INVESTMENT OPPORTUNITIES IN ASEAN COUNTRIES

USHA DAR
PRATAP K. DAR

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Usha Dar
Pratap K. Dar

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Preface

One of the most significant developments in international economic cooperation has been international investment and sharing of technology. This expansion of business activity across national frontiers has two important facets.

On the one hand there is a quest for areas which offer opportunities for investment in different countries. This involves a study of the resource base of individual countries, the status of their industrial development, national plans for development, incentives for foreign investment and the legal framework for them.

On the other hand the rise of international business has confronted the nation states with the kind of business which is not adequately covered by traditional legislation. It has generated concern about the protection of national interests and resulted in legislation governing foreign investment, repatriation of dividends, royalties, interest and capital, extent of local participation, employment of expatriates, etc.

This book has been written in response to a felt need for careful study and research into the opportunities and environment for investment in the Asean countries. The material included in the book is based on authentic documents published either by the governments of these countries or the agencies set up for investment promotion. The authors express their grateful thanks to the investment promotion agencies which have so generously responded to their request for relevant literature. The authors also express their thanks to the libraries of the Indian Investment Centre, the Indian Institute of Foreign Trade and the British Council for extending all cooperation and help. The preparation of any book exerts a tremendous pressure and strain on an author's secretary. Grateful thanks are due to M.L. Jain, who despite his normal heavy work-load painstakingly typed the manuscript with unusual energy and aplomb.

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Usha Dar
Pratap K. Dar

CONTENTS

Preface v

1

Negotiations for International Business 1

2

Business Opportunities in Indonesia 11

3

Scope for Joint Ventures in Malaysia 53

4

The Philippines : Avenues for Investment 129

5

Scope for Collaboration in Singapore 188

6

Thailand : Its Investment Opportunities 217

7

Indo-Asean Joint Ventures and Trade 263

8

Benefit-Cost Appraisal of Foreign Investment 328

Index 351

1

Negotiations for International Business

Most developing countries today believe that it is not possible for them to achieve their development aspirations entirely on their own and therefore, need the cooperation of other relatively more developed countries. This cooperation may take the form of foreign direct investment or sharing of technical know-how, skilled personnel and management expertise. It should, however, be clearly understood from the beginning that the foreign investor is not motivated by considerations of extending aid for development. The prime motivation is commercial, and he expects returns from his investment. This is very sharply brought out in a number of empirical studies which have examined the factors leading to international production.

An important reason for setting up foreign production facilities is to safeguard exports. Many industries have substantial exports to developing countries and it may become increasingly difficult to maintain these exports because of import restrictions imposed by the developing country either to conserve foreign exchange or to protect its domestic industry.

Another causative factor in foreign production may be the desire to open up new markets. Developing countries are looked upon as potential markets for the future. The foreign investor is likely to capture a sizable market share of the product, if he sets up the industry in anticipation of demand.

Another consideration in basing a production facility abroad would be that a raw material or input which is in short supply or commands a high price in the international market may be available relatively cheeply in the host country. By locating the industry in the country which supplies the raw material, access to raw materials is reasonably assured and transportation costs almost eliminated.

Most advanced countries face the problem of shortage of labour or high labour cost. It would, therefore, be advantageous for them to locate the labour intensive industries in developing countries which have comparatively lower labour costs. If goods can be produced at lower costs in a developing country, then it would be possible to sell the goods at lower prices. This would give the foreign investor a better competitive sales position in the world market.

Foreign production does not necessarily mean production associated with direct investment. It could also mean technological collaboration and therefore it is important to understand why a foreign collaborator would want to export technology. The market strategy for technology as distinct from the market strategy for a product has not been worked out. The different theories of foreign direct investment[1] and the findings of various empirical studies[2], are variants of the basic theme that the corporations wish to retain as well as enlarge their share of foreign markets. The major factor, therefore, which has been highlighted is market strategy for the product. The Product Cycle Theory[3] of foreign direct invest-

1. For a detailed discussion of the theories of foreign direct investment see John H. Dunning. "The Determinants of International Production", *Oxford Economic Papers*, No. 3, Nov. 1973, pp. 289-330.

2. Mira Wilkins, *The Maturing Multinational Enterprise*, Harvard University Press, 1971.

   Thomas W. Allen, 'Direct Investment of European Enterprises in South East Asia" Study No. 3, July 1973, The Economic Cooperation Centre for the Asian and Pacific Region, Bangkok, Thailand.

   Koichi Hamade, "The Japanese Investment Abroad" in "Direct Foreign Investment in Asia and the Pacific", ed. Peter Drysdale, University of Toronto Press, 1972.

3. Raymond Vernon, "International Investment and International Trade in the Product Cycle", *Quarterly Journal of Economics*, May 1966, pp. 190-207.

   Raymond Vernon, "Sovereignty at Bay", *New York Basic Books*, 1971, pp. 65-112.

ment, however, carefully underlines the technological reasons for products crossing national frontiers.

According to the Product Cycle Theory the products go through a cycle of initiation, exponential growth, slow down and decline. It is important to recognise that these commercial phases are linked with the technological phases. New technology leads to a new product, and the first phase starts with the commercial introduction of the new product. At this stage the producers are uncertain about the dimensions of the market. After the period of initiation is over, the product is well known and has an established market. Now 'parallel innovators' emerge, product substitutes are available in the market, and the product faces competition. The demand having reached its peak in the home market tends to decline.

This market behaviour arises because on the one hand the basic technological know-how is shared by competitors and on the other, research has not yet led to the stage where changes in the product can be introduced. Is there any alternative then to producing results which would come about as a consequence of technological change? One of the effects of technological change is to alter the resource base[4] and this in turn means shifts in the cost of production. Hence, producing abroad in effect means a change in the resource base, because labour and other inputs may be available relatively cheaper. Thus, foreign production is a partial substitute for technological change.

Given the motivations for foreign investment and industrial cooperation, it is necessary to ensure that this cooperation is mutually beneficial. All negotiations, therefore, must be conducted with an explicit understanding that the foreign investor is looking for an adequate return on his investment; the local investor similarly is looking for an adequate return on his investment and the recipient country is looking for maximum benefit for its economy.

Foreign private industrial collaboration in a developing country opens up two levels of negotiations : (i) between the foreign collaborator and the local partner, and (ii) between the foreign collaborator and the local partner on the one hand and

4 C.P. Kindleberger, *Foreign Trade and the National Economy*, Yale University Press, 1963. p. 29.

the host government on the other.

Generally, the broad framework within which the negotiations take place are provided by the host government. This framework is generally found in the legislation and procedures which govern foreign investment. These may at first sight appear to be contradictory trends in such legislation; one restraining foreign investment in the sense of specifying the conditions under which foreign investment may enter the country and continue to operate in it, and the other which gives a number of incentives like tax holidays, tax rebates, subsidies etc. A closer look, however, will reveal that there is, indeed, no contradiction in the simultaneous imposition of constraints and offer of incentives. The constraints have to be interpreted in the wider perspective of the broad policy objectives of self-reliance and reduction in the concentration of economic power, while the incentives have to be seen against the technological gaps in the country.

Issues for Negotiation between the Foreign Collaborator and the Local Partner

Packaged versus Unpackaged Technology

Technology may be transferred in the form of (1) patents, trade marks, designs, processes etc., (2) plant and equipment, and (3) specialised scientific and technical manpower and management techniques.

The import of technology as an integrated package of all these elements is extremely useful in the initial stages of industrialisation of a developing country. However, as a country becomes more and more industrialised it becomes necessary to identify the areas where it still needs packaged technology and the areas where only specific elements of the technology are required.

The foreign collaborator would prefer to supply packaged technology particularly, "(a) where financial and human resources are available, (b) control over present and future market development is desirable, particularly with products having a longer life cycle, (e) the firm fears licensing will result in the give away (sic) of valuable know-how or will threaten its position in established markets (d) the transfer involves a broad line of products or is an integrated part of marketing and financial management (e) the technology is highly complex and the transfer requires a prolonged and sustained relationship to effect the transfer or (f) there is concern over protecting the product standards or trade name."[5]

When the entire package of technology is imported the local partner has to import even those items which he does not really require from outside the country and therefore, he has to make payments for items which are not strictly necessary. The importer also does not know the constituent elements of the package, and therefore, cannot get them from a cheaper alternative source of supply. Packaged technology also increases the monopolistic advantages of the supplier and thus enables him to adopt monopolistic and restrictive trade practices.

It is also possible for the supplier of technology to fix the price of a service or product to his own advantage. Since the product or service does not pass through the market the supplier can fix the price in such a way that it becomes a means of transferring profits or funds to the foreign company. In cases where a product is traded internationally, the customs administration of the host country has some method of gauging the price. In many cases, however, the product is not traded internationally and therefore, the foreign company has greater freedom to adjust its price.

When packaged technology is looked at from the point of view of the host country, it is seen, that in cases where the entire package is not necessary, there is an avoidable strain on the balance of payments. Also "in virtually every country there is a growing suspicion that by using sophisticated transfer pricing policies and accounting procedures, large international firms dissimulate the true profitability of their local subsidiaries and deprive host governments of legitimate tax resources."[6] Another problem is that of unemployment. This is associated with the introduction of capital intensive methods of production,

5. Jack Baranson, "Technology Transfer through International Firm", *American Economic Review*, Papers and Proceedings, May 1970, p. 435.

6. *Business International*, "PR need to Avert Transfer Pricing Quarrel," Feb. 12, 1971 p. 51.

developed in highly industrialised countries in the context of labour shortage and high price of labour.

In view of the possible adverse effects of packaged technology, it is necessary to unpackage it. In other words, the importer of technology must know in detail the technological elements to be transferred, and the price of each element separately so that each item is separately negotiable.

Price of Technology

Technology may be paid for in terms of equity or royalty or a combination of equity and royalty. An important issue for negotiation is the extent of equity which the foreign investor will be permitted. Since majority equity participation implies that the party which has the majority exercises control over the company, both the host national corporation and the foreign corporation are interested in majority equity participation, because each wants to exercise control over the company. Apart from the control aspect, the host-government is interested in foreign minority participation because lesser the foreign equity, correspondingly small will be the flow of funds outside the country and hence the strain on the balance of payments will be reduced. Experience in a large number of countries shows that minority equity participation is increasingly being accepted by the foreign investors. Knowledge of the characteristics of companies which want to opt out of minority equity participation or joint ventures would indeed be very helpful in negotiations. According to Lawrence G. Franco, a study of 50 companies who did not accept minority participation showed "that first and foremost, the firms that avoid joint ventures are those that tend to limit the scope of their activities to one relatively narrow product line. They are the one-industry if not the one-product companies. Not only the reluctance of these companies to enter joint ventures, but also their propensity either to buy, or to sell out of them has been found to be strongly related to strategies for defending particular non-diversified product lines. Although these non-diversified firms may desire local partners during the early stages of entry into a new market, they almost inevitably strive to retain control of their product line, until it enters a mature competitive phase of the international product cycle. As their products standardise, their technologies become diffused and old barriers to entry may break down.

Conversely, as a consequence of their strategy choice, and the ravages of time, these firms often try to erect more and more barriers to entry in marketing in order to foreclose competition. They may, insist on selling under one internationally known brand name, or try to build a tightly integrated international organisation, so that lessons learned in one market can immediately be transferred to another. Whatever the tactical choice, centralised marketing policy making is the common result. From the point of view of the MNE not only do 'contributions' by joint venture partners become superfluous, but conflicts over marketing policy are inevitable and irreconcilable if joint ventures are ever entered, they eventually become intolerable to the MNE, are broken up and avoided thereafter."[7]

The *Business International* interviewed about two dozen large US firms to find out how much equity an investor should get for his know-how in a new foreign venture.[8] While the interview did not result in a simple answer, an important finding was that 'past cost plus a mark-up' was never the main consideration in determining the value of know-how. An important determinant was the estimated contribution to know-how over a period of time. In fixing the minimum limit the development cost and the costs of delivering the know-how are important factors.

The study has further shown that in negotiating the share of equity a number of factors have to be taken into account; first the earning power of the venture over a period of time, (usually 10 years); second, local share-price/earnings per share averages or in countries where this figure is not readily available the prime commercial bank rate plus a 50% risk factor, third, the calculation of earning and risk if the venture were 100% owned; if the product was being exported earlier then the past earnings from the products; the possibility of the partner acquiring know-how by alternative means; the size of the partner's company

7. Lawrence G. Franko, "International Joint Ventures in Developing Countries: Mystique and Reality, *American Bulletin of International Licensing and Joint Venture Opportunities*, Vol. 3, Dec. 1974, p. 34.

8. *Business International*, Jan 25, 1963 p. 7.

and his ability to finance future expansion.

The study by the *Business International* also pointed out that "firms generally confine the equity swap to past know-how, proving for current know-how in a separate agreement with first technical assistance fees or a royalty usually based on gross sales varying from 1-3%. Some companies report foregoing such royalties for 5 years or so in order to secure a high equity position; others include an option to accept equity up to a certain maximum rather than cash for future know-how."[9]

Royalty payments for technical know-how may be either in lumpsum or as a percentage of gross or net sales. In order to avoid any definitional difficulty at the time of payment, it is important that the licence agreement should clearly specify the definition of gross and net sales. The time when an obligation to pay a royalty begins should also be clearly specified. It is further necessary to specify the duration of the agreement because the period for which an agreement is stipulated has a direct bearing on what issues can be covered and in how much detail. A time limit for agreements is also important, because it is difficult to predict the course of technological developments. Another reason is that the percentage of royalty to be paid depends on the time flow of costs, receipts and profits, and it is not possible to predict these accurately over a long period.

It follows from the above analysis that the sale and transfer of technology takes place in a highly imperfect market and the price is negotiable. However, since the supplier of technology has greater bargaining power, he is often able to change prices much above his own reserve price.

Confidentiality Clause and Sub-Licensing

It has been generally observed that a condition imposed upon the licensee is that the technological information and documentation supplied by the licensor will be kept confidential. This is indeed a reasonable requirement because technical know-how is a commercial secret. Sometimes, however, a licensor insists on the insertion of a commercial clause in terms of which the licensee is required to return all technological documentation and information to the licensor at the expiry of the

9. *ibid.*, p. 7.

agreement. The licensee is also required to give an undertaking that the licensor will not manufacture the product thereafter. This is an unreasonable demand and the licensee should insist on the right to continued use of the technology after the expiry of the agreement.

Restrictive Business Practices and Sale of Technology

The Commission on Transnational Corporations has identified a number of restrictive business practices which are associated with the sale of technology. These are : obligation to enter into a remunerated contract of "transfer of technology" in order to obtain the possibility of acquiring products, machinery and equipment abroad; imposition of contractual secrecy is an abusive manner, tending to transform a technology not patented in the requiring country, into an industrial property right; collection of royalties on patents which have entered into the public domain or which have not been patented in the demand country; compulsory transfer of improvement and invention rights to the grantor of technology when the improvements have been made by the recipient; imposition of the use of a foreign trade mark for the acquisition or transfer of the technology; compulsory export through the technology supplier : total or partial limitation of production during and/or after the effective period of the technology contract : maintenance of a contractual vehicle, with or without remuneration even after the expiration of the industrial property privileges; imposition of participation in the capital of the firm requiring the technology; limitation to the research policies and activities of the firm requiring the technology; obligation of purchasing labour from the supplier; prevention of contesting the industrial property rights alleged or secured by the technology supplier; restrictions to obtaining technology either not desired or not needed by it; practices by the supplier which apply quality control or production standards as a means to impose upon the acquirer of technology unjustified requirements: practices requiring higher payments for technology on goods produced for export *vis-a-vis* goods for the domestic market; submission to foreign courts of information or judgements in law-suits regarding the interpretation or fulfilment of contracts; mandatory provisions to be held beyond the life of the contract.

In negotiating the conditions on which technology is to be imported it has to be carefully ensured that these restrictive business practices are not built into the licensing agreements.

Re-negotiation of Agreements

Experience has repeatedly shown that it is extremely difficult to predict the course of technological developments. Hence the agreements which are based on perfectly reasonable considerations turn out completely out of tune with the new technological realities.

Apart from technological developments additional information may have become available since the signing of the agreement, on the basis of which the local partner no longer believes that the original agreement was fair. For example, it may have come to the knowledge of the local collaborator that more favourable terms have been given to another collaborator in his country or another country for the same technology and naturally this would set him rethinking about the terms of the agreement.

The negotiating strength of the licensee may have altered because alternative sources of supply may have become available since the signing of the agreement. Hence technological collaboration agreements should normally provide for re-negotiation. The provision for re-negotiation is generally made by putting a time limit on the duration of the agreement. After the expiry of the stipulated period, if the need is still felt for extending the period of the collaboration, then the terms of the collaboration may be re-negotiated, if necessary.