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FOREIGN INVESTMENT DECISIONS

THE WORLD VIEW FROM UNILEVER

by F A Maljers

A. INTRODUCTION

Modern thinking and attitudes now recognise foreign direct investment (FDI) as a promoter of sustainable development. Within this context the UN's World Investment Report identified transnational corporations such as Unilever as very realistic "engines for growth". This is a welcome change from anachronistic views of FDI as foreign exploitation.

This shift in attitudes came with the growing conviction of opinion formers and governments that economic progress was better furthered by market solutions. The reasons for the shift differed. There were arguments that for emerging technology to be used effectively markets must be freed. There were arguments based on human motivation and values, on the lines of Adam Smith's "invisible hand". And there were pragmatists who compared the performance and progress of market economies against those that were "controlled". Thailand's impressive progress compared to neighbouring Burma, and Western Europe versus the old Soviet block are evidence to back these theories.

This shift in thinking has been accompanied by a change in the government of countries themselves. There are fewer constraints on freedom to operate. For example India's liberalisation program which started 1991/92 has considerably eased operating conditions. The worldwide trend towards privatisation has profoundly affected the nature of markets and competition. It has also reduced the risk of a government confiscating a whole business entity in the interests of "nationalisation".

Multinational corporations paralleled these changes through their activities and operations. It has even been said that pioneering international companies actually help facilitate the change in attitude and governmental practice. Their clear long term commitment to developing markets and their sensitivity to the threats and barriers to development make companies such as Unilever credible vehicles for world growth.

Unilever has been acutely aware of the changing global environment. In general we see evidence for *more* confidence and have extended and deepened our operations. But we must continue to be aware of the different paces of change and not close our minds to the possible reverses of many of these attitudes and practices.

B. UNILEVER IN PROFILE :- SALES AND INVESTMENT

Unilever today cannot be understood without some knowledge of our history. The company has been involved in setting up agencies and factories around the globe for over a hundred years. Investment decisions at a corporate level are more often about prioritisation and *degrees* of investment than about whether to enter (or, in the newly liberalised world, "re-

enter"). Our long history of international business provides us with a wide network of operations and a deep pool of experience in foreign management. It is from this relatively broad base that we face further FDI decisions.

Last year Unilever had sales of nearly $45 billion. Approximately 60% of sales were in Europe and 20% in North America. The remaining 20% in the Rest of the World were largely accounted for by developing countries but sales in Japan and Australia are included here.

Capital Expenditure roughly mirrored our sales split. Of the $1,940 million capital expenditure last year, a little over 60% was in Europe, a little under 20% in both the North American region and the Rest of the World.

Unilever Sales and Investments 1992

$ million	sales		capital expenditure		net operating assets (1991)	
Europe	25,800	59%	1,220	63%	5,680	50%
North America	8,740	20%	360	19%	3,320	29%
Rest of the World	9,180	21%	360	19%	2,340	21%
TOTAL	43,720		1,940		11,430	

We have operating companies in some 75 countries and export to, or trade in, many more. Our consumer products of foods and drinks, detergents and personal products range from premium priced prestige items, through products every household uses such as tea, to cheaper products for low income households such as hard soap.

In addition to our consumer businesses, our chemicals and plantations operations supply raw materials and intermediate products both to Unilever and third parties.

Investment in physical capital and the resulting sales generated are easy to quantify. It is less easy to measure the returns from Unilever's human capital investment. This expenditure in time and money builds knowledge and skills relevant to a country, its market, its infrastructure, competitive forces and ultimately its potential. It also increasingly builds up an awareness of how that country or market fits in with the *wider* global environment in which Unilever as a whole operates. The returns from human investment come in the longer-term - it can take two decades to train good managers. Many will need to develop an international perspective. The benefits of a manager with this perspective accrue widely across countries, not merely in that manager's specific location . Unilever recognises the weight of the human element of FDI.

C. UNILEVER IN PROFILE : - MOTIVATIONS

There are a number of theories of why companies invest abroad and why they invest in some countries rather than others. Those theories addressing the WHY? of foreign investment include arguments based on saturated home markets, economies of scale, the need to spread ever burgeoning development costs, cheaper production locations, raw material access etc. Questions of WHERE? overlap with this list but must factor in the specifics of country and regional characteristics.

C.1 Why Invest Abroad?

Perhaps the primary reason to invest abroad is to extend one's market beyond existing saturated borders. Saturated markets may generate cash on relatively low investment but do not tend to facilitate growth. Cash and expertise from existing "mature" markets may be redirected to develop new growth opportunities overseas. This is particularly relevant where consumption in *developing* countries lags *developed* countries (eg frozen food). Patterns of development may be identifiable. But the product lifecycle theory should not be pushed too far. Income inequalities ***within*** a country and external factors such as climate, religion or culture etc can affect the pattern by which opportunities develop. There is no rigid deterministic model.

Economies of scale are also important in motivating that international expansion. These forces are not simply factory scale economies - which tend to encourage centralisation of production and exports - but involve economies in R&D, in product development, in elements of marketing. It involves any activity where incremental sales provide incremental contribution to centrally "sunk" investments. In the modern, high tech, fast moving world, such required investments are getting larger and larger.

A further general argument for investing abroad is to preempt or contain competitors. This is similar in intent to having a presence on supermarket shelves. It is not only markets that are becoming more global, it is also the competition. Delay in entering a new country or in expanding existing operations could mean a competitor acquires a leading sustainable position to the detriment of your own ambitions. There are real first mover advantages in some sectors, particularly in markets where you can set the standards, be it in electronics, baked beans or toothpaste.

Behind all of this are the necessary skills in technology, marketing, logistics etc. These are what give us competitive advantage. Moreover the experienced multinational is likely to have an edge over competitors who may be technically as proficient but less experienced at working in foreign environments. We have seen this with some of our Japanese competitors whose formidable strengths in their home market are sometimes diluted when operating abroad. But they are also learning and evolving and we are certainly not complacent about our relative strength.

C.2 Where to Invest?

Regions or countries have specific characteristics which feed into the investment prioritisation

process. Before discussing these a general point must be highlighted. Unilever is a commercial company with the overriding objective of maximising long run profits and thereby shareholder wealth. There is always the problem of recognising the value of long-run returns from investments while we must absorb the investment costs *now*. Countries in which the costs of doing business are high are not necessarily unattractive, providing the costs can be passed on. Similarly, we are aware that the countries which give generous tax incentives may not be countries with high after tax profits if competition erodes margins. Even countries were local profitability is questionable may warrant investment if there is *strategic* value in being in that market - ie there are returns to the company as a whole but not directly accruing in that location. Once again the wider international perspective is crucial.

Profits generated overseas must be sent back to head office if they are to benefit shareholders. High but unremittable profits cannot foreseeably aid our corporate objective. Other factors in the investment decision are subject to complex tradeoffs (eg factor prices, political risk, demographics etc) but if we are prevented from making long term profits or cannot remit them, however attractive the other features, we could not justify investment.

Labour costs have not been a major factor in the location of Unilever's investments. This is partly because exports have played a relatively minor role in our operations. It is also because real labour cost differentials are rare, when one takes productivity into account. Low wages do not necessarily imply low unit labour costs. There are of course countries where restrictive labour practices or social regulations have genuinely affected the cost of labour and this may carry weight in a location decision. If such costs can be passed on to the consumer, difficult operating conditions need not necessarily reduce profitability but only if imports are similarly affected by tariffs. A country such as this would not be chosen as an export base.

Unilever has had considerable experience of operating under widely differing government policies. Our main objections are to controls which prevent us from determining our own success in the market. Price controls interfere with marketing strategies, distort market forces and often impact on margins if costs do not face similar controls. We have been subject to output restrictions which not only checked new investment but cramped our ability to compete. Governments with attitudes and policies which harm business operations cast long shadows. If policies change, the suspicion that the basic ideology remains can hold off new investment. This will be even more true for companies smaller and less international than Unilever. The costs for a small company of researching a new foreign market can provide a high entry barrier, and a regime's reputation of being unfriendly to business makes the payoff from such research more uncertain.

C.3 How to Invest?

Foreign direct investment can be seen as the end result of a gradual process of building a product presence. This process may involve first exports or licensing progressing to direct investment at a later stage. Transport costs, security or availability of supply, legal requirements and various other factors can affect the speed of the evolution of presence. In this context direct investment decisions can be seen once again as questions of degree of involvement in a foreign country.

C.3.i The Scope of the Decision - Regional Investments

Moves towards a single market in Europe led us to review our production operations. As the costs of shipments across national boundaries are reduced, so economies of scale of production become more important in location decisions. But great care still needs to be taken to recognise continuing differences in consumer tastes and habits and to recognise remaining imperfections in the single market. Although the member states have undertaken to move to a "single market" there are still factors disrupting progress to this end. New German packaging legislation adds cross border complications and the collapse of the exchange rate mechanism has reintroduced the costs of exchange rate uncertainty. Exchange rate volatility has a profound affect on our decisions for regional production sites - revenues arrive in a variety of currencies while the associated production *costs* are in the currency of the single country of location. Even while nominal exchange rates were stable, the lack of convergence in monetary and financial conditions was producing divergences in real exchange rates. Yet the Single Market programme plus other factors reducing the importance of geography and distance (eg information technology advances, cheaper transport) have led us to concentrate production within Europe.

Elsewhere similar forces are encouraging us to look towards regional planning of production. The Andean pact, Mercosur (Brazil, Argentina, Uruguay and Paraguay) and ASEAN are regional trading blocks that will increasingly affect the way multinationals do business. The close links between Canada, the US and Mexico through the NAFTA negotiations have led us recently to combine executive control of our Mexican business with our North American ones. We are increasingly seeing investment opportunities in regional terms, rationalising production within this context.

C.3.ii The Impact of Globalisation

For a company like Unilever, globalisation is not merely about extension of production into more and more countries. On the contrary the tide is in favour of concentration of production facilities and rationalisation. Globalisation is an attitude. It may imply increased presence but most importantly requires an awareness of the wider implications of local action.

The nature of our products and markets, meeting the everyday needs of consumers worldwide, limits the speed and extent of rationalisation of activities and limits the potential standardisation of products for world markets. This is to be compared with, say, the textile industry where production shifted dramatically between countries and consumers are fairly similar across nations. However while no fundamental transformation in re-locating Unilever production facilities may have resulted from "globalisation" there have been important consequences.

The concept of "globalisation" has a number of different aspects. One is to see all countries as potential markets for a company's products. In that sense as Unilever establishes factories and sales offices in Eastern Europe and China, marketing products such as ice cream, tea and soaps, we might be said to have become more "global". But this is really only an extension of traditional ways of doing business in areas we were prevented from entering before. A more fundamental interpretation is to consider operational decisions against a *global* as

distinct from a national or regional context. Investment decisions are based on implications and returns to the *whole* organisation, rather than on their stand alone potential. The reason for this approach is that knowledge and skills flow abundantly and rapidly around the world where competition is everywhere. A company polluting in a remote rainforest can suffer thousands of miles away if concerned consumers read of these actions in their local newspapers. New products can be more rapidly rolled around the world than before because consumers in one country are increasingly aware of products and brands available elsewhere.

Keeping abreast of changing markets, competitor activities, scientific discoveries and relating these to company operations has become more demanding. In the world of finance, where reaction to information can be instantaneous, it is claimed that one cannot beat the market, that all information is already reflected in prices. But you can do worse than the market if you do not search for all available information. Likewise in manufacturing, although relevant information is not as widespread nor transmitted as rapidly, the pace has quickened. Unilever fully recognises the advantage to be had from successfully managing these information flows at a global level. Entrepreneurs in developing countries increasingly gain access to information on processes, techniques and managerial practice once the proprietary secret of the multinational. FDI decisions must be made against a backdrop of increasingly "able" local competition. Against this, the global company enjoys economies in marketing, international brands, the ability to diffuse discoveries rapidly around the world and to attract and train high calibre international managers. And so do its multinational competitors!

It is interesting to see how the pattern of FDI is shifting. Historically, the weight of investment from companies based in certain countries was where that *country* had a relatively strong political influence. British investment was predominately in the Commonwealth and the USA. Japanese FDI, modest compared to its economic size until recently, had largely been in South East Asia. US corporations invested heavily in Latin America and Canada with very little activity in Africa. For many multinationals, and certainly for Unilever, it is now the commercial opportunity rather that political support which determines investment flows. We may not have factories all over the globe but commercial thinking and analysis is always global.

C.3.iii Corporate Structure and the Investment Decision

Unilever's size, product range and geographic diversity make delegation vital. Our culture extends this principle further than in many other comparable companies, and we see it as a core strength. Our executive divisions - Management Groups - are very large businesses themselves. They take regional and global decisions independently of each other and separate from corporate control. But at the same time there are clearly issues which are the preserve of corporate thinkers or are more efficiently done centrally - here our corporate centre performs a key role in identifying the wider implications of management group action. An example might come from one management group's decision to prioritise a developing market - the corporate centre can recognise how this plan impacts on other ambitions both in that region and elsewhere in the concern.

D. TO SUM UP

Unilever has for many years been an international business in terms of operations and presence. We are however becoming increasingly global. In terms of attitudes and actions we reflect the changing world conditions and opportunities. Foreign investment is taken in the light of evolving global business conditions. We recognise the extended timescale of many projects and the impact our activities may have on the change process itself. FDI is a continuing opportunity for mutual gain for *all* stakeholders be they consumers, shareholders, employees or governments.

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