

# The Theory Basis on Location Choice in FDI of the Multinational Enterprise

## BASE THEORIQUE DU CHOIX GEOGRAPHIQUE DANS L'INVESTISSEMENT DIRECT A L'ETRANGER DE L'ENTREPRISE TRANSNATIONALE

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**Abstract:** fundamentally speaking, when all multinational enterprises invest directly abroad, choosing which country or area to invest depends on the judgment of anticipated benefits or anticipated net profits, the country or area which has high anticipated benefits will become the investment location. When making the location choice of FDI specifically, multinational enterprise needs to consider three aspects that include the motivation of direct-target layer of FDI, the competitive force condition of enterprise's FDI, and all kinds of investment environment factors of investing-target country or area.

**Key words:** multinational enterprise, FDI(foreign direct investment), location choice

**Résumé:** D'une manière générale, toutes les entreprises transnationales, en s'investissant à l'étranger, choisissent le lieu selon leur appréciation sur le bénéfice net prévu. Le pays ou la région où on prévoit le plus grand bénéfice net serait élu pour le lieu d'investissement. Dans l'application concrète, l'entreprise doit considérer synthétiquement les trois facteurs suivants : les mobiles au niveau de l'objectif direct, la compétitivité d'investissement direct de l'entreprise et l'environnement d'investissement du pays ou région cible.

**Mots-Clés:** entreprise transnationale, investissement direct à l'étranger, choix géographique

The theory on FDI needs to think what is the mechanism that multinational enterprise choosing one country or area to invest, not to choose another country or area to invest. It is hard to grasp the rule of location choice of FDI, because of many-faceted investors, the complicated investment motivation and strategy and host country's different characters. So far, no theory can explain the rule of international investment's location choice in all-around and system view. The paper tries to study the theory basis on location choice of FDI.

### 1. THE MOTIVATION OF DIRECT-TARGET LAYER OF MULTINATIONAL ENTERPRISE'S FDI

Though maximizing the net profits is the fundamental motivation and final goal for multinational enterprise's FDI, enterprise pursues much motivation of direct-target layer which includes (1) minimizing total cost; (2) maximizing sales price of product and service (expected monopoly); (3) minimizing tax revenue

(policy elusion); (4) maximizing sales quantity (market share). Multinational enterprise may emphasize on one or several motivations.

The investors who want to minimize total cost may choose the appropriate countries that can bring minimized cost, such as the investment on labor-pursued will choose the country having enough labor force and cheap labor cost; investment on technology-pursued will choose the country having higher technical level; investment on resource-pursued will choose the country having abundant natural resource; investment on lower information and transportation cost pursued will choose the close and familiar country having convenient communication; investment on avoiding or policy-pursued will choose the country having preferential tax revenue policy or relative policies; and investment on maximizing the price of product and service will choose the country having higher salary level, enough purchasing power and large market capacity.

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## **2. THE COMPETITIVE FORCE OF MULTINATIONAL ENTERPRISE'S FDI**

The competitive force of enterprise's FDI means that comparing with the competitors in the foreign changeable or stable environment, can has the ability to successfully invest and operate, continuously survive and develop, and obtain better revenue. It is the combination of enterprise's all kinds of abilities. The competitive force of enterprise's FDI is the ability which enterprise has before investing and can exist in a long-term.

When multination enterprise chooses investment location, it needs to value it's the competitive force of FDI. The elements of the enterprise's competitive force of FDI include below aspects:

**Money capability:** the premise of any enterprise's investment abroad is to have money to invest.

**Technical capability:** enterprise's technical capability contains R&D capability by itself and the capability to grasp and absorb the technology.

**Talent capability:** talent is the core of enterprise and the most important resource of enterprise.

**Information capability:** it is the exceedingly important capability which enterprise must have.

**Product and service capability:** product and service is the carrier of gaining net profits and directly influences how large of the net profits.

**Strain capability:** enterprise must have strong strain capability to adapt the change of inside or outside environment in the investment process.

**Management capability:** it includes the strategic-plan capability and the executing capability.

**Local fusion capability:** the local fusion includes the relationship with the local forms, the enterprise culture and the compatibility, as well as the management custom.

**Risking bearing capability:** enterprise has to bear risk and lost, when some serious risk happen.

Competitive force of FDI is the combination of enterprises' various abilities and capacities. Those elements construct the competitive force of FDI, as a whole, they act on the competitive force of FDI. Any enterprise cannot have strength on the all projects, but one enterprise can have strength on some projects and those projects' combination can enable enterprise to get the competitive force of FDI. When enterprise has the competitive of FDI, it can consider investment directly abroad.

## **3. RELATIVE INVESTMENT ENVIRONMENT FACTORS OF INVESTING-TARGET COUNTRY**

Investment environment factors of investing-target country have crucial influence on the location choice of enterprise's FDI. Only the location factors of investing-target country can satisfy the demand of enterprises' FDI from every aspect, it maybe becomes the host country that enterprise finally chooses. The relative investment environment factors of investing-target country that multinational enterprise need consider mainly includes several aspects below.

**Political and macroscopic economic conditions:** the political stability of investing-target country is the first question considered by transnational enterprise. When one country's political situation is bad, it is dangerous to invest in this country.

It is not hard to understand that macroscopic economic environment of investing-target country such as economic growth rate, economic growth stage, financial policy, exchange rate, interest rate, unemployment rate and inflation rate also have important influence on FDI for the enterprise.

**Social and culture factors:** because social and culture factors are series of invisible factors, FDI on investing-target country often has trouble. Enterprise must pay attention to the social and culture factors of investing-target country that contain language, religion, nation relationship, value and behavior standard, education, the relationship between invest country and host country. The degree of understanding on one country can affect the location choice of investors deeply.

**Labor force conditions:** enterprise's FDI may subject the influence of labor force's quality, quantity and source abroad. The income distribution of laborer in the target country also can affect the investment choice of transnational enterprise.

**Resource natural endowment:** economic activities generally gather on the center of population and natural resource place in order to obtain the convenience of the supply of resource and the market. The difference on total amount and structure of resource endowment among every country brings the foundation and power of arranging resource in the global scope for enterprise.

**Inputs conditions:** enterprise's investment and operation abroad need a flock of inputs. If the quantity and cost of inputs which enterprise obtained have better result, the investment revenue of enterprise can have a certain guarantee.

**Technical level:** the operation of projects of FDI needs local suitable technical level to provide cooperation and support service. The ideal technical environment not only satisfies the demand of enterprise's technical transfer and outside technical

cooperation, but also enables enterprise to get and use some local technical achievement even research force.

Management level: enterprise's investment and operation activities in the host country can involve the management of the host country's many function departments, so the management level of host country influence the efficiency and revenue of enterprise's investment and operation directly. Enterprises may choose the country which has high management level to invest.

Market demand: when enterprise choose the location of investment, it need consider the demand of market and know how large the exist market and potential market are in the host country, the market scale and structure, the key factors depending on the market capacity and structure and their change trend, the competitive structure of market, market price, market stability, the monopoly and control conditions and the difference of market demand.

Infrastructure condition: infrastructure includes road transportation, communication system, electric power system, banks, schools, hospitals, life facilities and so on. Infrastructure condition is the essential influential factor for the enterprise's FDI. Bad infrastructure condition from some countries and areas may produce great negative influence on FDI. The enterprise often gets out of these countries and areas when investing.

Relative services: the investment activities of enterprise generally involve some relative services, including finance, law, accounting, information,

transportation, communication, and consultancy. Better relative services abroad have important positive influence on investment and operation of enterprise, so these countries and areas have larger attraction for the enterprise.

Competitive enterprises condition: a large market means that it has many producers and competitors. Existing and potential competitors' scale, the competitive force, and market share which must be considered, when the enterprise makes the investment location decision.

Relative enterprises condition: fierce competition forces the enterprise to enhance the specialization of its key capacity, and to more depend on the relationship with outside cooperators. Domestic and foreign relative enterprises' development condition deeply influences whether the investment project of multinational enterprise can operate stably and profit or not.

#### 4. THEORETICAL BASIS OF LOCATION CHOICE OF MULTINATIONAL ENTERPRISE'S FDI

Concluding above, the paper considers that the location choice of enterprise's FDI depends on the motivation of direct-target layer of enterprise's FDI, the competitive force of enterprise's FDI and all kinds of investment environment factors from investing-target country or area. (as the figure 1)

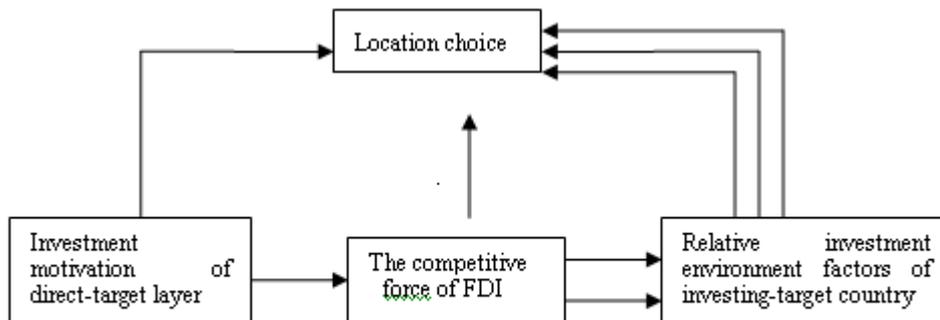


Figure 1: location choice of multinational enterprise's FDI

From the view of the investment decision of enterprise, generally speaking, after enterprise has motivation of FDI, it will consider itself whether has the competitive force of FDI. When confirm having the competitive force of FDI, the enterprise then consider or choose location of FDI. The three elements are mutually influenced and constrained with each other. On one hand, the relative investment environment factors of target country influence and constrain the competitive of FDI; on the other hand, the competitive force and motivation of the enterprise's FDI directly influence and constrain the

location factor.

If the enterprise has a sufficient motivation of FDI, but lacks of the competitive force of FDI or the suitable investment environment factors of investing-target country, it won't have the capabilities of FDI or choose one location as a host country to invest; if the enterprise has a sufficient motivation as well as the competitive force of FDI, but lacks of the relative investment environment of target country, the investment to the location won't be achieved. Obviously if the enterprise has both the competitive force of FDI and relative investment environment, but lacks of the motivation or

enthusiasm of FDI, the investment won't be achieved either. If the enterprise has both the motivation of FDI and the relative investment environment of target country, but lacks of the competitive force of FDI, it shouldn't invest in the location. In the all, as long as the enterprise lacks of one of the three elements which contain the motivation of FDI, the competitive force of FDI and the relative investment environment of target country, the investment in the target country won't be achieved. Unless the three elements are possessed, the enterprise will invest in the location.

## 5. CONCLUSION

Fundamentally speaking, the final goal which all

multinational enterprises' FDI pursue is to maximize the net profits. Choosing which country or area to invest depends on the judgment of anticipated benefits or anticipated net profits, the country or area which has high anticipated benefits will become the investment location. When choosing the location of FDI specifically, the multinational enterprise needs to consider the motivation of direct-target layer of FDI, the competitive force of FDI, host country's investment environment factors and its developed-change trend. One or several of host country's environment factors have not enough to attract investment activities of the multinational enterprise, and it is dangerous for the multinational enterprise's investment decision to just consider one or several influencing factors.

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