

The exogenous initiating forces found in the present study in order of their significance were: a credible outside proposal, growing demand

*The level of significance was set at .05. The hypotheses H₁, H₂, and H₃ were tested by using t-tests. Canonical correlation analysis was used to test H₃ and H₄.
for the product, high prices for the commodities, unfavourable political
environment in the home country, fear of losing an export market, and
successful direct investment operations of one's competitors abroad.

The second hypothesis said that those who conduct sequential
investigation will judge the subjectively estimated cost of that inves­
tigation to be significantly higher than those who do not conduct such
an investigation was also supported by the t-test \( U_1 \ 2.82 \) for those who
conducted sequential investigation and \( U_2 \ 2.19 \) for those who did not con­
duct sequential investigation). During data collection thirteen other
patterns of investigation were found to be valid as compared to the one
(library research, field investigation, and report) emphasized by Aharoni.
It was found that the pattern of investigation mentioned by Aharoni was
valid only in 37 decisions while in the remaining 52 decisions the first
stage of library research was skipped by all firms because considerable
information was internal to the firm. In other cases the second stage of
field investigation was not followed for the same reason.

The results of canonical correlation analysis \( R_c = .705, \) eigen-
value = .497, Wilk's lambda = .281 and chi-square = 98.973) also supported
the third hypothesis which contended that the intensity of investigation
and degree of commitment are positively related. In the set of investiga­
tion variables such sources of information as published materials, an
outside consultant, a credible proposal from outside, export experience
in the host country, internal sales records, capital cost calculations,
cost of acquisition, and information from host government were found
important. The market related investigation variables found important
in the present study were: market size, price behaviour, information
about partners in a host country, competition, consumer tastes, cost of production, market share, availability of minerals, and dealer survey.

Market size and price behaviour are typical Canadian considerations because of the small size of markets in Canada and the dominance of resource-based industries in British Columbia and the rest of Canada which are affected by frequent fluctuations in commodity prices. The four important commitment variables found in this study were the creation of an international division, the desire to stabilize demand, the desire to stabilize profits and the desirability of retaining an export market. It was repeatedly emphasized by respondents that their firms have strong commitments to profit and demand.

The fourth hypothesis which claimed that there exists a positive relationship between the extent of negotiations and amount of uncertainty was also supported by canonical correlation analysis ($R_c = .909$, eigenvalue = .827, Wilk's lambda = .008, and chi-square = 372.34). The set of negotiation variables consisted of three subsets of variables, namely, negotiations with host country banks and negotiations with host country partners. The set of uncertainty variables consisted of 16 variables.

The issues found important in negotiations with host country governments were remittance of dividends, repatriation of capital, applicable rates of taxation, environment or pollution control, and depreciation or depletion allowances. Negotiations with host country banks consisted of establishing a credit line, making inquiries about availability of loans for a specific project, and making inquiries about general credit climate. The extent of negotiations with potential partners in the host countries in order of importance were: signing of the
final draft, negotiations for the type of joint venture, just discussion, and preparation of a draft agreement.

The uncertainty variables in order of importance in the present study were: demand for the product, inflation, local competition, corruption, devaluation, government intervention, availability of product (minerals), red tape, labour unrest, nationalization, cultural differences, change in government through democratic process, expropriation, military coup, civil war, and war with another country.

The last hypothesis compared positive and negative decisions in terms of initiating forces, investigation, commitments, negotiations, and uncertainty. The hypothesis claimed that in cases where the decision has been made to invest abroad, there will be stronger initiating forces, more investigation, greater degree of commitments, greater extent of negotiations, and lower amount of uncertainty than in those cases where the decision has been made not to invest abroad.

The results of the t-test did not confirm the first part of the hypothesis which said that the initiating forces will be stronger in the case of positive decisions than negative decisions ($U_1$ of positive decisions = 7.58 and $U_2$ of negative decisions = 8.53). The slightly stronger initiating forces in the case of negative decisions were explained in terms of lack of quantification of the set of initiating forces by Aharoni and the presence of intervening variables such as investigation, commitments, negotiations, and uncertainty.

The remaining four parts of the hypothesis relating to investigation ($U_3$ of positive decisions = 20.14 and $U_4$ of negative decisions = 16.94), commitment ($U_5$ of positive decisions = 4.14 and $U_6$ of negative decisions = 3.24), negotiations ($U_7$ of positive decisions = 8.97 and $U_8$ of negative
decisions = 8.82), and uncertainty (U of positive decisions = 25.68 and 
U of negative decisions = 36.94) were supported by the t-tests. However, 
the one-tail probability in the case of the set of initiating forces was 
.083. For the set of negotiations variables the one-tail probability was 
.448. This could be due to the fact that Aharoni did not treat negotiations 
with banks and potential partners in the host country as a process.

C. Implications

1. Implications for Host Countries

The present study has implications for host and home countries and 
the theory of the firm. Most of the developing countries are interested 
in attracting direct investment from developed countries. In the present 
study out of 89 decisions, 26 were related to the developing countries.

A study of the decisions concerning developing countries showed 
that in selecting a firm the developing countries must match the size of 
the proposed project with the size of the firm. Often a negative decision 
was made because big firms were generally not interested in the smaller 
projects. In several cases strong initiating forces caused investigation 
which was followed by negotiations and assessment of uncertainties, but 
the result was negative because the firm considered it too small a project. 
However, the general probability of a government selecting a big firm 
even for a small project is very high because big firms are known, have 
reputation, and are considered to possess more technical expertise.

Another important consideration in the selection of the firms is 
their area of specialization. Resource-based firms particularly specialize 
in very specific product lines. In all likelihood these firms will not 
consider a proposal in a line which lies outside their area of
specialization. For example, for zinc and related products Cominco would be one of the most appropriate choices provided the size of the project could create sufficient interest in that firm.

Firms also tend to form perceptions about countries and geographical areas. These perceptions operate as strong barriers unless broken by strong initiating forces. During the interviews, when the vice president of a big firm was asked about his firm's lack of interest in South Africa, he replied by saying, "Competition is too tough from other Western companies and return is too low." Similar comments were made by other respondents. "We do not go to Africa because Western firms are not welcomed in that continent. Zambia and Congo nationalized mining companies. There are little incentives. Our firm has to be profit-oriented to stay alive." "Nigeria is good, but we do not know too much about it." If a firm has formed a poor image about a country or a region from media or other sources, very strong initiating forces are required to change it.

The timing of the proposal also plays a very important role. The period before the annual meeting of a company, for example, is the busiest time for the decision makers. The executives want to concentrate their entire attention on presenting a good picture in the annual report about their division or area. If time is a very scarce resource in a firm, it becomes unavailable for anything else on such occasions.

In another respect the timing of a proposal or approach plays an important role. If prices of commodities are depressed, or the market outlook for a certain product is dim, the probability of a favourable decision becomes extremely low. "If we receive a proposal on copper in 1977, it would be rejected outright because the prices are so low and the future outlook is dim," said the vice president of a big mining firm.
The developing countries trying to attract direct investment must ensure that the government officials nominated for negotiations with the representatives of investing firms should not press them for what the manager of international operations of a big firm termed as "seed money." The impressions the interviewer got from the top executives was that those officials thought they were doing a big favour to the potential investing firm by letting it operate in their country. This becomes a big nuisance factor. The governments of developing countries must ensure that the officials selected for negotiations with the potential investors are honest.

The feeling of doing a big favour to the potential investors went to the extent that on one small project in which the potential investing firm was not at all interested, but was virtually "pushed" to investigate and negotiate by a lobbyist, the government officials asked $300,000 from the firm for letting it exploit the small low grade deposit in an area where no water and infrastructure existed. "We were astonished to hear that," said one top executive of the firm, "we had decided that if we invested at all in that project, we would ask for a subsidy from the government. But look, they were asking money from us. Even if we were willing to give the money, we were not sure for how long that official would stay in his position. Then another person comes and asks for money. It is a never ending process. It is not investing, but buying a big headache so we said no."

The developing countries should realize that simply by offering tax holidays and other incentives they cannot attract foreign investment. The mere statement of intent that the country needs foreign direct investment will also not help on its own in attracting such investment. The officials of developing countries must understand that attracting foreign direct
investment is a complex process in which each stage in the decision-making process plays an important role and leads to the other stages. Special care must be taken in attracting the first direct investment because, according to the findings of Knickerbocker, the band-wagon effect is an important characteristic of industries dominated by oligopolies. If a developing country succeeds in attracting one foreign firm in a certain industry, then other firms will also follow.\textsuperscript{19} This interesting process of following the leader or one's competitor can be clearly seen in several developing countries, for example, in their pharmaceutical industries. This industry in most of the developing countries is dominated by foreign firms.

In their efforts to attract foreign direct investment the developing countries must be cautious about industries which pollute the environment. As a result of a change in public attitudes towards such industries in the developed countries an effort is being made to "export" such industries to developing countries. This was clearly stated by Yoshihara in his empirical research. "The Japanese government had made it mandatory for industry to invest in the prevention of pollution of air and water. This has raised the production costs for some industries. Such industries will move part of their production bases to Southeast Asian countries, though they will avoid Singapore where pollution control is as strict as in Japan. There is a moral question involved in this move, but we have to bear in mind that pollution is partly the problem of congestion.... Therefore, the countries which have unpopulated land may absorb some pollution-prone

\textsuperscript{19} Frederick T. Knickerbocker, \textit{Oligopolistic Reaction and Multinational Enterprise}, op.cit.
industries." Unfortunately despite what Yoshihara says the fact remains that pollution may do more harm in developing countries because of relative ignorance about pollution in the minds of the general public, workers, and government officials.

The issue of locating pollution-prone industries in developing countries naturally leads one to other highly controversial issues in foreign direct investment from the point of view of host countries in general and Canada in particular. It is said that in an industry dominated by foreign firms there are very few high level jobs for the indigenous people. Research and development are centralized in the home country. Subsidiaries are neither allowed to make serious decisions nor they are encouraged to export anything other than raw materials. It is also said that the presence of foreign firms may retard the development of indigenous entrepreneurial talent. Moreover, the balance of payments costs to the host country will ultimately outweigh the benefits received. On top of all these is the question of extraterritoriality where, for example, subsidiaries of American firms located in Canada were prohibited from trading with nations with which Canada enjoyed full diplomatic relations.  

20 Kunio Yoshihara, Japanese Direct Investment in Southeast Asia, op.cit., p. 17.

21 For a detailed discussion of these issues, see the references on page 146. See also


Jack N. Behrman, Criteria for Foreign Direct Investment in Latin America, op.cit.


Grant L. Reuber and F. Roseman, "International Capital Flows and the Take-Over of Domestic Companies by Foreign Firms: Canada 1945-51," in
To resolve some of the issues in foreign direct investment from host countries' point of view, a conference was held in Dusseldorf. Unfortunately for widely disparate reasons there was consensus at the Conference against any major attempt at an international organization to oversee the multinational enterprise. 22

The purpose of mentioning the controversial issues in the implications for the host countries was simply to introduce the idea that foreign direct investment has its own problems. The benefits of foreign direct investment for the host country are numerous. It creates jobs. Workers are trained on new machines. There is an increase in the tax revenue for the host country government. Local purchases of supplies and raw materials increase the demand and consequently their supply (production) increases which in turn creates more jobs in the host country. The increase in shipping and other type of transportation also creates some jobs. There is a possibility for some of the industries in a host country to get sub-contracting from the foreign investors. Foreign direct investment is an important means of transfer of superior technology. If capital is also brought by the foreign investors into the host country, there is an

---


immediate positive effect on the balance of payments of the receiving country. 23

2. Implications for Home Country

If direct investment by Canadians in other countries is increasing, its usefulness for Canada may be questioned by some persons. The effects of flows of foreign investment on the home country were discussed by Ricardo and Keynes. Ricardo advocated the creation of an institutional bias in favour of investment at home in preference to investment abroad. He believed that foreign investment deprived the home country of a resource that it could have used to greater advantage at home.

Keynes' objection was to a difference in the risk factor involved in any project from the point of view of the investing economy as a whole and from the point of view of private entrepreneur. The specific risks were those of the economic failure of the project, loan repudiation on a bond issue or expropriation without adequate compensation of real assets located abroad. If the venture were made in a foreign country, these risks, if fulfilled, would leave both the investor and the investing country empty-handed. If a comparable investment had been made domestically, the investor would still have been left empty-handed, but the

---


nation would have been left with the tangible assets that the investment procured.\textsuperscript{24}

Both Ricardo and Keynes were mainly concerned with portfolio investment which dominated the international scene in those days. An interesting characteristic of foreign direct investment these days is that it may not necessarily result in the flow of funds from home country. The investing firms may borrow (as they do) in the host country's financial markets.

An interesting study of the effects of foreign direct investment on the home country and the investing firm was done by Reddaway. He faced the complications caused by the time factor in measuring the effects of direct investment on a home country. The consequences of a single act of investment will be spread over a large and variable number of subsequent years. Keeping this limitation in mind, he found that the scale of the parent company's operations in the U.K. was enlarged as the result of supplying intermediate products to subsidiaries abroad and consequently the cost of production was lowered.\textsuperscript{25}

Reddaway also estimated that for every £100 spent on foreign direct investment, British exports rose on the average by about £9 and as a result of this the balance of payments on current account improved by £9.\textsuperscript{26} In terms of profitability of the direct investment he found no correlation –

\textsuperscript{24} Ricardo and Keynes quoted in H. Peter Gray, \textit{The Economics of Investment Abroad}, op.cit., Chapter VII.


\textsuperscript{26} Ibid, p. 122.
positive or negative - between the profitability of an industry's overseas operations and the spread of their growth.

Bruck and Lee studied the effects of direct investments of the 500 largest U.S. corporations listed by the Fortune magazine in 1967. They found that direct investment operations always generated an element of short-run weakness in the overall accounts but also serve as a source of long-run strength. Bruck and Lee also found that United States direct investments have enjoyed a higher return in the form of exports and remitted earnings from less developed countries than from Western Europe and Canada. 27

The political environment of the home country also plays an important role in the flow of foreign direct investment. This particular factor was not highlighted by other empirical findings because most of them related to U.S. direct investment in other countries. The attitude of the federal and the provincial governments toward domestic firms is of utmost importance. Whenever the firms see a change in attitude, they perceive their existence threatened and their future dark. They look for safe havens. Changes in domestic tax and labour laws and price controls are seen as changes in attitude toward the firms. 28 Nehrt called this "investment climate" whose


components are policy statements of political leaders and the government, actions of the government, and historical contexts within which the statements and actions took place.29

The economic effects of direct investment by Canadians on the country's economy depend, among other things, on the purchases of capital equipment by the subsidiaries of Canadian parent firms. If these purchases are made in the host country, then there will be little improvement in exports from Canada. It appears from circumstantial evidence (superior technology, large scale production, and lower prices of capital equipment in the United States) that at least in the United States these purchases are made from the host country suppliers. In the present study 45 decisions out of 89 were related to the United States. There was clear evidence in the case of foreign direct investment in other countries that raw materials at least (e.g. wood pulp) were exported from Canada to Canadian subsidiaries in host countries.

There appear to be some intangible advantages of these investments for the Canadian economy because the investments in a highly developed country, such as the United States, keep the Canadian businessmen in touch with the latest technological, managerial, and marketing developments in their own industries. The investments in less developed countries by Canadian firms help in building the image of a technologically superior

Robert B. Stobaugh, Nine Investments Abroad and Their Impact at Home: Case Studies on Multinational Enterprise and the U.S. Economy, op.cit.


country. This image may help in increasing the export of other products from Canada. As Canada has no history of colonizing other countries, the Canadian firms can immensely benefit from this historical fact. They can increase their investment and export, other things being equal, without creating the usual suspicion of economic imperialism in less developed countries.

The argument (investment in home versus investment in host country) of Ricardo and Keynes (although their argument related to portfolio investment) does not appear to hold good in the case of the present study. These investments, as discussed before, were not, in most of the cases, a choice between home or host country. They were made because the firms wanted to internalize demand and/or supply. A resource-based firm has, in any case, not much of a choice. If the pine trees become mature faster (100 years in B.C. versus 20 years) in Alabama or if rich gold deposits are located in Colombia, the firms in British Columbia face a choice of go-or-no go rather than of investing at home or abroad. An obvious advantage to the firms in the present study and for the Canadian balance of payments is the remittance of profits by the Canadian subsidiaries operating abroad.

3. Implications for the Theory of the Firm

Profit is an important consideration in foreign direct investment decisions. The investments of U.S. manufacturing firms in Israel were an exception because Israel is a special case. If a big U.S. firm makes an unprofitable investment in Israel or elsewhere, it is a small part in terms of the total resources of that big firm. Small losses have little effect upon the total profit of a firm. In this connection, Helliwell also emphasizes the concept of overall contribution of investments.
"... investment projects are not valued for their individual yield and risk characteristics, but for their impact on the risk and yield characteristics of the set of projects in which they could be included." 30 The overall view of profit was also supported by Caves. 31

Generally, a firm will not tolerate an executive whose decisions contribute to losses in a big way, however influential that executive may be and whatever the length of his association with a firm. Macmillan Bloedel, for example, could not tolerate the wrong decisions of its president and vice president although these decisions were made with the good intention of product and market diversification. They were forced to leave the company despite their long association with the firm. Singer Company's president lost his job in 1976 after the failure of the office machinery and equipment division. The magazine Business Week is full of such examples.

Some of the examples given by Aharoni in support of his argument that firms may invest in loss contributing projects could be interpreted differently. It could be argued that Edsel Ford's decision to enter into arrangements with the Brazilian state of Para for a gigantic rubber plantation was simply to ensure the supply of rubber to Firestone, who in turn supplied 65 percent of all the tires for Ford's cars in 1927, and not simply, as Aharoni said, because "Henry Ford and Harvey Firestone were friends of long standing, having enjoyed annual vacation trips together and exchanged visits as families." The sale of the plantation in 1945 to


Brazilian government at a net loss of $8 million was similar to many other projects, which firms plan carefully and execute enthusiastically, but ultimately give up after suffering considerable losses. The classical example of this is the failure of the Edsel car introduced with great planning, enthusiasm, pomp, and show by the Ford Motor Company.

Another useful implication for the theory of the firm arises from the constraints imposed on firms because of the nature of their business. For example, the resource-based firms are led by the location of resources, be they in the home country or abroad. The vice president of a mining firm said, "We are led by the geology." Another vice president said it differently, "We go where mines are." Such firms may go abroad because the resource is not at all available in the home country, or else it is available, but its quality is not good, or it is a non-renewable resource and its quantity is diminishing (depletion) which increases the cost of its exploitation. An interesting example of non-availability of a resource is tuna fish. Faced with a growing demand for canned tuna in Canada and the United States, the B.C. firms had to invest abroad to ensure the supply because import from Japan was not regular. Another firm had to engage in direct investment in Central American countries because hardwood used in brooms and wooden handles was not available in Canada.

An example of foreign direct investment for quality reasons is the investment of Macmillan Bloedel in Alabama and Brazil. The pine trees are fast growing in those areas compared to British Columbia. As a commercially

---

planted forest in British Columbia takes 90 to 100 years to reach maturity, the same element becomes an important consideration.

The result of depletion of a resource is an increase in the cost of extraction. An open pit operation is much cheaper, but cannot be continued indefinitely because one has to go deeper and deeper. Firms have to search for the resource in remote areas. The high cost of operations in remote areas forces the firms to seek the same resource overseas. The cost of operations in northern parts of British Columbia and Yukon is very high. Planes have to be chartered to survey or examine properties because of difficult terrain. As a result of poor weather conditions work cannot be carried on all through the year, but the staff must be paid for 12 months. Higher wages and salaries have to be offered to employees to attract them to work in such places.

Another important observation made during the present study concerning the behaviour of the firm was the desire on the part of the resource-based firms to internalize the source of supply and demand. It appeared that through foreign direct investment the firms wanted to minimize or if possible eliminate altogether the uncertainties originating in the areas of supply and demand. As explained earlier, the firms would like to extend their control to sources of supply through acquisitions or joint ventures. This would ensure a continuous supply. Similar methods were used to internalize demand by acquiring controlling shares of the firms that were buying the output of the B.C. firms as the basic ingredient of their finished product. Wholly owned subsidiaries and joint ventures were also used for the same purpose.
D. Areas for Further Research

The conclusions drawn in this research were based on 89 foreign direct investment decisions of 16 firms in British Columbia. This is perhaps the first attempt to quantify and test Aharoni's behavioral theory. The results in this study should be interpreted with caution because 80 percent of the decisions related to resource-based firms. There is a need to replicate the study in other places to see that the decision processes described here are not peculiar to resource-based firms or to firms in British Columbia. However, greater confidence could be placed in the results because most of the findings were tested before by Aharoni although he had used the case method for his research.

Much useful insight could be gained about decision processes of firms if their domestic investment and foreign direct investment decisions are compared after collecting data. This is a useful area for further research because, as far as the knowledge of the writer of this report goes, no significant empirical work has been done in this area.

To test the role of profit as a motivating force, an interesting area for further research could be a comparison of the earnings of foreign subsidiaries with earnings from domestic operations of parent companies. This unfortunately is rarely possible on a broad scale because multinational corporations do not usually issue separate financial statements for foreign subsidiaries and parent companies.

To partially achieve the same objective, the earnings of companies having significant foreign direct investment could be compared with the earnings of firms which confine their operations to domestic market because of the nature of their business or because of their attitudes.
towards foreign direct investment. Monsen, Chiu, and Cooley had made a similar comparison of the return on the invested capital of owner-managed firms and management controlled firms.  

Another interesting area for further research is the buying practices of Canadian firms going abroad. Such a study is necessary to determine the benefits of foreign direct investment for the Canadian economy in terms of its effects on export from Canada. Still another potential area for research is the practices of Canadian firms relating to financing of foreign direct investment projects because of its implications for the Canadian economy and the balance of payments.

---


Aharoni, Yair, Foreign Investment Decision Process. Boston: Division of Research, Graduate School of Business Administration, Harvard University, 1966.


Green, Robert T., Political Instability as a Determinant of U.S. Foreign Investment. Austin, Texas: Bureau of Business Research, Graduate School of Business, The University of Texas, 1972.


Knickerbocker, Frederick T., Oligopolistic Reaction and Multinational Enterprise. Boston: Division of Research, Graduate School of Business Administration, Harvard University, 1973.


Stobaugh, Robert B., Nine Investments Abroad and Their Impact at Home: Case Studies on Multinational Enterprise and the U.S. Economy. Boston: Division of Research, Graduate School of Business Administration, Harvard University, 1976.


APPENDIX A

QUESTIONNAIRE - FOREIGN DIRECT INVESTMENT DECISIONS OF CANADIAN FIRMS

PART I - BACKGROUND INFORMATION

Name of Firm: ____________________________

Address of Firm's Head Office: ____________________________

Telephone Number: ____________________________

Respondent Executive: ____________________________

Title: ____________________________

Date of Interview: ____________________________

Duration of Interview: ____________________________

Place of Interview: ____________________________

PART II - INFORMATION ABOUT THE FIRM

A. Is your company:

(a) Public with widely held stock ownership? Yes____ No____

(b) Public with controlling shares held by one or few interests? Yes____ No____

(c) Privately owned? Yes____ No____

If (a) or (b) may we have copies of your annual reports for the years 1975, 1970, 1965, 1960.

B. Is Canadian ownership of the voting equity in your firm?

(a) 100%____ (c) 50%____ (e) Other specify____

(b) 75%____ (d) Less than 50%____
B(a) If Canadian equity in your firm is not 100%, please indicate the nationality of ownership of the remaining voting equity.

U.S. voting equity: Yes______ If yes, specify percentage______

No______

U.K. voting equity: Yes______ If yes, specify percentage______

No______

Japanese voting equity: Yes______ If yes, specify percentage______

No______

C. Is the Canadian share of ownership sufficiently concentrated to constitute effective control of the company and its operations?

Yes______ No______

D. Please indicate the approximate size of your company's assets, sales, and earnings before taxes for the most recent year (197 ).

<table>
<thead>
<tr>
<th>Assets, Sales, Earnings</th>
<th>Thousand $</th>
</tr>
</thead>
<tbody>
<tr>
<td>TotalecNetsAssets</td>
<td></td>
</tr>
<tr>
<td>Total Sales</td>
<td></td>
</tr>
<tr>
<td>Total Earnings before Taxes</td>
<td></td>
</tr>
</tbody>
</table>

E. In terms of sales (actual and potential), how important is foreign direct investment as compared to your company's domestic operations?

(a) Extremely important ______

(b) Quite important ______

(c) Important ______

(d) Not important ______

(e) Negligible ______
### OCCASION FOR FOREIGN DIRECT INVESTMENT DECISION

**Name of Country:** ____________________________  
**Name of Product:** ____________________________  
**Year of Decision:** ____________________________  

**Q1** How important were each of the following in making you aware of foreign direct investment opportunities?

<table>
<thead>
<tr>
<th>Variables</th>
<th>Critical</th>
<th>Very Important</th>
<th>Important</th>
<th>Unimportant</th>
<th>Not Even Considered</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. An outside proposal from (please specify source)</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>b. Fear of losing an export market.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. Strong competition from abroad in home market.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d. Saturation in the domestic market.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>e. Successful direct investment operations of your competitors abroad.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>f. Keen interest of a high-ranking executive in foreign direct investment.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>g. Desire to utilize abroad old machinery.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>h. Capitalization of patents or technical know-how.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. Desire to create market for components abroad.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>j. Desire to spread R&amp;D and other fixed costs.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>k. Others (please specify)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Q2 Which of the following type of investigation of foreign direct investment opportunity was used by you before conducting an on-the-spot investigation in the country where the opportunity was located? Also state the importance of each.

<table>
<thead>
<tr>
<th>Type of Investigation before Field Research</th>
<th>Degree of Importance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Critical</td>
</tr>
<tr>
<td>Used information given in the unsolicited outside proposal only.</td>
<td>4</td>
</tr>
<tr>
<td>Purchased information from Dun and Bradstreet or similar organizations.</td>
<td></td>
</tr>
<tr>
<td>Collected information from Department of Industry, Trade and Commerce.</td>
<td></td>
</tr>
<tr>
<td>Collected information from published sources.</td>
<td></td>
</tr>
<tr>
<td>Preliminary design drawings prepared by company.</td>
<td></td>
</tr>
<tr>
<td>Estimates of operating cost prepared by company staff.</td>
<td></td>
</tr>
<tr>
<td>Capital cost was calculated by company staff.</td>
<td></td>
</tr>
<tr>
<td>An outside consultant was asked to prepare a feasibility study.</td>
<td></td>
</tr>
</tbody>
</table>
Q2A Which of the following type of information was collected during field investigation in the country where direct investment opportunity was being investigated? Please state the importance of each.

<table>
<thead>
<tr>
<th>Type of Information</th>
<th>Degree of Importance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Critical</td>
</tr>
<tr>
<td></td>
<td>4 Points</td>
</tr>
<tr>
<td>Consumer Tastes</td>
<td></td>
</tr>
<tr>
<td>Dealer Survey</td>
<td></td>
</tr>
<tr>
<td>Market Share</td>
<td></td>
</tr>
<tr>
<td>Market Size</td>
<td></td>
</tr>
<tr>
<td>Information about Local Partners</td>
<td></td>
</tr>
<tr>
<td>Cost of Production</td>
<td></td>
</tr>
<tr>
<td>Price Behavior</td>
<td></td>
</tr>
<tr>
<td>Nature and Type of Competition</td>
<td></td>
</tr>
</tbody>
</table>
Q3 Relative to the size of the project, how would you judge the cost of this investigation to your company?

<table>
<thead>
<tr>
<th>Very Expensive</th>
<th>Somewhat Expensive</th>
<th>Expensive</th>
<th>Not Very Expensive</th>
<th>Insignificant</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 Points</td>
<td>4 Points</td>
<td>3 Points</td>
<td>2 Points</td>
<td>1 Point</td>
</tr>
</tbody>
</table>

Q3A In your investigation of this particular foreign direct investment opportunity, was the following sequence followed?

Library* → Field Research → Report

Please check one.

Q3B If your answer is no, please specify the sequence you followed.

_________________________________________________________________
_________________________________________________________________
_________________________________________________________________
_________________________________________________________________
_________________________________________________________________
_________________________________________________________________
_________________________________________________________________
_________________________________________________________________

*Means collection of information from published sources.
Q4 Please indicate the degree of influence of the following on the extent of investigation.

<table>
<thead>
<tr>
<th>Commitment Variables</th>
<th>Degree of Influence</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Very Important</td>
</tr>
<tr>
<td></td>
<td>5 Points</td>
</tr>
</tbody>
</table>

1. Desirability of retaining an export market through direct investment
2. Creation of an international division.
3. Concern about corporate image once investigation started.

Q5 In your negotiations with the host country government did your firm seek assurances or guarantees on the following issues?

<table>
<thead>
<tr>
<th>Issues Negotiated With Host Country Government</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Repatriation of dividends.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Repatriation of capital.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Applicable rates of taxation.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Special depreciation or depletion allowances.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Investment grants or low interest loans.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Tax deferments, exemptions, holidays (please underline the ones applicable.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Relaxation or restriction of import duties.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Tariff or quota protection against imports.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Q5A How extensive were negotiations between your firm and the banks in the host country:

<table>
<thead>
<tr>
<th>Extent of Negotiations With Banks in Host Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Relied on information in published sources.</td>
</tr>
<tr>
<td>2. Inquired about general credit climate.</td>
</tr>
<tr>
<td>3. Made inquiries about availability of loans for the specific project.</td>
</tr>
<tr>
<td>4. Submitted an application for loan.</td>
</tr>
<tr>
<td>5. Established a credit line.</td>
</tr>
</tbody>
</table>

Q5B How extensive were negotiations between your firm and local partners in the host country.

<table>
<thead>
<tr>
<th>Extent of Negotiations With Local Partners in Host Country</th>
<th>Classification of Extent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Just discussion.</td>
<td></td>
</tr>
<tr>
<td>2. Negotiations for type of joint venture.</td>
<td></td>
</tr>
<tr>
<td>3. Lawyers were involved in negotiations.</td>
<td></td>
</tr>
<tr>
<td>4. Preparation of a draft of agreement.</td>
<td></td>
</tr>
<tr>
<td>5. Signing of the final draft.</td>
<td></td>
</tr>
</tbody>
</table>
Q5C How confident did you feel in your ability to assess uncertainty in the country where you were investigating a direct investment opportunity?

<table>
<thead>
<tr>
<th>Degree of Perceived Confidence</th>
<th>Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full Confidence</td>
<td>5</td>
</tr>
<tr>
<td>Some Confidence</td>
<td>4</td>
</tr>
<tr>
<td>Confidence</td>
<td>3</td>
</tr>
<tr>
<td>Just Guess</td>
<td>2</td>
</tr>
<tr>
<td>Not Sure</td>
<td>1</td>
</tr>
</tbody>
</table>
Q5C What type of uncertainties and their extent do you believe your firm faced in this foreign direct investment opportunity?

<table>
<thead>
<tr>
<th>Types of Uncertainties</th>
<th>Very High Uncertainty</th>
<th>High Uncertainty</th>
<th>Uncertainty</th>
<th>Somewhat Uncertainty</th>
<th>Insignificant Uncertainty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Civil war.</td>
<td>5 Points</td>
<td>4 Points</td>
<td>3 Points</td>
<td>2 Points</td>
<td>1 Point</td>
</tr>
<tr>
<td>War with another country.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Military Coup.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change in government through democratic process.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government intervention.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Devaluation.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inflation.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inconvertibility of currency.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labor unrest.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nationalization.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expropriation.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corruption.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Red Tape.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cultural differences.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Attitudinal differences.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of demand.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local competition.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Availability of consultants.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Appendix B

Foreign Direct Investment Decisions of B.C. Firms by Host Countries

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Host Countries</th>
<th>No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Developed Countries</strong></td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td>U.S.A.</td>
<td>45</td>
</tr>
<tr>
<td>2.</td>
<td>U.K.</td>
<td>7</td>
</tr>
<tr>
<td>3.</td>
<td>Australia</td>
<td>3</td>
</tr>
<tr>
<td>4.</td>
<td>Spain</td>
<td>2</td>
</tr>
<tr>
<td>5.</td>
<td>Ireland</td>
<td>2</td>
</tr>
<tr>
<td>6.</td>
<td>Japan</td>
<td>1</td>
</tr>
<tr>
<td>7.</td>
<td>France</td>
<td>1</td>
</tr>
<tr>
<td>8.</td>
<td>Netherlands</td>
<td>1</td>
</tr>
<tr>
<td>9.</td>
<td>Greenland</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td><strong>Sub-total</strong></td>
<td><strong>63</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Developing Countries</strong></td>
<td></td>
</tr>
<tr>
<td>10.</td>
<td>Philippines</td>
<td>3</td>
</tr>
<tr>
<td>11.</td>
<td>Indonesia</td>
<td>2</td>
</tr>
<tr>
<td>12.</td>
<td>India</td>
<td>1</td>
</tr>
<tr>
<td>13.</td>
<td>Malaysia</td>
<td>1</td>
</tr>
<tr>
<td>14.</td>
<td>Hong Kong</td>
<td>1</td>
</tr>
<tr>
<td>15.</td>
<td>Pakistan</td>
<td>1</td>
</tr>
<tr>
<td>16.</td>
<td>United Arab Emirates</td>
<td>1</td>
</tr>
<tr>
<td>17.</td>
<td>New Guinea</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td><strong>Sub-total</strong></td>
<td><strong>11</strong></td>
</tr>
<tr>
<td>18.</td>
<td><strong>South America</strong></td>
<td></td>
</tr>
<tr>
<td>19.</td>
<td>Peru</td>
<td>1</td>
</tr>
<tr>
<td>20.</td>
<td>Colombia</td>
<td>1</td>
</tr>
<tr>
<td>21.</td>
<td>Argentina</td>
<td>1</td>
</tr>
<tr>
<td>22.</td>
<td>Brazil</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td><strong>Sub-total</strong></td>
<td><strong>4</strong></td>
</tr>
<tr>
<td>23.</td>
<td><strong>North America</strong></td>
<td></td>
</tr>
<tr>
<td>24.</td>
<td>Mexico</td>
<td>1</td>
</tr>
<tr>
<td>25.</td>
<td><strong>Central America</strong></td>
<td></td>
</tr>
<tr>
<td>26.</td>
<td>Honduras</td>
<td>2</td>
</tr>
<tr>
<td>27.</td>
<td>Nicaragua</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td><strong>Africa</strong></td>
<td></td>
</tr>
<tr>
<td>28.</td>
<td>Central African Empire</td>
<td>1</td>
</tr>
<tr>
<td>29.</td>
<td>Others</td>
<td></td>
</tr>
<tr>
<td>30.</td>
<td>Fiji</td>
<td>1</td>
</tr>
<tr>
<td>31.</td>
<td>Gilbert Island</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td><strong>Sub-total of developing countries</strong></td>
<td><strong>26</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Total Decisions</strong></td>
<td><strong>89</strong></td>
</tr>
</tbody>
</table>
Appendix C

Foreign Direct Investor B.C. Firms by Size of Assets

<table>
<thead>
<tr>
<th>Size of Assets (Million of CN$)</th>
<th>No. of Firms</th>
<th>No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 4</td>
<td>9</td>
<td>25</td>
</tr>
<tr>
<td>17 to 37</td>
<td>3</td>
<td>21</td>
</tr>
<tr>
<td>100 to 600</td>
<td>4</td>
<td>43</td>
</tr>
<tr>
<td>Total</td>
<td>16</td>
<td>89</td>
</tr>
</tbody>
</table>
Appendix D

Foreign Direct Investment Decisions of B.C. Firms by Type of Industry

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Type of Industry</th>
<th>No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Mining</td>
<td>44</td>
</tr>
<tr>
<td>2.</td>
<td>Forestry</td>
<td>17</td>
</tr>
<tr>
<td>3.</td>
<td>Marine Resources</td>
<td>10</td>
</tr>
<tr>
<td>4.</td>
<td>Manufacturing</td>
<td>18</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>89</strong></td>
</tr>
</tbody>
</table>
Perceived Importance of Foreign Direct Investment by B.C. Firms

<table>
<thead>
<tr>
<th>Degree of Perceived Importance</th>
<th>No. of Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extremely Important</td>
<td>52</td>
</tr>
<tr>
<td>Quite Important</td>
<td>16</td>
</tr>
<tr>
<td>Important</td>
<td>8</td>
</tr>
<tr>
<td>Not Important</td>
<td>10</td>
</tr>
<tr>
<td>Negligible</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>89</td>
</tr>
</tbody>
</table>