Contents

List of Illustrations vii

List of Contributors xii

1 The Global Crisis and the World: The Cases of Emerging and Developed Economies 1
Marin A. Marinov and Svetla T. Marinova

2 Foreign Direct Investment by Emerging Economy Multinationals: Coping with the Global Crisis 14
Geraldine McAllister and Karl P. Sauvant

3 Outward FDI from the BRICs: Trends and Patterns of Acquisitions in Advanced Countries 47
Fabio Bertoni, Stefano Elia, and Larissa Rabbiosi

4 Internationalization of Central and Eastern European Countries and their Firms in the Global Crisis 83
Witold Wilinski

5 Information and Communication Technologies in the Globalization of Small and Medium-Sized Firms during the Global Crisis: An Empirical Study in China, India, New Zealand, and Singapore 102
Thomas Borghoff

6 An Analysis of the Macroeconomic Determinants of Indian Outward Foreign Direct Investment 137
Rakhi Verma and Louis Brennan

7 Influence of Cultural Distance on Chinese Outward Foreign Direct Investment 154
Rian Drogendijk and Katarina Blomkvist

8 Russia's Emerging Multinationals in the Global Crisis 179
Sergey Filippov

9 Internationalization of Chinese Car Manufacturers 222
Françoise Hay, Christian Milelli, and Yunnan Shi

PROOF

10 Location Determinants of Polish Outward Foreign Direct Investment and the Impact of the Global Crisis 240
Aleksandra Wąsowska and Krzysztof Obłój

11 Reactions of Slovene Multinational Firms to the Global Crisis 259
Marjan Svetličič and Andreja Jaklič

12 Impact of the Global Crisis on the Internationalization of Estonian Firms: A Case Study 292
Tiia Vissak

13 Servicing Local Customers for Entering Foreign Markets: Internationalization of Russian IT Firms 314
Marina Latukha and Andrei Panibratov

14 Longitudinal Internationalization Processes of Born Globals: Three Chinese Cases of Radical Change and the Global Crisis 334
Xiaotian Zhang and Jorma Larimo

Index 366

2

Foreign Direct Investment by Emerging Economy Multinationals: Coping with the Global Crisis*

Geraldine McAllister and Karl P. Sauvant

Introduction

Even before the onset of the global crisis, the global market for foreign direct investment (FDI) had undergone significant changes. Foremost amongst these changes was the increasing importance of emerging market[1] multinationals (MNEs). While outward foreign direct investment (OFDI) from these markets is, in itself, not new, the magnitude that this phenomenon achieved prior to the crisis and its resilience in the face of the global crisis suggest that this is not a temporary occurrence but rather a sign of a fundamental change that is taking place in the global OFDI market. However, emerging markets are not homogenous: in addition to the rise in OFDI from emerging markets, the formation of new regional groupings has led to the emergence of fresh investment patterns. This chapter examines changes taking place in global FDI flows and looks at the impact of the crisis in the context of profound structural changes; it also focuses on the response of emerging markets and the enormous risks and challenges that lie ahead. It is vital to note that this crisis is ongoing, and it is too early to predict the final contours it will leave in its wake on the FDI landscape.

Changing patterns of OFDI: Beyond the global crisis

Changing patterns of OFDI

The rise of global OFDI over the past three decades has been remarkable. Prior to the crisis, global OFDI flows had grown by a factor of

*This text builds on Sauvant *et al.* (2010).

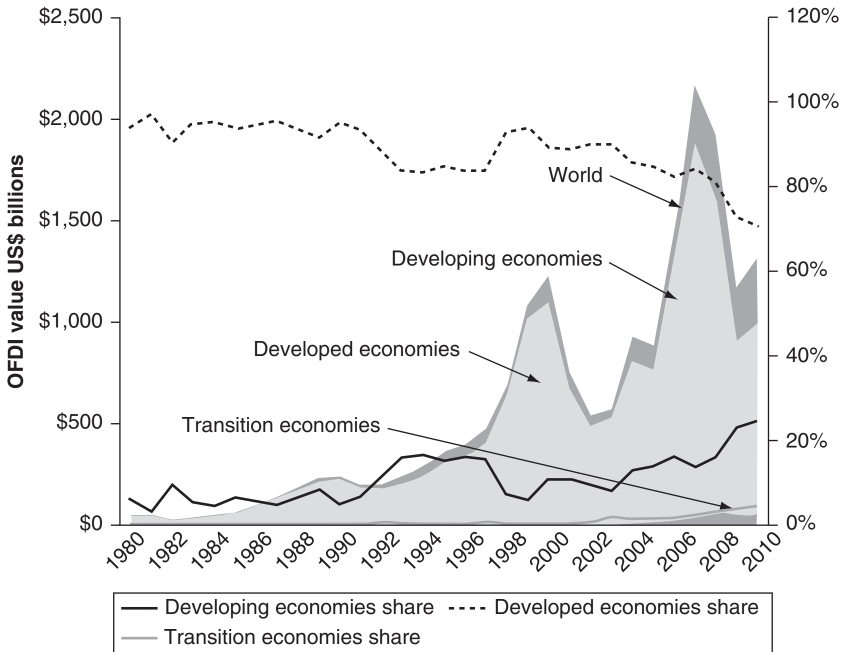

Figure 2.1 FDI outflows, globally and by group of economies, 1980–2010 (US$ billions)
Source: Authors, based on data from unctadstat.unctad.org.

40 in less than three decades, from a yearly average of US$47 billion in 1980–1985, to US$2.2 trillion in 2007 (Figure 2.1 and Table 2.1). Since peaking in 2007, OFDI flows have declined significantly. Nevertheless, at US$1.2 trillion, average OFDI flows for the five-year period 2003–2007 were almost 40 per cent higher than in the period 1998–2002, when they averaged US$860 billion.

Even more remarkable has been the rise in OFDI from emerging markets in recent years,[2] and its ability to withstand the worst of the global crisis. From less than 5 per cent of OFDI flows in 1990, emerging markets accounted for almost 30 per cent of OFDI flows in 2010 (Figure 2.2), a trend that showed no sign of changing in 2011 too. (UNCTAD, 2011a). In terms of inward foreign direct investment(IFDI), the performance of emerging markets has been equally impressive. The share of inward investment flows rose from 17 per cent in 1990, to no less than 50 per cent each year until 2009, reflecting an average annual growth of 12 per cent since 2000 (UNCTAD, 2012b).

Table 2.1 FDI outflows by home region and BRIC economy, 1980–2010 (US$ billion)

Region	**1980**	**1990**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
World	51.6	241.5	1,232.1	752.7	537.2	573.8	930.1	882.1	1,405.4	2,174.8	1,910.5	1,170.5	1,323.3
Developed economies	48.4	229.6	1,094.7	667.4	482.8	517.0	794.6	745.7	1,155.0	1,829.0	1,541.2	851.0	935.2
Developing economies	3.2	11.9	134.2	82.5	49.7	46.0	121.4	122.1	226.7	294.2	308.9	270.7	327.6
Brazil	0.4	0.6	2.3	−2.3	2.5	0.2	9.8	2.5	28.2	7.1	20.5	−10.1	11.5
China	–	0.8	0.9	6.9	2.5	2.9	5.5	12.3	21.2	22.5	52.2	56.5	68.0
India	0.0	0.0	0.5	1.4	1.7	1.9	2.2	3.0	14.3	17.2	19.4	15.9	14.6
Transition economies	–	0.0	3.2	2.7	4.7	10.8	14.1	14.3	23.7	51.6	60.4	48.8	60.6
Russian Federation	–	–	3.2	2.5	3.5	9.7	13.8	12.8	23.2	45.9	55.6	43.7	51.7

Source: Authors, based on data from unctadstat.unctad.org.

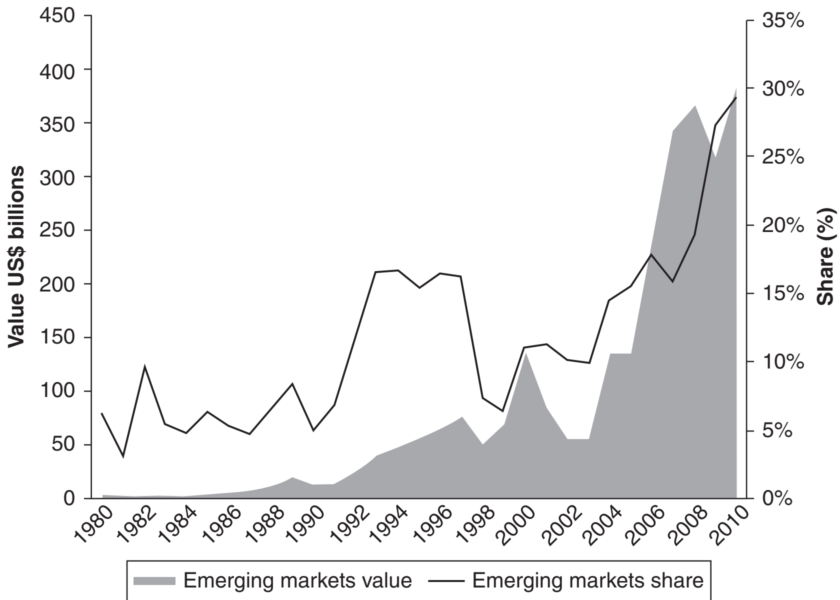

Figure 2.2 Emerging markets OFDI, value and share, 1980–2010 (US$ billions %)
Source: Authors, based on data from unctadstat.unctad.org.

The changing FDI landscape: Beyond the global crisis

To date, the focus has been on the immediate impact of the crisis, as measured by the value of OFDI flows. The dramatic increase in these flows till 2007 and their subsequent decline, however, is one of the visible aspects of the fundamental changes that are reshaping the global market for FDI. A number of these changes were perceptible prior to 2007–2008; the main impact of the crisis has been on their rate of change. Other changes stem directly from the crisis, but are likely to continue even when the world economy returns to robust health.

Number of MNEs

The ongoing economic crisis has halted or even reversed years of economic growth in many countries and slowed the rate of growth in others. Its impact on the trend toward an increasingly integrated world economy has been more limited, however, and, in many instances, the domestic downturn has spurred firms to seek growth opportunities abroad. The significant increase in the number of MNEs, despite

the recent years of economic turmoil, reflecting this trend. From about 70,000 MNEs in 2004, with about 690,000 foreign affiliates, there are over 100,000 MNEs in existence today, with more than 890,000 foreign affiliates (UNCTAD, 2005: xix; UNCTAD, 2011, annex table 34).

The geographical distribution of these MNEs and their foreign affiliates underlines the increasing integrated and competitive nature of the world economy, requiring MNEs everywhere to develop a portfolio of locational assets if they are to compete successfully in the global economy. In 2010, over 30,000 parent corporations were based in emerging markets, a whole 30 per cent of the total (UNCTAD, 2011, annex table 34). Emerging markets were host to over 500,000 foreign affiliates (58 per cent of the total), a 17 per cent increase on 2004 (ibid., UNCTAD, 2005: xix). Developed economies were host to more than 370,000 foreign affiliates (42 per cent of the total), a figure that has grown by over 50 per cent since 2004 (ibid.).

A new Triad?

The increasing importance of OFDI by emerging market MNEs is the latest discernible pattern in global OFDI. In a global market once dominated by the US and the European Union (EU), this duopoly gave way to the Triad of the US, EU, and Japan. This Triad declined, as Japan entered a prolonged period of economic stagnation, and is often referred to as 'Old Triad.' The rise in OFDI from emerging markets has contributed to the appearance of a 'New Triad' consisting of the US, the EU, and emerging markets (see Figure 2.3). Yet, Figure 2.3 reveals that this New Triad's share of global OFDI stocks was, in fact, higher in the early 1980s, underlining the frequently short-lived nature of such trends. Moreover, we may well move beyond a world of Triads. Economou and Sauvant (2011) look to the possible emergence of a 'multi-polar FDI world . . . in which smaller poles coexist with the dominant members of the former Triad,' (2011: 2). The World Bank envisions 'a new world order with a more diffuse distribution of economic power . . . the shift toward multipolarity' (The World Bank, 2011: xi).The changing origins of OFDI is only one part of the picture; the sectors into which OFDI flows is also undergoing change.

Sectoral change

The sectoral composition of global OFDI stock has changed considerably over recent decades and the service sector has assumed greater importance, aided by innovation and deregulation, as well as advances

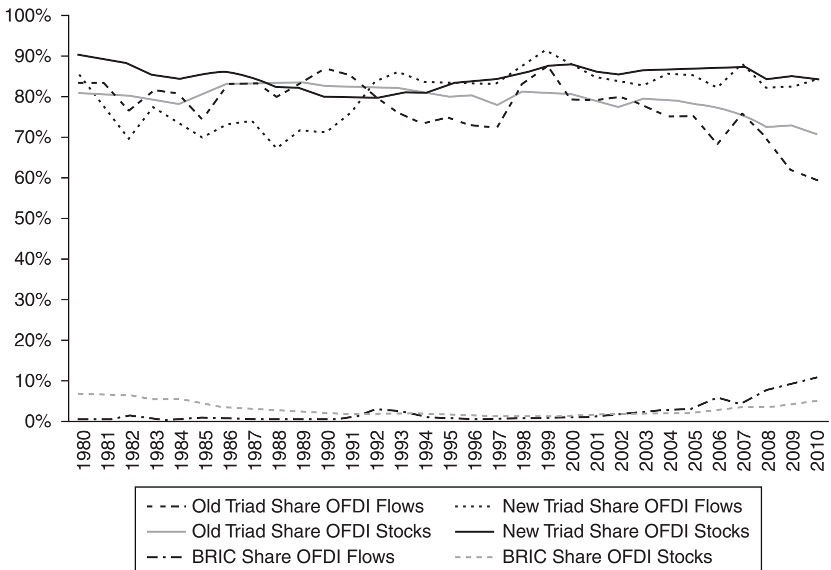

Figure 2.3 Old and New Triad, and BRICS share of global OFDI, 1980–2010 (%)
Source: Authors, based on data from unctadstat.unctad.org.

in information communications technology (ICT). In 1990, the service sector accounted for almost half of global OFDI stock, a share that had risen to two-thirds by 2009. Interestingly, over this period the share of finance within the service sector remained relatively constant, at 24 per cent in 1990 to 26 per cent in 2009 (UNCTAD, 2011, annex table 25). Almost all of the growth recorded, occurred within business activities, and was the result of a shift in management practices toward core activities, and technological advancements that facilitated the off shoring and outsourcing of various business support functions. The share of the primary sector in global OFDI stock declined only slightly over this period, from 9 per cent in 1990 to 8 per cent in 2009, as MNEs continued to seek secure access to finite reserves of natural resources (ibid.). Manufacturing, however, declined significantly, from 43 per cent of global OFDI stock in 1990, to only 24 per cent in 2009 (ibid.).

This picture is repeated across developed economies, where the share of the primary sector fell from 9 per cent in 1990 to 8 per cent in 2009 (ibid.). The services sector rose from 48 per cent to 64 per cent over this period, the result of increase in business services (ibid.). At the global

level, the share of manufacturing declined from 43 per cent in 1990 to 26 per cent in 2009 (ibid.).

The picture for emerging market OFDI is very different, and rather surprising. Both the primary and manufacturing sectors shrank significantly over the period 1990–2009, from 13 per cent to 6 per cent, and from 36 per cent to 11 per cent, respectively (ibid.). The service sector, which was the principal sector in 1990 accounting for 51 per cent of total OFDI stock, was dominating the scene by 2009, accounting for 79 per cent of OFDI stock, driven by growing OFDI in business services (ibid.). This is explained largely by significant investment in business activities in Hong Kong and China.[3,4]

The dramatic impact of the financial crisis and the ongoing global crisis continue to affect the investment choices and decisions of MNEs. For some, the need to reduce their debt burden has forced them to dispose whole divisions, creating an opportunity for others to capitalize on. Nevertheless, the sheer scale of the financial crisis and uncertainty over the shape of ongoing reform has resulted in the decline of investment in the service sector (Figure 2.4), and, in 2010, manufacturing accounted for almost 50 per cent of total investment in FDI projects.

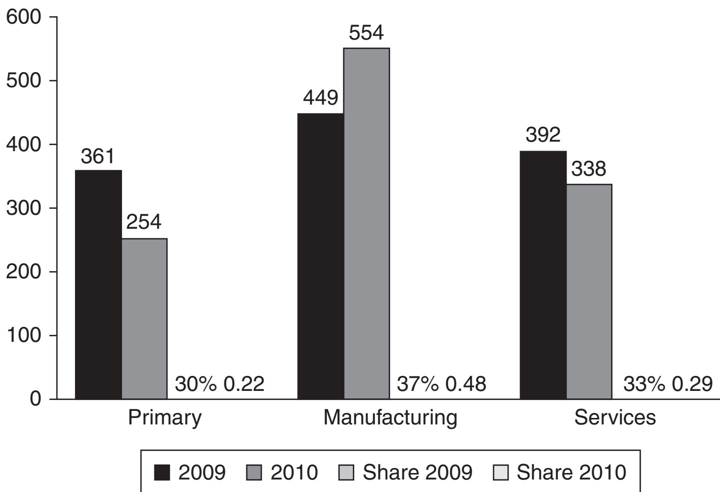

Figure 2.4 Sectoral distribution of FDI projects, 2009–2010 (US$ billions, %)
Source: UNCTAD (2011: 9).

Mode of investment

Levels of mergers and acquisitions (M&As) and greenfield investment, the principal vehicles for FDI, highlight the dramatic changes taking place in the global FDI market (Figure 2.5).

Total M&A activity peaked in 2007 at US$1 trillion, more than double the average of the previous decade (Figure 2.6). From 2008, however, as markets became illiquid and firms adopted a 'wait and see' approach to investment, M&A activity declined sharply, to US$250 billion in 2009, one quarter of the previous high. A gradual recovery took place in 2010, but at US$339 billion, total M&A activity was only one-third the level of 2007.

The decline in M&As was most pronounced in developed economies. From a high of US$842 billion in 2007, the total value of M&As had fallen 80 per cent, to US$161 billion by 2009 (UNCTAD, 2011, annex table 10). Growth resumed in 2010, but at US$216 billion, the total value of M&As undertaken by developed countries was one quarter of its 2007 high (ibid.).

Emerging markets have weathered the crisis better. From a high of US$167 billion in 2007, the total value of M&As declined 51 per cent to US$81 billion in 2009 (ibid.). As in developed countries, growth resumed in 2010, and by the end of the year the total value of M&As was almost two-thirds of its 2007 high, at US$106 billion (ibid.).

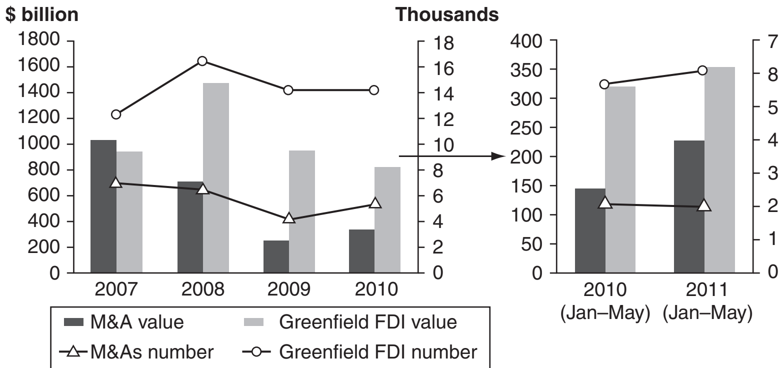

Figure 2.5 Value and number of cross-border M&As, and greenfield FDI projects, 2007–2011 (May)

Note: Data for value of greenfield FDI projects refer to estimated amounts of capital investment.

Source: UNCTAD (2011: 11).

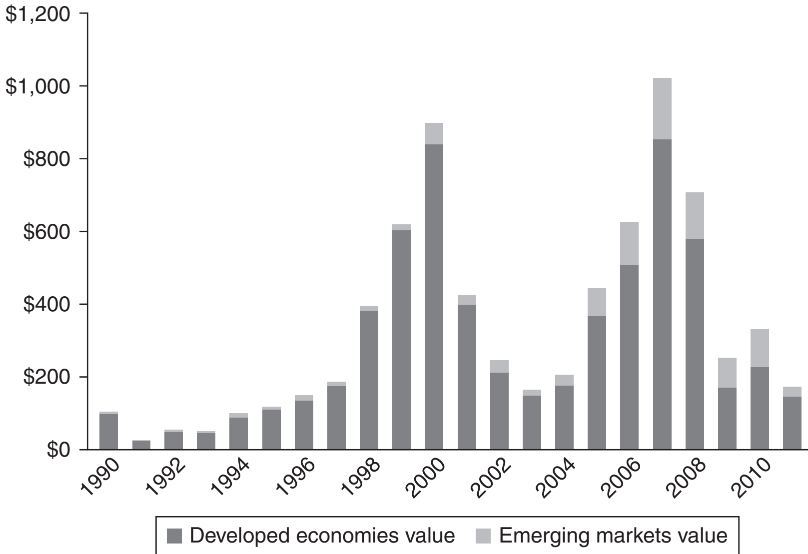

Figure 2.6 Total M&A value by purchase region, 1990–2011 (May) (US$ billions)
Source: Authors, based on data from UNCTAD (2011, annex table 10).

In terms of M&As, the shift in activity from developed economy MNEs to emerging market MNEs has gained momentum since the beginning of the crisis. Emerging markets accounted for only 10 per cent of all M&A activity in the 1990s, a share that rose to 17 per cent in the 2000s (ibid.). By 2010, one-third of all M&A activity was taken over by emerging market MNEs (ibid.).

Greenfield investments, which was by nature slower to react to changing economic circumstances, continued to grow through 2008, and reached a high of US$1.5 trillion, an 80 per cent increase on the average of the previous five years (Figure 2.7) (UNCTAD, 2011, annex table 18). They declined in 2009 and 2010, but the decline was less dramatic to that of M&As; at US$807 billion in 2010, the levels of greenfield investments were at 55 per cent in 2008, and in line with the average for the period 2003–2007, at US$801 billion.

The pattern of total greenfield investments since 2003 reflected also in the levels in both developed economies and emerging markets. Developed economies' greenfield investments peaked in 2008 at US$1 trillion, a rise of 60 per cent on 2007, before falling back to US$569 billion in 2010, a drop of 45 per cent (UNCTAD, 2011, annex table 18). Emerging markets' greenfield investment rose by 58 per cent in 2008 to reach a high of US$434 billion, and declined to 45 per cent over the next two

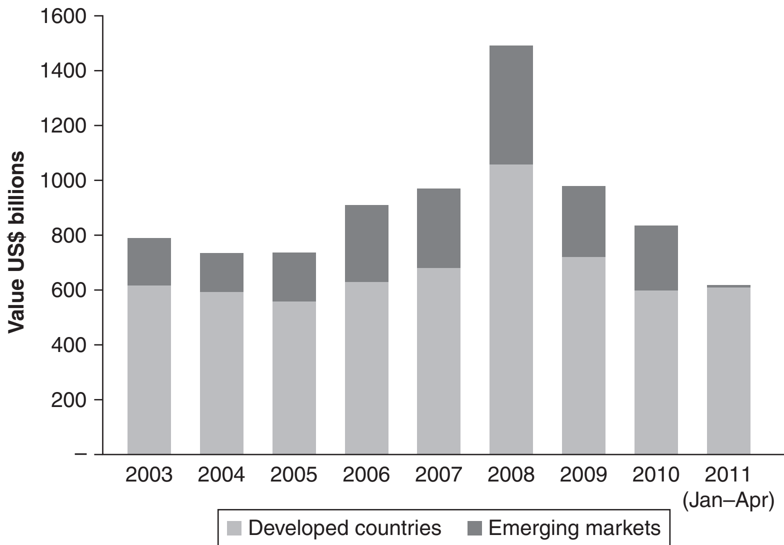

Figure 2.7 Value of greenfield projects by source, 2003–2011 (May) (US$ billions)
Source: Authors, based on data from UNCTAD (2011, annex table 18).

years to US$238 billion (ibid.). Nevertheless, over the course of the past decade, the share of emerging markets has increased gradually: From 23 per cent in 2003, it stood at 29 per cent by 2010 (ibid.).

Emerging markets: Coping with the crisis

The crisis that began in the banking and financial systems of the US and Europe in 2007, spread rapidly and spared few economies. Emerging markets have not escaped the crisis, but most have displayed greater resilience than developed economies, emerging earlier from the downturn, thereby strengthening their relative position in the global economy. That this has occurred less than a decade after a crisis had swept through Asia, Russia, Latin American, and Turkey, a decade that saw these economies become more closely integrated into the global economy, raises the question of how this group of economies has achieved this.

Coping strategies

The term ‘emerging markets’ encompasses a large, diverse group of economies, affected in different ways and to different degrees by the global crisis. In this section, we will examine the impact of the global

crisis on four key emerging markets: Brazil, Russia, India, and China, and examine how they have responded to, and coped with, it. We will consider the state of the economy at the onset of the crisis; the impact of the crisis on the economy and outward investment of MNEs; policy measures adopted in response to the crisis; and their success to date.

Brazil

Brazil, the largest economy in Latin American, enjoyed strong annual growth from 2000 to 2008, averaging 3.7 per cent, driven, in large part, by high commodity prices and increasing exports to China (UNCTADSTAT, 2012). Over this same period, the OFDI stock of Brazil more than tripled from US$54 billion to US$ 156 billion (ibid.).

The global crisis touched first on Brazil's financial markets. By the end of 2008, the value of the stock market had halved, and the real value of stocks depreciated as investors sought safe havens (Trading Economics, 2012). The crisis moved quickly to the broader economy. Foreign investment declined, commodity prices fell, and exports volumes declined as growth in Brazil's export markets, particularly its largest export market, China, slowed.

The Brazilian Government responded quickly to the crisis. In December 2008, it had launched a US$20 billion stimulus package, equivalent to 1.2 per cent of GDP, extending the Growth Acceleration Program of 2007 (Congressional Research Service, 2009: 75). The program included investments in infrastructure, tax cuts and measures to maintain household income, intended to shore up domestic demand. It was largely successful, and the large domestic market and stronger demand helped mitigate the effects of the global crisis on the economy. After contracting by 0.2 per cent in 2009, the economy grew by 7.5 per cent in 2010, one of the highest annual rates of growth since 1986 (OECD, 2010: 195).

OFDI activity by Brazilian MNEs was also curtailed during the crisis, and flows fell from US$20 billion in 2008, to minus US$10 billion in 2009, as intra-company loans were repaid, in order to shore up parent companies during the height of the crisis (ECLAC, 2009; UNCTAD, 2011). Growth resumed in 2010, and at US$11.5 billion, OFDI flows were just over half of their 2008 high (ibid.). However, the outlook for 2011 looks less positive, with concerns that high levels of intercompany loan repayment by foreign affiliates will result in negative outflows once again (see UNCTAD, 2011: 60). The higher than usual levels of intercompany-loan repayment may be the result of efforts to shore up parent companies, or it may be one solution to limited access to financing domestically. Unusual, as it is to see affiliates helping the

activities of their parent companies, this underlines the importance of OFDI to the continued success of Brazilian MNEs.

Russia

The 1980s and 1990s were a particularly turbulent period for the Russian economy, but that appeared to change in 1999, when Russia entered a decade of dynamic growth averaging 8 per cent per annum, driven largely by rising energy prices and a domestic lending boom (UNCTADSTAT). By 2007, Russia's foreign-held debt, including inherited Soviet-era debt, was paid down and the government debt to GDP ratio was only 7 per cent (The World Bank, 2012).Total financial assets were equivalent to only 68 per cent of GDP); there was a regular budget surplus, and foreign reserves totaled US$597 billion by mid-2008 (Nanto, 2009: 96). Over this period, Russian OFDI grew dramatically, from US$2 billion in 1999 to US$56 billion in 2008 (UNCTADSTAT). OFDI stock rose from US$9 billion in 1999, to US$370 billion by 2007 (ibid.).

The global crisis brought this decade of growth to an abrupt end. The fall in global demand caused commodity exports to fall and prices to collapse—extremely damaging for an economy in which ten of the twenty largest non-financial outward investors[5] are in the oil and gas, or metal industries (IMEMO-VCC, 2011: 2). More than half the value of the Russian stock exchange was wiped out between July 2008 and July 2009, as nervous investors withdrew (Financial Times, 2008: 13), and a weak banking system and tighter credit reduced domestic demand (Filippov, 2011). From growth of 8.5 per cent in 2007, the economy shrank by 7.8 per cent in 2009 (UNCTADSTAT). Over this same period, Russian OFDI stock also declined. Having grown 18-fold between 2000 and 2007 to a total of US$370, it fell by 44 per cent in 2008 to US$206 billion (UNCTADSTAT), reflecting a fall in the value of foreign assets, and firms pulling back after a period of rapid expansion (Panibratov and Kalotay, 2009). However, the downturn in 2008–2009 did not signal the beginning of an extended period of economic decline: The economy and OFDI both returned to growth in 2010, growing 4 per cent and 50 per cent, respectively (UNCTADSTAT).

How has Russia succeeded in coping with this global crisis, only a decade after a more-limited crisis forced the government to devalue its currency and default on its debt? One of the critical differences is that this was not a crisis solely of Russia's making and, as a result, its economy was less directly impacted than the economies of developed countries in whose banking systems the crisis had its roots. Strong global

growth before the crisis kept commodity prices high, allowing Russia to accumulate almost US$600 billion in currency reserves (Nanto, 2009: 96), including US$130 billion in the Stabilization Fund of the Russian Federation, created in 2004 (Ministry of Finance of the Russian Federation, 2012). As a result, the authorities enjoyed much greater 'space' in which to develop emergency policies in response to the crisis. The IMF estimates at 10.5 per cent of GDP the loosening that occurred in Russia's primary balance over 2008–2009 (IMF, 2010: 29), used to shore up the domestic economy through loans to banks, government purchase of stocks, emergency loans to strategically important firms, and a lowering of the corporate tax rate. Yet, not all efforts were successful: Attempts to support the ruble failed, at an estimated cost of US$200 billion (IMF, 2010: 28) and, finally, it was allowed to devalue.

The crisis highlighted structural weaknesses in the Russian economy: an over-reliance on the oil and gas and metal industry, and a weak banking sector. Yet, the government has done little to diversify economic activity; focusing resources on a small number of state-controlled firms further hampers private firms' access to capital (Nanto, 2009; Filippov, 2011). Finally, the government response has been criticized for its opacity (Jellinek, 2009; Wisniewska *et al.*, 2010; Filippov, 2011) with concerns that support went primarily to firms deemed strategically important, while failing to develop clear policies to support OFDI by Russian MNEs.

India

The years 2000 to 2010 saw India enjoy average annual growth of 7.9 per cent, its highest decade of growth since 1970 (UNCTADSTAT), driven largely by growing domestic demand. With the gradual liberalization of the economy from the 1990s onward, India became more closely integrated into the global economy through trade and capital flows, a trend that is reflected in the rapid growth of OFDI by Indian MNEs.[6] From US$1.4 billion in 2001, OFDI flows exceeded US$19 billion in 2008 (UNCTAD, 2011). In 2009, seven Indian MNEs featured among the top-100 non-financial MNEs of emerging markets (UNCTAD, 2011, annex table 30), in industries as diverse as metal and metal products and consulting services. Only one of the seven firms, Oil and Natural Gas Corporation Limited, is state-owned, reflecting the dominant role of the private sector in Indian OFDI.

As the home-country policy framework changed, so have the patterns of Indian OFDI. From an early concentration in manufacturing and an emphasis on south–south investments prior to 1991, Indian OFDI shifted toward investment in services, increasingly in developed

economies (Kumar, 2007). Deregulation spurred growth in the domestic economy, underlining the importance of securing access to natural resources. Between 2000 and 2007, 25 per cent of Indian OFDI was in the primary sector, with 40 per cent in manufacturing, and 35 per cent in services (Pradhan, 2011b). Hand in hand with this shift, OFDI by Indian MNEs increasingly took place through M&As in developed economies. Between 2000 and 2009, 58 per cent of all OFDI by Indian MNEs was in developed economies: Europe received 41 per cent of OFDI flows and North America 10 per cent, with 21 per cent in South-Eastern Asia (Pradhan, 2011a: 125, 127).

The greater openness of the Indian economy, with globalization acting as an accelerator in good economic times, lessened its resistance to the global crisis. From 9.6 per cent in 2007, the rate of growth of the Indian economy almost halved to 5.1 per cent in 2008, as exports fell and capital flows declined (UNCTADSTAT). The credit freeze limited access to overseas borrowing, a critical source of funding for cross-border M&As, and OFDI flows declined significantly. From a high of US$19 billion in 2008, OFDI flows from India fell by 18 per cent, to US$16 billion in 2009 (UNCTAD, 2011).

The Government responded swiftly to the global crisis through a combination of fiscal and monetary policy measures; its efforts focused on shoring up aggregate demand and maintaining liquidity. With domestic demand driving growth in the Indian economy, the downturn was short-lived (Pradhan, 2011b). The rate of growth picked up in 2009, reaching 7.7 per cent that year, and 8.5 per cent in 2010 (UNCTADSTAT). Yet, as the global downturn continued with developed economies worst affected, OFDI registered a further 8 per cent decline in 2010, falling to US$14.6 billion (UNCTAD, 2011).

China

China is the largest emerging market and, since 2011, the world's second largest economy, following three decades of average annual growth approaching 10 per cent, driven by the industrialization of the economy and its increasing openness to trade and foreign investment. Between 2000 and 2007 alone, annual growth averaged 10.5 per cent (UNCTADSTAT). OFDI by Chinese MNEs has also grown rapidly. From less than US$40 million in 1981, OFDI stocks totaled US148 billion in 2008, a 54 per cent increase on 2007 (UNCTAD, 2011). OFDI flows more than doubled from 2007 to 2008, to US$52 billion (ibid.). As a result of its growing trade surpluses and FDI, China's holdings of foreign reserves have increased dramatically, totaling US$1.6 trillion (excluding gold)

before the crisis (end 2007) and US$2.8 trillion at the end of 2010 (The People's Bank of China, 2008, 2010).

Despite its record of strong growth, the importance of trade and FDI to the Chinese economy exposed it to the recession in its largest export markets, the European Union and the US. By May 2009, exports were less than three-quarters of their level of the previous year (Congressional Research Service, 2009: 75). Inward FDI flows (IFDI), having doubled since the beginning of the decade, fell by 12 per cent in 2009 (UNCTADSTAT). The rate of growth of OFDI flows fell rapidly, from 132 per cent in 2007–2008, to 8 per cent in 2008–2009 (ibid.), but in a context in which world FDI flows halved. The impact on unemployment was swift, with the government estimating that 20 million migrant workers had lost their jobs in 2008 because of the crisis (Congressional Research Service, 2009: 75).

The Chinese authorities acted swiftly to mitigate the effects of the crisis on the domestic economy, launching a US$586 billion stimulus package in November 2008, equivalent to 12 per cent of GDP (Congressional Research Service, 2009: 75). The scale of the stimulus package and the speed with which it was announced, ahead even of the US announcement of a US$787 stimulus package in February 2009 (Recovery.gov), indicated the authorities' level of concern over the impact of the crisis on the Chinese economy. Their aim was to maintain aggregate demand through increased spending on infrastructure and social welfare, and tax deductions on capital spending by firms (Nanto, 2009). Monetary policy measures were also adopted: after a period of strengthening, the RMB was allowed to depreciate, interest rates and reserve requirements were lowered, and lending by state banks was eased (De Beule and Van Den Bulcke, 2010). Furthermore, the government sought to support OFDI by Chinese firms, by simplifying the approvals process, for example, and reducing restrictions on firms' lending to their affiliates (ibid.).

The measures adopted by the Chinese authorities in response to the global crisis were largely successful, sparing the economy from its worst effects. Growth, which had fallen from 14 per cent in 2007 to 9.2 per cent in 2009, exceeded 10 per cent in 2010 (World Bank Indicators). The rate of growth of OFDI picked up: From 8 per cent in 2008–2009, it reached 20 per cent in 2009–2010 (UNCTAD, 2011). By 2010, China's OFDI stock totaled US$298 billion, double their 2008 level (ibid.), as Chinese firms, unhindered by the credit crisis and taking advantage of lower asset prices, made a large number of acquisitions. Despite the apparent success of the policies implemented in mitigating the impact

of the crisis on the economy, concerns remain. While the measures implemented have helped Chinese firms weather the storm in the short term, will state-control hamper their ability to pursue policies based on economic objectives in the longer term? (De Beule and Van Den Bulcke, 2010).

The BRIC economies

The BRIC group of economies and the OFDI activities of their MNEs have shown great resilience in the face of the global crisis. As the crisis hit, MNEs responded by scaling back their OFDI: From a high of US$148 billion in 2008, OFDI flows fell by 14 per cent in 2009, to US$126 billion (UNCTADSTAT). Nevertheless, by 2010, activity had returned to pre-crisis levels and the combined OFDI flows from the BRIC economies totaled US$146 billion, 99 per cent of their record 2008 level (ibid.). In 2010, they accounted for 11 per cent of global OFDI flows, a dramatic increase on their 1 per cent share in 2000 (ibid.). For the first time, the combined OFDI stock of the BRIC group exceeded US$1 trillion in 2010, 5 per cent of the global OFDI stock (ibid.). This represented an almost tenfold increase on 2000, when their OFDI stock totaled slightly more than US$100 billion (ibid.).

There are a number of reasons for the resilience of these emerging markets and the OFDI activities of their MNEs in the face of the worst global crisis since the 1930s. The global crisis began in the financial markets of developed economies, where more than two decades of deregulation had reduced considerably levels of oversight and control at a time of great innovation in financial products. This was not the case in emerging markets, where the harsh lessons learned from the emerging markets crisis of the 1990s were still fresh. Governments in these economies have maintained a much greater role in the operation and supervision of financial markets. In addition, total levels of debt, especially foreign currency denominated debt, were low, and sustained budget surpluses combined with high levels of FDI, enabled governments to accumulate significant foreign currency reserves. Despite some initial weakening, therefore, emerging market currencies generally remained strong, limiting the impact of the crisis on the domestic economy.

High levels of growth in emerging markets are often attributed to the important role of exports in their economies. Exports are indeed important but their relative importance is declining. Instead, it is their strong domestic demand, with high levels of consumption and investment that has supported high growth rates in most emerging markets, and insulated them from the worst of the crisis. High savings rates and bank

deposits have supported domestic lending; critically, bank lending did not decline at the onset of the crisis. The authorities did not raise interest rates, and in a number of economies, including India, interest rates were lowered.

Emerging markets have benefited from the dominance of FDI in their private capital flows, generally considered a more stable form of capital than portfolio investment or other forms of debt finance such as loans and bonds. However, even FDI is not quite as stable a form of capital as it once was considered to be, as its composition also shifts from mainly equity to debt in the form of intra-company loans. The risks associated with this are seen in the OFDI from Brazil, which is expected to decline or become negative in 2011, the result of higher than usual levels of intra-company loan repayment (UNCTAD, 2011: 60). There are a number of possible explanations for this: Weaker performance in the home market may have reduced profitability, or access to capital may have become more limited; but the fact that foreign affiliates are shoring up their parent companies further underlines the importance of OFDI.

OFDI by emerging market MNEs has taken the form of greenfield investment for the most part, while developed country MNEs have relied more on M&As. The latter are more vulnerable to shocks to the financial system and, as liquidity and funding dried up, the number of M&As undertaken by developed economy MNEs fell rapidly. Emerging market MNEs, especially relatively young firms, have not enjoyed the same access to international capital markets, and they and their OFDI activities consequently suffered less. In those instances in which emerging market MNEs do engage in cross-border M&As, they are more likely to pay for them in cash rather than in shares (World Bank, 2011: 83–84), a decision linked to the ownership nature of these firms and the limitations of their domestic capital markets. Emerging market firms are more likely to be family or state-controlled entities that seek to avoid any dilution of their control, and so prefer to pay for acquisitions in cash (ibid., Resende *et al.*, 2010).

Finally, the strong performance of emerging markets and their MNEs highlights how critical it is to maintain strong economic fundamentals. Thanks to their sound economic management pre-crisis, with large foreign exchange reserves and low levels of national debt, these governments had the necessary ‘policy space’ to implement emergency measures to shore up their economies during turbulent economic times.

Global players from emerging economies: challenges ahead

In the immediate aftermath of the crisis, the attentions of key actors were focused on responding to its most pressing challenges and, to date, these efforts have proven relatively successful. By the end of 2010, OFDI flows from emerging market MNEs had reached a new high of US$388 billion (UNCTADSTAT). Inward investment to emerging markets has also made a strong recovery, reaching US$753 billion in 2011, 97 per cent of its 2008 high (UNCTAD, 2012). However, numerous other challenges persist, some inherent in the rise of these new global players, others resulting from the ongoing economic crisis. This section addresses a number of these risks and challenges, and considers the path ahead.

Key strategic challenges for emerging market MNEs

Perhaps the single most important challenge that emerging market MNEs face relates to their human resources. Building a successful, integrated international production network is a formidable challenge, to do so through the successful integration of acquired firms amplifies the difficulties. It places considerable demands on their human resources, in particular on their managerial skills and capacity. Moreover, the scale of the challenge is relatively higher for emerging market MNEs: Internationalizing often at an early stage in their development (and more recently), they have had less time to develop such skills and capacities. Those emerging markets that have a longer and greater experience with OFDI have distinct advantages in this area, having been able to develop management skills, expertise, and an understanding of international markets (Jaklič and Svetličič, 2010).

Emerging markets MNEs that have undertaken OFDI more recently are less likely to have built up expertise and capacity in integrating acquisitions and managing foreign affiliates, a gap that may be further compounded by an unwillingness to hire non-national managers. An example is Brazil, where the level of foreign managerial employment among leading MNEs is almost half that of the 100 largest developing country MNEs (Resende *et al.*, 2010: 104). Family-controlled MNEs seek to avoid any dilution of their control and high levels of 'in-group collectivism' (ibid.), and such practices complicate further the building of international management networks and do not bode well for the ability of those MNEs to create integrated international production networks.

There are also broader challenges to be met. MNEs face the continuous challenge of balancing opportunities and risks. The rapid pace of globalization and industry consolidation has led in many cases to a mind-set of 'hunt or be hunted' (Price Waterhouse Coopers, 2007: 5). One illustrative industry in this respect is mining, where record commodity prices facilitated the paying down of debt incurred to pursue acquisitions. Industry players saw consolidation as essential to achieving economies of scale and synergies in operations. Today, however, the dominance of resource-based firms in the OFDI of a number of emerging markets brings its own set of challenges (Kalotay, 2010). Natural-resource-based firms account for four-fifths of the foreign assets of the top 25 Russian MNEs, for example (ibid.). Their rapid expansion took place on the back of high commodity prices. While commodity prices have recovered, high levels of debt make for an uncertain future, in which divestiture and further industry consolidation may be the only options available.

Sustainable FDI is another area that presents potential challenges for emerging market MNEs, looking at the importance of FDI along four dimensions: 'economic development, environmental sustainability, social development, good governance' (VCC-WAIPA, 2010: 4) rather than in dollar and employment terms. Just as emerging markets become important players in global FDI markets, the scale against which importance is measured is shifting from quantity to quality (Filippov and Guimón, 2009). This represents a challenge for all MNEs—but the scale of the challenge is perhaps greater for emerging market MNEs. In the case of these MNEs, importance to the domestic economy is still measured in terms of dollars and employment created. In addition, emerging market MNEs are important investors in natural resources, a sector in which until recently the focus has been on short-term contributions measured in dollar terms. The ability of emerging market MNEs to adapt to these new standards is critical to their continued growth and success—and may ultimately have spillover effects in the home country, leading, in the longer term, to a harmonization of standards upwards.

Challenges for home country policies

Today, while the landscape of home country OFDI policies is very uneven, the vast majority of emerging markets do not provide a supportive environment for the OFDI activities of their firms, placing them at a competitive disadvantage vis-à-vis their developed country counterparts. The principal challenge for home country policy in emerging markets is, within the constraints of limited resources and widespread needs, to create an environment and policy framework that supports

domestic firms. This framework should enhance their competitiveness, enable them to compete effectively in the global arena and, ultimately, secure the benefits of OFDI for their home countries. Certainly, the substantial rise in outward investment from emerging markets is a relatively new phenomenon, and national policy is not written or rewritten overnight. On the one hand, if emerging market firms are disadvantaged by a continued lack of supportive policies, and thus are hampered in their competition on the world market, they may, in extreme cases, shift their base to another country in order to stay competitive. On the other hand, the scope of government action and policy-making is constrained by economic reality—limited resources, scarce foreign reserves, and potential concerns over the export of capital and jobs.

The lack of a supportive policy framework in many emerging markets[7] stands in contrast to developed countries, which have built an extensive and comprehensive policy framework over decades, policies that have evolved in tandem with, and complement, their economic situation. The result has been a gradual but persistent shift in home country policy from restricting and controlling OFDI, to permitting it, and finally to promoting OFDI actively, reflecting the recognition that, in a global market, firms must be globally competitive, with OFDI being one source of such competitiveness.

The experience of developed countries in building a policy framework for OFDI offers lessons for policy-makers in emerging markets. In the aftermath of World War II, early restrictions on OFDI focused on capital and foreign exchange controls. Gradually phased out by the early 1980s, these controls were eliminated, finally, as a global capital market became a reality. From restrictions on OFDI, developed countries adapted policies to shape and, ultimately, promote OFDI[8] (Buckley *et al.*, 2010). However, even with a detailed understanding of the policies implemented in developed countries, challenges remain for emerging markets. While the lack of a clear policy framework leaves domestic firms at a competitive disadvantage, changing the situation is not without its own challenges, given the lack of domestic experience and competence in this area, the risks of regulatory capture, and the absence of a significant social safety net (ibid.).

Coming through the crisis with their relative position in the global economy strengthened has done little to reduce the policy dilemma facing emerging markets. The need for firms to acquire a portfolio of locational assets in order to retain and maximize their competitiveness in a global setting must be balanced against the broad macroeconomic interests of home country needs. Concerns over the export of jobs are as

relevant in emerging markets as in developed economies (Broadman, 2010). Where national champions or state-owned enterprises (SOEs) from emerging markets undertake FDI, this poses potential political challenges for the home country as much as for the host country. Whilst a relatively small share of total OFDI in most emerging markets, as SOEs move abroad and 'grow up,' they may well seek greater independence in determining their own economic future, free from political constraints (ibid.). Furthermore, critics argue that SOEs crowd out more efficient private companies in markets for financial and human capital (The Economist, 2012: 11). How do home country policy-makers retain control, without hindering the competitiveness of their SOE-MNE? This question remains unanswered; but to hope that as they mature and expand, SOEs will simply throw of their political shackles is unrealistic.

Information on the experiences of developed countries and the different policy options available is useful for emerging markets, but how applicable is it? Furthermore, even with this information, the challenge of sequencing shifts in policy remains. The fact that emerging market MNEs may be 'born global,' or may skip stages of development and internationalization does nothing to lessen the complexity of the policy makers' task (De Beule and Van Den Bulcke, 2010). Rapid globalization and the early internationalization of emerging market MNEs render redundant some of the policy lessons from developed countries. It is more likely that emerging markets will instead combine elements of policy from different stages of development—the selective promotion of OFDI, for example, with retaining elements of control (ibid.).

China is an example of how one particularly important emerging market has addressed the challenges for home country policy and, in particular, the shift from OFDI restriction to promotion. China's OFDI policy evolved in three phases from 1984 to 2008 (Xue and Han, 2010). Adopted largely out of economic necessity in 1984, early policy involved strict controls on OFDI. By 1991, the domestic policy environment had liberalized gradually, and OFDI's role in economic growth was endorsed. From 1991, OFDI policy focused on large SOEs until, in 2000, funds were established to encourage the internationalization of small and medium-sized firms. The year 2000 also saw the unveiling of China's 'Going Global' policy and the differentiation of OFDI policies into policies of regulation, guidance and support (ibid.). China offers a particularly interesting example: It embraced 'Open-Door' policies only three decades ago but, in a relatively short period, OFDI flows have grown considerably, from only US$44 million in 1982 to US$68 billion in 2010 (UNCTADSTAT). Furthermore, the continued and prominent role of SOEs in the Chinese economy and the country's OFDI allows

the government a degree of direct influence, impossible for most other national policy-makers.

Challenges for host country policies

In spite of the global economic turmoil, the investment climate for FDI remains overwhelmingly welcoming, and virtually all countries seek to attract inward investment (Figure 2.9). While a certain number of restrictive and adverse measures have been introduced even before the onset of the global crisis, they should be considered in the context of an investment environment that is already largely open. Furthermore, the vast majority of the regulatory measures introduced were limited to specific sectors, including land ownership and investment in natural resources (Economou and Sauvant, 2012), particularly sensitive sectors even in the best of economic times. The OECD's FDI Restrictiveness Index for 2010, measuring the restrictiveness of FDI policies across 48 countries (Figure 2.8) shows that on a scale from 0 (open) to 1 (closed)

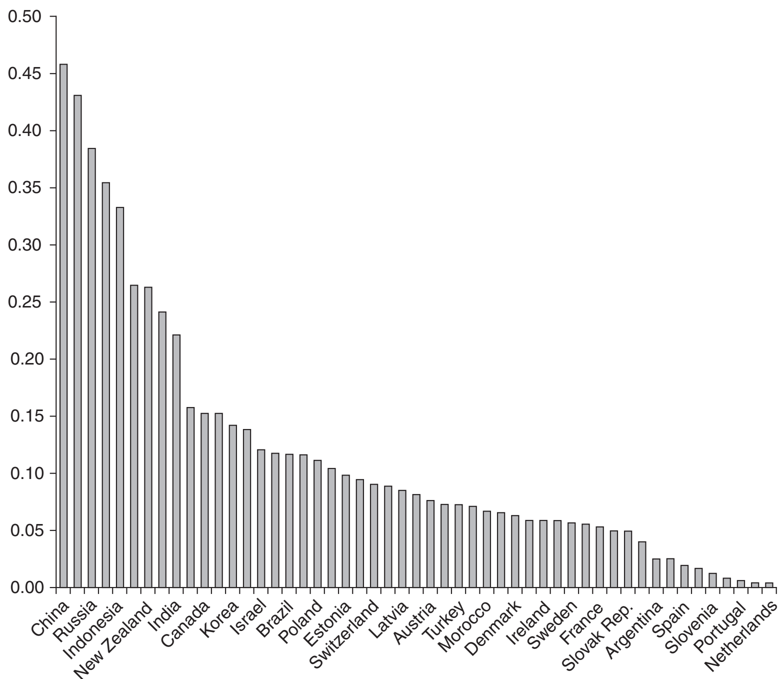

Figure 2.8 OECD's FDI Restrictiveness Index, 2010
Source: Authors, based on OECD (2010).

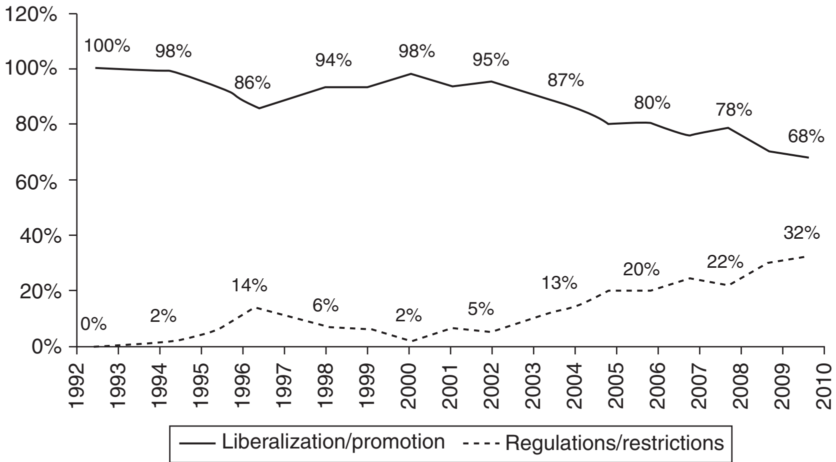

Figure 2.9 National regulatory measures, 1992–2010 (%)

all major economies are rated below 0.46, and most are rated below 0.15 (OECD, 2010).

Yet, a distinct trend toward a more restrictive investment climate has emerged over the past decade (Figures 2.9 and 2.10) and, in 2010, one-third of all national regulatory measures imposed greater regulation or restrictions on FDI.[9]

In a regulatory environment that has become more restrictive, the rise of outward investment from emerging markets presents its own set of challenges for host country policies, particularly for developed host countries. As noted above, investment by emerging market MNEs in developed economies generally takes the form of acquisitions, often considered less attractive by the host country because of the limited contribution to increased economic output. That the firms being acquired may be deemed part of a 'strategic sector,' raises further concerns over national security. When the acquiring firm is a state-owned enterprise or a sovereign wealth fund, this only amplifies host country concerns. In the US, the share of inward investment notices that progressed to investigations rose from 15 per cent in 2008 to 38 per cent in both 2009 and 2010 (Table 2.2) (Committee on Foreign Investment in the United States, 2011: 3).

The rapid rise in OFDI from China in the past decade and the dominant role played by SOEs in this outward investment represents a particular challenge to host country policy for the US (Sauvant, 2010a,b).

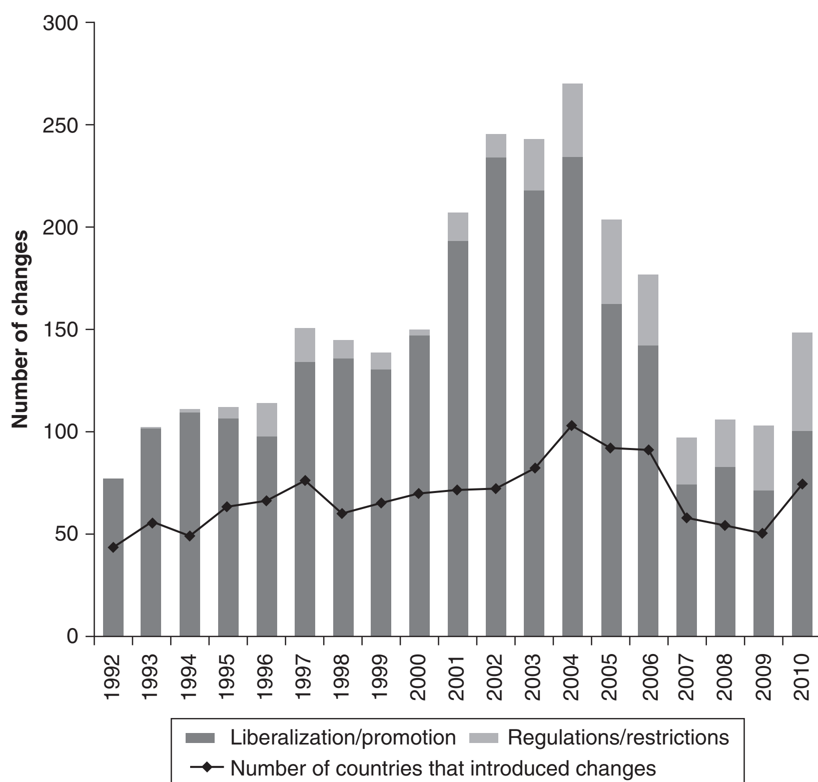

Figure 2.10 National regulatory measures, 1992–2010
Source: The authors, based on UNCTAD 2008 (13) and UNCTAD (2011) (94).

Table 2.2 CFIUS: Covered transactions, withdrawals, and presidential decisions, 2008–2010

Year	Number of Notices	Notices Withdrawn During Review	Number of Investigations	Notices Withdrawn During Investigation	Presidential Decisions
2008	155	18	23	5	0
2009	65	5	25	2	0
2010	93	6	35	6	0
Total	313	29	83	13	0

Source: Based on the Committee on Foreign Investment in the United States, Annual Report to Congress (2011: 3).

By the end of 2010, China had invested almost US$298 billion abroad, a near ten-fold increase since 20000 (UNCTADSTAT). China is the US government's largest creditor: It holds US$1.6 trillion of US securities and foreign exchange reserves of US$3.2 trillion (Morrison and Labonte, 2011: i). The fact that the vehicle of choice for most of this OFDI has been mergers and acquisitions only exacerbates tensions. Policy in the US has become more cautious in recent years, especially with regard to Chinese firms. National security concerns play a more important role in shaping this policy, fed by fears that Chinese investment decisions are driven as much (if not more) by strategic and political motivations rather than by economic motivations. This situation is not completely new, however: Japanese investment once stirred up similar fears, which were successfully allayed when Japanese firms worked closely with the different stakeholders in order to become 'insiders' (ibid., Milhaupt, 2010).

Host country apprehension—founded or not—that certain acquisitions are driven by political rather than commercial objectives will do nothing to reduce restrictions on FDI. Unchecked, this could evolve into FDI protectionism, inflicting damage on the recovery, continued integration, and smooth functioning of the global economy. Protectionism on the part of developed countries, traditionally the main proponents of liberalization, in response to the emergence of new players would border on hypocrisy, and would deprive host (developed) economies of the widely recognized benefits of FDI. Restricting the access of these new players to developed markets would deny their firms vital access to new skills, technologies, and markets, preventing them from building the portfolio of locational assets so essential to their global competitiveness. Ultimately, opportunities for both growth and development, for the firm, home and host economy, would be lost.

The path ahead

Two decades ago, outward investment from emerging markets accounted for less than 8 per cent of the world's outward investment stock (UNCTADSTAT). The Soviet Union had only recently reintroduced the right of private ownership in an attempt to stimulate its economy. Fifteen years ago, the Asian financial crisis devastated economies across the region and beyond. Today, as global players from emerging markets move toward the center of the world stage, the world is in the grip of the worst economic crisis since the 1930s, a crisis that broke over four years ago and that shows little sign of ending in a number of countries. Looking ahead, what are the main challenges facing FDI and the main actors

in this process? Will the current economic downturn require them simply to ride out this crisis, with normal business resuming as soon as possible? Alternatively, will the combination of the rise of global players from emerging markets and the global crisis require the rules of FDI to be rewritten?

Perhaps the single most important challenge that emerging market MNEs face relates to their ability to address the heightened levels of political risks resulting from the ongoing global crisis. The relative youth of many emerging market MNEs serves to increase the scale of the challenge. Broadly defined as 'the probability of disruption of the operations of companies by political forces and events' (MIGA, 2011: 21), until recently, the challenges presented by political risk have been viewed largely in the context of MNEs from developed countries investing in emerging markets. The global crisis has shattered this assumption.

It is important to recognize that, having developed in riskier political and economic environments, emerging market MNEs' notions of risk can be very different from those of developed countries' MNEs. Generally, the greater the levels of political risk in the home country, the greater the tolerance for risk that MNEs develop (MIGA, 2010). Location, sector, size of investment, and home country environment and earlier experience with outward investment all shape their perception of political risk (ibid.). Interestingly, in terms of entry mode, while greenfield investments are considered economically more desirable and less politically risky in developed countries, emerging market MNEs consider them more risky in other emerging markets where 'the presence of a domestic partner tends to reduce risk perceptions' (MIGA, 2010: 228). Fortunately, governments—alone or in conjunction with the private sector—have the ability to minimize the impact of political risk on investment decisions through the provision of insurance, a policy tool that should become an increasingly important element of home country policy in emerging markets.

However, since the onset of the global crisis, emerging market MNEs are most concerned by changes in the regulatory framework (Figure 2.11) and more concerned about such changes to the investment climate than they are about the state of the global economy and access to financing (MIGA, 2011). In particular, it is 'the instability of the regulatory regime ... rather than the regime itself' that concerns investors (MIGA, 2011: 22). The dramatic growth and strong performance of emerging markets and their MNEs mitigated the scale of the global downturn. The recovery of the global economy is patchy and remains

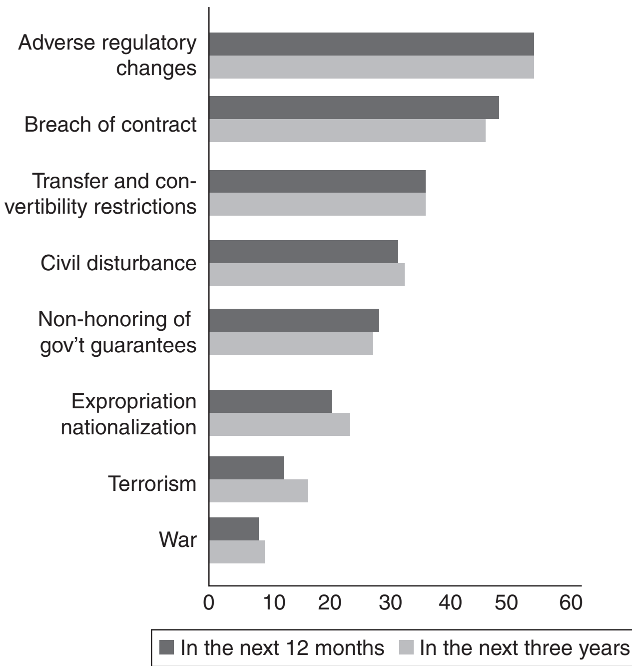

Figure 2.11 Types of political risk of most concern to investors in developing countries (% respondents)
Source: MIGA-EIU Political Risk Survey, reproduced in MIGA (2011) World Investment and Political Risk Report, 20.

fragile. It is vital that efforts are made to keep the global economy open to outward investments from emerging markets.

The financial crisis and subsequent government rescue programs have increased previously high public debt to unsustainable levels in several developed economies—in excess of 100 per cent of gross domestic product (GDP) in Ireland, Portugal, Greece, and Italy (Eurostat, 2012). Not since the 1930s has a Western European country defaulted on its debt, but there is real concern today that, orderly or disorderly, Greece cannot avoid a sovereign default. Greece's creditors are at immediate risk, and investors are wary of an economy that is in its fifth year of contraction. The greatest risk, however, is that this sovereign debt crisis will spread beyond Greece to other highly in debt Eurozone economies: Ireland, Portugal, Spain, and (of most concern given the size of its economy) Italy. The potentially disastrous consequences for the European

economy should fears of contagion become reality, make this one of the most pressing risks of the day. Moreover, the EU is a key pillar of the global economy, a vital source of, and destination for FDI, with the Euro a global reserve currency that accounts for close to 27 per cent of the world's currency reserves (The Economist, 2011). Whatever happens within the Eurozone and the European Union, therefore, will have dramatic implications for the global economy and FDI. Rising levels of civil unrest hinder the economic reform efforts of national governments and raise concerns about the stability and predictability of future policies. The crisis in Greece has laid bare the slow and unwieldy nature of EU policy-making and, more worryingly, the divisions that exist among member nations, exacerbated in these tough economic times. Further uncertainty in this region could well tip the global economy back into recession.

Conclusions

This chapter has sought to place the rise of emerging market MNEs in context, examining the role of these new global players in global FDI flows, how they have responded to the global crisis, and the challenges inherent in their rise for MNEs themselves as well as for home and host countries. Whatever the tensions and temporary setbacks, the great number of firms undertaking FDI will build an ever more interconnected and integrated international production system.

All this, finally, needs to be seen against one basic fact: Countries do not look at FDI as an end in itself. Rather, it is seen as a tool to advance their development, be it as a home country or host country. As part of that, FDI is a powerful means to help countries in their integration into the world economy. In addition, economic development through integration into the world economy is one of the means by which countries lift themselves out of poverty. Despite the global crisis, much progress has been made in recent years, yet much remains to be done—and the greater the number of firms involved in this process the better it is for all of us.

Finally, efforts to build a multilateral investment framework must be stepped up. The need to address and allay concerns that feed growing economic nationalism and FDI protectionism is not limited to MNEs, home and host country governments: This situation highlights the important role that international organizations must play if the international investment regime is to remain relatively open, transparent, and stable. An international framework, establishing best practices and

minimum standards, and bringing greater transparency to the now truly international investment regime are to the benefit of all.

Notes

1. According to UNCTAD terminology, the group of 'developed economies' comprises the 27 Member States of the European Union, plus Australia, Bermuda, Canada, Gibraltar, Iceland, Israel, Japan, New Zealand, Norway, Switzerland, and the US. 'Emerging markets' comprise both 'developing countries' and 'transition economies.' The 'transition economies' group consists of the six countries of Southeast Europe (Albania, Bosnia and Herzegovina, Croatia, The FYR of Macedonia, Montenegro, and Serbia) as well as the twelve countries of the Commonwealth of Independent States (CIS): Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, the Republic of Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan. All other countries are 'developing countries'.
2. For a full discussion, see Sauvant *et al.* (2010); Sauvant (2010); Ramamurti and Singh (2009); Ramamurti (2008); Sauvant *et al.* (2008).
3. See UNCTAD (2011, annex table 25), note [a].
4. UNCTAD (2011, annex table 25) Notes states that 'Data should be interpreted with caution. The world total was extrapolated on the basis of data covering 29 countries in 1990 and 54 countries in 2009, or latest year available. They account for 82 and 89 per cent of world outward FDI stock, respectively, in 1990 and in 2009. Only countries for which data for the three main sectors were available were included. The distribution shares of industries of these countries were applied to estimate the world totals of sectors and industries. As a result, the sum of the sectors for each group of economies is different from the totals shown in annex table 2. Approval data were used for India (2005 instead of 2007) and Taiwan Province of China. For 1990, the world total includes the countries of South-East Europe and the CIS although data by sector and industry are not available for that region. Moreover, as major home developing economies were not covered due to lack of data, the respective shares for developing economies were underestimated in that year,') http://www.unctad.org/sections/dite_dir/docs/WIR11_web%20tab%2025.pdf, last visited March 9, 2011).
5. Measured by foreign assets.
6. For a discussion of the rise of Indian MNEs, see Sauvant *et al.* (2010).
7. The term 'emerging markets,' the grouping together of developing countries and transition economies, risks giving the impression, falsely, of a homogenous group of countries. It should also remind us of the limitations inherent in any attempt to construct one policy framework that fits all emerging markets. The key to successful policy is to ensure that it is appropriate to the stage of development of the national economy.
8. The authors group these measures into seven categories: '(i) the provision of information and technical support, (ii) financial support, (iii) fiscal incentives, (iv) investment insurance and guaranteed, (v) support of national champions, (vi) international investment related concordats and agreements,

and (vii) official development assistance (ODA) programs' (Buckley *et al.*, 2010: 259).

9. Available data for 2011 (January–September 15), appear to show a slight shift toward a more relaxed investment climate, with almost three-quarters of all the measures adopted liberalizing or promoting FDI, but it is perhaps too soon to draw any definitive conclusions.

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PROOF

Index

The names of all authors are not listed in the index; readers wanting the names of all authors and titles of all sources are advised to refer to the references after each chapter.

Abramczuk, C., 124, 127, 129
ACP (Asseco Poland), 96
acquisition activity, 52, 74
acquisitions, 6, 8, 21, 28, 30–2, 36, 38, 47–69, 72–5, 79–82, 96–7, 149, 179, 186–7, 192–4, 200, 205, 207–8, 210, 212, 217, 221, 229–30, 233, 236, 243, 245, 276, 278, 281
  strategic, 13, 184, 219
  vertical, 57–8, 61, 63–4, 66
advanced countries, 47–8, 53, 56, 63, 66, 67, 73, 74, 143
Afonso, A., 87
Africa, 5, 95, 156, 158, 163–4, 193, 198, 226, 245, 347
Agromashholding, 196
Aguilera, R., 158–60, 170–1, 173
Aharoni, Y., 316
Ahokangas, P., 336
Akhter, S., 294
Alamdari, F., 306
Albania, 42, 96, 277
Aldrich, H., 121
Alfa-Bank, 195
Algeria, 226
Aliber, R., 141
Allen, R., 182
Almaz Capital, 197
Alpina, 273
Altzinger, W., 263, 288
Alvarez, R., 183
Ambos, B., 248
Amburgey, T., 121, 158
American companies, 347
Andersen, O., 315
Andreff, W., 84, 181
Apigian, C., 125
Arbat Prestizh, 200
Arcelor Mittal, 323
Arenius, P., 116–17
Argentina, 4–5, 35, 184, 235
Armenia, 42, 195
Arratibel, O., 85, 99
ASEE (Asseco South Eastern Europe), 96
Ashby, W., 104, 129
Asia, 5, 23, 87, 95–6, 100, 108, 154, 164, 182, 193, 198, 245, 282, 299, 301, 307, 313, 321, 326–7, 330, 333
Asian countries, 109, 162, 165
Asian crisis, 1, 157, 183, 218
Asian economic crisis, 81, 221, 313
Asian financial crisis, 38, 260
Asian firms, 94, 143
Aspelund, A., 337
assets, 25, 60, 64, 68, 73, 95, 109, 137, 141, 181–2, 188, 194, 199, 202, 205–6, 217, 223, 236, 263, 281, 285, 305, 308, 314
  acquisition of, 215–16
  financial, 1
  fixed, 188
  managerial, 64
  physical, 61
asset specificity, 57
Athukorala, P., 183
Aulakh, P., 116, 318
Australia, 42, 95, 132–3, 152, 156, 164, 167, 193, 311, 352, 364
Australian Manufacturing Council, 338
Austria, 35, 54, 86, 91–2, 96, 167, 174, 195, 200, 202–4, 270, 278, 284

PROOF

automotive industry, 94, 97, 188, 208, 222–4, 226–7, 229–30, 232, 237, 272, 278
automotive manufacturers, 223, 235–6
average OFDI flows, 15
average R&D spending, 55
AvtoVAZ, 191, 192, 196, 202, 208
Aykut, D., 261, 288
Azerbaijan, 42, 195

Baek, H., 141, 151
Bahrain, 3
BAIC (Beijing Automotive Industry Corporation), 226, 233–4, 236
Baltic countries, 165, 302
Baltika, 195, 200
Bangladesh, 167, 226
Bank of China, 28, 45, 236
banking sector, 97–8, 187, 263
bankruptcy, 93, 269, 273–4, 299, 305
Bank of Slovenia, 270
Bardhan, P., 230, 238
Barkema, H., 155, 158–60, 171–3
Barnard, H., 48–9, 51–2, 54, 56, 143
Barney, J., 241
Barrett, N., 118, 122–3
Barrington, L., 266, 284
Bartlett, C., 113, 120
BCG, 67
Beamish, P., 113, 115, 120, 294, 335, 340
Beaver, G., 292–3, 306
Beijing, 175, 229, 234, 321
Beijing Geely Kaixuan International Investment, 236
Belarus, 42, 194–5, 204, 302, 324–5, 346
Belgium, 54, 86, 88, 92, 196, 203
Bell, J., 119, 132, 174, 336–40, 362
Benito, G., 159, 173, 181, 294, 335, 340
Bennett, R., 115, 118
Benson, J., 110
Benson-Rea, M., 335
Berlin Wall, 84
Berry, M., 104, 114, 120, 122–3
Bertoncelj, M., 278, 284, 286–7
Bertoni, F., 8, 47
Beugelsdijk, S., 256
Billington, N., 142, 247
Birley, S., 338
Blaine, M., 112
Blomkvist, K., 9, 154
Blonigen, B., 141–2, 149
Boddewyn, J., 315
Bolivia, 174
Borås Wäfveri AB, 299
Borghoff, T., 8, 102, 104, 122
born global firms, 12, 109, 115, 334–41, 349, 361–2
Born Global Model, 338, 349, 359
born globals, 34, 109, 114, 117, 133, 334–6, 338, 340, 358–9, 362
Bosnia-Herzegovina, 42, 85, 96, 203
Boudier-Bensebaa, F., 84
Bower, J., 112
Bradley, S., 111
brand, 57, 228, 236, 238, 241, 243, 324–5
  awareness, 65
  recognition, 66
Braun, M., 293, 305, 312
Brazil, 4, 8, 16, 24, 30–1, 35, 49–50, 52–3, 56, 61, 67–70, 82, 84, 97, 129, 142, 177, 179, 181–2, 184, 198, 226, 274, 278, 287, 296, 340, 353
Brennan, L., 9, 138
Brewer, T., 159
BRIC acquisitions, 8, 50–5, 57, 61, 68, 74
  in Western Europe, 50, 69
BRIC countries, 5, 56, 74–5, 217, 266, 271, 282
BRIC economies, 5–8, 29, 184
BRIC firms, 49, 65, 67, 75
BRICs, 47, 49–53, 55, 58, 60, 65, 67–9, 72, 74–5, 82, 177, 181, 271
Bridgewater, S., 104, 117
British Virgin Islands, 194, 200, 300
Brock, B., 104, 114, 120, 122–3
Brunner, S., 158
Brynjolfsson, E., 112
Buckley, P., 33, 43, 57, 61, 84, 137, 141, 154, 156–7, 160, 162–3, 170, 172–4, 181, 240–2, 244, 247–9, 294, 315

PROOF

budget deficits, 86
Bulatov, A., 181–2
Bulgaria, 85, 87–8, 92, 96, 205, 301
Burger, A., 267–8
business activities, 19–20, 79, 183, 320
business environment, 216, 308
business groups, 81, 152
business models, 112–13, 124, 260, 266
business networks, 128, 336
Buttriss, G., 119

Calderon, C., 260
Calof, J., 294, 335, 340
Cambodia, 198
Campbell-Hunt, C., 339
Canada, 35, 42, 49, 54, 149, 163, 194, 197, 204, 206, 296, 343–4, 346, 349, 351
Cantwell, 48, 51–2, 54, 56, 111, 120, 122
capabilities, 48, 113, 123, 143, 225–6, 230, 236–7, 248, 280, 315
  catch-up, 320
  downstream, 63
  dynamic, 134, 294, 312–13
  technological, 143–4, 150
capital
  flight, 157, 187
  flows, 26–7
  intensity, 222
  investment, 2, 21
  social, 283
  state-owned, 216
capital markets, 142, 272
  domestic, 30
  international, 30
Capron, L., 49, 57, 241
Cardone-Riportella, C., 317
Carman, J., 316
Casson, M., 57, 156, 315
Castellacci, F., 315
Castells, M., 104
Cavusgil, S., 115, 120, 316, 337–9, 349
Cayman Islands, 164, 194, 200
Cazorla-Papis, I., 317
CEE (Central and Eastern Europe), 8, 83–4, 86, 88, 90, 92, 94–6, 98–100, 263, 273, 307
  countries, 85, 87–90, 92–3, 95, 97–9
  firms, 84, 95
  region, 84, 87, 90, 98
Central Asia, 156
Central Bank of Chile, 218
Chadwick, M., 314
Chakrabarti, A., 144, 244, 246–7
champions
  hidden, 262, 267–8, 283, 285, 290
  national, 34, 42, 223, 227
cheetahs, 11, 274–5, 278, 280–1, 285
Chetty, S., 295, 339
Child, 116, 155–6, 181, 320
Chile, 226
China, 2–6, 8–9, 24, 27–8, 34–6, 38, 43–5, 49–54, 67–70, 81–2, 107–8, 154–8, 160–5, 167–8, 170–4, 177–9, 181–2, 222, 224, 226–9, 231–2, 234, 236–8, 271–2, 285, 287, 296–7, 321–2, 343, 346–7
  Daily, 236, 238
  Ministry of Foreign Affairs, 164, 175
  OFDI, 155–6
  OFDI policy, 34
  OFDI stock, 28
  Statistical Yearbook, 162–4, 177
Chinese, 8, 10, 52, 61, 74, 81, 122, 152, 154, 157, 184, 222–32, 234–8, 285, 289, 335, 342–4, 346, 355
  acquisitions, 56–7, 60
  authorities, 28, 222, 224, 227–9, 236
  automaker Geely, 179
  automobile groups, 225
  brands, 238
  business networks, 175
  Communist Party, 223
  companies, 69, 72, 154, 160, 228, 232, 320
  consumers, 229, 232, 236
  Diaspora, 176
  economy, 28, 34, 157, 223, 230
  enterprises, 227, 232–3
  firms, 9, 28, 38, 53, 56, 60, 73, 82, 85, 95, 156–8, 160, 168, 171–3,

PROOF

175, 177–8, 181, 218, 222–3, 225, 230, 233, 236–8, 332, 341
  government, 10, 53, 155–7, 164, 174, 223, 231, 285
  manufacturers, 223, 225, 235, 238, 346
  market, 224, 229, 238, 349
  minorities, 158, 162, 173
  minority groups, 155, 158, 172
  OFDI, 9, 53, 79, 154–6, 158, 160–2, 164–5, 168, 170–4, 244
  partners, 227, 231–2, 286
choice, 38, 72, 74, 117, 142, 151, 242–4, 316–17, 329, 331
Choudry, Y., 294, 311
Chowdhury, A., 149
Cirman, A., 264
CIS (Commonwealth of Independent States), 42, 100, 182, 193–5, 200, 217–18, 326–8, 330
Clausen, L., 172
co-evolutionary approach, 365
Colombia, 167–8, 174, 198, 296
Commerzbank, 209
commitment, 183, 334, 336, 339, 353
commodity prices, 24, 26, 32, 217
communication technologies, 9, 102
companies
  foreign controlled, 264
  gas, 204–5
  high-tech, 318, 328, 330
  independent, 238
  international, 321, 326
  local, 256, 323, 325, 327
  parent, 24–5, 30, 209, 256, 299, 309
competence
  core, 283
  new, 266
  organizational, 67
  technological, 130
competition, 33, 47, 91, 130, 319, 322, 326, 328
  price, 228
competitive
  advantages, 48, 75, 83, 91, 93, 102, 111, 134, 192, 258, 266, 314, 318, 329
  positions, 216–17
competitiveness, 33–4, 48, 66, 91, 141, 173, 287, 318
competitors, 62, 73, 265, 268, 275, 280–1, 302, 305, 318, 329, 336
complementary
  products, 60, 66, 306
  resources, 73
complexity, 34, 102, 104, 112, 121, 123, 238, 256
Concern Traktornye Zavody, 196
conglomerate, 8, 57–8, 64, 71, 73, 75
  acquisitions, 49, 58, 64–5, 67, 75
  firms, 65
  investments, 8, 67
  mergers, 82
  transactions, 73
consolidation, 32, 228, 230, 274, 277–8, 280
constraints, 32, 103, 228, 317
  institutional, 73
  political, 34
  security, 232
construction sector, 286
consumers, 208, 229, 284, 316
consumption
  domestic, 224
  energy, 226
  household, 237
  private, 237
context
  emerging economy, 10
  global, 99, 104–5, 119, 220
  institutional, 81
  international, 103
convergence conditions, 86
co-operation, 104, 111, 238, 271, 297, 301, 304, 307, 309, 343, 347, 357
  bilateral, 271
  international, 339
  international economic, 269, 282, 288
coopetition, 319–20
corporate
  governance, 212
  strategy, 134
corporations
  government-owned, 211
  state-owned trading, 157
Cosmote, 323

PROOF

cost advantages, 357
countries
developed, 3–4, 8, 21, 25, 33–4, 38–9, 48–50, 52–3, 55–9, 63, 65–6, 68–9, 74, 89, 91, 94, 96, 143, 158, 173, 224–5, 233, 237, 240, 243, 256, 261, 320
developing, 6, 40, 42, 51, 53, 56, 91, 100, 138, 144, 152, 155–6, 158, 173, 225–6, 234–5, 243, 247, 261, 269, 271, 317, 319, 333
emerging, 47–9, 230, 237, 355
high-income, 65
industrial, 261
least developed, 99, 158, 175, 332
less developed, 99
small, 108
Coviello, N., 116, 339
Crane, K., 181
Crick, D., 294
crisis
adjustments, 184–5
banking, 264
corporate, 312
credit, 28
domestic, 274
exit, 277
global, 1–4, 6–13, 14–15, 17, 20, 23–5, 27–9, 35, 39, 41, 43, 83–5, 92, 95–8, 102, 179–80, 184, 186, 188, 192, 194, 199–200, 204, 206, 208–10, 215–16, 218–20, 254–6, 259–60, 288–90
management, 267
period, 4, 11–12, 192, 194, 204
prevention, 292
CRM (customer relationship management), 110–12, 114, 128
Croatia, 42, 85, 96, 278
cross-border
acquisitions, 48, 51, 62
alliance modes, 99
mergers, 6, 81, 186, 243
CSA (Country Specific Advantage), 74, 315, 328–9
Cuadros, A., 144
Cuervo-Cazurra, A., 66, 84, 158, 294, 320
cultural
differences, 9, 154–5, 160, 165, 171–3, 177
distance, 9, 154–6, 158–62, 164–5, 168, 170–8, 317
proximity, 172, 245, 253–4
culture, 154–5, 159, 172–3, 176, 316
dimensions, 161, 171–2
distance, 168, 170
national, 158, 165, 168, 170
currencies
foreign, 29, 92–3, 141, 204
global reserve, 41
local, 93
currency reserves, 26
customer(s)
behavior, 293
indigenous, 316
local, 12
segments, 310
Cyprus, 86, 88, 92, 174, 193–4, 196, 300
Cyrillic alphabet, 325
Czech Republic, 85, 88, 91–3, 96, 206, 245, 270, 285, 322

Daimler AG, 208, 238
Daimler-Chrysler, 233
Dana, L., 113
Danford, G., 117, 127
debt
denominated, 29
finance, 30
level of, 87, 92–3, 97
servicing, 87
sovereign, 185
transactions, 174
decision, 20, 30, 75, 117, 134, 138, 159, 183, 209, 211, 227, 267, 273, 287, 317, 329, 353, 355, 361
decentralized, 266
managerial, 281
market selection, 119
political, 188
technology adoption, 132
decision-making processes, 117, 121
strategic, 103

PROOF

de-internationalization, 12, 294, 335, 340, 351–2, 357, 359
delivery times, 299
Deng, P., 154, 156
Deng Xiaoping, 156–7
Denmark, 35, 54, 86, 88, 167, 196
depreciation premiums, 188
Derbes Breweries, 200
deregulation, 18, 27, 29, 47
de Ruyter, J., 316
Desai, P., 139, 183
determinants, 44, 81, 83, 119, 149, 152–3, 155, 181, 246, 315, 332, 340
  of direct foreign investment, 152
  of success, 133
devaluation, 205, 278
developed
  economies, 1, 3–4, 6, 8, 15, 18–19, 21–3, 27, 29, 34, 36, 40, 42, 48–9, 51, 53, 56, 74, 93–4, 151, 237, 248, 320, 326
  markets, 38, 67, 81, 156, 226, 325
development, 9–11, 31, 34, 38, 41–2, 45, 67, 79, 82, 99–100, 105–6, 110–11, 114, 116, 118, 123–4, 137, 139, 150, 154–7, 177, 187, 211, 220, 223, 227, 231–2, 273–4, 287–8, 320–4
  institutional, 178
  social, 32
  strategies, 280
  sustainable, 355
  technological, 314
Didier, 260
differentiation strategy, 337, 351
dinosaurs, 11, 274, 277, 280–1
discontinuous change, 118
disposable income, 224
distance, 171, 175–8, 244, 247
  geographic, 248–9, 252–3
distribution, 52, 54, 68, 162, 177, 232, 285, 329, 337, 351
  networks, 63, 73, 321
diversification, 94, 96, 275, 278, 280, 341, 352–3
  corporate, 130
  geographic, 75
diversified asset base, 208
Dnepropetrovsk, 203
Dneprovagonremstroy, 203
Dnevnik, 291
Doane, D., 249, 253, 257
Doh, J., 154, 164, 172
Domadenik, P., 276, 284–6
domestic
  demand, 5, 24, 86, 187, 206, 264
  firms, 33, 139, 150, 183, 221, 241, 260, 272, 291, 351
  market, 66, 75, 188, 192, 223–5, 237, 243, 264, 267, 287, 315, 317, 328, 340, 344, 346–7, 349, 353, 355, 358–9, 361
  market characteristics, 314, 319
  partners, 39, 357, 359
Donetsk, 202
Donovan, K., 117
Dooley, K., 295, 305
Dow Chemicals, 205
Dow, D., 155, 158–9, 205
Doz, Y., 113
Drogendijk, R., 9, 154, 158, 159, 160, 161, 162, 172
DST (Digital Sky Technologies), 211
Dubrovski, D., 292–3, 312
Dunning, J., 48, 54, 57, 61–2, 67, 79, 90, 97, 110, 117, 120, 137–9, 143, 148–9, 181–2, 241–4, 246–8, 314–15
Düsseldorf, 346
Duysters, G., 65
Dyer, W., 341

East Africa, 161
East Asia, 85, 97–8
Eastern Europe, 8, 84, 100, 219, 273, 278, 322, 325, 346
Eastern European, 99, 261, 320
  countries, 83, 86, 90, 94, 98
e-business, 117–19, 130, 132
  development, 131
Eclectic Paradigm, 130, 135, 242, 332
e-commerce, 103–4, 110, 114, 131, 136
  corporations (ECCs), 135
  metrics, 136

PROOF

economic
  activities, 26, 52, 130, 136, 163, 179, 186
  architecture, 283
  conditions, 94, 149, 216
  crisis, 17, 31, 90, 93–4, 180, 182–3, 185, 216, 219–20, 260, 263, 269, 276, 289, 292–5, 297, 302, 304–6, 309–10, 312
  development, 32, 41, 83, 106, 138–9, 148, 150, 152–3
  disparities, 84
  downturn, 179, 205
  environment, 39, 305, 309–10
  geography, 122, 133
  growth, 17, 34, 87, 89, 139, 144, 149, 151, 185–6, 237, 244
  growth rate, 88–9, 255
  impacts, 236
  nationalism, 41
  performance, 2–4, 82, 185–6, 258
  policy, 3, 87, 148, 152, 294
  recession, 2, 184, 293, 295, 311–12
  stagnation, 18
economies
  advanced, 2–3, 9, 48–9, 74–5, 181
  developing, 15, 42, 49, 79, 99, 222, 318, 320
  domestic, 26–9, 32, 94
  global, 18, 23, 26, 33, 38–41, 45, 80, 99, 182, 215, 218–19, 240, 282, 317
economies of scale, 32, 57, 119, 142, 223, 242–3, 286
Eden, L., 48
education, 67, 133, 143, 250, 287, 311, 347
efficiency, 102, 122, 194, 205, 243, 253, 272, 274–5, 292
Egelhoff, W., 113, 121
Ein-Dor, P., 115
Eisenhardt, K., 107, 112, 123, 126, 295, 318
Ekeledo, I., 316
electronic book series Analize CMO, 288
Elenkov, L., 319
Elia, S., 8, 47
Ellis, P., 339
embeddedness, 134, 259, 363
  local, 183
emerging
  economies, 2–8, 10, 12–13, 31, 47, 80–5, 91, 94, 99, 107, 153, 179, 181–2, 237, 240–1, 244, 246, 249, 271, 318, 332–3
  economy firms, 9, 84, 93
  market currencies, 29
  market enterprises, 81, 100
  market MNEs, 18, 22, 30–2, 34, 36, 39, 41, 44
  markets, 13, 14–15, 18, 21–4, 26, 29–34, 36, 38–40, 42–6, 47–9, 52–3, 60, 65, 74, 80–2, 99–100, 126, 137–8, 143, 148–9, 152–3, 181, 184–5, 219–20, 290, 316–18, 320, 331–3, 355, 357–8
  Russian multinationals, 10, 180–1, 189, 204, 215, 217
empirical
  analysis, 101, 133, 151–2, 257, 313, 333, 365
  studies, 79, 102, 104, 138, 260, 263, 276
employment, 32, 153, 260, 268, 270, 272, 274, 277–9, 285–6
EMU (European Monetary Union), 85
endangered koalas, 11, 274, 277, 280–1
Enderwick, P., 6, 184
enterprises
  medium-sized, 8, 187, 333
  medium-sized regional, 194
  state-owned, 34, 36, 156, 227
entrepreneurs, 115–16, 127, 241, 282
entry mode, 39, 104, 159, 176, 227, 243, 294, 316–17, 319
  choice, 104, 173, 176, 317, 332–3
environment, 32, 81, 105, 110–12, 114, 123, 259, 273, 302, 307, 320
  dynamic, 110
  host-countries, 352
  macroeconomic, 83
  protectionist, 279
environmental sustainability, 32
equity capital, 161, 174, 254
Ericsson, 323

ERP (enterprise resource planning), 110–12, 114, 119, 127–8
Erramilli, M., 316–17
Eshaghoff, T., 183
Essel Propack Ltd, 65
establishment chain, 114, 116–17, 128
  incremental, 118
  international, 114
establishment mode, 159
Estonia, 35, 85–8, 92, 131, 196, 200, 284, 293, 296–304, 307
E-strategy model, 135
EU (European Union), 2, 18, 28, 41–2, 55, 59, 61, 83, 85–7, 89, 92, 94, 96, 98, 141, 152, 182, 193–5, 200, 205, 241, 245, 254, 261, 270–1, 290, 299, 347, 352
  countries, 86–92, 95, 97, 254
EU Member States, 2, 85, 182
euro, 2, 41, 69, 72, 83, 91–2, 98, 303
Europe, 27, 59, 72, 75, 84, 94, 163–5, 193, 205, 222–3, 226, 236, 245, 295, 297, 301, 307–8, 311, 321, 327, 329–30, 346
European
  Central Bank, 98
  companies, largest, 189
  competitors, 267
  countries, 53, 98, 194, 266, 284, 296, 307, 321
  firms, 68, 267
  Investment Bank, 234
  markets, 60, 226, 321, 330, 347
  Monetary Union (EMU), 85
  multinationals, 130
  SMEs, 268
  Social Fund, 362
  steel market, 207
Eurozone, 2, 85–7, 90–1, 182
Evangelista, F., 108
evolution, 82, 106, 131, 133–4, 225, 364
evolutionary
  dynamics, 105, 110, 123
  theories, 122, 126, 130
exchange rate, 85–6, 93, 139, 141, 147, 149, 151, 153, 162, 264, 299
  adjustments, 152
  fluctuations, 299
  movements, 85, 100, 149
  volatility, 142
existing international networks, 278, 281
experiential knowledge, 221, 294, 313
  acquired, 294
expertise, 31, 66, 236
exports, 3, 6, 27–9, 33, 67, 91–3, 109, 116, 138–41, 143–5, 153, 163, 168, 170, 211, 225–6, 228, 230, 234, 242, 249–50, 252, 262, 264, 270, 285, 300, 346, 349, 351–3
  activities, 118, 311, 349
  barriers, 131
  behaviour, 333
  benefit, 347
  dynamics, 91
  marketing, 129
  market selection, 175
  orientation, 281
  performance, 129, 363
  promotion programs, 129
  revenue, 3
  share, 297, 349, 351, 355
  strategies, 182, 342
  structure, 270
  subsidies, 228
  tax rebates, 157
exporters, 114, 264, 293
exporting, 116, 133, 135, 159, 299, 307–8, 316, 318, 321, 327, 347, 349, 352–3, 355, 357
externalization, 286

factor endowments, 315
Faiola, A., 2
FAW (First Automobile Works), 232–3, 236
FDI (foreign direct investment), 6, 14, 17–18, 20–2, 26–30, 32, 34–6, 38–46, 47, 81–2, 85, 99–100, 127, 137–9, 141, 144, 148–9, 151–4, 158–9, 173–8, 218–20, 230, 240–4, 247–50, 252, 254–5, 257, 260–2, 288–90, 314–16
  asset-exploiting, 314
  efficiency-seeking, 243
  inflows, 89, 139, 153, 186, 240, 260–1

PROOF

FDI (foreign direct investment) – *continued*
- market-seeking, 242
- outflows, 15, 149, 247, 249, 254
- policies, 35
- projects, 20
- protectionism, 38, 41, 184
- resource-seeking, 262
- stocks, 139, 186, 245, 256–7
- strategies, 99

Federal Reserve System, 153
Feeny, D., 120
Fernández, Z., 103, 112–14, 125
Fetscherin, M., 154–6, 172
Filatotchev, I., 82
Filippov, 25–6, 43, 182, 184, 219, 262
Fillis, A., 116
financial
- institutions, 2, 86, 199, 211, 217, 244
- intermediation, 79
- leverage coefficient, 276
- leveraging, 276
- markets, 24, 29, 44, 85, 150
- performance measures, 102
- regulator, 193
- resources, 187, 222, 265, 344
- systems, 2, 23, 30

Financial Times, 25, 43, 98
Finkelstein, S., 49, 57–8
Finland, 54, 86, 92, 196, 298, 346, 364
firms
- accounting, 331
- acquired, 49–50, 276
- acquiring, 48–9, 56, 66
- automobile, 232
- biotechnological, 84
- blue chips, 269
- car-producing, 10
- competitiveness of, 80
- computer software, 133
- entrepreneurial, 258
- export-oriented, 341
- independent, 231, 236
- internationalized, 282, 284, 293
- latecomer, 230
- private, 26

fiscal decentralization, 223
Fischer, R., 172, 176
Flores, R., 158–60, 170–1, 173
Ford Motor Company, 180
foreign
- acquisitions, 82, 97, 177, 189, 192, 194, 204, 216, 276
- affiliates, 18, 24, 30, 139, 157, 184, 206, 262
- assets, 25, 32, 42, 96, 187, 199–200, 209, 217
- companies, 96–8, 192, 207–8, 224, 227, 230–2, 235–6, 286, 319, 353
- debt refinancing, 188
- exchange reserves, 38, 45, 185
- firms, 47, 96, 98, 141, 227, 231–3, 259, 273, 285, 306, 327, 331
- investors, 9, 11, 90, 186, 217, 245, 267, 281, 283
- market commitments, increasing, 132, 176, 257, 332
- market entry strategies, 331
- markets, 2, 12, 53, 82, 109, 115–17, 126–7, 141, 143–4, 148, 183, 192, 199, 206, 215, 217, 242–3, 256, 262, 264, 294, 296, 298, 311, 314, 316–18, 336–7, 339–40, 351, 357
- partners, 182, 225, 232, 235–6, 269, 344, 355, 359
- production operations, 362
- reserves, 25, 27, 33, 185
- subsidiaries, 183, 188, 308

foreignness
- liability of, 48, 155, 158, 241, 257, 363

Forrest, R., 182
Forsgren, M., 118
forward vertical acquisitions, 58, 61–3, 66, 79
France, 2, 4–5, 35, 53–4, 86, 88, 92, 97, 130, 194, 196, 211, 224, 231, 236, 272, 296, 321, 347, 351
Freeman, S., 111, 339–40
Froot, K., 141
functional activities, 112
FYR of Macedonia, 42, 96, 277

PROOF

Gabrielsson, M., 338
Galbraith, J., 113, 121
Gammeltoft, P., 6, 181
García-Canal, E., 48
gas
  distribution networks, 194
  extraction, 63
  producers, 212
Gazprom, 189, 194–6, 200, 212, 216
Gazprombank, 195–7, 207
GDP (gross domestic product), 2, 4, 24–6, 28, 40, 84, 86–9, 94–5, 138–41, 144–7, 150, 168, 179, 185–6, 249–52, 255, 263–4
  growth of, 4, 253, 255, 293
  per capita, 89, 249
Geely Holding Group, 180
Genc, M., 84, 158, 320
General Motors, 232–4, 236, 238
geographic distances, 69
geographic proximity, 253, 255
Gerber, S., 116
Germany, 4–5, 53–4, 59, 86, 88, 92, 96, 142, 167–8, 194, 196, 204, 206, 211, 219, 224, 233–6, 245, 272, 278, 284–6, 296, 298, 321, 340, 344, 346, 349, 352
Getin Bank, 246
GFCF (gross fixed capital formation), 186–7
Ghana, 167, 198
Ghauri, P., 57, 61, 108, 204, 295, 342
Ghemawat, P., 158
Ghoshal, S., 113, 120
Gibbert, M., 126
Gibraltar, 42
global
  business, 125, 130, 186, 312
  competition, 65, 332, 363
  competitiveness, 38, 52, 364
  depositary receipt (GDR), 212
  economic crisis, 3, 6, 9–10, 43, 100, 180, 184–5, 193, 200, 215–18, 220, 225, 229, 236–7, 241, 270–1
  financial crisis, 44, 180, 185, 189, 210, 219, 232, 335, 344, 346, 352, 357, 359, 361
  firms, 2, 7–8, 97, 121
  growth, 133, 321
  industries, 10, 134, 136, 237
  market, 14
  OFDI, 14, 18–19
  players, 31, 38–9, 100, 320, 330
globalization, 8, 27, 32, 100, 104–8, 110–11, 115–16, 120, 122–4, 127–30, 238
  Paradox, 13
  patterns, 107
  process, 9, 90, 104–5, 107–8, 110–11, 114, 123, 126–7, 133
Globaltrans, 193
Gobo, G., 107
Goldman Sachs, 211
Goldstein, 47, 84, 181
Goodhart, C., 183
Gorenje, 277–9, 284, 287
Gorg, H., 183
Gorynia, M., 240–1
governance
  mechanisms, 118
  reforms, 47
  structure, 131
government, 3–4, 25–30, 35, 39, 73, 75, 86, 90, 95, 99–100, 109, 115, 151–2, 156–7, 208, 210, 219, 223, 226–7, 229–31, 238, 241, 244, 262, 272, 276, 280, 285, 327–8, 360
  contracts, 96–7
  debt, 25, 87
  intervention, 115, 145
  involvement, 320
  national, 41, 67, 179, 183
  policies, 46, 52, 124–5, 315, 363
  program, 278
  rescue programs, 40
  stimulus package, 237
Granovetter, M., 339
Great Depression, 1–2, 4, 13, 179
Great Wall, 226, 238
Greece, 2–3, 40–1, 86, 92, 167, 174, 322
greenfield investments, 6, 21–2, 30, 39
Greiner, L., 118, 121
Grewal, R., 292, 294–5, 305–6, 309
Grubaugh, S., 149
Guangzhou, 231

PROOF

guanxi, 158, 172–3, 177, 230
based business practices, 178
development, 175
relations, 158
Gugler, P., 154–6, 158, 172
Guillén, M., 48
Guisinger, S., 159–60, 170–1, 173
Gulati, R., 339
Gummesson, E., 295
Gupta, J., 112, 306
Gurvich, E., 187–8

Hadjikhani, A., 293–5
Hagström, P., 118
Haidar, J., 85
Hair, J., 168
Håkansson, H., 120
Haleblian, J., 49, 57–8
Halinen, A., 318
Hangzhou, 323
Hannan, M., 111
Hara, G., 339
Harman, C., 1
Harzing, A., 159, 203
Haunschild, P., 49, 57–8
Hay, F., 10, 222
Healy, M., 114, 117, 121, 127
hedge hogs, 274, 277, 280–1
Heinrich, A., 181
Helsinki, 133, 332, 364
Hennart, J.-F., 57, 257
Herzer, D., 141
Hickson, D., 113
Hidria, 277–8, 287–8
high research-intensive manufacturing, 55, 57, 59, 61–4
High River Gold Mines Ltd, 206
Hitt, M., 48, 112
Hofer, C., 305–6
Hofstede, G., 154, 158–61, 167, 171–3, 175–6, 178
Hofstede's indices, 176
Holmquist, C., 293–4
home country, 32–4, 39, 41, 47–8, 51, 69, 74–5, 141–5, 149–50, 260, 301, 314–16, 338, 352
agents, 141
exchange rate, 141
locational advantages, 49
networks, 135
OFDI policies, 32
policy, 32–4, 39
policy framework, 26
policy makers, 34
home market, 30, 116, 137, 159, 247, 271, 294, 340
Hong Kong, 157, 164–5, 174, 215
Hopkins, H., 57
horizontal
acquisitions, 58–60, 66, 80
investments, 8, 57, 59, 67–8
strategies, 81
Hornby, G., 104, 116, 131
Hoskisson, R., 47
host countries, 9, 13, 34, 36, 41, 49, 68, 75, 142, 149, 153, 155, 158, 160–3, 165, 168, 170–2, 183, 242–4, 247–9, 253, 260, 262, 316–17, 327
assets, 141
currency, 141
government, 41
labor costs, 248
market size, 255
HRM (Human Resource management), 103, 282, 332
Huettinger, M., 174
Hufbauer, G., 260–1
Hulland, J., 113
human capital, 34, 137–40, 143, 145–50, 267, 308–9
accumulation, 149
development, 143
skills, 149
human resources, 31, 106, 150, 282
Hungary, 85–6, 91–3, 167, 196, 219, 270, 285
hybrid engines, 229
Hymer, S., 57, 259

IBM, 287, 321, 329
Iceland, 2, 42, 245
ICT (information communications technology), 19, 102–28, 130, 132, 134, 136
applications, 103
capabilities, 124

PROOF

infrastructure, 111
investment, 134
IEI (Internet-Enabled Internationalization), 135
IFDI (inward foreign direct investment), 15, 28, 138–9, 149, 250, 252
Ihanainen, O., 114
IJVs (international joint ventures), 116, 175, 324
IMF (International Monetary Fund), 4, 26, 43, 51, 81, 240
IMP (Industrial Marketing and Purchasing), 363
incentives, 109, 115, 187, 306
incremental learning, 115
Index of Economic Freedom, 182
India, 4, 8–9, 16, 24, 26–7, 35, 42, 44, 49–50, 52–4, 56, 60–1, 63, 67–70, 75, 82, 84, 102, 107–8, 111, 125, 132, 135, 138–9, 142–5, 148–53, 181–2, 237–8, 322–3, 352–3
Indian
companies, 59–60
economy, 27, 139, 148, 150
export activities, 148
export industries, 122
firms, 53, 56, 138, 143–4, 148
GDP, 141
government, 9, 145, 148, 150
MNEs, 26–7, 42, 149–50
OFDI stocks, 140
outward FDI, 26–7, 138, 142, 144, 146, 148, 150, 152, 184
pharmaceutical industry, 153
individualism, 161, 165, 170–3, 177
Indonesia, 4–5, 35, 162, 165, 167, 235
industrial zones, 340, 343, 346
information technology, 33, 130–2, 134–6, 150, 237, 351
infrastructure, 24, 28, 84, 124, 205
innovation, 18, 29, 124, 130, 132–3, 230, 257, 265–6, 270, 275, 279, 282–3, 287–8, 290, 294, 297, 306, 311, 325–6, 332, 352, 355, 360, 362
capabilities, 177, 230
instability
financial, 2
macroeconomic, 260
institutional
advantage, 73
environment, 244, 315
frame, 156
legacy, 155
institutions, 44, 90, 100, 187, 244, 258
credit, 86
educational, 307
governmental, 322
local, 132
regulatory, 115
intangible resources, 48, 243, 334
integrated supply chain (ISC), 111, 114, 119
integration, 8, 38, 41, 104–5, 111–12, 120, 122, 124, 128, 200, 283
intellectual
property division, 145
rights protection, 330
intercultural experience, 115
interfirm cooperation, 131
intermediaries, 117
internal
demand, 187
factors, 11, 137, 317, 334
resources, 317
internalization, 181, 314–15, 330, 361
international
acquisitions, 192
activities, 8, 10–11, 95, 108–9, 117, 120, 123, 242, 292–4, 311, 314, 326, 331, 349
business research, 6, 130, 312, 363–4
development, 12, 118, 231
entrepreneurship, 113–15, 127, 129, 134, 313, 362, 364–5
expansion, 8, 85, 98, 158, 185, 206, 215, 230, 242, 254, 318, 320–1, 327, 329, 333
experience, 74, 115, 119, 160, 175, 317
investment regime, 41–2
involvement, 337
networks, 274, 278, 280–1, 353
operations, 65, 215, 244, 335–6, 341
production, 137, 257, 268

PROOF

international – *continued*
resources, 181
sales division, 347
supply chain management, 134
internationalization, 8–13, 34, 79, 83–4, 86, 88–90, 92, 94–8, 100–1, 103–5, 109–11, 115–20, 123, 126–8, 130, 132–4, 181–2, 241–4, 248, 253–4, 276–8, 282, 293–5, 315–16, 318, 326–8, 336–7, 339–41, 353–5, 359–62
activities, 315
behavior, 359
decision, 274
degree of, 103, 117, 362
drivers, 8
factors, 182
linear, 335
motives, 12, 95, 241, 248
nonlinear, 335
paths, 173, 180, 182
patterns, 159
processes, 56, 84, 90, 98, 115–19, 128, 130, 132, 134, 138, 172, 242, 244, 253, 272, 316, 318, 326, 328, 334–6, 342, 351, 357–8, 362
of R&D, 45
of service companies, 315
strategies, 10, 52, 67, 75, 84, 96, 98, 182, 185, 241, 246, 280
theories, 81, 111, 126–7, 244, 336
trajectories, 182
of Western MNCs, 155
internet, 103, 107, 109–11, 114–25, 127, 129–30, 132–6, 324, 326, 342
based exporting strategies, 115
companies, 324–6
industry, 325
inventory management, 312
investment(s)
asset-seeking, 97
decisions, 39, 155, 160, 171, 272
Development Path (IDP), 99, 139, 149, 152–3, 241
financial, 183
flows, 7
funds, 194
global, 284
hubs, 286
incentives, 242
insurance, 42
labor-seeking, 247
large-scale public, 150
market-seeking, 314
protection treaty, 298
resources-seeking, 314
south-south, 26
strategic asset-seeking, 314
threshold, 69
vertical, 8, 57, 61, 63, 75
investors, 1, 24, 39–40, 43, 85, 216, 256, 260
INVs (international new ventures), 117, 128, 134, 338, 363
inward FDI, 51, 139, 142, 148
IPOs (Initial Public Offerings), 189, 192, 212
Iran, 4–5, 226, 235
Iraq, 167, 226
Ireland, 35, 40, 54, 59, 86, 88, 91, 165, 167, 196, 203
ISC (Integrated Supply Chain), 111, 114, 119
Iskra Avtoelekrika, 277
Isle of Man, 300–1
Israel, 35, 42, 96, 167, 184, 198, 301
Israel Quantum LLC, 233
Israel Stock Exchange, 96
Isuzu, 233
Italy, 40, 53–4, 86, 92, 142, 194, 196, 204, 211, 344

Jackson, S., 306
Jaklic, A., 244
Jamaica, 167
Japan, 4–5, 18, 42, 49–50, 53–4, 94–5, 100, 149, 177, 202, 222, 224, 227, 233, 236, 296, 321, 352
Japanese
economy, 230
FDI flows, 85
investments, 38, 242
Jarillo, J., 110
Javalgi, R., 113, 316–17, 341
Jaw, Y.-L., 103–4, 110, 115–17, 120–1
Jeon, B., 114, 142
Johansen, S., 146

PROOF

Johanson, J., 120, 155, 158–9, 171, 293–5, 315, 334, 335, 336, 340
Johnson, C., 227
Jongwanich, J., 85, 94, 260, 283
Juselius, K., 146

Kalotay, K., 25, 47–8, 53, 58, 66–7, 84, 99, 181, 184, 262
KAMAZ, 196, 208
Kanai, T., 339
Kanjas, K., 120
Kapital, 290
Karatau uranium mine, 201
Karimi, J., 121, 132
Karush, G., 120–1
Kasahara, H., 268
Kaspersky, 318, 320–1, 328–30
Katrishen, F., 315
Kazakhstan, 42, 194, 199–200, 324
Kazanis, P, 103, 126
Kent, R., 162
Keynesian theory, 87
Khanna, T., 149
Kiev, 322
Kim, S., 142
Kirghizia, 174
Kirkman, B., 159, 161
Klein, L., 104, 121
Knickerbocker, F., 243
Knight, G., 115, 120, 337–9, 349
know-how, 57, 209, 232, 234, 236, 243
  complementary, 66
  operational, 157
  superior, 199
  tacit, 60
knowledge
  deficiencies, 156
  development, 132, 176, 257, 332
  gap, 138
  intensive service firms, 55–6, 79
  intensive services, 55–6, 58–9, 61–4, 68
  internalization, 122
  management, 124
  management systems, 118, 124–5
  sourcing, 174
  transfer, 159
Kogut, B., 144, 158–61, 173
Kogut-Singh index, 158
Kohlhagen, S., 141
Kolektor, 278, 285–7
Kolverid, I., 240
Konsynski, B., 121
Korea, 35, 132, 142, 152, 184
Korhonen, H., 336
Korston Group, 197
Kosmos Association, 196
Kosovo, 277
Kostova, T., 111, 114
Kotha, S., 112
Kovintrade, 277
Kredobank, 246
Krenholm, 293, 298–300, 305, 307–10
Krugman, P., 1
Kueh, S., 149
Kuivalainen, 336, 363
Kumar, N., 27, 52, 66, 79, 144, 148
Kundu, S., 117, 120, 315
Kutschker, M., 118
Kuwait, 167
Kvale, S., 126
Kwok, C., 141
Kyrgyzstan, 42
Kyrkilis, D., 141, 143

labor, 243, 306, 315, 320, 325
  costs, 237, 244, 247, 249, 252–3
  market, 187
Lai, J., 305–6
Lall, S., 84, 142–4, 149
Larimo, J., 155, 158
latecomer disadvantages, 320
lateral rigidity, 117
Latham, S., 292–3
Latin America, 1, 5, 43, 164, 176
Latukha, M., 12, 314, 324, 326
Latvia, 2, 35, 85–6, 88, 92, 167, 174, 176, 196, 200, 298–9, 302–4
leadership
  competences, 283
  role, 267
learning process, 114, 232
Lebanon, 167
Lecraw, D., 84
Lengeard, E., 316

PROOF

Leonard-Barton, D., 341
Lesotho, 174
leverage, 48, 65, 109, 134, 181, 230, 337, 351
leveraging, 73, 226, 243–4
liability of outsidership, 257, 363
liberalization, 38, 47, 144, 150, 283, 287
Libya, 3
Lindqvist, M., 337
Linux Solutions, 321
Lipnik, K., 286
liquidity, 30, 209, 255
  constraints, 260
  crisis, 186
  problems, 200
  shortfall, 179
Lisbon, 132
Lisitsyn, N., 84
Lithuania, 85–6, 88, 92, 174, 176, 206, 245, 298–9, 302–4
Liuhto, K., 182, 320
Liu, L., 231
Liu, X., 149
Ljubljana, 285, 288–91
LLL paradigm, 181
Loane, S., 112, 114, 119–20, 124–5, 127
location
  advantages, 90, 314
  choices, 151, 159–61, 176
  competitiveness, 89
  decisions, 125, 159
Lowell, B., 261
low research-intensive manufacturing, 55–6, 59, 61–4
Ložar, B., 287
LSE (London Stock Exchange), 212
Lübbe, H., 104
Luganskteplovoz, 202
Luhmann, N., 104
Lukoil, 63, 72, 195, 197, 205–6, 212, 221
Lummaa, J., 338, 349
Lundan, 48, 61–2, 67
Luo, 6, 13, 47–8, 50, 65–6, 74, 81, 84, 100, 103–4, 117–18, 133, 158, 177, 319, 332, 365
Luostarinen, R., 117, 334, 336, 338
Luxembourg, 86, 88, 245
M&A, 6, 8, 21–2, 27, 30, 48–50, 53, 186, 243, 248
  cross-border, 21, 27, 30, 187
  total value of, 21
Macau, 164, 174
Macharzina, K., 118
macroeconomic
  advantages, 84
  conditions, 243
  determinants, 138–9
Madsen, T., 337–8, 340
Magna International, 209
Magnitogorsk Iron and Steel Works, 206
majority ownership, 287
Makhija, M., 183, 292, 306
Makino, S., 143
Malaysia, 162, 165, 167, 235, 296, 343
Malaysia outward FDI, 152
Malnight, T., 118, 120
Malo, S., 84
Malta, 86, 88, 92, 167
management, 44, 78, 81–2, 102–3, 105, 114, 116, 135, 175–6, 196, 202–3, 219–21, 238, 257, 262, 265, 269, 273–5, 277, 281–3, 289, 297, 302, 307, 309, 311–13, 317, 364
  buyouts, 276
  capabilities, 227, 294
  characteristics, 317
  competences, 280
  crisis, 274
  dimensions, 122
  Information Systems, 112
  practices, 19
  processes, 112
managing director, 61, 63, 65
Manrakhan, S., 110, 120
manufacturers, 65, 202–3, 223–4, 226, 228–9, 231, 235–6, 293, 342–4, 347
manufacturing, 5, 10, 19–20, 26–7, 50, 53, 56, 63, 195–8, 210, 222, 262, 313, 315, 322, 327
  activities, 222
  assets, 194
  base, 222

PROOF

capabilities, 227
companies, 265, 284
enterprises, 133, 343
facilities, 224
research-intensive, 55, 59–62, 64
manufacturing firms, 107, 109, 112, 270, 290
high research-intensive, 55, 79
low research-intensive, 55, 79
research-intensive, 55–6, 79
Maoist period, 222–3
Marinova, S., 1, 7, 84
Marinov, M., 1, 7, 84
market
access, 230
changes, 273
conditions, 294
economies, 230, 240, 267, 269
entry mode, 317
entry strategy, 331
exit, 335
failures, 81
knowledge, 318
leader, 320, 329
openness, 144
orientation, 84
power, 57
price, 300
segments, 308, 311
selection, 173
share, 2, 97, 216, 228, 231, 238, 272, 302, 304, 316, 324
size, 49, 56, 127, 168, 244, 247, 252–3
success, 73
value, 216
marketing, 133, 273, 285, 299, 301, 308, 330, 343, 362–3
capabilities, 339
know-how, 315
Markusen, A., 110
Markusen, J., 143, 149
Marquardt, D., 168
Marschan-Piekkari, R., 131, 312
Marshall, R., 158
Martín Martín, O., 159
Marx, 13
masculinity, 161, 170–3
scores, 168
Mathews, J., 47–8, 113–14, 117–21, 127, 181, 230, 231, 253, 256
Mattsson, L.-G., 334, 336
Maxton, G., 238
Mazda, 233, 236
MBOs (management buy outs), 265, 269–70, 273–6, 281, 286
McAllister, G., 7, 14
McAuley, A., 339
McDougall, P., 115, 116, 120, 337–9, 340, 349
McKelvey, B., 111
McMahon, P., 104, 120
Mechel, 197, 207–8, 221
Meissner, H., 116
Melbourne, 364
Mercator, 277–9
Merkur, 273–4, 276, 284
Merriam, S., 126
Mexico, 165, 167, 184, 235, 346, 349
Meyer, K., 143
Michailova, S., 84
Middle East, 95, 286, 322
Milelli, C., 10, 222
Miles, M., 341
Miller, D., 118, 121
mindset, 32, 106, 109, 113, 114, 115, 117, 120, 124, 127, 288, 354
global, 134, 282, 338–9
managerial, 127, 282
minority stakes, 192, 200, 217
Mirax Group, 200
MK Založba, 284
MNCs (multi-national companies), 48, 56, 154–5, 173, 219, 243, 246–7, 256, 281, 284
MNEs (multi-national enterprises), 14, 17–20, 24, 27, 29, 31–2, 39, 41, 100, 130, 132, 142, 259–60, 262–3, 268, 271–2, 274, 277, 279, 282, 287, 319–20, 331
family-controlled, 31
non-financial, 26
mobile operators, 301
models of development, 223, 229
Moen, Ø., 104, 112–14, 121, 337

PROOF

MOFCOM (Ministry of Commerce), 157, 160, 166, 174, 177
Moini, H., 117
Moldova, 96, 195
Mongolia, 198
monopolistic advantages, 66–7, 152
monopolistic rents, 66
Montenegro, 42, 85, 96, 197, 217
Montgomery, C., 57
Morck, R., 73, 154, 156, 170
Morgan-Thomas A., 104, 117
Morocco, 35
Morris, S., 145
Moscow, 3, 43–4, 211, 215, 320–2, 344, 346
motivations, 74, 79, 109, 150, 162, 175, 178, 182, 243, 314, 320
motives, 6, 8, 74, 94–5, 97, 108, 194, 218, 241–4, 246, 280, 317, 326, 335
Motorola, 323
Mrak, M., 269
Mukherji, A., 121
multinational
  companies, 80, 99, 179, 181–3, 187, 192, 211, 215–17, 219, 256, 315
  enterprises, 43–5, 80–2, 99, 130, 132, 142, 151, 175, 219, 257, 259, 290, 333
  firms, 7–11, 91, 93–4, 99, 176
Mumbai, 323
Munro, H., 116, 339
Murphy, G., 114
Myanmar, 174

Nakashima, 13
Narjoko, 183, 220
Narula, R., 84, 137–9, 143, 148, 181, 218
NASA, 284
NASDAQ, 96
national
  companies, 223
  culture, 158, 161–2, 176–7, 315
  currency devaluation, 185, 204
  economy, 1, 8, 42, 210–11, 216, 227, 282
  firms, 81, 289, 326
  industries, 55
National Bank of Poland, 245–6, 250
National Bank of Ukraine, 2
National Innovation System, 153
Natural Gas Corporation Limited, 26
natural resources, 19, 27, 32, 35, 56, 154, 156, 168, 247–8, 252, 314, 319, 326, 331
NDRC (National Development and Reform Commission), 157, 227
negotiations, 209, 282
Nepal, 174
net
  debt, 208
  loss, 303
  profits, 189, 296–7, 301–3, 342
Netherlands, 5, 35, 54, 88, 92, 142, 165, 167, 194, 199, 201–2, 204–5, 234, 245, 321, 346
network, 60, 93, 103–4, 106, 110–11, 118–21, 123, 128, 131, 134–5, 207, 211, 217, 230, 288, 339, 346, 352, 354, 360, 364
  approach, 336, 363
  based MNC structures, 133
  development, 115
  leverage, 104, 120
  linkages, 151
  location, 363
  partners, 339
  relationships, 294
  theories, 126–7
networking, 334, 339–40, 363
  capability, 120
  global, 105, 111, 119
New Delhi, 153, 322
new markets, 59–60, 139, 157, 188, 260–1, 266, 268, 273, 280, 302, 311, 314, 339–40, 355
New Model for Global Growth, 133
New Triad, 7, 18–19
new ventures, 133, 271, 337
  international, 117, 131, 134, 338, 363
New Zealand, 8–9, 35, 42, 102, 107–8, 111
Nguyen, T., 118, 122–3
Nieto, M., 103, 112–14, 125
Nigeria, 167
Niosi, J., 56, 60

PROOF

Nissan, 233, 236
nonlinear internationalisation, 364
Norburn, D., 338
Nord Gold, 207
Norilsk Nickel, 193
North Africa, 322
North America, 49–50, 53–4, 94–5, 164, 208–9, 322, 343–4, 347, 352–3
North Western Europe, 205
North-Western Oil Group, 197
Norus, J., 84
Norway, 42, 54, 167, 197, 245
Novatek, 200
Novell, 321
Novorossiysk Sea Trade Port, 198
Nummela, N., 113–14
NYSE (New York Stock Exchange), 215

Obloj, K, 10, 240–1, 253
Oceania, 164
ODA (Official Development Assistance), 43
ODE (Original Design Engineering), 65
ODM (Original Design Manufacturer), 347
OECD (Organization for Economic Cooperation and Development), 24, 35–6, 44, 51, 53, 67, 81, 143–4, 153, 181, 220, 256, 258, 263, 284, 290
  countries, 98, 284
OEG (Olympic Entertainment Group), 300, 302–5, 307, 309–10
OFDI (outward foreign direct investment), 6–8, 14–15, 18, 25–34, 36, 38, 44, 46, 47–52, 73, 81–2, 85, 95, 98–9, 101, 137–9, 141–55, 160, 163, 168, 173, 175–7, 218–20, 240–2, 257, 260, 320
  flow, 15, 17–18, 24, 26–9, 31, 34, 53, 155
  stock, 20, 25, 27, 29, 139–40
official development assistance (ODA), 43
offshore outsourcing, 268
ÖKO-TEX, 296, 300
Old Triad, 18
OLI (Ownership, Location and Internalization), 242, 257, 314, 329–30
  framework, 242, 314–15
  paradigm, 181
Open Door policies, 34, 156
operating cash-flows, 72
operational efficiencies, 265
operational results, 279
Oracle, 323
organisational
  ecology, 129
  evolution, 135
  flexibility, 283, 291
  practice, 132
  resources, 102, 112
Original Design Engineering (ODE), 65
original equipment manufacturer (OEM), 343, 353
Oslo, 130
output linkages, 151
outsourcing, 19, 122, 268, 273
Overby, 119, 134
overseas
  activities, 95
  business development, 355
  operations, 317–18
Oviatt, B., 115, 116, 337
ownership, 181, 207, 210, 217, 242, 260, 269, 276, 289, 315, 327, 329
  advantages, 9, 48, 66–7, 137–8, 150, 181, 183, 220, 241, 260, 314, 329
  structure, 182, 269, 287
Oystein, M., 316

Palepu, K., 150
Paloni, N., 143, 149
Palvia, P., 120
Panama, 198
Pananond, P., 48
Panibratov, A., 12, 25, 84, 314, 320
Pantelidis, P., 141, 143
Paraguay, 174

PROOF

partnership, 230, 236, 318, 321–5, 327, 329, 331, 339, 361
passive globalizers, 116–17
Patton, 107, 134
Pecotich, A., 339
Peng, M., 48, 156
pension funds, 188
performance
  long-term, 80
  strong, 206
  superior, 260
Perkins, J., 1
perspectives
  contingency, 332
  dynamic capabilities, 313
  emerging supply chain, 110
  entrepreneurial, 254
  industrial organization, 57
  information processing, 103
  international supply chain, 119
  life cycle, 112
  micro-economic, 180
Peru, 198
Petersen, B., 121, 127
Petrokommerts, 195
Petrol, 277
Petrou, A., 48
Petrov, S., 287
pharmaceuticals, 56, 66, 79, 150, 195–6, 243
PIK Group, 195–6
Piscitello, L., 122
Pla-Barber, J., 317
Playtech, 295, 300–1, 304, 307, 309, 310
Podjetja, 288
Poland, 2, 10, 35, 85–6, 88, 91–2, 95, 217, 240–1, 245, 247, 254, 257, 285, 296, 302, 304, 321, 324
policies
  anti-crisis, 188
  contract rights enforcement, 244
  corporate, 317
  domestic, 9
  incremental, 226
  market-oriented, 47
  national, 33
  public monetary, 1
policy
  context, 44
  dilemma, 33
  framework, 32–3, 42
  implications, 44, 180, 259
  responses, 180, 183–5, 187, 219
Polish
  banks, 246
  capital, 246
  casinos, 304
  companies, 98, 244–5, 248, 254, 256
  FDI, 245, 253, 255
  firms, 95, 241
  investments, 245
  investors, 240, 245, 253, 255–6
  managers, 253
  market, 96, 256
  Ministry of Economy, 256, 258
  OFDI, 10, 241–2, 246, 248–9, 254
political
  democracy, 240
  risk, 39–40, 44, 168, 253
  risk insurance, 44
Porter, M., 103, 113
portfolio investment, 30
Portugal, 35, 40, 54, 86, 92, 167, 183, 197
Poslovni Dnevnik, 277, 287, 289
Poulis, K., 107
Powell, T, 113, 120, 125
power, 3, 173, 189, 225, 237, 262, 267, 284, 329
  distance, 161, 165, 170–3
Pradhan, J., 27, 143, 184
Prague, 322
Prahalad, C., 113
Prašnikar, 288–91
PRC (People's Republic of China), 173
Prikarpattya Bank, 246
Primerod International Ltd, 200
privatization, 269, 280, 295
privatized firms, 265
proactive approaches, 261, 274, 280
product
  adaptation, 242
  design, 308
  expansion strategies, 323
  innovation, 265

PROOF

production
  capacities, 65, 300, 323
  costs, 300, 358
  networks, 182
  technologies, 79, 337
productivity, 143, 266, 269, 289
profitability, 49, 73, 87, 93, 102, 142, 189
  negative, 192
  reduced, 30
promotion, 34, 230, 271, 355, 359–60
property
  intellectual, 66
  private, 222
protectionism, 38, 185, 234
Prugel, T., 149
psychic distance, 115, 119, 158–9, 175, 178, 244, 248, 257
pull factors, 74

quality certificate, 300
Quantech Global Services LLC, 65
Quelch, J., 104, 121

R&D, 45, 178, 195, 230, 265, 268, 272–3, 279, 281, 306, 355
Rabbiosi, L., 8, 47, 67, 69, 74
Ramamurti, R., 42, 44, 84, 181
Rani, U., 111
Rantapusca, T., 114
Rao, H., 121
Rasiah, R., 320
ratio
  current, 72–3
  fixed capital, 276
  public expenditure, 88
  solvency, 72–3
raw materials, 66, 157, 293, 300
recession, 4, 28, 41, 45, 184, 218, 261, 272, 279, 290, 292, 305, 311–12
recovery, 4–5, 38–9, 217–18
re-entry, 335, 340–1, 353, 355–7
regionalization strategy, 154
regional multinational enterprises, 100
regulations, 34, 65, 157, 310
re-internationalization, 12, 294, 309, 335, 341, 351, 353, 361
relationships, 57, 65, 120, 123, 138, 146, 148–50, 152, 172, 230–2, 273, 336, 339, 363
  capital market, 141
  co-integration, 146
  complementary, 112
  contractual, 316
  direct causal, 149
  established, 321
  improved customer, 266
  personal, 173
  vendor, 323
reliability, 103, 108, 113–14
Renault, 285
Renova Group, 210
Repovž, 285, 290
Republic of South Africa, 211
reputation gap, 258
research interests, 334
resilience, 14, 29, 205, 216
resource, 26, 48, 64, 67, 109, 115, 124, 135, 137, 156, 168, 181–2, 194, 205, 208, 229, 242–3, 246–7, 266, 286, 294, 297, 305, 312, 315–17, 320, 337, 339, 341, 351
  allocation, 230
  based industry, 55–6, 59, 61–4, 68
  based view (RBV), 316
  commitment, 294
  company-level, 317
  endowment, 103, 115
  gap, 258
  network, 363
  proprietary, 314
  restrictions, 125
  rich countries, 56–7
  seekers, 247
  unique, 314
Rhee, J., 294
Rhee, S., 142
Rialp, A., 338, 340
Rindova, V., 112
risk management, 283, 288, 312
RMB, 28, 224, 229, 236, 343
Rocha, V., 183, 260
Rodrigues, S., 116, 155–6, 181, 320
Rodrik, D., 1
Rojec, M., 84
Romanelli, E., 118

PROOF

Romania, 85–8, 91–2, 96, 194, 197, 205, 302, 304, 321–2
Ross, C., 292–3, 306
Rosson, P., 117
Rugman, A., 47–8, 67, 93, 154, 164, 172, 315
Ruigrok, W., 126
Rui, H., 73, 156
Rusal, 215
Rushydro, 212
Russia, 3–4, 8, 23–6, 35, 43–4, 45, 49, 51–4, 56–7, 59–61, 64, 67, 69–70, 72, 75, 82, 85, 94–5, 177–89, 200, 206, 208, 212, 215–16, 218–21, 278–9, 319–20, 322, 324–5, 344
Russian, 58, 63, 72, 82, 84, 185, 187–9, 192–5, 198–9, 205, 207–12, 216–19, 273, 314, 316, 318–20, 322, 324, 326–8, 330–2
  acquisitions, 53, 55, 194
  aerospace MNCs, 332
  companies, 69, 181–2, 184–9, 192–4, 199–200, 204, 209–10, 212, 215–17, 219, 319, 322
  Development Bank, 216
  economy, 25–6, 180, 185–7, 216, 320, 326
  Federation, 26, 42, 44, 50, 163, 219
  firms, 52, 55, 84, 192, 318–20, 327, 329
  government, 10, 52, 180, 185, 187–8, 199, 204, 210–12, 216–17, 328
  investments, 217–18, 327
  market, 210, 325
  MNEs, 26, 32, 100, 318–20, 327, 331
  multinationals, 9–10, 180, 182, 184–5, 189, 192, 194, 200, 208, 215, 217–18, 327
  OFDI, 25, 320
  oil, 204–5, 216
  service companies, 327–8
  software companies, 328
  stock market, 185, 193
  Trading System (RTS), 211
Russkie Mashiny, 208
SAIC (Shanghai Automotive Corporation), 233, 236
sales
  department, 347
  promotion activities, 273
  revenues, 324
  subsidiaries, 307
Salidjanova, N., 85, 95
Samarakoon, I., 85
Samiee, S., 104, 115
Samii, M., 120–1
Sanchez-Peinado, E., 317
San Diego, 135
San Francisco, 133
Sao Paulo, 271
Sauvant, K., 7, 14, 35–6, 47–8, 52–3, 55, 84, 154, 181, 184, 218, 240–1, 244, 254, 262
Sberbank, 195–6, 209, 216, 221
Scabini, P., 340
Schuknecht, L., 89
Schuler, R., 306
Schulz, A., 104
Schwartz, S., 161
Scordis, N., 315
Serbia, 42, 85, 96, 197, 286
Servais, P., 316, 337–8, 340
Service(s)
  after-sales, 148
  cleaning, 283
  communication, 55
  companies, 315–16, 331
  firms, 109, 112, 317, 332–3
  industries, 53, 327, 332
  insurance, 200
  internet security, 321
  legal, 243
  marketing, 317
  online, 103
  sector, 18–20, 56, 135, 243, 295, 315, 333
Severstal, 192, 195–7, 206–7, 221
Seward, L., 249, 253
Shama, A., 293, 306
Sharma, D., 112, 316, 333, 339
Shenkar, O., 126, 159, 161
Shenzhen, 229
Shi, Y., 10, 222
Sicily, 206

PROOF

Siddarthan, N., 143
Siegfried, J., 65, 82
Siemens, 323
Silicon Valley, 324
Silovye Mashiny, 198
Simon, A., 293
Simon, H., 262
Sinani, E., 143
Singapore, 8–9, 102, 107–8, 110–11, 115, 125, 142, 164–5, 167, 343
Singh, H., 42, 57, 84, 159, 161, 162, 173, 181
Singh, J., 100
Singh, N., 117, 120
Sivakumar, K., 316
Skovgaard, L., 260–1
Slangen, A., 154, 158–9, 161–2, 173
Slovakia, 85–6, 88, 92, 96, 197, 302, 304
Slovene
  economy, 259, 263–4, 268–9, 282
  enterprises, 267–8
  firms, 264, 267–9, 271, 280, 284–5, 287, 289
  managers, 267
  market, 277
  MNCs, 263, 277, 279–80, 284, 286
  MNEs, 259, 266, 268, 270–2, 279, 281–2, 286–7
  multinationals, 286
  outward FDI, 270
  SMEs, 268, 285
Slovenia, 35, 44, 85–6, 88, 91–2, 96, 184, 219, 244, 263, 265, 267, 270–1, 273, 278–80, 284–6, 288–90
Slovenian Statistical Office, 287
(SMEs) Small and Medium-Sized Firms, 102, 104, 106, 108, 110, 112, 114, 116, 118, 120, 122, 124, 126, 128, 130, 132, 134, 136
  born global, 339, 361
  e-commerce experience, 131
  internationalization theory, 135
Smrekar, T., 277
social
  consequences, 3
  systems, 104–6, 122, 127, 132
  welfare, 28
SOEs (state-owned enterprises), 34, 36, 156, 227, 229, 232, 236, 238
software
  industries, 60, 321, 327
  market, 322
  producers, 330
solar energy, 210
solutions provider, 65
South Africa, 4–5, 174, 235
Southeast Asia, 1, 322
South-East Europe, 42
South-South FDI, 6
Sovdat, 276, 286, 290
sovereign wealth funds, 36, 154
Soviet Bloc, 84
Soviet market, 295, 298
Spain, 35, 40, 54, 86, 88, 92, 96–7, 135, 197, 206, 344, 347, 351
Spanish banks, 331
Special Economic Zones, 227
Spence, M., 294
spillover effects, 32
Sri Lanka, 174
Stabilization Fund, 26
Standifird, S., 158
state
  assets, 157
  budget, 87–9, 97
  capitalism, 45
  corporation, 187
State Economic and Trade Commission, 157
Stein, J., 141
Stevens, G., 141, 153
Stiglitz, J., 283
stock
  exchanges, 86, 98, 215, 298
  market interdependence, 100
  market speculation, 157
Stöttinger, B., 158
strategic
  alliance, 273, 306, 325, 340
  resources, 60, 243, 247, 249, 252–3
strategies
  current, 295
  defensive, 277
  de-internationalisation, 363
  differentiated, 184
  offensive, 278

PROOF

strategies – *continued*
proactive, 262
regional, 164
turnaround, 312–13
structural reforms, 276
Sub-Saharan Africa, 175
subsidiaries, 93, 97, 116–17, 132, 141, 145, 183, 194, 212, 234, 236, 278, 294, 297, 301, 316, 319, 322, 325
Sudarsanam, S., 305–6
Sundqvist, S., 336
suppliers, 120, 122, 190, 242, 278, 284, 297, 306, 336, 353, 358
supply chains, 111–12, 119, 307
Surgutneftegaz, 189, 196
survival strategy, 266
sustainable
solutions, 114
value enhancement, 66
Sutyrin, S., 100
Svenšek, K., 284
Svetlicic, M., 244
Sweden, 35, 54, 86, 88, 165, 167, 234, 245, 296–9, 321, 346, 349
Switzerland, 35, 42, 54, 130, 174, 194, 197, 204, 245
Syria, 3, 226

Tadzhikistan, 174
Taiwan, 130, 132, 198
Takagi, S., 85
Tallinn Stock Exchange, 302
Tanzi, V., 89, 99–100
target financing, 311
Tatneft, 212
taxes
excise, 98
gambling, 304
indirect, 98
tax rates, 91
corporate, 26, 83, 90–1, 300
tax system, 205
technical expertise, 236
technological
advancements, 19
advantages, 143, 183
agglomeration, 122
gap, 89
leapfrogging, 79
resource base, 248
solutions, 278
Teece, D., 293–4
telecommunications, 67, 150, 194–5, 197
equipment, 322
Thailand, 162, 167, 235
Third World Enterprises, 99
Third World Multinationals, 101
Thomas, D., 48
Thorelli, H., 110
Timan-Pechora, 205
Tong, S., 158, 178
Törnroos, J., 318
Toyota, 232–3, 236
trade
barriers, 242, 244
deficit, 244
fairs, 109, 117, 297, 307, 344
flows, 173
liberalization, 144
networks, 137
sector, 144
Trade and Industry Bureau, 342
transaction cost advantage, 178
transformation
economic, 84
organizational, 130
transition, 82, 99–100, 133, 181, 218, 220, 257, 263, 267–9, 271, 288, 312, 320
economies, 15, 42, 81, 100, 261, 288
Transneft, 189
transport industry, 323
Trimo, 277, 284, 286–7
Tung, R., 6, 47, 50, 65–6, 74, 84, 161, 178, 319
Turkey, 23, 35, 96, 174, 184, 200
Turkmenistan, 42, 174
Tushman, M., 118, 135

Ukraine, 42, 85, 174, 194–5, 199–201, 204, 211, 235, 245–6, 278, 302–3, 309, 322, 324–5, 353
(UK) United Kingdom, 4, 59, 80, 82, 88, 100, 142, 149, 168, 194, 204, 206, 220, 296, 301, 312, 321, 352, 364

uncertainty avoidance, 155, 161, 165, 170–3
UNCTAD (United Nations Conference on Trade and Development), 6–7, 13, 15, 18–24, 26–8, 30–1, 37, 42, 45, 47–8, 52, 82, 94–5, 100, 140, 153, 174, 178, 181, 186, 220, 243, 258, 261, 270
UniCredit Bank, 246
United Arab Emirates, 296
United Company Rusal, 215
UN (United Nations), 82, 100, 160, 178, 220
Uppsala model, 131, 244, 253, 257, 312
Uralkhim, 196
Uralsib, 196
Uralvagonzavod, 196
Urbas, U., 277
Uruguay, 167, 174, 235
USA (United States of America), 4, 63, 135, 141, 149, 162, 194, 197, 204, 211, 223, 233, 236, 296, 298, 307, 330, 340, 343
US (United States), 28, 36–7, 42–5, 54, 58–9, 152, 164, 224, 226, 238, 321, 343, 347, 349
  banking system, 179
  bonds, 263
  location choices, 160
  manufacturing enterprises, 132
  manufacturing industries, 152–3
Uzbekistan, 42, 174, 195

Vahlne, J.-E., 115, 132, 176, 257, 312, 316, 332
Vahtra, P., 181–2, 320
validity
  analytical, 126
  external, 126
  internal, 126
value, 2, 17, 21–2, 24–5, 45, 53, 55, 89, 91–3, 95, 98, 119, 136, 142, 146, 155, 157, 159–60, 172, 176–7, 185, 187, 193, 201–2, 205–6, 209, 243–4, 252, 270, 283
  added activities, 80
  appropria, 258
  chain, 58, 122, 125
van Den Bulcke, D., 43
Vandermerwe, S., 314
variables
  dependent, 147, 160, 168, 170
  explanatory, 138–9, 146, 168, 173
  independent, 145–6, 161, 168, 249
Varum, A., 183, 221, 260
Vektor, 274, 276
Venezuela, 165
Verba, C., 320
Verbeke, A., 159, 161, 315
Veritas Energia, 202
Verma, R., 9, 137
Vernon, R., 121, 135
Viator, 274, 276
Vietnam, 134, 167, 226, 235, 352
Vissak, T., 292, 335, 341
volatility, 142
  environmental, 313
  political, 3
Volkswagen AG, 231
Volvo, 233–4
Voss, H., 170
VTB Bank, 194, 207, 216

Wade, M., 113
Wagner, B., 116
Wang, H., 231
Wang, J., 294, 306
Warsaw, 45, 221, 257–8, 290
Washington, 43–5, 81, 152–3, 290
Wasowska, A., 10, 240
Weerawardena, J., 293
Weiss, M., 277
Welch, C., 294, 335, 341
Welch, L., 131, 294, 334–6, 341
Wells, L., 84
Wendre Scandinavia AB, 296
Wennberg, K., 293–4
West Africa, 161, 207
Western Balkans, 272, 286
Westney, D., 111, 114
Wheeler, M., 149
Wiedersheim-Paul, F., 155, 158–9, 171
Wilinski, W., 8, 83, 84, 95
Wilkins, A., 341
Wilkinson, I., 119

PROOF

WIPO (World Intellectual Property Organisation), 162, 178
Wisniewska, I., 26
Woodward, J., 102
World Bank, 18, 30, 45, 160, 174, 178, 240, 290
  Development Indicator, 162
World Investment Report, 13, 45, 82, 100, 143, 153, 178, 220, 258
Wormald, J., 238
Wright, M., 48
WSE (Warsaw Stock Exchange), 95–7, 101
WTO (World Trade Organization), 163, 170–1, 223–4
Wu, L.–Y., 48, 293

Yamin, M., 107
Yandex, 325
Yin, R., 126, 135, 295, 341–2
Yip, G., 73, 156, 182
Young, S., 129
Youssef, A., 143, 149
Yugoslavia, 263–4, 267, 270, 290

Zagreb, 279
Zaheer, S., 110, 120, 159, 161
Zambia, 198
Zander, L., 172, 253, 256
Zelenograd, 322
Zettinig, P., 335
ZGG Cayman Holding, 200
Zhang, C., 111
Zhang, K., 143, 149
Zhang, X., 12, 334
Zhao, Z., 232
Zucchella, A., 340
Zupan, N., 268