MANAGING FOREIGN DIRECT INVESTMENTS: THE ROLE OF CROWDING OUT EFFECT

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Abstract: Our paper is concerned with the issue of management of foreign direct investments (FDI) and crowding out effect that is a result of multinational enterprises (MNE) and transnational companies (TNC) entering the national markets and destroying traditional embedded producers. The paper discusses the issues associated with the management of the crowding out effect and provides implications for the public governance, local business environments and entrepreneurs. We analyze the possible outcomes of the crowding out effect and weight out the positive and the negative sides of the process based on the managerial view and approaches. We show that crowding out effect, if managed properly, can bring a plethora of positive externalities for the economies in transition or emerging economies.

Key words: foreign direct investments, international management, crowding out effect, multinational companies, global change

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Introduction

International competition penetrates through the borders and boundaries at the national and sectoral levels while simultaneously becoming more competitive and global. Nowadays, firms and companies all around the world often have to prioritize and optimize which makes them to move their focus from exports to international production. As a result of these processes and trends, dominating position on local and domestic markets (even when those markets are represented by the world's most prevalent and important markets such as China or the European Union (EU) with its European Economic Area (EEA)) cannot suffice in a growing number of cases.

With regard to the newly-established situation described above, companies did not have any other choice but to engage into the mutual raiding of established customers and pirating each other's supply bases. The competition is getting severe and firms are now faced with the situation when they need to compete simultaneously in all major markets (most of all in Europe, especially in the European economies in transition represented by the so-called EU "New Member

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State" represented by the Czech Republic, Hungary, or Poland, North America and Asia (Ślusarczyk and Kot, 2012; Benedek et al., 2014; Dinu, 2015).
The whole process resulted in a rapid expansion of diversifying international production and shipment. There is a plethora of newly-established and constantly growing production sites being established outside the industrial heartlands of EU, North America, Japan and Korea. This process also went hand in hand with the other one – notably that since the 1980s, international production has expanded considerably faster than international trade. As a result, nowadays the turnovers and sales of transnational companies (TNCs) overpass exports which were the major vehicle for delivering goods and services to international markets. This expansions and growth of the international productions is very much likely to continue in the future and it will fundamentally change all spheres of economy and public life (Sitek, 2013; or Mariotti et al., 2015) as well as grow across all possible sectors of the economy (see e.g. Wan et al., 2014).
However, quantitative expansion remains only one part of the globalization and internationalization story. There are qualitative changes that are also very important. For instance, there is a shift from partial to systematic forms of globalization. As the requirements of the becoming increasingly demanding, firms and companies are forced to integrate their erstwhile stand-alone operations in individual host countries into increasingly complex international production networks in order to withstand the fierce global competition and its implications. In order to do so, companies are forced to break down their value chains into discrete functions and then find out when and how these functions can be conducted most effectively in order to make it easier to get hold of important international markets. Another crucial motivation all companies are faced nowadays is the reduction of transaction costs. Moreover, such issues as the access to clusters of specialized technologies and capabilities, or the penetration to the contested growth markets are also becoming very important. The companies need to increase their response time to the technological change and the rapidly changing market requirements. With regard to the above, an important question arises: how the companies' strategies might be effected by the increasing globalization and deepening of the functional integration between national production systems that used to be unlinked in the past?
In a globalized business-operating environment, the cross-border trading and the formation of regional trading blocs such as the European Union that characterize the operating environment of business have increased the level competition among business. This has facilitated the elimination of protectionist measures and the subsequent economic liberalization in most countries across the world. Multinational enterprises (MNEs) and local enterprises compete on an equal footing in domestic, foreign, and global markets because of these changes in the domestic and global operating environment (Gammeltoft et al., 2010; or Mariotti et al., 2015). However, the entry of MNEs and other foreign firms in domestic markets present various challenges to the established domestic players, the market

structures, and processes that are in existence in the market. This paper seeks to establish and describe the entry and practices of firms in foreign markets and the subsequent impact on the local and global markets.

Multinational Enterprises and Domestic Companies

One would probably agree that the entry of multinational enterprises in an emerging economy will have both negative and positive effects on the economy and the domestic firms operating in those economies. Quite often, the MNE bring about many structural changes.

These effects can be considered one by one: Firstly, multinational firms depending on the nature of a multinational corporation's operations will affect the labor standards in a country. Sitkin and Bowen (2010) argued that MNCs would identify, recruit, and retain the most skilled employees in an economy skimming off the top of the labor market in a developing or emerging economy. Consequently, the domestic players in the industry will have access to a labor market, which the multinational firms have employed the best employees. In concurrence, Meyer (2004) observed that as a key asset to an organization, the personnel resources of an organization are important to its continued success and where MNCs/MNEs skim the most talented and skilled employees from the labor market in an economy, they immediately realize a competitive advantage over domestic firms in an economy. In the long-term, this will have a negative impact on the operations of domestic firms.

In addition, multinational firms entering foreign markets will distort the wages and salaries structures established in a host country where the MNEs or MNCs enter (Meyer, 2004). Coming from a mother country where the companies are well established with a lot of financial power, in form of financial reserves and streamlined operations, the MNCs will offer wages that are more competitive than the wages and salaries offered by local firms in a domestic economy in the host country. Rugraff and Hansen (2011) argued that whereas domestic firms will implement various strategies to manage costs including managing the cost of labor, MNEs might come from an economy where the labor costs are relatively higher and will offer wages and remuneration packages higher than what is offered by domestic firms but lower than the standards in the mother country.

Furthermore, because of the financial power enjoyed by multinational corporations, the businesses on entering a foreign market, will invest heavily in marketing and advertising in order to win customers, conventionally serviced by the domestic firms. Compared to domestic business firms, multinational corporations will have a higher marketing and advertising budget than the domestic firms. Expenditure in well-orchestrated marketing and advertising strategies and activities will build brands that are stronger than local brands leveraging on the brand recognition and value realized from marketing expenditure. These strategies and activities will ensure that these businesses capture a market share from the domestic firms, and outgrow them. In the long-term, inefficiencies, and resources constrictions experienced by the domestic firms compared to the foreign firms could lead to the domestic firms being crowded out of the domestic market.

Positive and Negative Effects of Crowding Out

A thorough analysis of the crowding out effect always reveals two sides of the coin that, figuratively speaking, a good manager should flip around in order to optimize and to achieve the desirable results. On the one hand, MNEs are in most instances global conglomerates that are large enterprises with standardized processes and procedures (Hanousek et al., 2011). They are able to realize economies of scale and produce large quantities of products cheaply and can, therefore, prize their products competitively or cheaper than the prices offered by domestic firms in the economy of the host country (Rugraff and Hansen, 2011). In addition, Meyer (2004) observed that because of the size of the operations of MNCs, the foreign firms are more likely to enjoy discounts and favorable trading terms from suppliers in the domestic market of the host country or from suppliers in the mother country. These operational aspects make the companies more competitive than the domestic firms in the host country because the MNCs can offer competitively and lower priced goods than the domestic firms (Sitkin and Bowen, 2010). Evidently, with the expectation and assumption that a rational customer, all factors remaining constant, will make a purchase that maximizes utility and minimizes cost, MNEs will eventually outsell the domestic firms. Consequently, with declining revenues, the inefficient domestic businesses will be forced to cease operations or give in to merging or acquisition strategies of MNEs, which are more efficient compared to the domestic firms.

Managing Standardization and Specialization

Moreover, with standardization and specialization being one of the main tenets of multinational corporations, the companies will avail a larger choice of standardized products to the local market (Meyer, 2004). Furthermore, Meyer (2004) additionally observed that despite the fact that the products offered by MNEs are standardized, they are similar or near similar to the product offered by the domestic firms in the host country. Consequently, where the multinational corporations sell standardized products, which are considerably cheaper, compared to the products sold by the domestic firms that are expensive because of the cost of inputs, the MNEs will have a competitive advantage and will eventually edge out the inefficient domestic firms from a market that the firms previously competed. In their study, Hanousek et al. (2011) established that business and economic scholars and practitioners from emerging European markets identified the sales of standardized products by MNEs as one of the activities that will have a direct impact on the competitive ability of domestic firms in the host country offering. The domestic firms offer near similar or similar products, which are less standardized and therefore more expensive to make. MNCs will sell larger quantities of standardized products cheaply to cover for the low-profit margins by the foreign multinational enterprises probably occasioned by the fact that the MNCs will import these products from the mother country before the establishment of a manufacturing or production facility in the host country (Sitkin and Bowen, 2010).

On the other hand, the entry and operations of multinational corporations in domestic markets will have positive effects on the domestic firms and the economy of the host country. Interestingly, Hanousek et al. (2011) posits that entry of MNCs in emerging markets is a double-edged sword, which cuts both ways; has negative and positive impact on the operations of domestic firms and the economy of the host country. Consequently, in addition to the negative effects on the domestic business firms, MNCs entry into the host country's economy will have numerous effects on the business enterprises in the economy.

Multinational Firms and Technology Transfer

The entry of multinational firms into the economy of a host country will foster technology and knowledge transfer, which if embraced and adopted by the domestic firms in the host nation's economy will improve operational efficiencies, performance, and productivity of the local firms in the host country (Rugraff and Hansen, 2011). The operations of domestic firms are streamlined and the firms realize improved efficiencies and productivity making them more competitive. The linkages and spillover effects of the entry of MNCs into the economy of the host country will facilitate the increased competitiveness of the domestic firms, which in turn can opt to expand out of the local domestic market and compete globally with the already established MNEs (Haskel et al., 2007). This transition is facilitated by the competitive advantages realized from the adoption of new technologies and knowledge in the operations of the companies.

Further, the skimming effect of the entry of MNEs in the domestic economy fosters overall industry operational efficiency, performance, and productivity. Hanousek et al. (2011) opined that when a multinational enters an economy of host country, the inefficient and non-competitive firms are the ones crowded out of the economy by the entry of the MNEs; the more efficient and competitive business firms are able to withstand the effects of the more competitive multinational corporations (Rugraff and Hansen, 2011). Consequently, the culling of non-competitive and inefficient firms from the domestic economy by the entrance and operations of the MNEs will foster industry and economic efficiency, which will improve productivity, quality of products, choice of products, and levels of customer service.

Managerial Implication of the Research Results

When it comes to the managerial implications of our research results, one has to consider the pros and cons associated with the management of the crowding out effect for and imposed by the public governance, local business environments as well as entrepreneurs. The managers might facilitate or hamper the entrance to the domestic market for the international companies depending on the targets and goals set for the economy in question. Quite often, it is a political decision to be made, however in a number of cases and scenarios, the interests of local owners of capital or, on the contrary, local workers (labor) should be taken into account. International companies might offer better remuneration and benefits to the local workers or they might import cheap foreign labor instead to reduce the costs. Moreover, they might drive out the local monopolists or increase the competition. In both cases, the costs and benefits for the local economy should be considered by the managers. These considerations should be used as a basis for the well-balanced decisions and effective steps to reduce the negative externalities associated with the foreign FDI and crowding out.

Summary

Globalization and liberalization of national economies have fostered competitiveness in the business-operating environment, which has resulted from businesses from different countries across the globe establishing operations in other countries. These changes imposed new rules of the game and altered the perception of business environment that was common and traditional for managers for decades.

Our results show that the entry of multinational enterprises into the national economies of the host countries has both positive and negative effects on the domestic firms in those markets. The negative effects result in the non-competitive and inefficient domestic firms being edged out of the market. On the other hand, the linkages and spillover effects of the entry of MNEs foster efficiency and productivity among the domestic firms in the local economy or the economy of the host country. Overall, it seems that by using correct managerial approaches, any given economy can steer the changes and direct them in a right way that would enable further growth and increase of prosperity of the economy. These conclusions are of a special importance for the economies in transition and emerging economies that are mostly faced with the inflow of FDI and crowing out effects and therefore should prepare themselves to the changing environment on the world markets using the right mix of managerial techniques.

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ZARZĄDZANIE ZAGRANICZNYMI INWESTYCJAMI BEZPOŚREDNIMI: ROLA EFEKTU WYPIERANIA

Streszczenie: Niniejszy artykuł dotyczy kwestii zarządzania zagranicznymi inwestycjami bezpośrednimi (ang. foreign direct investment, FDI) i efektem wypierania, który jest wynikiem niszczenia tradycyjnych producentów przez międzynarodowe przedsiębiorstwa (ang. multinational enterprises, MNE) i firmy ponadnarodowe (ang. transnational companies, TNC) wchodzące na rynki krajowe. W artykule omówiono kwestie związane z zarządzaniem efektem wypierania i dostarczania implikacji dla zarządzania publicznego, lokalnych środowisk biznesowych i przedsiębiorców. Autorzy analizują możliwe skutki efektu wypierania i określają wagi pozytywnych i negatywnych stron procesu bazującego na kierowniczym punkcie widzenia i różnych podejściach. Pokazano, że efekt wypierania, jeśli jest właściwie zarządzany, może przynieść mnóstwo pozytywnych efektów zewnętrznych dla gospodarek w okresie przejściowym lub gospodarek wschodzących.
Słowa kluczowe: zagraniczne inwestycje bezpośrednie, zarządzanie międzynarodowe, efekt wypychania, międzynarodowe firmy, globalna zmiana

管理外部直接投資：發揮作用的作用

摘要：本文涉及跨國企業（跨國企業）和跨國公司（TNC）進入國家市場並破壞傳統嵌入式生產者的外商直接投資（FDI）管理和擠出效應問題。本文討論與管理擠出效應相關的問題，並為公共治理，當地商業環境和企業家提供了影響。我們分析了擠出效應的可能結果，並根據管理觀點和方法對過程的正面和負面進行了重視。我們表明，如果得到妥善管理，擠出效應可能會給轉型經濟體或新興經濟體的經濟帶來過多的積極外部性。
關鍵詞：外商直接投資，國際管理，擠出效應，跨國公司，全球變化