Term Paper

FDI & Kuwait Law

International Business Operations

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Introduction

Foreign investment is the other side definition of the international business, hence all countries try to furnish a rules and regulations to the foreign investors to invest in their country and comply with its political strategy.

On the other hand, countries try also to benefit from those investors to enhance and improve its economic conditions and social situation of its own people.

The approach of each foreign investor is different from a firm to another and from an industry to another; therefore there are many approaches or ways that an investors believe about when thinking about entering a new market.

Kuwait has its own political and economic situation which allow it to have their own foreign investment Law in accordance with their objectives

We are going to discuss here about the foreign direct investment, entry mode, overview about Kuwait regulations and our own analysis of the best way of entering Kuwait market focusing on the main industries.

Foreign Direct Investment

Definition

Foreign direct investment (FDI) plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development. Foreign direct investment, in its classic definition, is defined as a company from one country making a physical investment into building a factory in another country. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment, which is considered an indirect investment. In recent years, given rapid growth and change in global investment patterns, the definition has been broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investing firm's home country. As such, it may take many forms, such as a direct acquisition of a foreign firm, construction of a facility, or investment in a joint venture or strategic alliance with a local firm with attendant input of technology, licensing of intellectual property, in the past decade, FDI has come to play a major role in the internationalization of business. Reacting to changes in technology, growing liberalization of the national regulatory framework governing investment in enterprises, and changes in capital markets profound changes have occurred in the size, scope and methods of FDI. New information technology systems, decline in global communication costs have made management of foreign investments far easier than in the past. The sea change in trade and investment policies and the regulatory environment globally in the past decade, including trade policy and tariff liberalization, easing of restrictions on foreign investment and acquisition in many nations, and the deregulation and privatizations of many industries, has probably been the most significant catalyst for FDI's expanded role.

The most profound effect has been seen in developing countries, where yearly foreign direct investment flows have increased from an average of less than $10 billion in the 1970's to a yearly average of less than $20 billion in the 1980's, to explode in the 1990s from $26.7billion in 1990 to $179 billion in 1998 and $208 billion in 1999 and now comprise a large portion of global FDI. Driven by mergers and acquisitions and internationalization of production in a range of industries, FDI into developed countries last year rose to $636 billion, from $481 billion in 1998 (Source: UNCTAD)

Proponents of foreign investment point out that the exchange of investment flows benefits both the home country (the country from which the investment originates) and the host country (the destination of the investment). Opponents of FDI note that multinational conglomerates are able to wield great power over smaller and weaker economies and can drive out much local competition. The truth lies somewhere in the middle.

For small and medium sized companies, FDI represents an opportunity to become more actively involved in international business activities. In the past 15 years, the classic definition of FDI as noted above has changed considerably. This notion of a change in the classic definition, however, must be kept in the proper context. Very clearly, over 2/3 of direct foreign investment is still made in the form of fixtures, machinery, equipment and buildings. Moreover, larger multinational corporations and conglomerates still make the overwhelming percentage of FDI. But, with the advent of the Internet, the increasing role of technology, loosening of direct investment restrictions in many markets and decreasing communication costs means that newer, non-traditional forms of investment will play an important role in the future. Many governments, especially in industrialized and developed nations, pay very close attention to foreign direct investment because the investment flows into and out of their economies can and does have a significant impact. In the United States, the Bureau of Economic Analysis, a section of the U.S. Department of Commerce, is responsible for collecting economic data about the economy including information about foreign direct investment flows. Monitoring this data is very helpful in trying to determine the impact of such investments on the overall economy, but is especially helpful in evaluating industry segments. State and local governments watch closely because they want to track their foreign investment attraction programs for successful outcomes.

How Has FDI Changed in the Past Decade?

As mentioned above, the overwhelming majority of foreign direct investment is made in the form of fixtures, machinery, equipment and buildings. This investment is achieved or accomplished mostly via mergers & acquisitions. In the case of traditional manufacturing, this has been the primary mechanism for investment and it has been heretofore very efficient. Within the past decade, however, there has been a dramatic increase in the number of technology startups and this, together with the rise in prominence of Internet usage, has fostered increasing changes in foreign investment patterns. Many of these high tech startups are very small companies that have grown out of research & development projects often affiliated with major universities and with some government sponsorship. Unlike traditional manufacturers, many of these companies do not require huge manufacturing plants and immense warehouses to store inventory. Another factor to consider is the number of companies whose primary product is an intellectual property right such as a software program or a software-based technology or process. Companies such as these can be housed almost anywhere and therefore making a capital investment in them does not require huge outlays for fixtures, machinery and plants.

In many cases, large companies still play a dominant role in investment activities in small, high tech oriented companies. However, unlike in the past, these larger companies are not necessarily acquiring smaller companies outright. There are several reasons for this, but the most important one is most likely the risk associated with such high tech ventures. In the case of mature industries, the products are well defined. The manufacturer usually wants to get closer to its foreign market or wants to circumvent some trade barrier by making a direct foreign investment. The major risk here is that you do not sell enough of the product that you manufactured. However, you have added additional capacity and in the case of multinational corporations this capacity can be used in a variety of ways.

High tech ventures tend to have longer incubation periods. That is, the product tends to require significant development time. In the case of software and other intellectual property type products, the product is constantly changing even before it hits the marketplace. This makes the investment decision more complicated. When you invest in fixtures and machinery, you know what the real and book value of your investment will be. When you invest in a high tech venture, there is always an element of uncertainty. Unfortunately, the recent spate of dot.com failures is quite illustrative of this point.

Therefore, the expanded role of technology and intellectual property has changed the foreign direct investment playing field. Companies are still motivated to make foreign investments, but because of the vagaries of technology investments, they are now finding new vehicles to accomplish their goals. Consider the following:

- Licensing and technology transfer. Licensing and tech transfer have been essential in promoting collaboration between the academic and business communities. Ever since legal hurdles were removed that allowed universities to hold title to research and development done in their labs, licensing agreements have helped turned raw technology into finished products that are viable in competitive marketplaces. With some help from a variety of government agencies in the form of grants for R&D as well as other financial assistance for such things as incubator programs, once timid college researchers are now stepping out and becoming cutting edge entrepreneurs. These strategic alliances have had a serious impact in several high tech industries, including but not limited to: medical and agricultural biotechnology, computer software engineering, telecommunications, advanced materials processing, ceramics, thin materials processing, photonics, digital multimedia production and publishing, optics and imaging and robotics and automation. Industry clusters are now growing up around the university labs where their derivative technologies were first discovered and nurtured. Licensing agreements allow companies to take full advantage of new and exciting technologies while limiting their overall risk to royalty payments until a particular technology is fully developed and thus ready to put new products into the manufacturing pipeline.
- Reciprocal distribution agreements. Actually, this type of strategic alliance is more trade-based, but in a very real sense it does in fact represent a type of direct investment. Basically, two companies, usually within the same or affiliated industries, agree to act as a national distributor for each other's products. The classical example is to be found in the furniture industry. A U.S.-based manufacturer of tables signs a reciprocal distribution agreement with a Spanish-based manufacturer of chairs. Both companies gain direct access to the other's distribution network without having to pay distributor support payments and other related expenses found within the distribution channel and neither company can hurt the other's market for its products. Without such an agreement in place, the Spanish manufacturer might very well have to invest in a national sales office to coordinate its distributor network, manage warehousing, inventory and shipping as well as to handle administrative tasks such as accounting, public relations and advertising.
- Joint venture and other hybrid strategic alliances. The more traditional joint venture is bi-lateral, that is it involves two parties who are within the same industry who are partnering for some strategic advantage.

Typical reasons might include a need for access to proprietary technology that might tip the competitive edge in another competitor's favor, desire to gain access to intellectual capital in the form of ultra-expensive human resources, access to heretofore closed channels of distribution in key regions of the world. One very good reason why many joint ventures only involve two parties is the difficulty in integrating different corporate cultures. With two domestic companies from the same country, it would still be very difficult. However, with two companies from different cultures, it is almost impossible at times. This is probably why pure joint ventures have a fairly high failure rate only five years after inception. Joint ventures involving three or more parties are usually called syndicates and are most often formed for specific projects such as large construction or public works projects that might involve a wide variety of expertise and resources for successful completion. In some cases, syndicates are actually easier to manage because the project itself sets certain limits on each party and close cooperation is not always a prerequisite for ultimate success of the endeavor.

- Portfolio investment. Yes, we know that you're paying attention and no we're not trying to trip you up here. Remember our definition of foreign direct investment as it pertains to controlling interest. For most of the latter part of the 20th century when FDI became an issue, a company's portfolio investments were not considered a direct investment if the amount of stock and/or capital was not enough to garner a significant voting interest amongst shareholders or owners. However, two or three companies with ″soft″ investments in another company could find some mutual interests and use their shareholder power effectively for management control. This is another form of strategic alliance, sometimes called ″shadow alliances″. So, while most company portfolio investments do not strictly qualify as a direct foreign investment, there are instances within a certain context that they are in fact a real direct investment.

Why is FDI important for any consideration of going global?

The simple answer is that making a direct foreign investment allows companies to accomplish several tasks:

1. Avoiding foreign government pressure for local production.

2. Circumventing trade barriers, hidden and otherwise.
3. Making the move from domestic export sales to a locally-based national sales office.
4. Capability to increase total production capacity.
5. Opportunities for co-production, joint ventures with local partners, joint marketing arrangements, licensing, etc.;

A more complete response might address the issue of global business partnering in very general terms. While it is nice that many business writers like the expression, "think globally, act locally", this often used cliché does not really mean very much to the average business executive in a small and medium sized company. The phrase does have significant connotations for multinational corporations. But for executives in SME's, it is still just another buzzword. The simple explanation for this is the difference in perspective between executives of multinational corporations and small and medium sized companies. Multinational corporations are almost always concerned with worldwide manufacturing capacity and proximity to major markets. Small and medium sized companies tend to be more concerned with selling their products in overseas markets. The advent of the Internet has ushered in a new and very different mindset that tends to focus more on access issues. SME's in particular are now focusing on access to markets, access to expertise and most of all access to technology.

What would be some of the basic requirements for companies considering a foreign investment?

Depending on the industry sector and type of business, a foreign direct investment may be an attractive and viable option. With rapid globalization of many industries and vertical integration rapidly taking place on a global level, at a minimum a firm needs to keep abreast of global trends in their industry. From a competitive standpoint, it is important to be aware of whether a company's competitors are expanding into a foreign market and how they are doing that. At the same time, it also becomes important to monitor how globalization is affecting domestic clients. Often, it becomes imperative to follow the expansion of key clients overseas if an active business relationship is to be maintained.

New market access is also another major reason to invest in a foreign country. At some stage, export of product or service reaches a critical mass of amount and cost where foreign production or location begins to be more cost effective. Any decision on investing is thus a combination of a number of key factors including:

1. assessment of internal resources;
2. competitiveness;
3. market analysis;
4. and market expectations.

From an internal resources standpoint, does the firm have senior management support for the investment and the internal management and system capabilities to support the set up time as well as ongoing management of a foreign subsidiary? Has the company conducted extensive market research involving both the industry, product and local regulations governing foreign investment which will set the broad market parameters for any investment decision? Is there a realistic assessment in place of what resource utilization the investment will entail? Has information on local industry and foreign investment regulations, incentives, profit retention, financing, distribution, and other factors been completely analyzed to determine the most viable vehicle for entering the market (Greenfield, acquisition, merger, joint venture, etc.)? Has a plan been drawn up with reasonable expectations for expansion into the market through that local vehicle? If the foreign economy, industry or foreign investment climate is characterized by government regulation, have the relevant government agencies been contacted and concurred? Have political risk and foreign exchange risk been factored into the business plan?

Entry Modes

Introduction:

With years entry modes has been always the key of success of each investor that are s trying to take the advantage of entering a foreign market opportunity. Therefore the one million dollar question of each investor is “what kind of strategy should be used for the entry mode selection?”

To answer such a question you need to spend a huge amount of time and money on the marketing research. Not only that but it also needs to study the implementation of your strategy.

Moreover, explaining the answer of this question will really take more the anticipated time and size to be explained in this term paper. Therefore we will be having an overview on the entry modes that would be sufficient to understand each one.

Influencing Factors:

Your choice of entry mode shall be similar to your neighbor entry mode even if you both provide the same product or service. It is very critical to look after all the factors that shall be considered in your marketing research and implementation plan.

Below are the factors that we believe that affect the entry mode decision:

1. Internal Factor:

Firm Size

It is very important to realize your firm size in term of resources, whether it is financial or human resources. If all your marketing research provided you with a 100% guarantee of success with an entry mode, a failure might be an option if you didn’t realize the firm size.

Example: Will it be feasible for a sun glasses manufacture to open a subsidiary in another country!

Product/Service:

Provided that your neighbor succeed in his business with his choice of entry mode, you have to realize what is the product he is trying to sell (product in marketing definition is either physical product or in intangible service). And based on that analyze your own and see if your research support your entry mode with your product.

Example: Can you provide oil and gas services by export mode!

2. External Factors:

Country Risk:

There is always a risk behind going international; here we are not discussing such type of risk that risk is equal for all countries.

What we are discussing here is the additional amount of risk due to our choice of that specific country, in term of it political stability and its relation with all countries around it and more importantly its relation with your country.

Such a risk will always be considered first in your choice of country. Not only that but also in your entry mode.

Example: Do you believe that you can establish your own subsidiary in Iraq or Afghanistan now? Though it might be very profitable but still risky!

Market growth:

The market growth in the targeted country is a factor that you considered initially before making the choice of the country. But here you have to analyze the relation between the market growth and your entry mode.

Example: Do you think that with a booming market you consider only export mode of your product! Could be and could lose a great opportunity.

3. Investor Culture:

Risk Averse

If the decision maker a risk averse, he will probably will prefer consider the factors in a very conservative way.

Therefore this will really influence his decision in the entry mode.

Example: Dr. Saad Al Barrak and his desire to go internationally compared with a local family owned business.

Control

Companies which have their unique identity and want to reserve this identity all around the world probably will take this factor as the most important one and the best example of it is Starbucks & McDonald's.

Entry Modes:

Here we are going to explain briefly about the entry modes, a detailed explanation will take more than the anticipated time and efforts for this paper.

Modes are:

Export modes:

This is the most secured and conservative modes that basically you send you products to that targeted country and a representative from that country takes care of the rest. It is as selling your product for an international customer.

It has many ways:

Indirect export modes

It occurs when using independent organizations located in the targeted foreign market, simply by considering the said organization as a domestic customer.

Examples of the organization are:

i. Export buying agent
ii. Broker
iii. Export management company
iv. Trading company

Direct export modes

It occur when the firm sells the products to an importer or the final user at the targeted foreign market

Examples of those importers are:

i. Distributer
ii. Agents

Cooperative export modes

It is when multiple of company wants to target a specific foreign market and they have different product.

They rely on this mode to save money of the logistics.

Advantages of this mode are:

1. Limited commitment and investment required
2. Access to the local market experience and contacts with potential customers
3. Shared cost and risks of internationalization.

Disadvantages of this mode are:

1. No or limited control of the marketing mix elements other than the product
2. Risk are unbalanced.
3. Limited marketing experience in the market.

Intermediate mode

They call it a contractual mode, which describe the main function of this mode. You will have to sign a contract with another firm to start your business in this particular country/region.

It has many options that each one can be explained in a book:

a) Contract manufacturing

Basically is that you move you plan or create a new plan in different location and another local firm will make the production from that location and you will be in charge for marketing and financing.

b) Licensing and Franchising:

We merged them together because it is very difficult to distinguish between those two options in brief. But basically they both function that you provide you pattern to a local company which will take care of selling your product in that market. Difference between licensing and franchising might include but not limited to:

- Control
- Contract term
- Goodwill presence

c) Joint venture or strategic alliance.

This is usually made in international business for the following reasons:

1. Complementary technology, management and technicality.
2. Partnering in host country presence
3. Regulations of the targeted countries

Modes Advantages and Disadvantages:

Advantages of this mode are including but not limited to:

1. Increase the income on product that already developed and costs money on the research.
2. Access market with larger scale of experience of technical ability
3. Less risk than hierarchical mode
4. Great degree of control

Disadvantages of this mode are including but not limited to:

1. Transfer of production know-how is difficult and dangerous for competition.
2. Sharing profit with others
3. More risk than export mode.

Hierarchical Modes:

It is the modes where the firm controls and owns the foreign entry mode completely. It means that the whole operation of the entry will be under the mother company but still how much of that control from the mother company comes from the strategy allocated to that subsidiary.

Structure of the new firm has many prospective that depends on the strategy of the mother company toward this subsidiary or toward the product/service provided in this particular country/region.

The differentiation between each structure/mode is the following:

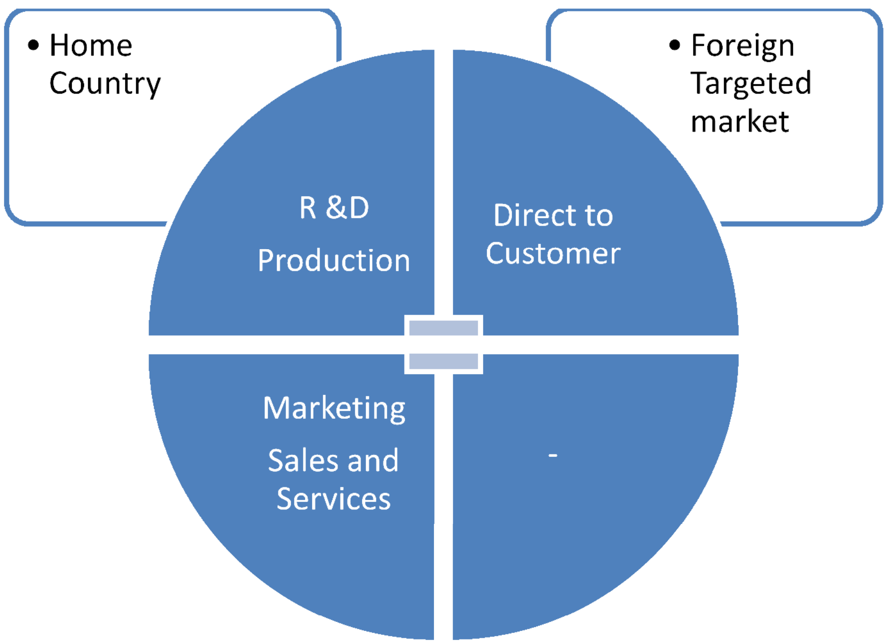
i. Research and development
ii. Production
iii. Marketing

iv. Sales and services

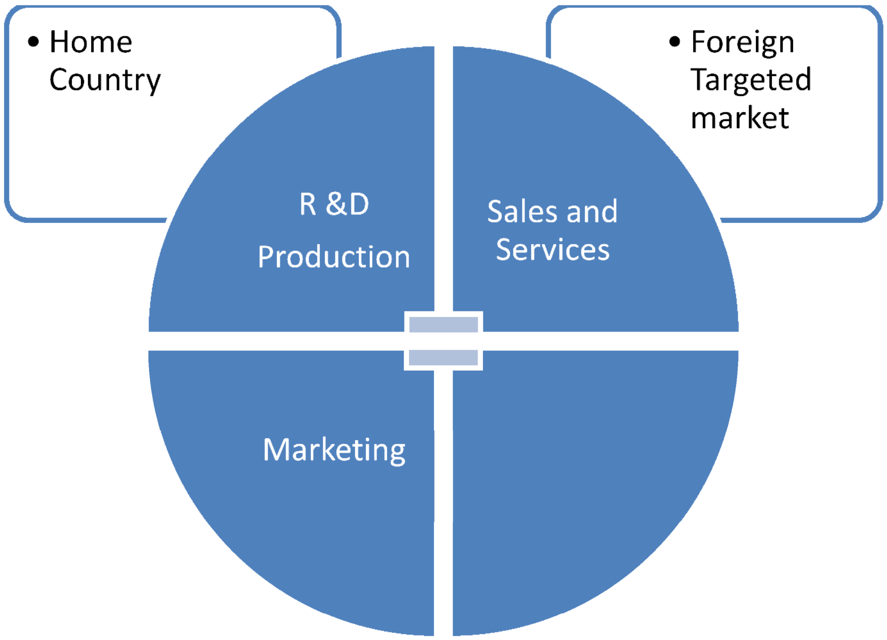
Examples of the structures or modes of entry for the hierarchical modes are:

Note: left areas represent what is responsibility of Home Country while right area represent the responsibility of the Foreign targeted market

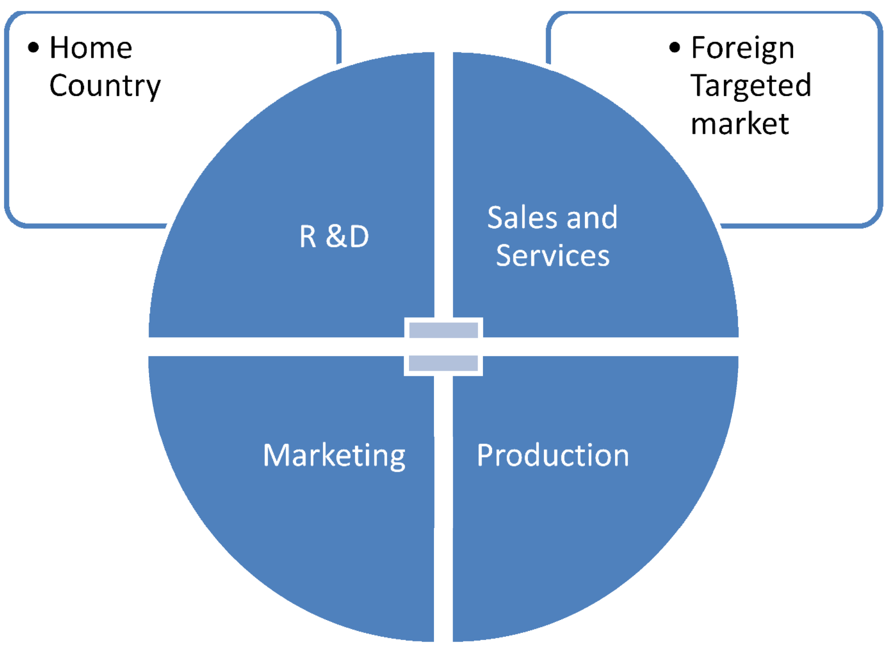
Domestic based sales representative / manufacture's own sales force



Resident Sales Representative/Sales Branch

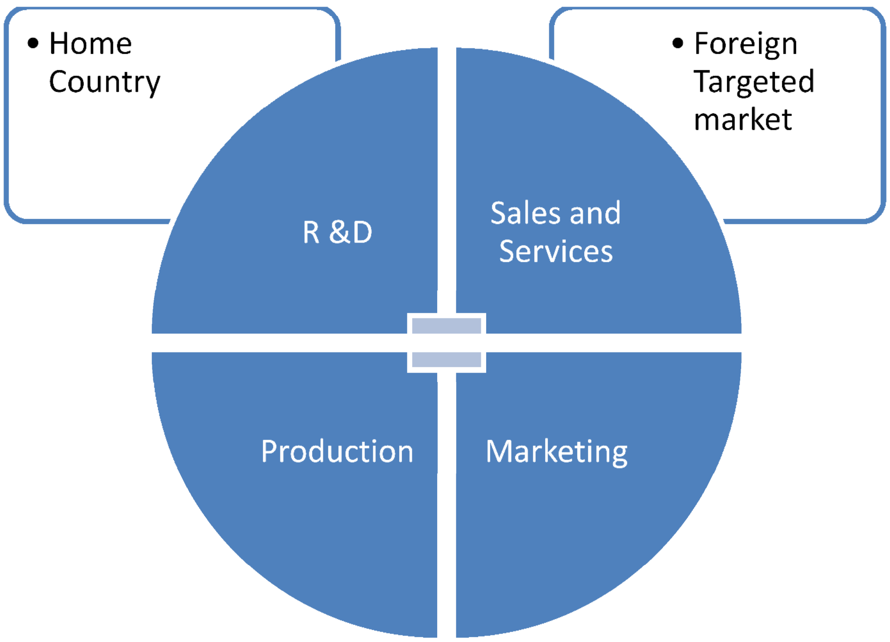


Sales and Production Subsidiary

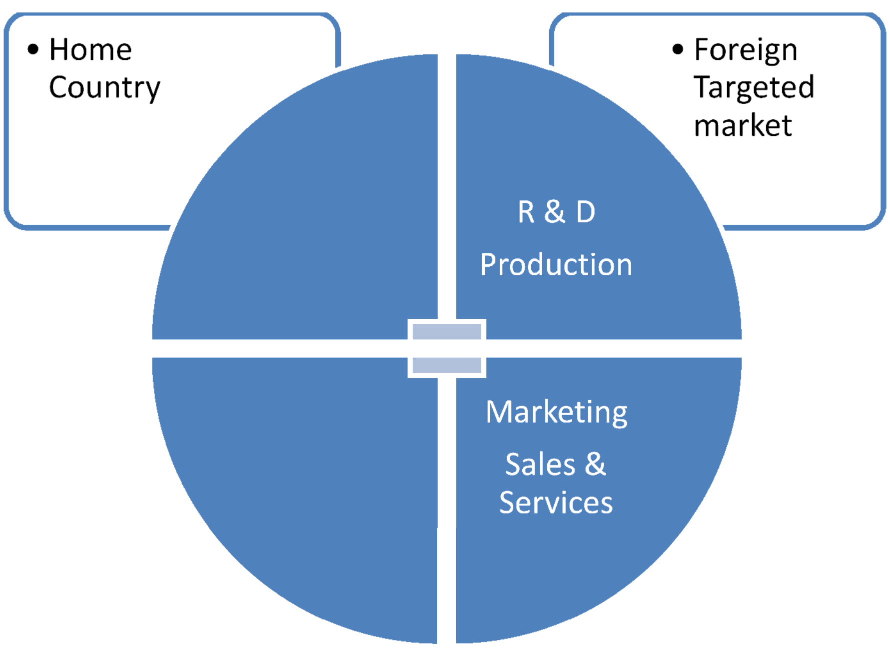


Region Center:

Option A



Option B



Establishment of the wholly owned Subsidiary

All previous modes and structure and formed on the following ways:

Acquisition:

Its name really self-explanatory and it allows you for a rapid entry into the market especially if the acquired firm was well organized.

Greenfield investment:

It is to furnish the new subsidiary from all prospective going through all the channels and formalities of the targeted country.

It allows you to integrate between all subsidiaries by forming the company in the way that can match your strategy.

Advantage and disadvantages of that mode:

Advantages are:

i. Control on all activities
ii. High profit
iii. Close contact with the customers
iv. Achieve synergies on global scale
v. Rapid and strong entry to the new market (in case of acquisition)

Disadvantages are:

i. High investment cost
ii. High risk
iii. Taxation problem

Overview on Kuwait's Foreign Direct Investment Laws and Regulations

Among all GCC countries, Kuwait is the least country in the region in FDI stocks as shown in below table. And that's due to the laws and regulations provided from the Kuwaiti government.

FDI Stocks, Middle East, $m

	1995	2000	2001
Bahrain	2.403	5.772	5.864
Kuwait	12	527	487
Oman	2.210	2.480	2.529
Qatar	451	1.920	2.158
Saudi Arabia	915	1.699	1.904
UAE	1.770	1.836	1.681

We will not be explaining the FDI of Kuwait but we will have an overview about the obstacles and the Kuwaiti's prospect toward FDI.

Obstacles:

- *Restricted regulations on fully owner firm in Kuwait*,

Hence you will not have the ability of owning the firm located in Kuwait and that almost eliminate the heretical modes.

- *Difficulties in entering and leaving the country*,

In another way the sponsorship restriction. Example of that Zain telecommunications company shifted their HQ to Bahrain due to that reason where the government has rejected some key personnel that Zain are trying to invite in Kuwait to do business with them and that was declared by Dr. Saad Al Barrak many times through the media channels.

Kuwaiti Stand point toward those obstacles:

- *Restricted regulations on fully owner firm in Kuwait*,

After " Al Manakh Recession" in the beginning of 80s n the previous century Kuwait had a lesson learned of not allowing the FI to control and have a heavy weight in their economy and that prove itself on the recent financial crisis where local Kuwaiti company didn't affected as much as international firms.

- *Difficulties in entering and leaving the country*,

Due to the political situation in Kuwait, especially that it is s small country surrounded by three big countries and with the amount of wealth owned by Kuwait. They have to consider any stability threats that might be coming from the surrounded countries and control more the resident of Kuwait.

Analysis of Entry Modes for Kuwait per Industry

We will provide our own analysis of the best entry modes on some of the industry in Kuwait based on the previous data provided in the paper

Industries are:

Services:

Since Kuwait has a great opportunity in this industry provided that more than 90% of the GDP of Kuwait come from oil and gas industry, therefore services is the most influenced industry in the Kuwait economy.

I believe that international companies are successful in the intermediate mode which they allow a local partner in Kuwait to support then from his management and part of the financials and they take care of the technical part of it.

Food & Restaurants and Fashion

It is really attractive industry in Kuwait specially that Kuwait is a very conservative country that doesn't allow a night life.

Food industry really successful in Kuwait and they successful modes was usually the intermediate modes where they franchise or license their product to a local company.

Example of that Al Shaya Group where they franchise most of the food and restaurant industry and they are very successful in it.

Production:

Most of the companies prefer to enter Kuwait market through the export modes which really relief them from the bureaucracy headache in Kuwait.

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