Executive Summary

Danish industry is increasingly present in developing countries through foreign direct investment. This development raises a number of important questions in regards to implications for Danish companies and firms in developing countries alike. An important partner in Danish foreign direct investment in developing countries is the Industrialization Fund for Developing Countries (IFU). Since 1967, IFU has assisted Danish foreign direct investments in developing countries with the view of promoting economic and social development. In order to get a better understanding of the context in which its clients – Danish companies – operate, IFU asked us – three researchers from Copenhagen Business School – to undertake a study of its portfolio of investment projects. Hence, our study focuses on two issues: First, what role does direct investments in developing countries play in the strategies of Danish companies? And second, how do investments of Danish companies affect developing countries in terms of job creation, technology transfer, skills level and market access? During 2005 we (a) reviewed IFU's project database, (b) conducted a survey of 72 of IFU's partner companies with, all in all, 92 investments, and we (c) undertook in-depth interviews with 10 IFU partners. Our main findings from these three sources are summarized below.

What Is the Role of Developing Countries in Danish Company Strategies?

Our study suggests that Danish companies are in the process of reconfiguring their value chains towards a more global orientation and a deeper integration of developing countries. 85 per cent of the sample compa-

nies' workforce is located outside Denmark, and about one fifth is located in developing countries - a higher share than that located in Denmark! Moreover, Danish direct investment in developing countries have grown significantly in recent years; a growth driven largely by SMEs and/or service companies investing in Eastern Europe and Asia.

Our study examines the motives behind investment in developing countries. More than half the responding companies argue that market access is a "very important" motive. This is typically companies following their business clients into developing countries, or large companies seeking access to household consumers in these countries. However, while Danish companies typically invest in developing countries to get market access, a growing proportion is looking for low cost potentials; not so much unskilled labour, but rather pools of skilled labour embedded in clusters of competent supply industries. Our study finds that one third of the investors consider cost savings as "very important" and that this motive has gained importance in recent years. The increase appears to be driven by SME investors in metals and machinery and services increasingly pressured into low cost locations by their customers. Interestingly, the responding companies report that they prefer to exploit low cost potentials in developing countries through local subsidiaries (FDIs) rather than through outsourcing. The growing importance of cost motivated investments is indicative of a greater integration of developing countries in the strategies of Danish companies.

Our study also suggests that a clear division of labour is maintained. While production of goods increasingly is located in developing countries, activities demanding higher skills and capabilities remain located in Denmark. For instance, the proportion of white-collar workers is much higher in Denmark than in developing countries. Although we find that marketing, research and design activities are frequently located in developing countries these activities are typically aimed at adapting products and services to local market demands - not at feeding into the global value chains of the Danish companies. Moreover, while the study

documents extensive flows of resources between Denmark and developing countries, it is also clear that the Danish parents overwhelmingly maintain control over flows of knowledge, services and finances.

What are the implications of these investments for Danish job creation and composition? We find little evidence of adverse job effects in Denmark. However, in production-related activities the study does detect negative job effects, although the respondents overwhelmingly reported that without the investment the job situation in Danish parent company would have been even worse. Furthermore, the study detects little evidence of companies planning a wholesale relocation to developing countries of more advanced functions, such as administration, IT and R&D. To the extent such off-shoring is planned, it is targeting OECD countries mainly.

How Do Danish Direct Investments Affect Developing Countries?

Now turning to the second main question addressed: How do Danish companies' investments impact developing countries in terms of job creation, technology transfer, skills level and market access? Seen from the perspective of host countries, direct investments come with a package of tangible and intangible assets, including technology, know-how, managerial skills and market access that can be vital to the industrial development process. In its positive sense, such investments may lead to job creation, technology transfer, upgrading of skills and capabilities, export generation etc. But investments may also impact negatively, e.g. by transferring inappropriate technologies, crowding out local industry, or creating dependent industrial structures.

On average, the Danish investment projects have around 300 employees. This average number conceals great variation: Some investment projects have several thousand employees - mainly market seeking investment in least developed countries - while others are small ventures with only a handful of employees. Another very important effect has to do with export generation. As Danish companies often take lead in inte-

grated global production or distribution chains, their investment in developing countries may constitute vital links between local industries and global markets: Around one third of the projects are very export-oriented – and typically cost motivated investments.

Often, the Danish investor invests substantial resources in developing capabilities in their developing country affiliates in order to ensure quality of inputs, timely delivery, and to avoid adverse effects on company reputation and brands. Hence, most investors transfer new technology to affiliates, monitor closely the affiliate's performance, devise elaborate training programmes, and assign expatriates for extended periods. Moreover, the majority of the investing companies formulate internal quality standards (and frequently also environmental and social standards) for affiliates. Though, few companies apply formalized and externally documented standards – such as ISO 9000 and ISO 14001 – in their developing country affiliates.

In some instances, the direct investment effects are multiplied: To access local markets, to get contacts to authorities, and to utilize local labour resources effectively, the Danish investor frequently foster close linkages to local companies. Traditionally, linkages to local companies have been equity based (joint ventures), but we find that this type of linkages is being phased out and replaced by non-equity modes. Linkages to non-equity partners are in fact quite frequent. As an average, the respondents estimate that for each new job in the Danish affiliate additional 1.3 jobs are created in the local partner companies. It is notable that extensive linkages are created not only upstream in the value chain to suppliers and subcontractors, but increasingly also downstream to distributors, sales agents and franchisees, and these linkages span from shallow to deep. In the latter case, Danish companies may invest substantial resources in upgrading local partners through formulation of standards, monitoring, and technical assistance. Such deep linkages are particularly common where there is a high level of value chain integration, i.e. interdependence between the Danish and local companies. Finally, the observation is made that collaboration with local partners typically focus on quality

and technical aspects, but surprisingly often the collaboration involves working conditions and environmental protection issues as well.