THE MULTINATIONAL COMPANIES AND THE LOW-COST MARKETS OF SOUTH-EAST ASIA

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In order to be considered a low-cost market, the cost advantage of one or more factors of production offered by a state – generally, a developing one – must be exploited by the multinational firms. Therefore, we may speak about these markets only after 1970-1980, when some significant political, cultural and technological changes allowed the multinational companies relocate their production in these countries, through foreign direct investments. Next to China and Central and Eastern Europe, the low-cost markets of South-East Asia represent another main region on which the multinationals, determined by the location advantages, establish their production subsidiaries. The main purposes of the present paper are to identify the factors that have stimulated the foreign direct investments in the South-East Asian region and, also, to analyze the evolution of these low-cost markets.

Keywords: multinational company, low-cost market, foreign direct investments, developing state, location advantages

JEL Classification: F21, F23

1. Introduction

The term of low-cost market refers to that region or country that has the low cost advantage of one or more factors of production (labor force, land etc.)[80]. Generally speaking, these markets are located inside the developing or emergent states and are exploited especially by the multinational companies. These firms, relocating their manufacture in the developing regions or countries through foreign direct investments, have the opportunity to produce, with very low costs, goods which will lately be sold at much higher prices, due to the well-known brand that they are wearing. Consequently, in order to be considered low-cost markets, the advantages offered by them must be exploited by the multinational companies. Regarding this aspect, we may speak about the low-cost markets only after 1970-1980, when the trade and investments have been opened and the global markets occurred.

We may notice that, nowadays, the developing states represent a great opportunity for multinational companies to grow and intensify their activities. The potential of these markets has already determined significant shifts in the multinationals' actions: if in 1992 the foreign direct investment (FDI) inflows to the developing countries were only 18% from the total amount of FDI, in 1996 this percentage rose up to 33%, exceeding 100 billion dollars[81]. While these investments are widely interpreted as heralds of a major restructure of the global economy, the emerging markets are considered to be the source of the future growth.

At a global level, next to China and Central and Eastern Europe, the low-cost markets of South-East Asia represent another main region on which the multinationals, determined by the location advantages, establish their production subsidiaries. Between 1988 and 1997, the recently industrialized states from this region attracted great amounts of foreign direct investments (FDI), which played an important role in compensating for some lacks of the national technology and organizing abilities. So, if in 1980 the proportion of the investments' inflow in the South-East

80 See PriceWaterHouse Coopers, „Low-cost Country Sourcing", 2005, http://www.pwc.com/extweb/pwcpublications.nsf/docid/B038BC9F3CEB6DC9852570CE007815F5, accessed in June 2006.

81 UNCTAD, World Investment Report 1996, United Nations Conference on Trade and Development, New York, 1996.

Asia was about 7% of the world investments, in 1997 this percentage totaled 16%. It was not only about the low production costs of these states, but also the sustained economic growth rates, the highly skilled labor force, the large national and regional markets, as well as the possibilities of developing the infrastructure that attracted the FDI.

2. The Evolution of the Foreign Direct Investments in the South-East Asian Low-Cost Markets

The Asian area has a diversified experience with the FDI. The percentage of the sales, in the manufacturing sector, owned by the multinationals' subsidiaries at the end of the '80s was about 40-50% in Singapore and in the four ASEAN states (Indonesia, Malayezia, Filipine and Thailand), in Korea and Hong Kong of 21,5% and, respectively, 17,3%; a similar situation to Hong Kong was in Taiwan. Yet, the aggregates in their gross dimension, such as the percentage of the foreign subsidiaries in the sales from the manufacturing field or the rate of the FDI in the national capital accumulation, do not necessary point out the global importance of the FDI in the industrialization process. For example, in Korea the foreign subsidiaries owned a quarter of the exports of manufactured products, value which is much greater than their small percentage in GDP or in the gross capital accumulation. In the basic field of the economy – the electrics and electronics' sector – the percentage owned by the multinationals' subsidiaries was about 63-73% in the '90s[82]. This is why an important role at the economic development of Korea and Taiwan was played not only by the national firms but also by the investments of the multinationals in some key-sectors of the economy.

One of the most important features of the multinationals which invested in the low-cost markets of South-East Asia is that the FDI were mainly focused on the exports, compared to the FDI from other developing regions. This aspect reflects the political efforts of using the investments in a larger context of the developing strategy. The biggest economies of the first wave of the recently industrialized states had a restrictive approach, based on the cost-benefit analysis of the FDI's net contribution to the promotion of the national enterprises and to the development of the local technological abilities. Singapore, that had a more open policy, also used various measures to direct the FDI to the strategic fields. Compared to the economies from the first industrialized states, the second wave of the industrialized countries had a less restrictive approach regarding the FDI. In the second half of the '80s, there have been adopted more liberal regulations regarding the FDI, which coincided with the concerted measures to accelerate the exports of the manufactured products and with the rapid changes in the firms' competitive position both from Japan and from the states of the first industrialization wave. The most impressive investments' increases occurred in Korea, Hong Kong, Singapore and Taiwan, where the exports promoting policies were more correlated to the FDI, fact that determined not only the rapid orientation towards the manufacturing products, but also the substantial growth of the high-tech exports[83]. Yet, this phenomenon must be regarded with scepticism because the contribution of the second industrialized states to these sophisticated exports consisted more in assembling various imported equipments, which required medium or low skills.

The strategy successfully used by ASEAN countries to attract the multinationals' FDI consisted in facilitating the investments between these states. There are two explanations for implementing such a strategy. First of all, ASEAN has to compete alone to other regional blocks or growth zones, such as MERCOSUR or China, and, consequently, it is necessary "to stress its critical mass as a community of closely co-operating economies as opposed to a club of individualistic

82 Ramstetter, E.D. (ed.), Direct Foreign Investment in Asia's Developing Economies and Structural Change in the Asia-Pacific Region, Westview Press, 1991.

83 UNCTAD, Trade and Development Report 1996, United Nations, Geneva, 1996.

nation-states"[84]. Secondly, ASEAN region is a developing market inside which the multinationals are looking for taking advantages of the regional division of labor, process that requires a close cooperation between these states.

Table no 1 Priority Policies to Encourage Foreign Direct Investments into and within ASEAN

Policy/measure	*Applicable at the level*	
	Intra-ASEAN	*Trans-ASEAN*
Measures to ensure regional political and economic stability		
Extension of AFTA block	++	+
Reduction in restriction on foreign investors		
Removal of all barriers on participation of foreign corporations	+++	+++
National treatment for the foreign firms	+	++
Creation of an enabling environment for FDI		
Establishing a good quality industrial support	+++	++
Establishing a good physical and commercial infrastructure	++	+++
Predictably and transparency of all the laws and regulations	+++	+++
Stimulating highly skilled labor force	+	+
Harmonization of FDI policies in all the ASEAN states	+++	+++
Harmonization of all the ASEAN corporate laws and regulations	+++	++

Source: Adapted from Mirza, H., „Reviving FDI Inflows in Southeast Asia", Institute of Southeast Asian Studies (ISEAS), Singapore, 2001, pp. 8-10

In order to stimulate both the FDI in ASEAN region and the investments between these states, there were adopted some measures and policies, showed in the table no. 1. The importance of implementing the measure/policy is indicated by the number of the pluses, where „+++" means a high priority, „++" a medium one and „+" suggests a low priority, that decision being less necessary.

The Asian crisis from the end of the last century highlighted some macro-economic weaknesses of the low-cost markets, fact that significantly influenced the attracted FDI. In order to indentify the attractiveness degree of the South-East Asian countries for the FDI, before and after the crisis of the '90s, Bartels and Freeman conducted a study on 110 multinationals, according to which the states were classified in four main categories: "winners", "survivals", "laggards", "underdogs"[85]. In the "winners" category have been included those countries regarded by the multinationals as attractive before the crisis and very attractive after the crisis. Among the ten Southeast Asian countries, only Singapore has improved its position from this point of view, after the crisis

84 Mirza, H., „Reviving FDI Inflows in Southeast Asia", Institute if Southeast Asian Studies (ISEAS), Singapore, 2001, pp. 6-7, http://www.gapresearch.org/finance/publications.html, accessed in July 2008.

85 Bartels, F.L., Freeman, N.J., „Multinational Firms and FDI in Southeast Asia. Post-Crisis Changes in the Manufacturing Sector", ASEAN Economic Bulletin, vol. 17, no. 3, 2000, pp. 324-340.

(despite the fact that it has no longer the labor low-cost advantage, due to the fact that it confronts with a labor force deficit), Thailand maintaining its attractiveness for the foreign investors. So, these two states can be considered "winners". At the time of the survey, 48% and, respectively, 42% of the multinationals investigated were about to implement their FDI plans in Singapore and, respectively, in Thailand.

The "laggards" are those states which, before the crises, were considered attractive by the multinationals but, after that moment, their attractiveness diminished. Malayezia, Filipine, Vietnam and Indonesia are included in this category but, of all these, only Indonesia was considered to be unable, until recently, to project effectively the economic and business policies, having a volatile political environment.

The "underdogs" category includes those states which did not show a high degree of attractiveness for the multinationals, either before or after the Asian financial crisis. There are states such as Brunei, Cambodgia, Laos or Myanmar which, generally, prior to 1997 did not encompass factors attractive for FDI, with the exception of some location specific advantages in Brunei (oil and gas reserves). Moreover, Cambodgia, Laos and Myanmar are considered to be unstable from the economic and political point of view.

The "survivors" category refers to those countries regarded by the multinationals as unattractive before 1997, but which managed to increase their attractiveness after the financial crisis. The Asian reality showed that no country is included in this category: none of the Indochina's four members are considered to have a location specific disadvantage, able to be translated, through exogenous shocks, into a location specific advantage.

Yet, even after the crisis, the South-East Asian region was considered an important low-cost market for 68% of the 110 multinationals surveyed. Moreover, 84% of the respondents indicated strong or very strong investment commitments to South-East Asian region as a whole; 61% of these companies have planned big future corporatist investments. According to the survey, at the beginning of the XXIst century, no other region seemed to compete with the low-cost markets of South-East Asia, from the point of view of the possibilities to attract the FDI, excepting China. The multinational companies had a global perspective that prioritized, after China and South-East Asia, the low-cost markets of the Central and Eastern European Union (55%), the North-East Asia (52%), the NAFTA states (48%), South Asia (45%), the attractiveness of the low-cost markets of South America being of only 29%. From all the South-East Asian countries, the ASEAN ones - Indonesia, Malayezia, Filipine, Singapore and Thailand – were generally preferred by the multinationals, compared to the Indochina states – Brunei, Cambodgia, Laos, Vietnam and Myanmar.

The reason for which the multinational companies preferred these countries of South-East Asia has changed during the time: if in the '60s the desire to have access to the great potential offered by the host market prevailed, at the beginning of the XXIst century the multinationals were firstly attracted by the availability of the cheap, highly skilled labor force, by the low distribution costs, by the financial aid of the governments, as well as by the local reliable partners. Yet, there are some risks that threaten the multinationals with subsidiaries on the South-East Asian market, such as the political instability, ambiguous governmental regulations and the problems related to the infrastructure. Due to all these difficulties, many of the 110 multinationals surveyed considered that the South-East Asian region was not fully able to respond to the requirements of the "new economy".

At all the inconveniences mentioned above may also be added the increase, from the last five years, of the operational and production costs, with a higher rate than the efficiency and productivity growth. This is one of the reasons for which, nowadays, it can be noticed a decrease in the amount of the foreign direct investments, attracted especially by the ASEAN region. Correlating the evolution of the FDI from this area with its specific features and analyzing the consequences of the entrance of the multinationals on the low-cost markets, we can estimate that the problems the ASEAN states confront with in attracting the foreign investors are mainly caused by their success. Representing an important pole of attraction of the FDI, not only between 1988 and 1997, but also at the beginning of the XXIst century, the ASEAN members have rapidly developed, fact that determined the increase of the incomes' level. This proves that the advantages pursued by the multinationals inside the emerging countries will gradually disappear because these economies, while developing, are loosing their low-cost markets' characteristics.

3. Conclusions

Considering all the aspects mentioned above, we can argue that, on **short term**, *the low-cost markets of South-East Asia are very attractive for the multinationals* due to the fact they offer not only the advantage of the low-cost of the factors of production, but also some other fiscal and legislative facilities. Yet, on **long term**, *the advantages may become disadvantages* if there is no strict control of the products' quality made in these states, any mistake having a negative influence on the reputation of the firm involved.

Another conclusion that results from analyzing the case of the South-East Asian region is that, on **long term**, *the advantage of the low cost of the factors of production will disappear*, these markets loosing their low-cost characteristic. The explanation consists in the fact that the foreign direct investments, attracted by a state, significantly influence the economic development of that country, aspect that will lead to an increase in living standards and, consequently, of the production's costs.

In a **future research** it will be interesting to determine the *impact that the nowadays financial crisis will have on the FDI inflows* in these countries. Moreover, it could be of a great importance to *analyze the measure in which the South-East Asian low-cost markets will still represent*, after a few years, *a pole of attraction for the multinationals*. This future study could start with the identification of the economic progress made by the low-cost markets and of its impact on the costs' evolution of the factors of production.

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