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FOREIGN TRADE AND INVESTMENT
DECISIONS OF EUROPEAN COMPANIES

by

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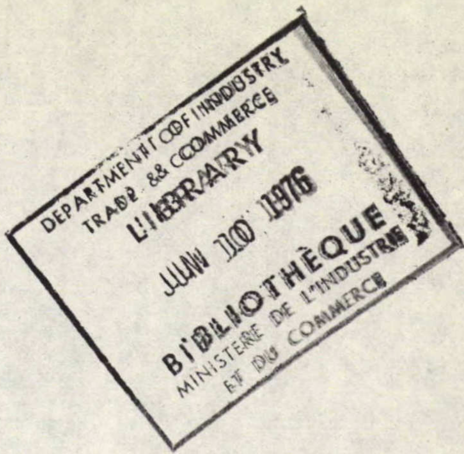

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The views and opinions expressed in this report are those of the authors and are not necessarily endorsed by the Department of Industry, Trade and Commerce.

Tomlinson's Interim Report II
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FOREIGN TRADE AND INVESTMENT DECISIONS OF EUROPEAN COMPANIES

I. INTRODUCTION

During the spring of 1973 the Department of Industry, Trade and Commerce of the Government of Canada commissioned the Faculty of Commerce and Business Administration at the University of British Columbia, Vancouver, B. C., to undertake a study of Foreign Trade and Investment Decisions of European Firms. This study followed an earlier study of Foreign Trade and Investment Decisions of Canadian Firms. The international investment decision processes of Canadian firms will ultimately be compared to those of continental European, English, Japanese and U.S. firms, with the objective of making some useful predictions concerning future development and potential Canadian strategies in relation to international competitors.

The study is being carried out by Dr. J.W.C. Tomlinson, and Hans-Joachim Himmelsbach.

II. SELECTION OF A SAMPLE

Preliminary Research

For the purpose of obtaining a list of European firms that have subsidiaries outside their home countries, several sources of information were used. As a starting point the various European Trade Missions or Consular offices in Vancouver, B.C., were

contacted, to provide further information either in the form of additional contacts[1] or reference materials.[2] Two Trade Commissioners through their home offices established contacts with firms and cleared the way for interview appointments. Three Trade Commissioners produced lists of internationally operating firms domiciled in their countries, thus making additional search for a sample of firms unnecessary. Financial Institutions were excluded from the sample, because their international investment decision processes are based upon criteria which are different from those of industrial corporations and would have tended to bias the findings untypically.

Criteria for Selection

The firms contacted had to meet the following criteria in order to be eligible:

a) The individual firm had to be controlled by interests in the country of domicile, in most cases this meant that more than fifty percent of the firm's outstanding common share equity had to be held by residents of the parent country, and

b) the firm had to maintain physical assets (manufacturing facilities) or at least substantial minority interests outside the parent country. Firms whose "foreign investments" consisted merely of sales offices abroad were not considered to be eligible for the purpose of this study.

Number of Firms Selected and Breakdown by Countries

A total of 100 firms were approached located in the following countries:

Country	Number
Austria	14
Belgium	11
France	11
Germany	24
Netherlands	5
Sweden	19
Switzerland	16
Total	100

Fifty firms participated, and personal interviews concerning their foreign investment experiences were completed. Information concerning one firm was not included as it did not satisfy the criteria listed above. Three additional firms answered questionnaires which were mailed to them.[3] The net sample of 52 companies eligible for the study was broken down into the following countries:

Country	Number
Austria	5
Belgium	4
France	5
Germany	14
Netherlands	2
Sweden	10
Switzerland	12
Total	52

This preliminary report does not include information from English firms. These data will be treated separately and will be used later for comparative purposes.

An extensive questionnaire was prepared in English and German, but it was not mailed to the interviewees in advance,

because, based on previous experience in similar studies a poor participation rate and a poor quality of responses would have been expected. This expectation was also verified in this particular study, since some questionnaires were later sent to firms that were not interviewed (see footnote 3, above). Instead top executives of the individual firms were interviewed personally, while the questionnaire was used as a guide and framework within which the interviews were conducted. Information was sought on six major sub-headings of the overall project. These major areas were:

I. General Classification and Description
II. Exporting and Exports
III. The Product Life Cycle Hypothesis
IV. Research and Development, Licensing
V. The Foreign Investment Decision, and
VI. Organization, Control and Evaluation

III. GENERAL CHARACTERISTICS OF THE RESPONDENT FIRMS

a) Classification by Industry

The respondent firms were classified into the following major industrial categories:

EXHIBIT 1

Industry	No. of firms	Percenta of Sampl
1. Food and Beverages	3	6%
2. Lumber, Pulp, Newsprint and Paper	0	0%
3. Primary Metals and Metal Fabrication	11	21%
4. Machinery	6	12%
5. Automobiles and Transportation Equipment	6	12%
6. Electrical and Electronics	9	17%
7. Petroleum and Coal Products	0	0%
8. Chemicals	11	21%
9. Miscellaneous Manufacturing	5	10%
10. Trade, Services and Utilities	1	2%

EXHIBIT 2

Form of Ownership (Parent Company)

No. of Firms

Country	Widely-Held	%	Closely-Held	%	Private	%	State-Owned	%	Total
Austria	-	-	1	20%	2	40%	2	40%	5
Belgium	-	-	3	75%	1	25%	-	-	4
France	3	60%	2	40%	-	-	-	-	5
Germany	5	36%	6	43%	3	21%	-	-	14
Netherlands	1	50%	1	50%	-	-	-	-	2
Sweden	3	30%	7	70%	-	-	-	-	10
Switzerland	5	42%	6	50%	1	8%	-	-	12
Total Europe	17	33%	26	50%	7	13%	2	4%	52

b) Ownership and Control of the Parent Firm

1. Form of Ownership

The sample included seventeen public corporations whose common equity was widely held (33% of the sample), and twenty-six (50%)where it was closely held. Seven firms (13%) were privately owned, while two were state-owned enterprises (4%). See exhibit 2.

2. Degree of Home Country Ownership

Twenty-two firms were wholly-owned by home country residents (42%);in twenty-eight firms the majority of the common equity (> 50%) was owned by residents of the companies' home countries (54%), while the remaining two firms (4%) were 50% owned by domestic shareholders.

3. Degree of Control

All of the fifty-two firms stated that the control over their decision making processes rested in their parent countries. In three cases substantial minority positions were held by foreign residents, but effective control rested with the managements of these firms.

c) Size Classification

1. Assets, Revenues, Earnings

For those firms which were prepared to provide detailed information, the breakdown of the companies according to domestic and foreign assets, revenues and earnings before taxes was as follow

EXHIBIT 3

European Firms
Assets, Revenues, Earnings

No. of Firms

Range	Domestic Production T.A.	Domestic Production T.R.	Domestic Production E.B.T.	Foreign Production T.A.	Foreign Production T.R.	Foreign Production E.B.T.
x ≤ $1m	0	0	0	1	1	8*
$1m<x≤$5m	0	0	8	2	3	8
$5m<x≤$25m	2	2	13	3	3	7
$25m<x≤$100	7	6	6	11	11	7
$100m<x≤$250m	8	17	4	8	13	0
$250m<x	20	24	2	6	20	0
	37	49		37	51	

*Including two firms operating at losses

When the approximate weight of foreign vs. domestic operations is computed and broken down by nationalities of the parent firms, the following picture emerges:

EXHIBIT 4

Home Country of Parent Firms	Domestic Operations (%) Total Assets	Domestic Operations (%) Revenues	Domestic Operations (%) EBT	Export Ratio (%)	Foreign Operations Total Assets	Foreign Operations Revenues	Foreign Operations EBT
Austria	80%	64%	97%	52%	20%	36%	3%
Belgium	44%	23%	20%	45%	56%	77%	80%
France	-	71%	-	22%	-	29%	-
Germany	70%	77%	80%	31%	30%	23%	20%
Netherlands	-	56%	-	25%	-	44%	-
Sweden	70%	76%	81%	46%	30%	24%	19%
Switzerland	43%	36%	57%	50%	57%	64%	43%

2. Number of Employees

When firms in the sample were grouped according to the number of total employees, the following results were obtained:

EXHIBIT 5

No. of Total Employees	Domestic Operations	Foreign Operations
	No. of Firms	
$0<x\le 100$	1	2
$100<x\le 500$	1	2
$500<x\le 1,000$	1	2
$1,000<x\le 2,500$	5	3
$2,500<x\le 5,000$	6	8
$5,000<x\le 10,000$	12	12
$10,000<x\le 25,000$	10	13
$25,000<x$	16	9

As expected, in majority of cases, the respondent firms employed larger organizations at home than abroad. There were, however, some situations in which firms maintained - sometimes significantly - larger operations outside their home countries. Additional analysis of these preliminary findings, particularly cross-tabulation of the aggregate results presented above, will clarify this feature further and determine the possible significance of variations by nature of business or scale of operations.

3. Number of Product Lines

There were some problems in determining relative numbers of

product lines, a major one being the difficulty of defining explicitly what constituted a product line in individual situations. Where such difficulties arose, particularly in the case of relatively diversified companies, a firm's main activity was classified as a product line.

A generalization which can be inferred from the results obtained thus far is that the number of product lines maintained for domestic and export business was larger than the number of product lines offered by the firms' foreign subsidiaries. This was expected to be the situation, but in some cases foreign activities were different from domestic and export business, and more explicit comparisons resulting from further analysis will have to take into account such differences.

d) Geographical Distribution of Foreign Investments of European Firms

The European respondent firms covered thus far had 923 foreign affiliates, of which two-thirds were located in developed countries. However, the significance of investments in less developed countries should not be overlooked. The distribution by geographical areas is shown in exhibit 6.

While there were some firms that had interests exclusively in developed countries and that showed no desire to become involved in developing countries, the majority of the European firms interviewed had at some time invested in less developed countries and will continue to do so in the future. Most of the

EXHIBIT 6

Geographical Distribution of Foreign Subsidiaries

No. of Subsidiaries of Parent Companies with Headquarters in

Location of Subsidiaries	Austria	%	Belgium	%	France	%	Germany	%	Netherlands	%	Sweden	%	Switzerland	%	Total Europe	%
Canada	-	-	-	-	6	12%	4	2%	7	5%	6	4%	5	2%	28	3%
U.S.A.	1	5%	1	1%	2	4%	15	6%	2	1%	6	4%	4	2%	31	3%
E.E.C.	11	58%	49	61%	11	22%	53	21%	38	25%	51	33%	80	37%	293	32%
U.K.	1	5%	1	1%	5	10%	5	2%	1	1%	8	5%	15	7%	36	4%
Other Europe	3	16%	20	25%	6	12%	57	23%	33	22%	20	13%	38	18%	177	19%
Africa	2	11%	2	3%	9	18%	14	6%	41	27%	5	3%	13	6%	86	9%
Australia	-	-	1	1%	-	-	7	3%	5	3%	11	7%	7	3%	31	3%
Asia	1	5%	-	-	1	2%	50	20%	15	10%	11	7%	18	8%	96	10%
Latin America	-	-	6	7%	11	22%	46	18%	7	5%	36	23%	34	16%	140	15%
Other America	-	-	-	-	-	-	-	-	2	1%	1	1%	2	1%	5	1%
TOTAL	19		80		51		251		151		155		216		923	

firms surveyed maintained subsidiaries in several different foreign countries, approximately 44 % of the sample had investments in six to ten countries as shown below:

EXHIBIT 7

No. of Different Countries where Investments are Located

No.	No. of Parent Firms	% of Total
1	3	6%
2	2	4%
3	2	4%
4	2	4%
5	2	4%
6	4	8%
7	6	12%
8	2	4%
9	6	12%
10	4	8%
12	1	2%
13	1	2%
14	1	2%
15	1	2%
16	3	6%
17	4	8%
18	1	2%
20	1	2%
23	1	2%
24	1	2%
25	1	2%
28	1	2%
35	1	2%
46	1	2%

A detailed breakdown in financial terms is not yet available, but it can already be stated that investments in other European countries probably account for more than fifty percent of the total value of the sample's foreign investments.

IV. THE FOREIGN INVESTMENT DECISION

a) Importance of Foreign Operations and Profitability

When asked about the degree of importance attached to their firms' international operations vis à vis competitors, the overwhelming majority of the responding executives (80%) felt that their international operations were important; thirty-nine percent felt that their foreign operations were of critical importance, thirty percent viewed their foreign affiliates as being very important, while a further ten percent merely attached the adjective "important" to their foreign subsidiaries.

Sixteen percent of the respondents stated that their firms' foreign ventures were unimportant, while a further four percent felt that foreign operations did not affect their corporations either way.

Relative profitability of foreign vs. domestic operations was not clear-cut. Only sixteen percent of the firms had foreign subsidiaries which were more profitable than their domestic operations, and only two percent of these showed a significantly higher profitability abroad. Thirty percent of the respondents reported equivalent profitabilities abroad, while fifty-four percent of the sample maintained less profitable operations abroad; the latter being divided into the categories "slightly less" (16%) and "much less" (8%).

Relative productivity of foreign vs. domestic operations was

similarly inconclusive. Four percent of the respondents stated that the level of productivity within their foreign affiliates was higher, fifty-one percent felt there was no difference, while fifty fifty-four percent of the firms had to cope with lower levels of productivity abroad.

b) Criteria Applied When Making the Foreign Investment Decision

This section attempted to assess the relative importance of various criteria which are commonly taken into account by companies considering investment abroad. In this preliminary report we simply describe briefly the general nature of the firms' responses when questioned on the validity of each specific factor.

1. Using Patents and/or Know-How

Whether the answer concerned actual patents - as was the case with most of the science-based firms in Europe - or the firms' manufacturing processes and technology, ninety-four percent of the companies viewed the use of their technology as being an important factor in their investment decisions. In the majority of the cases the responses were that this was a critical (43%) or very important (34%) consideration. Generally European corporations have command over very sophisticated technology and know-how, a fact that is also reflected in the composition of the sample. Most of these firms are involved in science and

technology-based industries, and many were originally formed to develop some specific scientific discovery or invention. In foreign countries, particularly in developing nations, these firms are at a special advantage because of their highly developed products and processes. Frequently European firms pool their technology by entering into joint ventures in third countries or areas; this is particularly the case in the chemical industry and to some extent in the electrical and electronics sectors.

2. Attractive New Market Potential

Attractive new market potential or relative saturation of the domestic market by the firm's products were viewed as being highly important criteria for the firms' decisions to locate abroad in 94% of the situations covered. Forty percent viewed this criterion as having been critical, thirty-four percent felt it was very important, and 20% of the firms stated that new market potential was an important consideration. Only in four percent of the decisions this was an unimportant factor while in three percent of the cases new market potential had not made any difference.

3. Overcoming Tariff or Quota Barriers

This factor was rated as being highly important with seventy-four percent of the respondents attaching various degrees of importance to it, the dominant adjective being "critical" (30%). Twelve percent of the sample felt that tariffs and quotas did

not sway the decision to invest either way, while fifteen percent did not view this factor as having been an important consideration. The rather high degree of importance attached to the tariff and quota factor is largely due to the timing of the investments and the countries or areas where the investments were made. A significant proportion of the situations covered by this study represents foreign investments made by European firms during the post World War I era which was generally characterized by prohibitive tariff walls and other governmental measures restricting international trade. After World War II a significant number of the respondent firms invested in developing countries which imposed import restrictions because of balance of payments considerations or development policies. The imposition of such measures virtually forced many European firms to replace exports by local manufacture.

4. Developing an Existing Export Market

For the majority of the respondent firms (79%), the further development of a market area serviced by exports from the home country was a very important reason for making the decision to manufacture abroad. Only ten percent of the respondents attached no importance to this investment criterion, while in twelve percent of the cases export displacement had no influence on their decisions to invest abroad.

5. Geographical Diversification

A large portion of the respondents (79%) considered this factor

to be very important, eighteen percent saw no influence of this issue on their decisions and a mere three percent viewed this as an unimportant consideration. This question and the replies to it actually tie in with the question concerning market potential abroad, since geographical diversification in most cases was spurred either by the relatively small size of the domestic market (e.g. Austria, Belgium, Netherlands, Switzerland and, to some extent, Sweden) or by an already attained dominance of the firm in the domestic market. In some individual cases firms diversified their production geographically with the purpose of reducing or minimizing political risks; these firms actually exported some of their capital from Europe, mainly to South America, South Africa, the United States and Canada during the Cold War era, because they felt that their domestic operations were threatened, because they were located in the front line of a possible conflict.

6. Ready-Made Opportunity

Eighty-three percent of the respondents viewed this criterion - with all its various interpretations - as being highly important, while the remainder felt that it did not influence their foreign investment decisions. The respondent firms discussed ready-made opportunities, such as an offer made by a prospective partner, the award of an important contract, or an existing business association at home being extended to a foreign country. In some cases such an opportunity consisted of an incentive by the

prospective host government or the firm's home country government. Thus these answers overlap somewhat with the replies to other questions.

7. Political Stability of the Host Country

In approximately fifty-six percent of the situations surveyed this was an important factor which was considered before making a decision to invest in a certain country. The majority of those company executives, however, did not attach very high degrees of importance to this criterion, but merely viewed it as being "important". A mere six percent of the respondents stated that political stability of the prospective host country was unimportant, while in two out of five cases it did not influence the decision to invest either way. Surprisingly several of the corporations that were not overly concerned about political risks had been expropriated by foreign authorities at least once, and some - particularly German firms - lost individual foreign subsidiaries twice in the same countries. There could be an explanation for this lack of concern. Firms that have experienced the trauma of being expropriated in a certain country have been exposed to this problem and they have learned to cope with such a situation; it is no longer an unknown factor to management, and such a company may be better equipped for hedging against expropriation than a firm which lacks such an experience.

8. Future Protection of an Existing Market

The majority of the respondents (62%) felt that protecting a threatened export market was a fairly important reason for investing in manufacturing facilities within that market. Twenty-nine percent of the situations covered were not influenced by this criterion either way, and nine percent of the firms stated that this was not an important factor. Particularly defensive in their investment decision processes were the automotive and pharmaceutical industries whose export markets were threatened by local content rules, specifications or complete or partial import restrictions, as experienced particularly in Latin America. To some extent these replies overlap somewhat with the responses to the question on tariffs and quotas.

9. Surplus Capital or Physical Assets Available to the Parent Firm

This question was interpreted in most cases as having funds available for investment in the home country or elsewhere. The majority of the respondents (65%) viewed this as an important criterion for their foreign investment decisions; the stress was on the adjective "important" rather than "critical" or "very important". In twenty-four percent of the situations covered surplus capital or assets available did not influence the decision either way, while ten percent of the sample felt that this factor was unimportant.

10. Preference or Experience of (a) Senior Executive(s)

The majority of the sample (60%) viewed this as an, although somewhat less important but not very important decision factor, while thirty-nine percent of the respondents stated that it may have been considered but did not influence their decisions to invest in the countries in question. A mere one percent of the sample felt that this issue was unimportant. This criterion weighed slightly heavier with firms that were either privately-owned or closely-held, and thus were more centralised in their decision-making than large widely-held corporations.

11. Matching Competitors

Despite the fact that the largest single group of respondents (34%) felt that this criterion did not influence the decision to invest abroad, and that it was unimportant to a further five percent, fifty-nine percent of the overall responses attached various degrees of importance to the issue; the attribute "important" being dominant among these latter.

12. Managerial Facilities Available

The availability of management personnel within the firm was usually an important factor in the foreign investment decision process in that fifty-nine percent of the European sample described it as such. Yet it was apparently not a critical or very important factor, since more than one-half said it was merely important.

Only in two percent of the cases was this issue described as unimportant. The remainder (39%) stated that the availability of management personnel, although considered, did not influence the investment decision.

13. Availability of Local Management

A slight majority of the respondents (53%) felt that this issue was important to their decision to invest, while forty-five percent felt that this factor had a neutral effect. In only two percent of the situations surveyed was this criterion unimportant. Initially the availability of local management might not have been overly important. Most European firms, however, are quite concerned about obtaining some form of local identity and being recognized as good corporate citizens of the host countries. Thus over relatively short periods after having established subsidiaries abroad, local personnel are being trained for technical and managerial positions, and as soon as local managers are capable of executing their responsibilities efficiently within the guidelines of overall company policies, the majority of parent company staff will be withdrawn and repatriated. Some firms appoint local citizens to their subsidiaries' board of directors even if those subsidiaries are wholly-owned.

14. Availability of Local or International Capital

Thirty-nine percent of the overall respondents attached various

degrees of importance to this factor, while eleven percent felt that this issue was not important to their foreign investment decision. The remaining forty-nine percent considered this problem, but it did not influence their decision-making process either way. Generally European corporations, particularly the larger firms, did not encounter difficulties in gaining access to international money and capital markets at the time the foreign investments were made. Access to local or international capital resources nevertheless appeared to be somewhat important to the majority of the respondent firms. During the periods following World War I and World War II, however, many European firms, particularly German and Austrian companies, experienced severe shortages of funds and restricted debt capacity preventing the undertaking of major foreign investments.

15. Availability of Local Physical Assets

This factor was considered to be important in only twenty-seven percent of the situations covered by this study. Forty percent of the respondents stated that this issue did not affect their investment decisions, while the remainder (34%) felt that this was an unimportant consideration. The responses to this question overlapped somewhat with the question on ready-made opportunity which meant the mere possibility of setting up or acquiring local manufacturing facilities.

16. Higher Return on Investment

Somewhat surprisingly a large majority of the respondents(70%) felt that this investment criterion did not sway their decision to manufacture abroad either way; twenty-five percent stated that this factor was somewhat important, while in the remaining four percent of the situations possible higher returns were not important. Several executives stressed that higher profitabilities abroad cannot be expected for the foreseeable future, because of superior productivity, better economies of scale and better market conditions at home. In many cases the mere access to a foreign market or raw material source or defensive investment criteria overrode the desire for better returns abroad. Many firms hoped that their increased international exposure through growth in sales would eventually bring about equivalent growth in profits.

17. Lower Cost Conditions Abroad

The responses to this question were quite similar to the answers to the question concerning higher return on investment. Seventy-two percent of the executives questioned stated that this criterion was considered, but did not influence the investment decision, while fifteen percent felt that this issue was unimportant. A mere thirteen percent of the respondents attached some importance. The cheap-labour-cost argument apparently could not be verified by the findings of this study. This may be due to the size of the

firms and type of industries contained in the sample. European firms thus far have imported their "cheap labour" and they did not have to locate their plants in areas with ample and low-cost labour resources. This, however, most probably will change in the future, when European firms may have to export increasing amounts of capital to countries or areas where labour surpluses persist, because economic, political, social and environmental pressures and problems will prevent further plant expansion at home and importation of additional labour.

18. Host Government Incentives

Fifty percent of the European firms saw no importance in local government incentives; nineteen percent of the respondents considered this factor, but it did not influence their decision to invest in the foreign country in question. The remaining thirty percent felt that this issue was quite important to their foreign investment decision. Host government incentives were welcomed by all of the firms, but such "bonuses" were rarely included during the process of determining the feasibility of establishing facilities in the particular country in question. Government incentives tended to become somewhat more important to the decision to invest in certain areas of the European Economic Community (e.g. Southern Italy, Southern Belgium, Ireland, etc.). Yet these incentives tend to affect not so much the foreign investment decision but the decision to choose a

certain location for the plant within the country or area where the firm decided to invest. Incentives can disappear overnight and firms generally tend to disregard them when determining the viability and profitability of an investment opportunity; thus, as one executive explained, "if a prospective investor determines a certain opportunity as not being viable on its own merits over the medium or longer term, government incentives are quite unlikely to change this firm's decision."

19. Obtaining Raw Materials or Components

This criterion was viewed as being unimportant by the majority of the respondent firms (55%), while some fifteen percent felt that this was an important issue. The remainder of the sample (30%) stated that, although having considered it, this factor did not influence their investment decisions either way. The majority of the respondent firms purchase their manufacturing inputs from other domestic companies, and thus obtaining raw materials or components is relatively unimportant to these firms. Companies that stressed the importance of this factor were mainly producers of steel, non-ferrous metals and to some extent chemicals and food. Particularly central European steel and aluminum producers have significant foreign investments (mostly minority holdings) with the purpose of securing the supply of iron ore, coal, bauxite etc. Their subsidiaries are mainly located in developing countries (Brazil, Liberia, Mauritania, Sierra Leone etc.); a significant portion of their raw material suppliers are also located in the U.S. (iron ore and coal), Canada and Australia. In the future investments in Canada may increasingly be the result of her ample endowment

with raw materials and energy. "Canada has vast resources of raw materials and energy resources which are vital for the manufacture of our finished product; rather than importing these raw materials into our country and working them at the prevailing high energy costs here, it is quite conceivable that in the future we may expand our presently small Canadian subsidiary to such a size that it can supply the entire European market with those 'energy intensive' products presently manufactured domestically." (Executive of a chemical company)

20. Integration of Control of Global Operations

This criterion was largely unimportant in seventy-three percent of the situations covered by this study; sixteen percent of the firms considered this factor, but it did not influence their decision to invest. Eleven percent of the sample attached some degree of importance to this issue.

This suggests that while many of these European firms are major international companies, they are not primarily concerned with an overall concept involving optional integration of supply with demand on a global basis. In this sense they do not operate as multinational corporations but run a group of relatively independent binational operations which are basically oriented to the potential return the parent company can achieve in a number of discrete markets.

21. Incentives Provided by the Home Country Government

Eighty-two percent either felt that this issue was unimportant or did not consider it at all, while ten percent considered this factor, but it did not influence the investment decision. Seven percent, however, felt that either direct government incentives to invest abroad or governmental discouragement of further domestic

expansion were important investment criteria. The German government within the framework of its foreign aid policy directly encourages investments by German firms in certain designated developing countries through special taxation provisions.[4] France appears to provide some incentives to French firms that are willing to invest in former French colonies, while the Netherlands, and to some extent Switzerland,[5] discourage further domestic expansion of industrial capacity due to social and environmental problems.

21. Other Criteria

In addition to the criteria explicitly introduced many executives named some other factors which they stated were of importance for their firms' decisions to invest abroad. Many executives, particularly those of German and Swiss firms, stated that the rather acute labour shortages at home encourage their firms to invest abroad; the shortage of land may be a further factor stifling plant expansion at home. One German chemical firm employed fifty thousand people at its main plant, and the radius of its workers commuting daily to and from work covers approximately fifty to sixty miles; "there is no way we can materially add to our plant capacity here, because our labour-intake radius would then have to increase to 80 - 100 miles, and no one would be willing to commute over such distances. We are also unable to import and accommodate more foreign workers near our plant because of the lack of housing capacities here; to set up new plants in other regions of Germany would not solve the problem either, thus we are virtually forced to make new

investments abroad and to limit our capital expenditures in Germany to improvements of existing facilities."

Recent drastic changes in relative exchange rates coupled with inflationary pressures at home, particularly vis à vis the U.S. dollar have seriously threatened some companies' ability to increase or even maintain their levels of export business. This has become an important decision factor for firms that sell a significant portion of their output in the United States and Canada. During 1973 A.B. VOLVO decided to assemble its cars in the U.S., and VOLKSWAGENWERK A.G. was intensively studying the feasibility of manufacturing its "beetles" in the U.S.[6] Some companies, however, did not feel that exchange rate charges would materially affect their export business adversely, because the demand for their products is relatively inelastic with respect to price. This was particularly true in the case of the machinery industry, but even the executive of a major automobile company which sells a significant portion of its output in Canada and the U.S. was conspicuously unconcerned about the deterioration of the value of the dollar vis à vis his country's currency: "despite the dollar devaluation we expect our export sales to Canada and the U.S. to increase significantly, and there will be no need to consider local manufacture to maintain these markets, because the demand for our cars is not price elastic. Our cars compete on quality and as status symbols, and thus they will always be bought at virtually any price."

The remaining comments touched on a variety of other factors.

c) Search and Surveys of Foreign Investment Opportunities

1. Informal Contacts

Executives were asked to provide some information on which of various more informal contacts and sources of information were important to their foreign investment decision.

i. Local Contacts in the prospective Host Country:

All of the respondents felt that local contacts provided important information affecting their firms' decisions to invest in various foreign countries; forty-five percent of these executives stated that these contacts were of rather critical importance, while the remainder felt, that this issue was either very important (33%) or merely important (22%).

ii. Executives familiar with the Host Country:

The firms' own executives were viewed as important sources of information in most of the cases covered by this study. Fifty-three percent of the respondents felt that this "contact" was very important, a further twenty-four percent stated that it was of critical importance to the decision to invest abroad while sixteen percent attached somewhat lesser importance to their own executives providing information on the host country. The remainder (6%) stated that this issue had a neutral effect.

iii. Host Country Government Contacts:

In more than two thirds of the situations covered (69%) the host country governments proved to be fairly

valuable contacts, these were generally regarded as having been merely "important" (49%) rather than "critical" (4%) or "very important" (16%). Eight percent of the respondents attached no importance to this factor, while the remainder (22%) considered using the host country governments as sources of information, but their decision to invest was not influenced by this either way.

iv. Other Domestic Contacts:

Almost three quarters of the respondent firms (73%) viewed such contacts as having been fairly valuable; of these fifty-three percent attached the label "important" to this issue, four percent felt that it was "critical", while sixteen percent viewed this criterion as having been "very important". The remainder of the sample either had considered using such contacts, but they did not influence the investment decision (24%), or viewed such contacts as having been unimportant (2%).

v. Information about the operations of competitors:

Forty-three percent of the respondents considered this issue, but it did not influence their decision while for twelve percent this source was unimportant. The remainder (45%) felt that such information was important to their foreign investment decision process.

vi. Information from Competitors:

In only sixteen percent of the situations convered did competitors provide information that was important to the firms' foreign investment decisions, while sixty-seven percent felt that this issue was unimportant. The remainder (16%) considered information received from competitors, but it did not sway the companies' decisions.

vii. Home Country Government Contacts:

Only ten percent of the respondent firms attached some importance to information provided by their own governments, while twenty-nine percent considered such contacts, but their foreign investments were not affected by those. The remainder (61%) felt that this issue was either unimportant or not even worth considering.

2. Surveys

European firms, particularly large enterprises, tended to be self-reliant when surveying particular foreign investment opportunities. In cases where international surveys were conducted all of the respondents engaged their own personnel. Country surveys were mainly undertaken by the companies' own staff (97%), while three percent utilized private sources. Only in two situations did a company engage a consulting firm. In a large majority of the situations (91%) unsolicited information utilized was provided

from private sources, while the balance (9%) received unsolicited information from local government sources.

In the majority of the individual situations, once the surveys and feasibility studies had been completed, the decision whether or not to invest usually followed almost immediately.

d) Risk

Preliminary results in this subject area are based chiefly upon answers received to a number of more subjective questions asked during the personal interviews. The replies to those questions overlapped somewhat with results obtained in other subsections, particularly data on decision criteria.

Firms generally ranked the various kinds of risk in order of importance. The majority of the respondents (69%) ranked political stability as a most important risk factor, while six percent looked at currency risks first, the remainder attached prime importance to commercial risk (26%) in their ranking.

Secondary ranking was given to commercial risk by thirty-nine percent of the executives interviewed, fourteen percent ranked currency risks in second place, political and economic risks ranked second in eighteen and twenty-five percent of the situations covered, while the remainder of the firms (4%) rated attainment of economies of scale as being of secondary importance. Other risk factors, particularly foreign ownership regulations and economies of scale were generally ranked in third or fourth order of importance. Firms

were also questioned on the degree of sophistication their risk evaluation techniques had reached. The majority of the executives stated that they evaluated political risks in a rather subjective manner. A much higher level of sophistication, however, was displayed by the respondents when evaluating the much more easily quantifiable commercial, currency and general economic risk aspects.

Only twenty-five responses were received to the question on specific criteria considered when dealing with risk; the more important factors being as follows:

Return on Investment:	32%
Small Capital Investment	16%
Foreign Investment Insurance:	13%
Payback:	16%
Local Partners:	10%
Ad-hoc Decisions:	10%
Investment exclusively in stable countries:	3%

Only sketchy information was received on the question whether the firms had established definite threshold levels for the above criteria. Some firms desired a somewhat higher return on investment while others were content with equivalent profitabilities but preferred to have only small amounts of capital invested in "risky" countries. Other executives stated that they required shorter payback periods on investments in developing countries relative to ventures at home or in relatively stable developed nations.

No definite quantitatively defined profit margins on pay-back criteria were provided possibly because of a lack of established guidelines or because company policies did not permit the disclosure of such details. European executives appeared to have open minds about investing virtually anywhere in the world, and in many cases partnerships with local interests were welcome. Some firms had established the policy of encouraging local participation in the ownership of all of their subsidiaries.

e) Opportunity Costs

Most firms did look at relative opportunity costs of foreign and domestic investment prospects in one way or another (88%), but many companies did not appear to apply any clearly-defined models for such analyses. A mere twelve percent of the sample stated that they did not conduct analyses of such opportunity costs.

Seventy-eight percent of the respondents felt that such analyses were important for their foreign investment decisions, while ten percent attached no importance to opportunity costs; the remaining executives (12%) considered this issue, but it did not influence their decisions.

f) Negotiation and Financing

1. Availability and Cost of Capital

A majority of the respondents (53%) stated that lack of capital did not prevent their firms from investing in foreign countri

The remainder of the firms questioned felt that lack of capital, although considered, did not influence the decision to invest (10%), or that it had been a definite restraining influence upon expansion abroad (32%). Many of these latter respondents were either medium-sized firms that were unable to secure sufficient funds for the purpose of grasping all of the opportunities offered, or some of the larger German firms were forced to make use of the rather limited funds available in order to re-build their domestic facilities which had suffered heavy damages during the Second World War and the immediate post-war period, when major firms' facilities were wholly or partially dismantled by the Allied occupation forces.

Thirty-nine percent of the sample attached some importance to relative costs of obtaining funds at home or abroad for capital investments in foreign countries. Thirty-three percent considered such costs, but they did not influence their foreign investment decision processes, while the remainder of the respondents (29%) did not feel that this issue was important.

Many firms stressed, however, that, although the cost of capital was an important secondary factor, the really important issue was the availability rather than the cost of investment funds.

2. Sources of Financing

Fifty-nine percent of the European firms included in this survey

financed their international investments through a package of internally generated funds, domestic and local (or international) capital sources. In most cases the internally and domestically raised portion of the package usually financed the less liquid assets of the subsidiaries, where working capital was often financed locally. Thirty-five percent of the sample financed their foreign investments through utilization of domestically and internationally (or locally) obtained funds, while a mere four percent financed their foreign ventures exclusively through the use of internally generated funds. Local or international financing was generally obtained for large projects, and the firms using these sources were usually large corporations which enjoyed a relatively easy access to international capital on money markets.

V. PARENT CONTROL OVER FOREIGN SUBSIDIARIES

1. Ownership

Analyzing the European parent firms' equity ownership in their foreign subsidiaries, we found that the majority of the subsidiaries covered by this study (52%) was wholly-owned. Most of the executives, however, would not explicitly state that 100% ownership was a definite policy of their companies. In only sixteen percent of the cases did the parent own a minority share, four percent owned less than 25% and twelve percent owned between 25% and 49%. Nine percent of the sample represented 50/50 joint ventures, and twenty-four percent of the foreign subsidiaries

were majority-owned by the respondent firms; of these thirteen percent were in the 51% to 74% range, while in the remaining eleven percent of the cases the parent firm owned between 75% and 99% of the subsidiaries' equity.

In most cases the remaining shares of the foreign subsidiaries were held by local individuals, corporations or governments. In some cases a portion of the share capital was held by third country nationals or interests of the same nationality as the parent company. Fifty-fifty joint ventures were quite frequent in the chemical industry, mostly between corporations of similar size and technology. As one executive explained, "if two equally large corporations pool their interests in a third country, neither partner wants to take forty-nine percent and yield the majority to the other; thus a straight 50/50 venture is the most logical solution which both partners can happily live with."

2. Control over the Subsidiary's Decision Processes and Organization

i. Capital Expenditures:

All of the respondent firms had to give prior approval, before the foreign subsidiaries were able to spend funds on major capital projects.

ii. Pricing:

The majority of the subsidiaries (59%) were highly autonomous in their pricing decisions which they could make independently, a further thirty-seven percent merely had to consult the

parent company prior to making price changes. The remainder (4%) of the subsidiaries was required to obtain advance approval from headquarters.

iii. Dividend Policy:

Virtually all of the parent firms (96%) highly controlled dividend payments by their subsidiaries which had to be approved. Only four percent of the parents merely demanded to be consulted, and none of the parents granted full independence to their subsidiaries.

iv. Organization:

Eight percent of the respondents left decisions in this area entirely up to their subsidiaries, seventy-six percent demanded to be consulted on this issue, and the remainder (16%) reserved the right of approval of any decision made by the foreign subsidiary on organization.

v. Product Selection, Design and Planning:

The majority of the subsidiaries (65%) were required to obtain approval by their parent firms prior to making decisions, and a further twenty-nine percent had to consult their parents on these matters. Only six percent of the European companies granted full independence to their affiliates in this area.

vi. Production Planning or Control:

Some fourteen percent of the sample granted full autonomy to their subsidiaries concerning decisions on these day-to-day matters, while twenty-two percent had established the policy of prior approval by head-quarter. Sixty-three percent of the sample wanted to be consulted on these matters.

vii. Quality Control:

Thirty-one percent of the parent firms exercised tight quality control over their subsidiaries' products. These were mainly firms whose products or production processes were highly sophisticated. The majority of the sample (53%) wanted to be consulted, while in sixteen percent of the cases the subsidiaries acted independently in making quality control decisions.

viii. Marketing and Sales:

The foreign subsidiaries of European corporations are generally quite independent in their marketing decisions (76%). Only twenty percent were required to consult their parent firms on these matters, while four percent had to await prior approval by the head office.

ix. Purchasing:

In fifty-three percent of the situations covered by this study asked the subsidiaries independently, and

forty-five percent occasionally consulted their parents. The remainder of the subsidiaries (2%) was required to obtain advance approval by the headquarters. In many cases (e.g. automobile and chemical companies) the nature of the products made it necessary for the subsidiary to purchase parts, materials and ingredients from the parent firm or from its suppliers because of the know-how and technology involved.

x. Costing Methods:

In sixty-seven percent of the cases foreign subsidiaries were required to consult with their parent companies on this matter, and sixteen percent had to obtain prior approval. The remainder of the European firms (16%) granted full independence to their subsidiaries in making decisions concerning costing methods.

xi. Budgeting and Budgetary Control:

Thirty-seven percent of the European companies wanted to be consulted by their subsidiaries on budgeting decisions, while in fifty-nine percent of the situations the parents' prior approval had to be otbained. Only four percent of the subsidiaries were able to make budgeting decisions on their own.

xii. Financial Accounting Procedures:

In fifty-nine percent of the cases consultation with the parent company was necessary when such procedures were to be established or changed, while thirty-three percent of the parents had to render their pri approval. The remainder (8%) decided upon these matters independently.

xiii. Wage and Labour Policy:

The subsidiaries of all of the European companies enjoyed complete autonomy in making decisions pertaining to wage and labour policies.

xiv. Selection, Promotion and Compensation of Executives:

Such decisions had to meet with the prior approval of the parent company in the majority of cases (53%), while in a further thirty-seven percent of the situations the subsidiary had to consult the head office. The remainder (10%) decided independently.

xv. Training:

The majority of the subsidiaries (53%) consulted their parents on training procedures, while forty-one percent made such decisions independently. The remaining affiliates (6%) had to obtain prior approval of such measures.

xvi. Administrative and Supervisory Techniques:

Thirty-one percent of the respondents let their subsidiaries decide independently on these areas, while the majority (65%) wanted to be consulted, and four percent of the firms approved such measures at headquarters.

xvii. Recording and Reporting Procedures:

Control over decisions in this area appeared to be fairly tight, as forty-five percent of the respondent firms reserved the right of approval by their headquarters, and fifty-one percent demanded to be at least consulted. Only in four percent of the cases did the subsidiaries make these decisions independently.

xviii. Transfer Prices:

Practically all of the European firms exercised tight control over the establishment of inter-company transfer pricing leaving their subsidiaries very little freedom in making decisions on this matter.

xix. Operating Areas Available to the Subsidiary:

In a large majority of the cases (82%) the parent had to approve suggestions made by the subsidiary's management, and twelve percent of the affiliates were required to at least consult headquarters. The remainder (6%) granted full autonomy to their subsidiaries in making decisions on operating territories.

RESEARCH AND DEVELOPMENT AND LICENSING

a) Research and Development Spending by European Firms

On average the respondent firms spent approximately four percent of their revenues on Research and Development in their home countries. The size of these outlays varied from country to country and from industry to industry. Firms within the same industry groups tend to budget relative amounts for Research and Development that are highly similar to the outlays of their domestic and foreign competitors. This is particularly true for such high-technology industries as automobiles, chemicals, electrical products and machinery. These industries also account for most of the Research and Development expenditures that the foreign subsidiaries of the respondent firms incur. Approximately one percent of foreign turnover is spent on R & D. The Swiss respondent firms showed the highest R & D effort at home (7%), followed by the Swedish and German companies (6.9% and 5.1% respectively); the Swiss firms ranked first in R & D spending abroad (3.8), the Germans second (1.4%), and the Swedish firms took third place (0.9%).

Generally the respondent firms maintained fairly large research staffs as shown by the following results:

EXHIBIT

	No. of People Employed in R & D	
Range	Domestic	Abroad
	No. of Firms	
NIL	1	7
$0 < x \leq 100$	0	4

(continued on next page)

EXHIBIT (continued)

	No. of People Employed in R & D (No. of Firms)	
Range	Domestic	Abroad
$100<x\le 500$	4	2
$500<x\le 1,000$	3	2
$1,000<x\le 2,500$	4	0
$2,500<x\le 5,000$	3	1
$5,000<x$	4	0

One firm conducted its entire Research and Development outside its home country.

b) Licensing

In order to obtain some information on the determinants of licensing, as compared with investment in foreign manufacturing, firms were asked specifically whether a steadily rising level of export sales alone was likely to encourage them to consider:

i. licensing a foreign manufacturer or

ii. direct investment in manufacturing.

The answers were summarized as follows:

i. licensing a foreign manufacturer:

YES: 36%

NO: 64%

ii. direct investment in manufacturing:

YES: 72%

NO: 28%

Thus European companies generally appeared not to favour licensing foreign or domestic firms. The major reasons for this

attitude were disclosed by replies to questions concerning factors favouring or inhibiting licensing. Firms that did not favour licensing stated that such an arrangement was either less profitable, that they were concerned about maintaining secrecy of the manufacturing process or that the firm's technology was part of an indivisible corporate package.

When questioned about factors favouring licensing arrangements, firms generally attached various degrees of importance to governmental restrictions of profit and capital remittances and to "other factors". The latter represented mainly restrictive foreign ownership regulations imposed by the host country governments, political instability, a small and relatively uninteresting market which was already being serviced by another firm, or the license would cover a product or process that was not of major importance to the firms' overall business activities.

CONCLUDING COMMENT

This interim report has merely presented some of the information, obtained during the first stage of the study, in simple summary form.

The data collected are currently being put on file for computer analysis. The most interesting results will come from further analysis using cross tabulations and correlations of the refined ard detailed information which was broadly summarized here. After this analysis it will be possible to interpret our

European results more explicitly in terms of both theory and the current situation in Europe. In the next stage of the study, we will analyse differences between the Canadian and the European data to form a basis for comparison and evaluation of the nature and determinants of foreign trade and investment decisions in different countries. The ultimate objective will be to provide useful models for Canadian companies to build upon and to improve their performance in international operations.

June 1974

FOOTNOTES

[1]For example: Bundesverband Der Deutschen Industrie.

[2]Such reference materials used were published by German and Swiss banks and the General Export Association of Sweden.

[3]Questionnaires (either in English or German) were mailed to an additional 32 firms in: France 4
in: Germany 15
in: Switzerland 13
As expected, the results were rather meagre; of the six firms that replied acknowledging receipt of the questionnaires, only two companies answered the questionnaires, while the remainder refused to participate.

[4]Under the German Property Tax Act (Vermögenssteuergesetz) foreign property taxes paid can be offset against property tax liabilities in Germany (elimination of double taxation), and higher exemptions are allowed for investments in developing countries. Under the Foreign Investments Act (Auslands-investitionengesetz) tax-free reserves can be established, losses of foreign subsidiaries can be offset against profits of German operations, and allowances for losses of foreign subsidiaries can be deducted from pre-tax income in Germany. In addition to the above mentioned regulations, special write-offs, depreciation schedules, tax-free allowances and reserves apply to investments in specified developing countries according to the Foreign Aid Tax Acts (Entwicklungshilfe-Steuergesetze).

[5]The Swiss government recently severely curtailed immigration into Switzerland; this policy further aggravated the already existing shortage of labour and will ultimately force Swiss firms to shift their investments into new plants abroad.

[6]In fact a recent press release indicates that VW have now made a commitment to invest in production facilities in the U.S.

(Frankfurter Allgemeine Zeitung, May 14, 1974)
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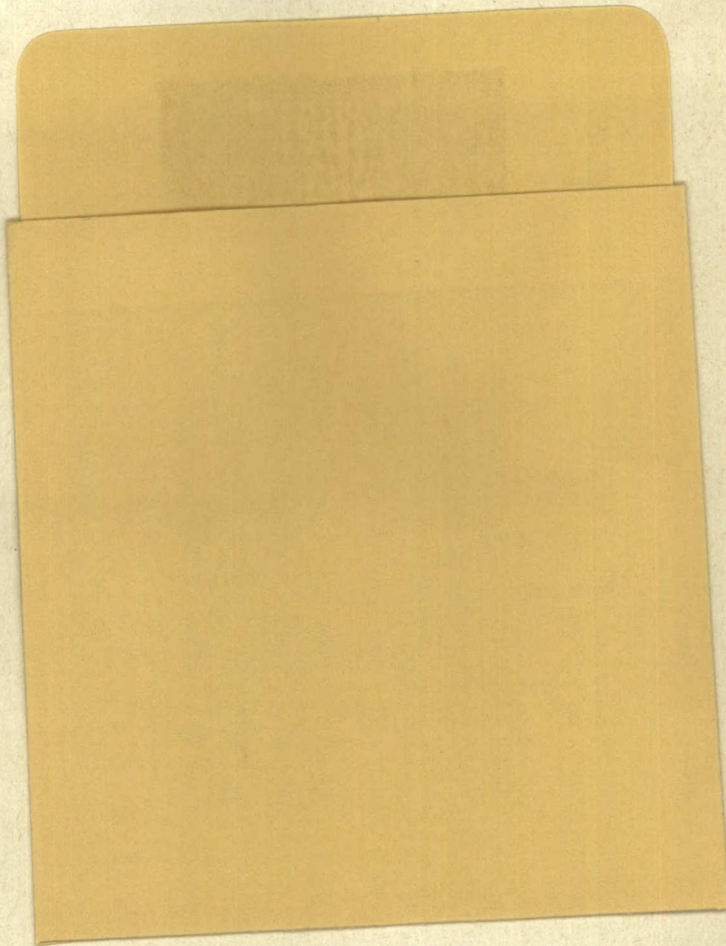

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