

# INTERNATIONAL INVESTMENTS

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## OUTLINE

International Investments I: Basic Concepts  
Event Study Methods  
International Investments II: The Evidence

# **INTERNATIONAL INVESTMENTS I: BASIC CONCEPTS**

## **1. THEORY OF COMPARATIVE ADVANTAGE**

### **1A. ASSUMPTIONS**

- FREE TRADE
- PERFECT COMPETITION
- NO UNCERTAINTY
- COSTLESS INFORMATION
- NO GOVERNMENT INTERFERENCE

### **1B. THE THEORY STATES**

- EXPORTERS IN COUNTRY A SELL UNRELATED IMPORTERS IN COUNTRY B
- FIRMS IN COUNTRY A SPECIALIZE IN RELATIVELY EFFICIENT PRODUCTION
- FIRMS IN COUNTRY B SPECIALIZE TOO
- THE COMBINED OUTPUT OF A AND B IS MAXIMIZED
- FACTORS OF PRODUCTION CANNOT BE MOVED FREELY. BENEFITS OF SPECIALIZATION COME FROM INTERNATIONAL TRADE
- BENEFITS OF EXTRA PRODUCTION, TERMS OF TRADE
- NEITHER A NOR COUNTRY B IS WORSE, BETTER OFF
- PROVIDE ILLUSTRATIVE EXAMPLE IF NEEDED

## **1C. INTERNATIONAL TRADE AND COMPARATIVE ADVANTAGE**

- COUNTRIES DO NOT SPECIALIZE
- FACTORS OF PRODUCTION MOVE EASILY
- FACTORS OF PRODUCTION COMPLEX
- COMPARATIVE ADVANTAGE CHANGES. LESS DEVELOPED COUNTRIES BECOME DEVELOPED
- UNCERTAINTY, INFORMATION COSTS, PRODUCT DIFFERENTIATION, IMPERFECT MARKETS, ECONOMIES OF SCALE

## **1D. COMPARATIVE ADVANTAGE BASED ON**

- SERVICES, TELECOMMUNICATIONS, INTERNET.
- MIXTURE OF LABOR SKILLS, ACCESS TO CAPITAL, TECHNOLOGY.

## **2. MARKET IMPERFECTIONS**

- PRODUCTS, FACTORS OF PRODUCTION, FINANCIAL ASSETS, ECONOMIES OF SCALE, MANAGERIAL AND TECHNOLOGICAL EXPERTISE, PRODUCT DIFFERENTIATION, INFORMATION MONOPOLIES

## **3. STRATEGIC MOTIVES**

- MARKET SEEKERS
- RAW MATERIAL SEEKERS
- PRODUCTION EFFICIENCY SEEKERS
- KNOWLEDGE SEEKERS
- POLITICAL SAFETY SEEKERS

## **4. TRANSFERRING COMPETITIVE ADVANTAGE TO INTERNATIONAL MARKETS**

- FIRM HAS SUSTAINABLE COMPETITIVE ADVANTAGE IN THE HOME MARKET
- ADVANTAGE IS FIRM-SPECIFIC, TRANSFERABLE, AND BIG ENOUGH TO OVERCOME COSTS OF OPERATING ABROAD (FX RISKS, POLITICAL RISKS, HIGHER AGENCY COSTS).

### **4A. ECONOMIES OF SCALE AND SCOPE**

- PRODUCTION, MARKETING, FINANCE, RESEARCH AND DEVELOPMENT, TRANSPORTATION, AND PURCHASING

### **4B. MANAGERIAL AND MARKETING EXPERTISE**

- SKILL IN MANAGING LARGE ORGANIZATIONS (HUMAN CAPITAL AND TECHNOLOGY)
- MODERN ANALYTICAL TECHNIQUES AND THEIR APPLICATION

### **4C. ADVANCED TECHNOLOGY**

- SCIENTIFIC AND ENGINEERING SKILLS

### **4D. FINANCIAL STRENGTH**

- MINIMIZING COST OF CAPITAL
- AVAILABILITY OF CAPITAL

#### **4E. DIFFERENTIATED PRODUCTS**

- PRODUCE, MARKETING DIFFERENTIATED PRODUCTS
- R&D-BASED; MARKETING BASED

#### **4F. COMPETITIVENESS OF THE HOME MARKET**

- COMPETITIVE HOME MARKET STRENGTHENS FIRM'S COMPETITIVE ADVANTAGE
- PORTER'S DIAMOND OF NATIONAL ADVANTAGE

#### **5. OLI PARADIGM**

- WHY FIRMS PREFER FDI OVER EXPORTS, STRATEGIC ALLIANCES, MANAGEMENT CONTRACTS, LICENSING, JOINT VENTURES
- "O" *OWNER-SPECIFIC*
- "L" *LOCATION-SPECIFIC*
- "I" *INTERNALIZATION*, ORGANIZING WITHIN THE FIRM

#### **6. WHERE TO INVEST?**

- IDENTIFY COMPETITIVE ADVANTAGES, SEARCH WORLDWIDE FOR MARKET IMPERFECTIONS AND COMPARATIVE ADVANTAGE,  $MRR > MCC$
- IN PRACTICE, EXTERNAL STIMULUS:
  - OUTSIDE PROPOSAL
  - LOSING MARKET
  - FOLLOW THE LEADER
  - FOREIGN COMPETITION IN HOME MARKET

## **7. MODES OF FOREIGN INVOLVEMENT**

### **7A. EXPORTING VERSUS PRODUCTION ABROAD**

- EXPORTS ARE LOW RISK
- LOWER INVESTMENT
- RISK OF LOSING MARKETS TO IMITATORS AND GLOBAL COMPETITORS

### **7B. LICENSING AND MANAGEMENT CONTRACTS VERSUS FDI**

- *LICENSING*: PROFITS; MINIMAL COMMITMENT
- DISADVANTAGES:
  - POSSIBLE LOSS OF QUALITY CONTROL
  - LICENCING FEES ARE LOWER
  - POTENTIAL COMPETITOR IN THIRD-COUNTRY MARKETS
  - RISK THAT TECHNOLOGY WILL BE STOLEN
- *MANAGEMENT CONTRACTS*: PROVIDE CASHFLOWS; MINIMAL EXPOSURE OR INVESTMENT; LOWER POLITICAL RISK

### **7C. JOINT VENTURE VERSUS SUBSIDIARY**

- *JOINT VENTURE*: SHARED OWNERSHIP
- ADVANTAGES:
  - BETTER UNDERSTANDING OF LOCAL CUSTOMS, MORES AND INSTITUTIONS OF GOVERNMENT
  - PROVIDING FOR CAPABLE MID-LEVEL MANAGEMENT
  - SOME COUNTRIES DO NOT ALLOW 100%

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  - CONFLICTS ABOUT DIVIDENDS, SOURCES OF FUNDS
  - TRANSFER PRICING ISSUES
  - RATIONALIZING GLOBAL PRODUCTION

## 7D. GREENFIELD INVESTMENT VERSUS ACQUISITION

- *GREENFIELD INVESTMENT*: FROM THE GROUND UP
- *ACQUISITION* IS QUICKER. CHEAP WAY TO OBTAIN TECHNOLOGY AND/OR BRAND NAMES
- PRICE MAY BE TOO HIGH

## 8. STRATEGIC ALLIANCE

- *STRATEGIC ALLIANCE*: CONVEYS DIFFERENT MEANINGS
- TWO FIRMS EXCHANGE OWNERSHIP
- PARTNERS EXCHANGE OWNERSHIP AND CREATE JV
- JOINT MARKETING AND SERVICING AGREEMENTS

# EVENT STUDY METHODS

## 1. EVENT STUDY

### 1A. EVENTS

- FIRMS ANNOUNCE EVENTS SUCH AS CEO HIRINGS AND FIRINGS, EARNINGS AND DIVIDEND ANNOUNCEMENTS, NEW PRODUCT ANNOUNCEMENTS, BOARD OF DIRECTORS, MERGERS, LITIGATION, ADVERTISING CAMPAIGNS, FINANCING DECISIONS, ETC
- SOME EVENTS ARE OBSERVED BY INVESTORS, SUCH AS CEO DEATHS, PLANE CRASHES, COMPETITIVE EVENTS (BING BY MICROSOFT)
- SOME EVENTS ARE MACROECONOMIC IN NATURE SUCH AS INTEREST RATE ANNOUNCEMENTS, MONEY SUPPLY, EXPORTS, IMPORTS, FX RATES, TERRORIST ATTACKS, ETC

### 1B. CALENDAR TIME

- EVENTS ARE ANNOUNCED/PERCIEVED BY INVESTORS IN CALENDAR TIME
- EXAMPLE: EARNINGS ANNOUNCEMENTS BY FIRMS A, B AND C
- A, JULY 15; B, JULY 19; C, July 21, 2009

	A	B	C	
Jan 1				Dec 31



## 1C. EVENT TIME

	A
	DAY 0
	B
	DAY 0
	C
	DAY 0

EVENT DAY IS  $T = 0$

DEFINE DAYS IN RELATION TO DAY 0. THE TIME PERIOD 100 DAYS BEFORE IS  $[T-100, 0]$

## 1D. MEASURING EXCESS RETURNS

- MARKET MODEL
- $R_i = a_i + b_i R_m$
- ESTIMATE MODEL OVER  $[T-100, T-10]$  OR SOMETHING SIMILAR
- WE KNOW THE ACTUAL  $R_i$  AND  $R_m$
- CALCULATE EXCESS RETURN FOR ANY DAY AS
- ACTUAL RETURN – EXPECTED RETURN
- $ER = R_i - e(R_i) = R_i - \hat{a}_i + \hat{b}_i R_m$
- $H_0 = E(ER) = 0$

## 1E. ESTIMATION ADJUSTMENTS

- SERIAL CORRELATION
- CROSS-SECTIONAL CORRELATION
- EVENT INDUCED INCREASE IN VARIANCE

## 1F. CROSS-SECTIONAL REGRESSION MODELS

- $ER_i = f(\text{EXPLANATORY VARIABLES})$

# **INTERNATIONAL INVESTMENTS II: THE EVIDENCE**

## **1. EVIDENCE ON VALUE CREATION IN THE FINANCIAL SERVICES INDUSTRIES THROUGH THE USE OF JOINT VENTURES AND STRATEGIC ALLIANCES**

### **1A. COOPERATIVE ACTIVITY ANNOUNCEMENTS**

Information from *Securities Data Corporation International Joint Ventures* database

D = Domestic I = International R = Related C = Cross-Product

#### **1B. JOINT VENTURES**

- 1. Banc One Corp** entered into a *joint venture* with **BankAmerica Corp** and **Chemical Banking Corp** to operate a nationwide system for microchip- embedded 'smart cards'. The venture was called SmartCash. The smart card was to enable value from a cardholder's deposit or credit account to be loaded on it. Financial terms were not disclosed (August 16, 1995) [D R].
- 2. Marsh & McLennan Company** and **J.P. Morgan & Co.** formed a *joint venture* company to exploit the rising global interest in the catastrophe reinsurance market. The market had suffered losses after hurricanes Andrew in 1992 (November 6, 1992) [D C].
- 3. Citibank NA** and the **Government of Saudi Arabia** signed an agreement to form Saudi American Bank, a *joint venture* to provide banking services in Saudi Arabia (January 1, 1990) [I R].
- 4. State Street Boston Corp** and an undisclosed European bank formed a *joint venture* to provide foreign currency trading services to European companies. The joint venture was to be named Galleon Capital Corp (April 19, 1995) [I C].

## 1C. *STRATEGIC ALLIANCES*

1. **Ameritech** and **Citibank** formed a *strategic alliance* to offer interactive banking services. The companies planned to combine telephone and banking services delivered to the home of the consumer using screen telephones. Consumers were to do their banking through these interactive services. The telephones were equipped with digital display screens and a typewriter-like keyboard. Ameritech and Citibank planned to market the telephones directly to consumers. Financial terms were not disclosed (November 9, 1993) [D R].
2. **Smoky Mountain Technologies**, a unit of UniComp Inc, and **First Tennessee National Corp** entered into a *strategic alliance* to provide a combined credit card, debit card and frequent shopper program targeted at the quick service food market (May 30, 1997) [D C].
3. **Lippo Ltd**, a Philippines unit of Lippo Capital, entered into a *strategic alliance* with **First Union Corp**. The purpose of the alliance was to combine their marketing efforts into a trade finance network in Southeast Asia and the Pacific Rim. Under the terms of the agreement, the network would include seven existing Lippo offices in Southeast Asia and the Pacific Rim. In addition, First Union planned to open a Los Angeles office at Lippo Bank, to process letters of credit related services. Financial details were not disclosed (February 15, 1995) [I C].
4. **Banco Nacional de Mexico** entered into a *strategic alliance* with **Wells Fargo Bank**, a unit of Wells Fargo & Co, to develop a series of banking products and services. Under the terms of the agreement, the two banks would offer foreign trade financing and related products to firms operating in each of their respective markets. In addition, the banks would offer financial products to firms and individuals with operations in Mexico and the US, with each attending clients of the other in its home market. The banks believed the alliance would capitalize on the rapidly expanding interaction between their respective customer bases, which was enhanced by the North American Free Trade Agreement. Financial details were not disclosed (May 15, 1995) [I R].

## 1D. PARTICIPATION CHARACTERISTICS OF THE COOPERATIVE ACTIVITY FIRMS

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*Frequency of Cooperative Activity Use by Partner Firms*

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Number of events	Number of firms	Firm name
1	83	
2	29	
3 to 5	43	
6 to 8	15	
11 to 12	4	Equitable Life Insurance, First Chicago (11 each) JP Morgan, PNC (12 each)
14 to 16	6	Bank of Boston, First Union, Wells Fargo (14 each) Cigna, State Street (15 each) Aetna (16)
18 to 20	2	Mellon (18) Bank One (20)
23	1	Banker's Trust
29	1	Chase Manhattan
32	1	Bank of America
39	1	Citigroup
55	1	American International Group

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# 1E. CUMULATIVE ABNORMAL RETURNS BY COMBINED STRATEGIC/COMPETITIVE MOTIVES

		CAR Event Windows		
	No.	(-1, 1)	(-1, 0)	+/-
<i>Total Sample</i>				
Domestic-Horizontal	67	0.49 (1.23)	0.25 (0.78)	35/32 (0.08)
Domestic-Diversifying	244	0.62 (3.40)***	0.51 (3.49)***	141/103 (3.28)***
International-Horizontal	66	1.18 (3.04)***	1.00 (3.13)***	44/22 (3.10)***
International-Diversifying	131	0.49 (2.22)**	0.41 (2.25)**	72/59 (1.48)

## 1F. LONG-HORIZON HOLDING PERIOD ABNORMAL RETURNS

		HPR Event Windows			
		Max	(1,6)	(1, 12)	(1, 18)
<i>PANEL A: LHHPR BY INDUSTRY CLASSIFICATION</i>					
Total Sample	187	4.86 (1.70)*	7.18 (2.62)***	7.94 (2.00)**	
Commercial banks	86	5.46 (2.44)**	7.24 (2.03)**	7.45 (2.12)**	
Investment srvcies	37	4.33 (1.13)	9.44 (1.86)*	10.26 (1.98)**	
Insurance	64	4.35 (1.49)	6.29 (0.97)	7.40 (1.74)*	
<i>PANEL B: LHHPR BY STRATEGIC/COMPETITIVE MOTIVE</i>					
Domestic	134	5.13 (1.89)	6.90 (2.02)**	9.40 (2.05)**	
International	52	4.15 (1.40)	7.90 (2.28)**	4.05 (0.66)	
Horizontal	54	7.48 (1.79)*	7.76 (1.87)*	14.79 (2.28)**	
Diversifying	131	3.78 (1.69)*	6.94 (2.12)*	5.10 (1.12)	

## **2. SIGNIFICANT VALUE CREATION FOR FIRMS ANNOUNCING**

- COOPERATIVE STRATEGIES
- COOPERATIVE STRATEGIES ARE INTERNATIONAL
- COOPERATIVE STRATEGIES ARE HORIZONTAL
- EXPANSION OF SCOPE OF OPERATIONS
- LONG-HORIZON HOLDING PERIOD RETURNS

## **3. IMPLICATIONS FOR FINANCIAL FIRMS**

- JV'S AND SA'S CREATE VALUE
- CAPITALIZE ON DOMESTIC EXPERTISE WITH HORIZONTAL EXPANSIONS
- COOPERATIVE ACTIVITIES PROVIDE STRATEGIC AND COMPETITIVE ADVANTAGES

# INTERNATIONAL INVESTMENTS II: THE EVIDENCE

## 1. EXPANSION BY U.S. MNCS TO AFRICA

### ***1A. THE ECONOMIST***

- “THE HOPELESS CONTINENT:” POVERTY, GOVERNMENT CORRUPTION, AND POOR INFRASTRUCTURE
- “BYOI” (BRING YOUR OWN INFRASTRUCTURE)
- “LAST FRONTIER”

### **1B. POPULATION**

- AFRICA, 934 MILLION
- SOUTH AMERICA, 382 MILLION
- EUROPE, 830 MILLION

### **1C. OECD TECHNICAL PAPER**

- ORIENTATION OF POLICYMAKERS IN AFRICA
- OPENING PRIVATIZATION TO FOREIGN BIDDERS
- TRADE POLICY
- GOVERNMENT INTERVENTION IN ECONOMY
- PROPERTY RIGHTS PROTECTION
- OPENNESS TO FOREIGN INVESTMENT
- PRICE CONTROLS

### **1D. WHY AFRICA?**

- NATURAL RESOURCE SEEKING
- MARKET SEEKING



- EFFICIENCY SEEKING
- STRATEGIC ASSET SEEKING

## **1E. WHY SOUTH AFRICA BY ITSELF?**

- HISTORY OF OPENNESS TO FDI
- INVESTMENT DIVERSIFIED ACROSS ECONOMIC SECTORS
- COMPETITION FOR FDI FROM NON-US MNCS
- REVOLUTION IN CORPORATE GOVERNANCE
- LOCATION SPECIFIC, INFRASTRUCTURE, TELECOM, BANKING

## 2. SAMPLE DISTRIBUTIONAL CHARACTERISTICS

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### SAMPLE DESCRIPTIVE CHARACTERISTICS-LOCATION DISTRIBUTION

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Country	Number of Expansions	Country	Number of Expansions
Undisclosed	5	Mali	2
Africa			
Algeria	8	Morocco	7
Angola	4	Mozambique	1
Botswana	3	Namibia	1
Cameroon	1	Niger	2
Chad	1	Nigeria	12
Congo	1	Sierra Leone	1
Egypt	26	South Africa	113
Ethiopia	1	Sudan	5
Gabon	2	Swaziland	1
Guinea	1	Tanzania	1
Ivory Coast	2	Tunisia	4
Kenya	1	Uganda	2
Libya	2	Zambia	2
Malawi	1	Zimbabwe	6

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### 3.WEALTH EFFECTS FOR EXPANSION TO AFRICA

SAMPLE TYPE	N	CAERs <sup>a</sup>	Z-STAT
PANEL A: Overall, South Africa, Rest of Africa			
Overall Sample	218	-0.15	-0.57
South Africa	112	-1.23	-2.64***
Rest of Africa	105	1.00	2.72***
PANEL B: By Mode of Expansion, Overall Sample			
Acquisitions	114	-0.32	-0.82
Contracts	21	0.11	0.12
Joint Ventures	73	-0.29	-0.48
PANEL C: Mode of Expansion, South Africa			
Acquisitions	75	-1.37	-2.85***
Joint Ventures	33	-1.27	-1.06
PANEL D: Mode of Expansion, Rest of Africa			
Acquisitions	39	1.70	2.50**
Joint Ventures	40	0.50	1.02
PANEL E: First Versus Subsequent Expansion, Overall Sample			
First Time	150	-0.47	-1.25
Subsequent	68	0.45	0.97
PANEL F: First Versus Subsequent Expansion, South Africa			
First Time	77	-1.79	-3.47***
Subsequent	36	-0.05	-0.07
PANEL G: First Versus Subsequent Expansion, Rest of Africa			
First Time	73	0.92	1.86*
Subsequent	32	1.17	2.07**
PANEL H: Prior Accounting Performance, Overall Sample			
High ROE	96	0.05	0.08
Low ROE	95	-0.60	-1.03
PANEL I: Prior Accounting Performance, South Africa			
High ROE	56	-0.75	-1.12
Low ROE	55	-1.81	-2.68***
PANEL J: Prior Accounting Performance, Rest of Africa			
High ROE	40	1.17	2.42**
Low ROE	40	1.07	1.51

## **4. CONCLUSIONS**

### **4A. WHO GOES TO AFRICA**

- LARGEST
- MOST DIVERSIFIED FIRMS

### **4B. WHAT IS NEEDED**

- SUBSTANTIAL RESOURCE COMMITMENTS
- EXPERIENTIAL KNOWLEDGE

### **4C. MANAGERIAL IMPLICATIONS**

- EMPHASIS ON VALUE GENERATING ASPECTS OF THE EXPANSION
- DEVELOPMENT-RELATED STEREOTYPES
- DO NOT INTERMIX SOUTH AFRICA WITH THE REST

### **4D. POLICY IMPLICATIONS**

- PROFITABLE OPPORTUNITIES
- REFORM
- SUPPORT PRIVATIZATION
- IMPROVE LOCAL INFRASTRUCTURE
- IDENTIFY INVESTMENT OPPORTUNITIES OUTSIDE OF THE TRADITIONAL NATURAL RESOURCE EXTRACTION INDUSTRIES
- DIVERSIFY ECONOMIC BASE, LESS EXPOSED TO VOLATILITY IN COMMODITY PRICES

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- EVENTS ARE ANNOUNCED/PERCIEVED BY INVESTORS IN CALENDAR TIME
- EXAMPLE: EARNINGS ANNOUNCEMENTS BY FIRMS A, B AND C
- A, JULY 15; B, JULY 19; C, July 21, 2009

	A	B	C	
Jan 1				Dec 31

## 1C. EVENT TIME

	A
	DAY 0
	B
	DAY 0
	C
	DAY 0

EVENT DAY IS  $T = 0$

DEFINE DAYS IN RELATION TO DAY 0. THE TIME PERIOD 100 DAYS BEFORE IS  $[T-100, 0]$

## 1D. MEASURING EXCESS RETURNS

- MARKET MODEL
- $R_i = a_i + b_i R_m$
- ESTIMATE MODEL OVER  $[T-100, T-10]$  OR SOMETHING SIMILAR
- WE KNOW THE ACTUAL  $R_i$  AND  $R_m$
- CALCULATE EXCESS RETURN FOR ANY DAY AS
- ACTUAL RETURN – EXPECTED RETURN
- $ER = R_i - e(R_i) = R_i - \hat{a}_i + \hat{b}_i R_m$
- $H_0 = E(ER) = 0$

## 1E. ESTIMATION ADJUSTMENTS

- SERIAL CORRELATION
- CROSS-SECTIONAL CORRELATION
- EVENT INDUCED INCREASE IN VARIANCE

## 1F. CROSS-SECTIONAL REGRESSION MODELS

- $ER_i = f(\text{EXPLANATORY VARIABLES})$

# **INTERNATIONAL INVESTMENTS II: THE EVIDENCE**

## **1. EVIDENCE ON VALUE CREATION IN THE FINANCIAL SERVICES INDUSTRIES THROUGH THE USE OF JOINT VENTURES AND STRATEGIC ALLIANCES**

### **1A. COOPERATIVE ACTIVITY ANNOUNCEMENTS**

Information from *Securities Data Corporation International Joint Ventures* database

D = Domestic I = International R = Related C = Cross-Product

#### **1B. JOINT VENTURES**

- 1. Banc One Corp** entered into a *joint venture* with **BankAmerica Corp** and **Chemical Banking Corp** to operate a nationwide system for microchip- embedded 'smart cards'. The venture was called SmartCash. The smart card was to enable value from a cardholder's deposit or credit account to be loaded on it. Financial terms were not disclosed (August 16, 1995) [D R].
- 2. Marsh & McLennan Company** and **J.P. Morgan & Co.** formed a *joint venture* company to exploit the rising global interest in the catastrophe reinsurance market. The market had suffered losses after hurricanes Andrew in 1992 (November 6, 1992) [D C].
- 3. Citibank NA** and the **Government of Saudi Arabia** signed an agreement to form Saudi American Bank, a *joint venture* to provide banking services in Saudi Arabia (January 1, 1990) [I R].
- 4. State Street Boston Corp** and an undisclosed European bank formed a *joint venture* to provide foreign currency trading services to European companies. The joint venture was to be named Galleon Capital Corp (April 19, 1995) [I C].

## 1C. *STRATEGIC ALLIANCES*

1. **Ameritech** and **Citibank** formed a *strategic alliance* to offer interactive banking services. The companies planned to combine telephone and banking services delivered to the home of the consumer using screen telephones. Consumers were to do their banking through these interactive services. The telephones were equipped with digital display screens and a typewriter-like keyboard. Ameritech and Citibank planned to market the telephones directly to consumers. Financial terms were not disclosed (November 9, 1993) [D R].
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## 1D. PARTICIPATION CHARACTERISTICS OF THE COOPERATIVE ACTIVITY FIRMS

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*Frequency of Cooperative Activity Use by Partner Firms*

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# 1E. CUMULATIVE ABNORMAL RETURNS BY COMBINED STRATEGIC/COMPETITIVE MOTIVES

		CAR Event Windows		
	No.	(-1, 1)	(-1, 0)	+/-
<i>Total Sample</i>				
Domestic-Horizontal	67	0.49 (1.23)	0.25 (0.78)	35/32 (0.08)
Domestic-Diversifying	244	0.62 (3.40)***	0.51 (3.49)***	141/103 (3.28)***
International-Horizontal	66	1.18 (3.04)***	1.00 (3.13)***	44/22 (3.10)***
International-Diversifying	131	0.49 (2.22)**	0.41 (2.25)**	72/59 (1.48)

## 1F. LONG-HORIZON HOLDING PERIOD ABNORMAL RETURNS

		HPR Event Windows			
		Max	(1,6)	(1, 12)	(1, 18)
<i>PANEL A: LHHPR BY INDUSTRY CLASSIFICATION</i>					
Total Sample	187	4.86 (1.70)*	7.18 (2.62)***	7.94 (2.00)**	
Commercial banks	86	5.46 (2.44)**	7.24 (2.03)**	7.45 (2.12)**	
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Insurance	64	4.35 (1.49)	6.29 (0.97)	7.40 (1.74)*	
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International	52	4.15 (1.40)	7.90 (2.28)**	4.05 (0.66)	
Horizontal	54	7.48 (1.79)*	7.76 (1.87)*	14.79 (2.28)**	
Diversifying	131	3.78 (1.69)*	6.94 (2.12)*	5.10 (1.12)	

## **2. SIGNIFICANT VALUE CREATION FOR FIRMS ANNOUNCING**

- COOPERATIVE STRATEGIES
- COOPERATIVE STRATEGIES ARE INTERNATIONAL
- COOPERATIVE STRATEGIES ARE HORIZONTAL
- EXPANSION OF SCOPE OF OPERATIONS
- LONG-HORIZON HOLDING PERIOD RETURNS

## **3. IMPLICATIONS FOR FINANCIAL FIRMS**

- JV'S AND SA'S CREATE VALUE
- CAPITALIZE ON DOMESTIC EXPERTISE WITH HORIZONTAL EXPANSIONS
- COOPERATIVE ACTIVITIES PROVIDE STRATEGIC AND COMPETITIVE ADVANTAGES

# INTERNATIONAL INVESTMENTS II: THE EVIDENCE

## 1. EXPANSION BY U.S. MNCS TO AFRICA

### ***1A. THE ECONOMIST***

- “THE HOPELESS CONTINENT:” POVERTY, GOVERNMENT CORRUPTION, AND POOR INFRASTRUCTURE
- “BYOI” (BRING YOUR OWN INFRASTRUCTURE)
- “LAST FRONTIER”

### **1B. POPULATION**

- AFRICA, 934 MILLION
- SOUTH AMERICA, 382 MILLION
- EUROPE, 830 MILLION

### **1C. OECD TECHNICAL PAPER**

- ORIENTATION OF POLICYMAKERS IN AFRICA
- OPENING PRIVATIZATION TO FOREIGN BIDDERS
- TRADE POLICY
- GOVERNMENT INTERVENTION IN ECONOMY
- PROPERTY RIGHTS PROTECTION
- OPENNESS TO FOREIGN INVESTMENT
- PRICE CONTROLS

### **1D. WHY AFRICA?**

- NATURAL RESOURCE SEEKING
- MARKET SEEKING

- EFFICIENCY SEEKING
- STRATEGIC ASSET SEEKING

## **1E. WHY SOUTH AFRICA BY ITSELF?**

- HISTORY OF OPENNESS TO FDI
- INVESTMENT DIVERSIFIED ACROSS ECONOMIC SECTORS
- COMPETITION FOR FDI FROM NON-US MNCS
- REVOLUTION IN CORPORATE GOVERNANCE
- LOCATION SPECIFIC, INFRASTRUCTURE, TELECOM, BANKING

## 2. SAMPLE DISTRIBUTIONAL CHARACTERISTICS

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### SAMPLE DESCRIPTIVE CHARACTERISTICS-LOCATION DISTRIBUTION

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Country	Number of Expansions	Country	Number of Expansions
Undisclosed	5	Mali	2
Africa			
Algeria	8	Morocco	7
Angola	4	Mozambique	1
Botswana	3	Namibia	1
Cameroon	1	Niger	2
Chad	1	Nigeria	12
Congo	1	Sierra Leone	1
Egypt	26	South Africa	113
Ethiopia	1	Sudan	5
Gabon	2	Swaziland	1
Guinea	1	Tanzania	1
Ivory Coast	2	Tunisia	4
Kenya	1	Uganda	2
Libya	2	Zambia	2
Malawi	1	Zimbabwe	6

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### 3.WEALTH EFFECTS FOR EXPANSION TO AFRICA

SAMPLE TYPE	N	CAERs <sup>a</sup>	Z-STAT
PANEL A: Overall, South Africa, Rest of Africa			
Overall Sample	218	-0.15	-0.57
South Africa	112	-1.23	-2.64***
Rest of Africa	105	1.00	2.72***
PANEL B: By Mode of Expansion, Overall Sample			
Acquisitions	114	-0.32	-0.82
Contracts	21	0.11	0.12
Joint Ventures	73	-0.29	-0.48
PANEL C: Mode of Expansion, South Africa			
Acquisitions	75	-1.37	-2.85***
Joint Ventures	33	-1.27	-1.06
PANEL D: Mode of Expansion, Rest of Africa			
Acquisitions	39	1.70	2.50**
Joint Ventures	40	0.50	1.02
PANEL E: First Versus Subsequent Expansion, Overall Sample			
First Time	150	-0.47	-1.25
Subsequent	68	0.45	0.97
PANEL F: First Versus Subsequent Expansion, South Africa			
First Time	77	-1.79	-3.47***
Subsequent	36	-0.05	-0.07
PANEL G: First Versus Subsequent Expansion, Rest of Africa			
First Time	73	0.92	1.86*
Subsequent	32	1.17	2.07**
PANEL H: Prior Accounting Performance, Overall Sample			
High ROE	96	0.05	0.08
Low ROE	95	-0.60	-1.03
PANEL I: Prior Accounting Performance, South Africa			
High ROE	56	-0.75	-1.12
Low ROE	55	-1.81	-2.68***
PANEL J: Prior Accounting Performance, Rest of Africa			
High ROE	40	1.17	2.42**
Low ROE	40	1.07	1.51

## **4. CONCLUSIONS**

### **4A. WHO GOES TO AFRICA**

- LARGEST
- MOST DIVERSIFIED FIRMS

### **4B. WHAT IS NEEDED**

- SUBSTANTIAL RESOURCE COMMITMENTS
- EXPERIENTIAL KNOWLEDGE

### **4C. MANAGERIAL IMPLICATIONS**

- EMPHASIS ON VALUE GENERATING ASPECTS OF THE EXPANSION
- DEVELOPMENT-RELATED STEREOTYPES
- DO NOT INTERMIX SOUTH AFRICA WITH THE REST

### **4D. POLICY IMPLICATIONS**

- PROFITABLE OPPORTUNITIES
- REFORM
- SUPPORT PRIVATIZATION
- IMPROVE LOCAL INFRASTRUCTURE
- IDENTIFY INVESTMENT OPPORTUNITIES OUTSIDE OF THE TRADITIONAL NATURAL RESOURCE EXTRACTION INDUSTRIES
- DIVERSIFY ECONOMIC BASE, LESS EXPOSED TO VOLATILITY IN COMMODITY PRICES



# INTERNATIONAL INVESTMENTS

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## OUTLINE

International Investments I: Basic Concepts  
Event Study Methods  
International Investments II: The Evidence

# **INTERNATIONAL INVESTMENTS I: BASIC CONCEPTS**

## **1. THEORY OF COMPARATIVE ADVANTAGE**

### **1A. ASSUMPTIONS**

- FREE TRADE
- PERFECT COMPETITION
- NO UNCERTAINTY
- COSTLESS INFORMATION
- NO GOVERNMENT INTERFERENCE

### **1B. THE THEORY STATES**

- EXPORTERS IN COUNTRY A SELL UNRELATED IMPORTERS IN COUNTRY B
- FIRMS IN COUNTRY A SPECIALIZE IN RELATIVELY EFFICIENT PRODUCTION
- FIRMS IN COUNTRY B SPECIALIZE TOO
- THE COMBINED OUTPUT OF A AND B IS MAXIMIZED
- FACTORS OF PRODUCTION CANNOT BE MOVED FREELY. BENEFITS OF SPECIALIZATION COME FROM INTERNATIONAL TRADE
- BENEFITS OF EXTRA PRODUCTION, TERMS OF TRADE
- NEITHER A NOR COUNTRY B IS WORSE, BETTER OFF
- PROVIDE ILLUSTRATIVE EXAMPLE IF NEEDED

## **1C. INTERNATIONAL TRADE AND COMPARATIVE ADVANTAGE**

- COUNTRIES DO NOT SPECIALIZE
- FACTORS OF PRODUCTION MOVE EASILY
- FACTORS OF PRODUCTION COMPLEX
- COMPARATIVE ADVANTAGE CHANGES. LESS DEVELOPED COUNTRIES BECOME DEVELOPED
- UNCERTAINTY, INFORMATION COSTS, PRODUCT DIFFERENTIATION, IMPERFECT MARKETS, ECONOMIES OF SCALE

## **1D. COMPARATIVE ADVANTAGE BASED ON**

- SERVICES, TELECOMMUNICATIONS, INTERNET.
- MIXTURE OF LABOR SKILLS, ACCESS TO CAPITAL, TECHNOLOGY.

## **2. MARKET IMPERFECTIONS**

- PRODUCTS, FACTORS OF PRODUCTION, FINANCIAL ASSETS, ECONOMIES OF SCALE, MANAGERIAL AND TECHNOLOGICAL EXPERTISE, PRODUCT DIFFERENTIATION, INFORMATION MONOPOLIES

## **3. STRATEGIC MOTIVES**

- MARKET SEEKERS
- RAW MATERIAL SEEKERS
- PRODUCTION EFFICIENCY SEEKERS
- KNOWLEDGE SEEKERS
- POLITICAL SAFETY SEEKERS

## **4. TRANSFERRING COMPETITIVE ADVANTAGE TO INTERNATIONAL MARKETS**

- FIRM HAS SUSTAINABLE COMPETITIVE ADVANTAGE IN THE HOME MARKET
- ADVANTAGE IS FIRM-SPECIFIC, TRANSFERABLE, AND BIG ENOUGH TO OVERCOME COSTS OF OPERATING ABROAD (FX RISKS, POLITICAL RISKS, HIGHER AGENCY COSTS).

### **4A. ECONOMIES OF SCALE AND SCOPE**

- PRODUCTION, MARKETING, FINANCE, RESEARCH AND DEVELOPMENT, TRANSPORTATION, AND PURCHASING

### **4B. MANAGERIAL AND MARKETING EXPERTISE**

- SKILL IN MANAGING LARGE ORGANIZATIONS (HUMAN CAPITAL AND TECHNOLOGY)
- MODERN ANALYTICAL TECHNIQUES AND THEIR APPLICATION

### **4C. ADVANCED TECHNOLOGY**

- SCIENTIFIC AND ENGINEERING SKILLS

### **4D. FINANCIAL STRENGTH**

- MINIMIZING COST OF CAPITAL
- AVAILABILITY OF CAPITAL

#### **4E. DIFFERENTIATED PRODUCTS**

- PRODUCE, MARKETING DIFFERENTIATED PRODUCTS
- R&D-BASED; MARKETING BASED

#### **4F. COMPETITIVENESS OF THE HOME MARKET**

- COMPETITIVE HOME MARKET STRENGTHENS FIRM'S COMPETITIVE ADVANTAGE
- PORTER'S DIAMOND OF NATIONAL ADVANTAGE

#### **5. OLI PARADIGM**

- WHY FIRMS PREFER FDI OVER EXPORTS, STRATEGIC ALLIANCES, MANAGEMENT CONTRACTS, LICENSING, JOINT VENTURES
- "O" *OWNER-SPECIFIC*
- "L" *LOCATION-SPECIFIC*
- "I" *INTERNALIZATION*, ORGANIZING WITHIN THE FIRM

#### **6. WHERE TO INVEST?**

- IDENTIFY COMPETITIVE ADVANTAGES, SEARCH WORLDWIDE FOR MARKET IMPERFECTIONS AND COMPARATIVE ADVANTAGE,  $MRR > MCC$
- IN PRACTICE, EXTERNAL STIMULUS:
  - OUTSIDE PROPOSAL
  - LOSING MARKET
  - FOLLOW THE LEADER
  - FOREIGN COMPETITION IN HOME MARKET

## **7. MODES OF FOREIGN INVOLVEMENT**

### **7A. EXPORTING VERSUS PRODUCTION ABROAD**

- EXPORTS ARE LOW RISK
- LOWER INVESTMENT
- RISK OF LOSING MARKETS TO IMITATORS AND GLOBAL COMPETITORS

### **7B. LICENSING AND MANAGEMENT CONTRACTS VERSUS FDI**

- *LICENSING*: PROFITS; MINIMAL COMMITMENT
- DISADVANTAGES:
  - POSSIBLE LOSS OF QUALITY CONTROL
  - LICENCING FEES ARE LOWER
  - POTENTIAL COMPETITOR IN THIRD-COUNTRY MARKETS
  - RISK THAT TECHNOLOGY WILL BE STOLEN
- *MANAGEMENT CONTRACTS*: PROVIDE CASHFLOWS; MINIMAL EXPOSURE OR INVESTMENT; LOWER POLITICAL RISK

### **7C. JOINT VENTURE VERSUS SUBSIDIARY**

- *JOINT VENTURE*: SHARED OWNERSHIP
- ADVANTAGES:
  - BETTER UNDERSTANDING OF LOCAL CUSTOMS, MORES AND INSTITUTIONS OF GOVERNMENT
  - PROVIDING FOR CAPABLE MID-LEVEL MANAGEMENT
  - SOME COUNTRIES DO NOT ALLOW 100%

## FOREIGN OWNERSHIP

- LOCAL PARTNERS HAVE THEIR OWN CONTACTS AND REPUTATION WHICH AIDS IN BUSINESS
- JV'S NOT COMMON AS SUBS DUE TO:
  - HIGHER POLITICAL RISK WITH WRONG PARTNER
  - CONFLICTS ABOUT DIVIDENDS, SOURCES OF FUNDS
  - TRANSFER PRICING ISSUES
  - RATIONALIZING GLOBAL PRODUCTION

## 7D. GREENFIELD INVESTMENT VERSUS ACQUISITION

- *GREENFIELD INVESTMENT*: FROM THE GROUND UP
- *ACQUISITION* IS QUICKER. CHEAP WAY TO OBTAIN TECHNOLOGY AND/OR BRAND NAMES
- PRICE MAY BE TOO HIGH

## 8. STRATEGIC ALLIANCE

- *STRATEGIC ALLIANCE*: CONVEYS DIFFERENT MEANINGS
- TWO FIRMS EXCHANGE OWNERSHIP
- PARTNERS EXCHANGE OWNERSHIP AND CREATE JV
- JOINT MARKETING AND SERVICING AGREEMENTS

# EVENT STUDY METHODS

## 1. EVENT STUDY

### 1A. EVENTS

- FIRMS ANNOUNCE EVENTS SUCH AS CEO HIRINGS AND FIRINGS, EARNINGS AND DIVIDEND ANNOUNCEMENTS, NEW PRODUCT ANNOUNCEMENTS, BOARD OF DIRECTORS, MERGERS, LITIGATION, ADVERTISING CAMPAIGNS, FINANCING DECISIONS, ETC
- SOME EVENTS ARE OBSERVED BY INVESTORS, SUCH AS CEO DEATHS, PLANE CRASHES, COMPETITIVE EVENTS (BING BY MICROSOFT)
- SOME EVENTS ARE MACROECONOMIC IN NATURE SUCH AS INTEREST RATE ANNOUNCEMENTS, MONEY SUPPLY, EXPORTS, IMPORTS, FX RATES, TERRORIST ATTACKS, ETC

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## **2. SIGNIFICANT VALUE CREATION FOR FIRMS ANNOUNCING**

- COOPERATIVE STRATEGIES
- COOPERATIVE STRATEGIES ARE INTERNATIONAL
- COOPERATIVE STRATEGIES ARE HORIZONTAL
- EXPANSION OF SCOPE OF OPERATIONS
- LONG-HORIZON HOLDING PERIOD RETURNS

## **3. IMPLICATIONS FOR FINANCIAL FIRMS**

- JV'S AND SA'S CREATE VALUE
- CAPITALIZE ON DOMESTIC EXPERTISE WITH HORIZONTAL EXPANSIONS
- COOPERATIVE ACTIVITIES PROVIDE STRATEGIC AND COMPETITIVE ADVANTAGES

# INTERNATIONAL INVESTMENTS II: THE EVIDENCE

## 1. EXPANSION BY U.S. MNCS TO AFRICA

### ***1A. THE ECONOMIST***

- “THE HOPELESS CONTINENT:” POVERTY, GOVERNMENT CORRUPTION, AND POOR INFRASTRUCTURE
- “BYOI” (BRING YOUR OWN INFRASTRUCTURE)
- “LAST FRONTIER”

### **1B. POPULATION**

- AFRICA, 934 MILLION
- SOUTH AMERICA, 382 MILLION
- EUROPE, 830 MILLION

### **1C. OECD TECHNICAL PAPER**

- ORIENTATION OF POLICYMAKERS IN AFRICA
- OPENING PRIVATIZATION TO FOREIGN BIDDERS
- TRADE POLICY
- GOVERNMENT INTERVENTION IN ECONOMY
- PROPERTY RIGHTS PROTECTION
- OPENNESS TO FOREIGN INVESTMENT
- PRICE CONTROLS

### **1D. WHY AFRICA?**

- NATURAL RESOURCE SEEKING
- MARKET SEEKING



- EFFICIENCY SEEKING
- STRATEGIC ASSET SEEKING

## **1E. WHY SOUTH AFRICA BY ITSELF?**

- HISTORY OF OPENNESS TO FDI
- INVESTMENT DIVERSIFIED ACROSS ECONOMIC SECTORS
- COMPETITION FOR FDI FROM NON-US MNCS
- REVOLUTION IN CORPORATE GOVERNANCE
- LOCATION SPECIFIC, INFRASTRUCTURE, TELECOM, BANKING

## 2. SAMPLE DISTRIBUTIONAL CHARACTERISTICS

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SAMPLE DESCRIPTIVE CHARACTERISTICS-LOCATION DISTRIBUTION			
Country	Number of Expansions	Country	Number of Expansions
Undisclosed	5	Mali	2
Africa			
Algeria	8	Morocco	7
Angola	4	Mozambique	1
Botswana	3	Namibia	1
Cameroon	1	Niger	2
Chad	1	Nigeria	12
Congo	1	Sierra Leone	1
Egypt	26	South Africa	113
Ethiopia	1	Sudan	5
Gabon	2	Swaziland	1
Guinea	1	Tanzania	1
Ivory Coast	2	Tunisia	4
Kenya	1	Uganda	2
Libya	2	Zambia	2
Malawi	1	Zimbabwe	6

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### 3.WEALTH EFFECTS FOR EXPANSION TO AFRICA

SAMPLE TYPE	N	CAERs <sup>a</sup>	Z-STAT
PANEL A: Overall, South Africa, Rest of Africa			
Overall Sample	218	-0.15	-0.57
South Africa	112	-1.23	-2.64***
Rest of Africa	105	1.00	2.72***
PANEL B: By Mode of Expansion, Overall Sample			
Acquisitions	114	-0.32	-0.82
Contracts	21	0.11	0.12
Joint Ventures	73	-0.29	-0.48
PANEL C: Mode of Expansion, South Africa			
Acquisitions	75	-1.37	-2.85***
Joint Ventures	33	-1.27	-1.06
PANEL D: Mode of Expansion, Rest of Africa			
Acquisitions	39	1.70	2.50**
Joint Ventures	40	0.50	1.02
PANEL E: First Versus Subsequent Expansion, Overall Sample			
First Time	150	-0.47	-1.25
Subsequent	68	0.45	0.97
PANEL F: First Versus Subsequent Expansion, South Africa			
First Time	77	-1.79	-3.47***
Subsequent	36	-0.05	-0.07
PANEL G: First Versus Subsequent Expansion, Rest of Africa			
First Time	73	0.92	1.86*
Subsequent	32	1.17	2.07**
PANEL H: Prior Accounting Performance, Overall Sample			
High ROE	96	0.05	0.08
Low ROE	95	-0.60	-1.03
PANEL I: Prior Accounting Performance, South Africa			
High ROE	56	-0.75	-1.12
Low ROE	55	-1.81	-2.68***
PANEL J: Prior Accounting Performance, Rest of Africa			
High ROE	40	1.17	2.42**
Low ROE	40	1.07	1.51

## **4. CONCLUSIONS**

### **4A. WHO GOES TO AFRICA**

- LARGEST
- MOST DIVERSIFIED FIRMS

### **4B. WHAT IS NEEDED**

- SUBSTANTIAL RESOURCE COMMITMENTS
- EXPERIENTIAL KNOWLEDGE

### **4C. MANAGERIAL IMPLICATIONS**

- EMPHASIS ON VALUE GENERATING ASPECTS OF THE EXPANSION
- DEVELOPMENT-RELATED STEREOTYPES
- DO NOT INTERMIX SOUTH AFRICA WITH THE REST

### **4D. POLICY IMPLICATIONS**

- PROFITABLE OPPORTUNITIES
- REFORM
- SUPPORT PRIVATIZATION
- IMPROVE LOCAL INFRASTRUCTURE
- IDENTIFY INVESTMENT OPPORTUNITIES OUTSIDE OF THE TRADITIONAL NATURAL RESOURCE EXTRACTION INDUSTRIES
- DIVERSIFY ECONOMIC BASE, LESS EXPOSED TO VOLATILITY IN COMMODITY PRICES