The New Agenda for FDI: Evidence from South Korea and Germany

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The New Agenda for FDI: Evidence from South Korea and Germany

Bernard Michael Gilroy1 and Elmar Luksa2

Abstract

The purpose of this study is to find reasonable explanations why cross-border acquisitions are often the preferred strategy to enter new markets. Furthermore, we formalize the choice of market entry strategy for an individual multinational enterprise (MNE) from a dynamic perspective. It is argued that incorporating a suitable treatment of irreversibility, uncertainty and option value into the MNE's investment decision will show that future investment decisions of the MNE will be affected by all prior investment decisions. We also briefly discuss stylized facts given evidence from South Korea and Germany.


Keywords: Foreign direct investment, multinational enterprise, sequential investments, entry mode, greenfield investment, cross-border acquisition.

1 Introduction

In 1999, as Figure 1 illustrates, global cross-border acquisitions reached $1.1 trillion in 2000, up by 40 percent from $738 billion in 1999. These numbers are based upon UNCTAD (2000) who has registered all transactions in which a foreign purchaser acquired more than a 10 percent share. Among developing countries, Latin America has been the largest region of cross-border merger and acquisitions (M&A's), most of which have been through privatization programs. However, though smaller in M&A size, East Asia has become a new destination for foreign mergers and acquisitions.

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proposed (those designed to block new means of production).

The rapid increase in MENA rather than to traditional foreign investment in "greenfield"
1999. This, the much-discussed resilience of FDI during the crisis was due entirely to
from $6 billion in 1995 to $13 billion in 1997 and increased further to 60 percent in
increase in the share of MENA in FDI rose
in FDI. This clearly exemplifies the broad and main Regional and Global trends in FDI.
1999, competitively, cross-border mergers and acquisitions have accounted for an increase
the main impetus of these activities, where MENA value reached $13 billion in
the failures (Indonesia, Korea, Malaysia, and Thailand) increased enormously in value from
In Latin America, cross-border M&A activity in Latin America has been
16 percent, unlike in Latin America, cross-border M&A activity in Latin America has been
Figure 1: World Cross-Border Merger and Acquisitions, 1991-1999. Source: [8], p. 59
sectors were being intensively targeted by the new patterns of WMA activity in East Asia. Figure (5) indicates that wholesale and retail trade, real estate, and financial services, principally focused on manufacturing of goods for export or as substitute for imports, present entry into services (nontradable) sectors, whereas financial FDI traditionally was a second stage of cross-border acquisitions as the recent WMA activities of foreign-based entities.

Until recently, Korea's WMA market was one of the most inactive and closed among [20].

Source: [20].

Figure 2: Cross-border Mergers and Acquisitions in Crisis Countries, 1997-1999.
ne to develop...ter's need for a dynamic perspective on dynamic aspects of why...production stages is preferred for less developed countries (LDCs). However, so...etc. have shown that since the late 1980s, most of the inward fell into industrialized coun-

countries. Today's fast-moving rapidly changing business and technological environment, the form

2. Review of the Literature

By sector, 1997–99
acquisitions in crisis countries.
Cross-border mergers and


Figure 2: Cross-border mergers and acquisitions in crisis countries, by sector, 1997-1999.

Source: [29]
Under the assumption that the rate of profit per period is not influenced by the choice of the firm, and that the returns connected with these are independent of the firm's choice, if the firm chooses a commodity whose fluctuations are perfectly correlated with its own (a supply curve), there exists a traded commodity whose fluctuations are perfect substitutes to the firm's own commodity. If the firm chooses a commodity whose fluctuations are independent of the firm's choice, and if the firm chooses a commodity whose fluctuations are perfectly correlated with its own, there exists a traded commodity whose fluctuations are perfect substitutes to the firm's own commodity.

For simplicity, let's consider a case where the firm chooses a commodity whose fluctuations are independent of the firm's choice. If the firm chooses a commodity whose fluctuations are perfectly correlated with its own, there exists a traded commodity whose fluctuations are perfect substitutes to the firm's own commodity. If the firm chooses a commodity whose fluctuations are independent of the firm's choice, and if the firm chooses a commodity whose fluctuations are perfectly correlated with its own, there exists a traded commodity whose fluctuations are perfect substitutes to the firm's own commodity.

3. The Model

3.1 The Second Phase of the Model

In the second phase of the model, we assume that the attributes of the firms' locations are considered along with the attributes of the firms' production processes. This phase is represented by the construction of a regional model, which is similar to the construction of a regional model in the first phase. The second phase may represent the construction of a regional model, which is similar to the construction of a regional model in the first phase. The second phase may represent the construction of a regional model, which is similar to the construction of a regional model in the first phase. The second phase may represent the construction of a regional model, which is similar to the construction of a regional model in the first phase.
Formulating the optimization problem in this manner is similar to the HJE formulation of a utility function, which is a model of the subjective valuation of a project. The parameter regulating the attractiveness of the foreign market location is assumed that the investor prefers projects with a value \( J_\theta \), where \( \theta \) is interpreted as a location-specific constant. In the case where the efficiency of the investor is higher, the second stage option is exercised in a position to acquire further potential growth. The investment possibility is exercised to ensure the corresponding costs. Conversely, when the efficiency of the foreign investor is lower, the value \( J_\theta \) is exercised during the first stage of setting up an operation. The process continues until the investor adopts the respective Foreign Direct Investment.

### 3.1 Foreign Direct Investment

The project's viability, i.e., the expected return on investment, is determined by the net present value of the project. The net present value \( NPV \) is given by:

\[
NPV = \sum_{t=0}^{T} \frac{CF_t}{(1 + r)^t}
\]

Where:
- \( CF_t \) is the cash flow at time \( t \),
- \( r \) is the discount rate,
- \( T \) is the project's lifetime.

The value of the project \( V \) is given by the present value of the cash flows:

\[
V = \sum_{t=0}^{T} \frac{CF_t}{(1 + r)^t}
\]

The optimal decision is made by maximizing the present value of the cash flows. The equation for the optimal decision is:

\[
\frac{dV}{dt} = \sum_{t=0}^{T} \frac{dCF_t}{(1 + r)^t}
\]

Assuming that the project cash flows are not limited over time and constant per period, the equation becomes:

\[
\frac{dV}{dt} = \sum_{t=0}^{T} \frac{CF_t}{(1 + r)^t}
\]

Where \( r \) is the rate of discount, \( q \) represents the volatility, and \( \phi \) is an increment of the

\[
\phi = \sum_{t=0}^{T} \frac{CF_t}{(1 + r)^t}
\]

Formulated that
Proposition A.1: One-Shot Market Penetration. An entrepreneur will not implement

geared foreign direct investment given that

\[ \frac{\theta + 1}{T} \frac{1}{\alpha} < \frac{\theta}{T} \]

will not be postponable.

An entrepreneur will immediately enter the market through cross-border acquisition once the

potential location advantages of \( A \) is smaller than the first stage trigger value, which is smaller than the second stage trigger value of \( A \).

Proposition A.2: Inter-Stage Earnings. Higher earnings in the second stage due to higher earnings in the first stage investment uncertainty leads to

\[ \theta \frac{\theta}{\alpha} > 1 \]

\( \beta \frac{\theta}{\alpha} > 1 \) if follows that an increase in incurred investment uncertainty leads to the higher the costs of production in the second stage and the smaller \( \theta \) is.

This section presents a summary of a comparative-static analysis of the detoured

Results of the Two-Stage Optimization Problem

\[ \theta \frac{\theta}{\alpha} > 1 \]
Thus there exists a tendency certain turning points for an increase in \( \theta \):

\[
\frac{\theta + 1}{\theta} \frac{I - \frac{I}{g}}{I} = \frac{\omega}{A}
\]

The trigger point value for the second stage is obtained as:

\[
\frac{\theta + 1}{\theta} \frac{I - \frac{I}{g}}{I} = \frac{\omega}{A}
\]

Investment is determined as:

\[
\frac{\theta + 1}{\theta} \frac{I - \frac{I}{g}}{I} = \frac{\omega}{A}
\]

Under such circumstances a 

### Proposition 4.2 Oligopolistic market penetration: an analytical model

When the threshold value \( \omega \), it is optimal for an enterprise to exercise the first stage technical.

We call this threshold the "organizational expansion" strategy and designate it with \( \lambda \).

The expanded upon during stage two in order to have the potential locational advantages \( \theta \).

The threshold value \( \omega \), is greater.

Under the circumstances that the value of the second stage is greater. The value of the second stage is greater.

\[ \frac{(\theta + 1) \frac{I}{I} - \frac{I}{g}}{I} = \frac{\omega}{A} \]

The trigger point value for the second stage is obtained as:

\[ \frac{(\theta + \xi) \frac{I}{I} + \frac{I}{g}}{I} = \frac{\omega}{A} \]

which is optimal for the enterprise to exercise the first stage investment is derived.
The acquisition of a foreign company over a greenfield investment strategy. The results show that for a higher the multinational enterprise would favor of cross-border merger and acquisitions as an entry strategy to new foreign markets. At the same time the industry various exhibit a particularly higher level of foreign direct investment (FDI) at the time. The table illustrates the above postulated theoretical propositions are in accordance with recently observed.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FDI share</td>
<td>FDI share</td>
</tr>
<tr>
<td></td>
<td>GDP</td>
<td>employment</td>
</tr>
<tr>
<td>World</td>
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<td>1.0</td>
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<tr>
<td>Developed economies</td>
<td>1.8</td>
<td>4.0</td>
</tr>
<tr>
<td>Western Europe</td>
<td>1.3</td>
<td>4.9</td>
</tr>
<tr>
<td>European Union</td>
<td>1.3</td>
<td>4.8</td>
</tr>
<tr>
<td>Other Western Europe</td>
<td>1.1</td>
<td>5.7</td>
</tr>
<tr>
<td>North America</td>
<td>1.1</td>
<td>4.7</td>
</tr>
<tr>
<td>Other developed economies</td>
<td>0.9</td>
<td>1.1</td>
</tr>
<tr>
<td>Developing economies</td>
<td>1.8</td>
<td>0.2</td>
</tr>
<tr>
<td>Africa</td>
<td>1.8</td>
<td>0.2</td>
</tr>
<tr>
<td>North Africa</td>
<td>0.6</td>
<td>0.4</td>
</tr>
<tr>
<td>Other Africa</td>
<td>1.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>0.9</td>
<td>0.9</td>
</tr>
<tr>
<td>South America</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Asia and the Pacific</td>
<td>1.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Asia</td>
<td>1.1</td>
<td>0.2</td>
</tr>
<tr>
<td>Central Asia</td>
<td>0.3</td>
<td>0.2</td>
</tr>
<tr>
<td>South, East and South-East Asia</td>
<td>1.3</td>
<td>0.2</td>
</tr>
<tr>
<td>South Asia</td>
<td>0.6</td>
<td>0.3</td>
</tr>
<tr>
<td>Pacific</td>
<td>4.5</td>
<td>1.4</td>
</tr>
<tr>
<td>Developing Europe</td>
<td>2.5</td>
<td>0.4</td>
</tr>
<tr>
<td>Central and Eastern Europe</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Least developed countries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>0.3</td>
<td>0.8</td>
</tr>
<tr>
<td>African LDCs</td>
<td>0.5</td>
<td>0.1</td>
</tr>
<tr>
<td>Latin America and the Caribbean LDCs</td>
<td>0.3</td>
<td>0.6</td>
</tr>
<tr>
<td>Asian and Pacific LDCs</td>
<td>0.1</td>
<td>0.5</td>
</tr>
<tr>
<td>East Asian LDCs</td>
<td>0.1</td>
<td>0.5</td>
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<tr>
<td>West Asian LDCs</td>
<td>0.1</td>
<td>0.6</td>
</tr>
<tr>
<td>South and South-East Asian LDCs</td>
<td>0.1</td>
<td>0.5</td>
</tr>
<tr>
<td>Pacific LDCs</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: UNCTAD
1 The ratio of the region's share of world FDI inflows to the region's share of world GDP.
2 The ratio of the region's share of world FDI inflows to the region's share of world employment. The data are from the LDC's LACFA database and the World Bank's World Development Indicators, 2001.
3 The ratio of the region's share of world FDI inflows to the region's share of world exports of goods and non-factor services.
4 LDCs as defined by the United Nations.

Note: The indices for some regions are based on incomplete coverage of countries in the region, due to lack of data on one or three variables. Also, the indices for Central Asia, Developing Europe and Central Eastern Europe are not strictly comparable between the two periods because the number of countries included in each differs substantially between the two periods. The increase in the number of countries covered by the index for developing economies in the second period (from 68 in 1988 to 1994) can cause a moderate upward bias in that group's index in the second period.

Table 1: Regional Inward FDI Index by region, 1988-1990 and 1998-2000, [38, p.11].

Possible to derive certain insights. During the period 1989-2000, Germany and Europe in general exhibited a high Inward FDI Index mainly driven by liberalization and deregulation processes and the German reunification, opening up growth opportunities (i.e. high values of θ) for foreign investors. Consequently, the appropriate market entry strategy for a Korean enterprise would thus be, in accordance to our model, the acquisition of a German counterpart as reflected e.g. by Samsung's purchase of the German TV-tube manufacturer "Fernsehglas Tschenetz" in 1994.

On the other hand, South Korea has historically exhibited an Inward FDI Index lower that one. Consequently German investors should prefer market entry through greenfield investment. According to Mi-hui (2002) greenfield investment made up 68.4 percent of
These shielded facts are in accordance with our hypothesis that the active, quality rather
than price factors would suggest that these prices reflect differences in the assets' quality rather
at which distressed assets were sold, which ranged from 50 to 80 percent of
greater liquidity resulting from foreign exchange depreciation. The results differing price
more by new opportunities created by policy changes that encouraged MFA than by "prices", 1999.
Therefore, the greater MFA's contribution of assets have been shown
free (by 50 percent) in 1999 to 1999 despite a 15 percent appreciation of the won beginning in
only short up to $9 billion in 1998-was time higher than in 1997-98, also continued to
incur, last from the crisis and recovered pattern. Cross-border MFA transactions and
at the same price. Cross-border mergers and acquisitions were higher in Korea, which
increase resulted in the loss of assimilating that significant amounts of assets were sold.
reduced. However, recently, Mody and Negishi (2001) have reported that "the limited extent
the "new" MFA wave in Korea can not be sufficiently discerned
such pricing schemes of the new MFA wave in Korea can not be sufficiently discerned
meant (and costs, e.g., potential enhanced global competition favors or promotes) the
incentive to potential short and longer-term benefits (e.g., asset-strengthening policies direct interest.
emerging and re-emergence of relatively small multinational's a conservative answer is
activities of German enterprises (see Table 2 for some example).
However, recently, South Korea has removed their PFI restrictions enabling the MFA
production subsidies in Korea.

<table>
<thead>
<tr>
<th>Table 2 Cross-border MFA Entiy into Korea by German Enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
</tr>
<tr>
<td>------</td>
</tr>
<tr>
<td>2000</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>1999</td>
</tr>
</tbody>
</table>

Note: Data compiled from various sources.
5 Conclusion

A. Investment in R&D, affect the cost $I_{ref}$ in phase two as illustrated in Figure (5). (e) effect.

B. Market penetration is an outcome that the policyholder, such as the encouragement of Korean penetration. It is concerned that the policyholder is in the market in increasing levels of markets and acquisitions for been observed in E. in January through MEA an increase in the effect (5), effect (B) certain policyholders should be underserved above. If such interactions, that potential real localizational advantages may be inter-

Figure 5: Influence of Policy Reforms
Appendix 6

Investment under uncertainty: a partial compound option may be well

protected mode of entry given high levels of location-specific attractiveness.

strategies were employed set-up while cross-border mergers and acquisitions are the
day for companies to enter markets of countries characterized by low location-specific

Exercises (14.1-14.3 cont.):

(14.1) \[ \frac{\partial^2 V}{\partial^2 x} + \left[ \frac{2}{1} - \frac{\partial^2 V}{\partial x^2} \right] + \frac{\partial^2 V}{\partial x^2} = \frac{1}{d} \]

with

(14.2) \[ \psi^{(1)} V + \psi_{V}(\gamma) = (\gamma) \frac{\partial^2 V}{\partial x^2} \]

for \( x \leq a \). The general solution to the above second differential equation has the

(14.3) \[ 0 = \frac{\partial^2 V}{\partial x^2} - \frac{\Delta \theta}{\Delta \theta} \frac{\partial^2 V}{\partial x^2} + \frac{\Delta \theta}{\Delta \theta} \frac{\partial^2 V}{\partial x^2} = \frac{1}{d} \frac{\partial^2 V}{\partial x^2} \]

As the value of the corresponding possibility of \( (\lambda) \) \( (\lambda) \frac{\partial^2 V}{\partial x^2} \) and \( \psi_{V}(\gamma) (\gamma) \frac{\partial^2 V}{\partial x^2} \) are determined. The values of the first \( (\lambda) \) \( (\lambda) \frac{\partial^2 V}{\partial x^2} \) are solved for respectively. The values of the second \( (\lambda) \) \( (\lambda) \frac{\partial^2 V}{\partial x^2} \) are used in the recursive determination of the recursive investment (may now

The value of the corresponding possibility of \( (\lambda) \) \( (\lambda) \frac{\partial^2 V}{\partial x^2} \) and \( \psi_{V}(\gamma) (\gamma) \frac{\partial^2 V}{\partial x^2} \) are used in the recursive determination of

Exercises (14.1-14.3 cont.):
\[ I + \left( \varepsilon, \Lambda \right) \frac{\Delta P}{\varphi P} = \left( \varepsilon, \Lambda \right) \frac{\Delta P}{\varphi P} \]
\[ \rho \frac{\xi}{I} - \Lambda + \left( \varepsilon, \Lambda \right) \xi I = \left( \varepsilon, \Lambda \right) \xi I \]
\[ 0 = (0) \xi I \]

That option is expected of not. Thus is that the boundary condition according to which case one is examining change given. The implication being (cases of the case \( \varepsilon \), \( \Lambda \) < \( \varepsilon, \Lambda \) \( \forall \) (general investment). However, now one must examine whether the case (a) \( \varepsilon, \Lambda \) < \( \varepsilon, \Lambda \) \( \forall \) (general investment)

\[ \varepsilon, \Lambda \xi V + \psi, \Lambda \xi V = (\Lambda) \xi I \]

Solution form:
Equation (10) is applied to obtain the differential equation (2), which has the general form: The derivation of the above one integer point is analogous to section 6.1. The Bellman

6.2. Threshold Value of Stage One

\[ \frac{\xi}{\sigma_{\xi}} + \left[ \frac{\xi}{I} - \frac{\xi}{\sigma} \left( \frac{1}{I} \right) \right] \left[ \frac{\xi}{I} - \frac{\xi}{\sigma} \left( \frac{1}{I} \right) \right] = \xi I \]
\[ (\theta + 1) \frac{\xi}{I} \psi, \Lambda \frac{\xi}{I} = \xi V \]
\[ \frac{(\theta + 1) \psi, \Lambda \xi - \xi I}{\psi, \Lambda \xi I} = \xi I \]

With:

\[ \begin{cases} \varepsilon, \Lambda \leq \Lambda \quad \Rightarrow \quad \rho \frac{\xi}{I} - \Lambda (\theta + 1) = (\Lambda) \xi I \\ \varepsilon, \Lambda > \Lambda \quad \Rightarrow \quad \psi, \Lambda \xi V \end{cases} \]

The value of the investment possibility from equation (2) is obtained as:

\[ (\theta + 1) = (\varepsilon, \Lambda) \frac{\Delta P}{\varphi P} \]
\[ \rho \frac{\xi}{I} - \varepsilon, \Lambda (\theta + 1) = (\varepsilon, \Lambda) \xi I \]
\[ 0 = (0) \xi I \]

Under consideration of the following restrictions:

6.1. Threshold Value of Stage Two
(38) \[
\frac{\varepsilon^0}{\varepsilon^0} + \left[ \frac{\varepsilon^0}{\varepsilon^0} \right] \Lambda + \frac{\varepsilon^0}{\varepsilon^0} = \Lambda
\]

(39) \[
(\theta + z) \frac{1}{1 - \varepsilon^0} = \varepsilon^0 V
\]

(40) \[
\frac{(\theta + z)}{1 - \varepsilon^0} = \varepsilon^0 L
\]

with:

\[
\begin{align*}
\varepsilon^0 L < \Lambda & \quad f^1 \quad \Lambda^I - \Lambda^I - \Lambda^I - \Lambda^I \\
\varepsilon^0 L > \Lambda & \quad f^1 \quad \varepsilon^0 L^V = \Lambda^V
\end{align*}
\]

It follows then:

\[
(\theta + z) = (\Lambda^I) V^P
\]

\[
\Lambda^I - \Lambda^I + \Lambda^I - \Lambda^I = (\Lambda^I) V^I
\]

\[
0 = (0) V^I
\]

Given the following restrictions:

The value of the investment possibility (\(\Lambda^I V^I\)) can now be determined.

6.2.3. Acquisitions and Attributes

\[
\begin{align*}
(38) \quad & \frac{\varepsilon^0}{\varepsilon^0} + \left[ \frac{\varepsilon^0}{\varepsilon^0} \right] \Lambda + \frac{\varepsilon^0}{\varepsilon^0} = \Lambda \\
(39) \quad & \frac{\varepsilon^0 + $\Lambda}{\varepsilon^0 + \varepsilon^0} = \varepsilon^0 V \\
(40) \quad & \frac{\varepsilon^0 + \varepsilon^0}{\varepsilon^0 + \varepsilon^0} = \varepsilon^0 L
\end{align*}
\]

with:

\[
\begin{align*}
\varepsilon^0 L < \Lambda & \quad f^1 \quad \Lambda^I - \Lambda^I - \Lambda^I - \Lambda^I \\
\varepsilon^0 L > \Lambda & \quad f^1 \quad \varepsilon^0 L^V = \Lambda^V
\end{align*}
\]

determined. Then:

Consequently the value of the investment possibility (\(\Lambda^I V^I\)) may be

\[
\begin{align*}
(38) \quad & \Lambda^I + (1 - \varepsilon^0 - \Lambda^I V^I) = (\Lambda^I) V^P \\
(39) \quad & \Lambda^I - \Lambda^I + \Lambda^I - \Lambda^I = (\Lambda^I) V^I \\
(40) \quad & 0 = (0) V^I
\end{align*}
\]

The following restrictions are valid:

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