The Investment Development Path and Small Developed Economies
– The Case of Finland

Maria Sangder
S051574
Spring 2009
Supervisor:
Associate Professor
Tor Fredriksen

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
ABSTRACT

This study examines the development of foreign direct investment in Finland in relation to the Investment Development Path model and other small developed economies. The study attempts to understand the involvement of foreign direct investment and government involvement in the transformation of Finland’s natural assets to created assets and understand the affects of foreign direct investment on Finland’s development as an economy. It is concluded that the transformation into a knowledge economy and development of created assets in Finland has been due to a complex combination of foreign direct investment activity and government involvement. It is also concluded that there have been positive affects from inward foreign direct investment to the Finnish economy, but that future research should be conducted in order to be able to make suggestions for future policy.

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
# TABLE OF CONTENTS

**ABSTRACT** ........................................................................................................................................ 1  
**TABLE OF CONTENTS** ...................................................................................................................... 2  
**FOREWORD** ....................................................................................................................................... 4  
**BACKGROUND AND INTRODUCTION** ........................................................................................... 5  
**SECTION ONE: LITERATURE REVIEW ON FOREIGN DIRECT INVESTMENT**  
AND THE INVESTMENT DEVELOPMENT PATH AND METHODOLOGY OF STUDY  
1.1 Literature Review – Foreign Direct Investment and The Investment Development Path .......................... 7  
1.2 The Investment Development Path .................................................................................................. 9  
1.2.1 Stage One .................................................................................................................................... 13  
1.2.2 Stage Two .................................................................................................................................... 14  
1.2.3 Stage Three .................................................................................................................................. 16  
1.2.4 Stage Four .................................................................................................................................... 18  
1.2.5 Stage Five .................................................................................................................................... 19  
1.3 Methodology ..................................................................................................................................... 21  
1.4 Data .................................................................................................................................................. 22  
**SECTION TWO: THE INVESTMENT DEVELOPMENT PATH AND SMALL DEVELOPED ECONOMIES**  
2.1 Definition of Small Developed Economies ......................................................................................... 23  
2.2 Foreign Direct Investment Data for Small Developed Economies Compared and Discussed ....................... 24  
2.3 Literature Review on Countries that Individual Investment Development Path Studies have been Performed for .......................................................................................................................................... 28  
2.4 Net Outward Investment Position Statistics for Small Developed Economies Compared and Discussed .................................................................................................................................. 30  
**SECTION THREE: FINLAND AND THE INVESTMENT DEVELOPMENT PATH**  
3.1 Foreign Direct Investment and Net Outward investment Position Data for Finland ................................. 37  
3.2 FDI and Finland – A Historical Overview ......................................................................................... 47  
3.2.1 The Early Years – Autonomy and Industrialisation ....................................................................... 47  
3.2.2 The First Decades of Independence to Beyond the Second World War – Very Little International Activity .................................................................................................................................................. 49  
3.2.3 The 1960s to the 1980s – Attitudes Towards Internationalisation begin to Change ......................... 51  
3.2.4 The 1990s – A Clear Turn in the FDI Environment in Finland ......................................................... 53  
3.3 FDI and Finland – By Economic Activity and Sector ........................................................................... 55  
3.4 Motives of Foreign Direct Investment into and out of Finland ................................................................ 60  
3.4.1 Investment Motives for Investment into the Finnish Economy ..................................................... 61  
3.4.2 Investment Motives for Investment out of the Finnish Economy ................................................ 65  
3.5 Ownership Location and Internalisation Advantages in Finland and the Affects of Foreign Direct Investment in Finland ........................................................................................................................ 67  

---

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
3.6 Finland and the Investment Development Path – Assessing the Fit of the Model to the Economy and where Finland might Lie on the Path.................77
SUMMARY, CONCLUSIONS AND DISCUSSION.............................................81
REFERENCES ...................................................................................................87
FOREWORD

Foreign direct investment and the affect it has on host economies has been a special interest of mine throughout my academic career. The interest began while I studied for my Bachelor’s degree in the U.K., while attending a course by Professor Jim Love. Then, when possible, I often geared my own research projects around the subject. At that time, however much of the research was on a quite general level and was more geared toward the affects of FDI on developing economies, as is the majority of academic research on the subject. Over the years my interest into FDI remained and I became increasingly interested in the affects of foreign direct investment on more developed economies. I became more interested in the affects that it had had on the development of the Finnish economy. Then during the Finnish presidential election campaign in 2005 the conservative candidate emphasised the need to further encourage foreign investment into the Finnish economy. Based on my earlier research into the affects of FDI on the host economy, I was sceptical that this was necessarily the correct policy. My assumption of the time was that much of the FDI into Finland was strategic asset seeking and that the benefits to Finland as a host economy would be limited from this. Based on this interest, I then chose to look into this subject in my own Master’s Thesis to see if my initial assumptions were justified.

While on exchange at the Helsinki School of Economics I attended a course by Dr. Joanna Scott-Ken nel, who is specialised in foreign direct investment and small developed economies. She proceeded to help me a great deal in formulating the research questions of this thesis. I would like to acknowledge both Professor Jim Love and Dr. Joanna Scott-Ken nel, for how they have inspired my interest in foreign direct investment. I would especially like to acknowledge Dr. Joanna Scott-Ken nel for all her support and help in my work on thesis and my thesis advisor, Associate Professor Tor Fredriksen for his help and flexibility as I was finishing this work.
BACKGROUND AND INTRODUCTION

There has been an ongoing debate within International Business literature about the affects of foreign direct investment of multinational enterprises on the host economy. The majority of the studies into the subject have, however concerned either developing or larger economies. Only recently has more focus been on smaller, developed economies and the affects of foreign investment in those. Yet, most economies, smaller and large, developing and developed, are focused on attracting inward foreign direct investment.

Finland can be classified as a small and developed economy and has a government supported agency, Invest in Finland, that actively promotes inward direct investment into the economy. This said, there is little academic research that has been done into the affects of foreign direct investment on the Finnish economy. In order to be able to understand whether or not foreign direct investment into the economy should be promoted, an understanding of the level of foreign direct investment in the economy and the affect that that has had on the economy should be formed.

John Dunning’s Investment Development Path (IDP) stipulates that foreign multinational enterprises might help indigenous firms to upgrade their capabilities, and thus aid the economy in its development. The model identifies five stages along which countries can lie and suggests that inward foreign direct investment stimulates the host economy and its economic development and as such, assists the economy in moving from one stage to the other along the IDP. There is, however, little research that has been done into how inward foreign direct investment prompts indigenous firms to upgrade their ownership advantages. Before being able to access whether foreign multinationals have aided small economies to move along the IDP and how, the countries’
movements along the Investment Development Path must first be studied. As far as the author can find Finland’s IDP has not been mapped.

This study examines how the development of foreign direct investment in small developed economies relates to the Investment Development Path, specifically focusing on Finland. It studies Finland’s history with foreign direct investment and how the economy’s development in relation to foreign direct investment fits into the model. The study attempts to understand at what stage of the Investment Development Path Finland lies on and how it relates to other small developed economies. Through this the study attempts to gain some understanding into the affects of foreign direct investment on the development of the Finnish economy and formulate a picture of whether foreign direct investment has had a positive affect on the economy and thus, whether the active promoting of more foreign direct investment into the economy is justified.

The study is divided into three sections. The first section focuses on understanding foreign direct investment and the Investment Development Path and outlines a methodology for the study as well as discusses the statistical data used. The second section concentrates on small developed economies and their relationship to foreign direct investment and the Investment Development Path.

The third and final section focuses on Finland in relation to the Investment Development Path model. In the final section a historical overview into Finland and foreign direct investment is performed and statistical data on foreign direct investment in and out of the Finnish economy is analysed to form an understanding on where Finland lies along the investment Development Path. The final section also attempts to understand the motivation behind foreign direct investment in Finland and the possible ownership, location and internalisation advantages within the economy and through all of this understand the net affect of foreign direct investment on the Finnish economy.

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
1.1 Literature Review – Foreign Direct Investment and The Investment Development Path

A constant debate within academia over the last thirty years has been the effect that foreign direct investment (FDI) has on its host country. Foreign direct investment is investment by a Multi-National Enterprise (MNE) into foreign organizations. FDI is conducted either by buying a controlling share of an already existing organization or by Greenfield investment, and thus differs from portfolio investment abroad or simply buying shares abroad. Greenfield investment is a term used to describe the investment of new facilities or the expansion of existing ones.

Prior to the seventies foreign direct investment was viewed as a fairly neutral way of transferring capital, technology, management and skills into developing countries (Lall, 1975). In the 1970s, however, sceptics of FDI began to fear that multinational enterprises were gaining too much control and economists started to examine the effects of FDI on host countries. The consensus then seemed to be that the actions of MNEs must be regulated and thus many developing countries set up strict restrictions on the amounts and types of FDI allowed. In the 1980s the prevailing view started to change due to several factors. Firstly, the economic realities of the time forced many governments to seek financial and other investment from abroad. The short term relief that the loans from foreign banks had offered turned destructive as the third world slumped into a debt crisis in 1982 (Bhattacharya et al, 2004) which also effected the debtor countries in the...
North. Secondly, some critics were reassured by positive examples of FDI in the newly industrialized countries (NICs). More research had also been carried out and more empirical evidence was available that tended to indicate positive effects of FDI were available. Also it was suggested that foreign direct investment could also have indirect effects on the host economy, referred to as spillovers. In the eighties and nineties numerous empirical studies were performed investigating spillover effects (Barrel & Pain 1997, Blomstöm & Kokko 1998, Driffield & Love 2002 amongst others) and the general opinion appeared that they were largely positive.

As mentioned, the affects of multinational enterprises and foreign direct investment on host economies has been researched extensively over the past decades. It has been put forward by Dunning (1993) that the consensus is that there are three factors in particular that affect the role of FDI and multinational enterprises in an economy, and aid in the development of growth and structure of that economy:

1) The type of Foreign Direct Investment taken
2) The structure of the resources and capabilities of the host economy, the location specific assets
3) The macro-organizational and structural policies pursued by the government.

The nature of FDI has also altered with time. Originally it was put forward that most foreign direct investment was one of three kinds; efficiency seeking, resource seeking or market seeking. Offshoring embodies both the efficiency seeking and resource seeking kinds. When a firm seeks location bound assets such as cheaper labour or natural resources of a host economy they are engaging in efficiency or resource seeking investment. Market seeking investment tends to be where firms seek to exploit the competitive advantage that they might have and attempt to access a wider and new market for their
product or service. Later, it has been hypothesized that there is also a fourth type of foreign direct investment, namely strategic asset seeking. It has been noted, that at times firms enter a certain market in order gain what could be characterised in reverse spillover effects. If for example technological knowledge in a certain field exists within a market a firm might invest in that market in order to gain that knowledge and therefore enhance their competitiveness.

As with the affects of FDI on a host economy, the governments’ roles in encouraging inward and outward FDI have also been debated. Like with many debates, no clear consensus on the right way to act has come to be. Related to the topic of government involvement and FDI, as well as the affect that multinational enterprises have on aiding an economy in its development the Investment Development Path framework has formed.

1.2 The Investment Development Path

The Investment Development Path (IDP) is based on the notion that the outward and inward direct investment position of an economy is systematically related to its economic development that was first put forward by John Dunning in 1979 (Dunning & Narula, 1996). Since then both Dunning and other authors have revisited and extended upon the model. The Investment Development Path suggests that countries are likely to go through five different stages of development and that these stages can be classified according to the tendency of those countries to be outward and/or inward direct investors. The model maps economies into these stages with the aid of determining their Net Outward Investment Position (NOIP) as shown in the figure below, which can be calculated by subtracting the gross inward direct investment stock of an economy from the gross outward direct investment stock (Dunning & Narula, 1996).
Figure 1.1. The Pattern of the Investment Development Path (Dunning & Narula, 1996 pg. 2)

*Note: Not drawn to scale- for illustrative purposes only*

The Investment Development Path was originally put forward in order to show the relevance of the eclectic paradigm in explaining the net outward investment position of countries (Dunning & Narula, 1996).

Dunning developed the eclectic paradigm in the late 1970s and early 1980s (Dunning, 1988), to describe the nature of the international economic involvement. Within the discussion around the eclectic paradigm Dunning defines the ownership specific, location specific and internalisation advantages that he argues explain the participation of multinational enterprises in foreign direct investment (these definitions are shown in the table below).
Table 1.1 The Eclectic Paradigm of International Production (Dunning, 1998 pg. 27)

1. Ownership-Specific Advantages (of enterprises of one nationality (or affiliates of same) over those of another)
   a. Property right and/or intangible asset advantages
      Product innovations, production management, organizational and marketing systems, innovatory capacity; non-codifiable knowledge; ‘bank’ of human capital experience; marketing, finance, know-how, etc.
   b. Advantages of common governance
      i. Which those branch plants of established enterprises may enjoy over de novo firms. Those due mainly to size and established position of enterprise, e.g. economies of scope and specialization; monopoly power, better resource capacity and usage. Exclusive or favoured access to inputs, e.g. labour, natural resources, finance, information. Ability to obtain inputs on favoured terms (due e.g. to size or monopsonistic influence). Exclusive or favoured access to product markets. Access to resources of parent company at marginal cost. Economies of joint supply (not only in production, but in purchasing, marketing, finance, etc., arrangements).
      ii. Which specifically arise because of multinationality. Multinationality enhances above advantages by offering wider opportunities. More favoured access to and/or better knowledge about international markets, e.g. for information, finance, labour, etc. Ability to take advantage of geographic differences in factor endowments, markets. Ability to diversify or reduce risks, e.g. in different currency areas, and/or political scenarios.

2. Internalization-Incentive Advantages (i.e. to protect against or exploit market failure)
   Avoidance of search and negotiating costs.
   To avoid costs of enforcing property rights.
   Buyer uncertainty (about nature and value of inputs (e.g. technology) being sold).
   Where market does not permit price discrimination.
   Need of seller to protect quality of intermediate or final products.
   To capture economies of interdependent activities (see b. above).
   To compensate for absence of future markets.
   To avoid or exploit government intervention (e.g. quotas, tariffs, price controls, tax differences, etc.).
   To control supplies and conditions of sale of inputs (including technology).
   To control market outlets (including those which might be used by competitors).
   To be able to engage in practices, e.g. cross-subsidization, predatory pricing, leads and lags, transfer pricing, as a competitive (or anti-competitive) strategy.

3. Location-Specific Variables (these may favour home or host countries)
   Spacial distribution of natural and created resource endowments and markets.
   Input prices, quality and productivity, e.g. labour, energy, materials, components, semi-finished goods.
   International transport and communications costs.
   Investment incentives and disincentives (including performance requirements, etc.)
   Artificial barriers (e.g. import controls) to trade in goods.
   Infrastructure provisions (commercial, legal, educational, transport and communication).
   Psychic distance (language, cultural, business, customs, etc., differences).
   Economies of centralization of R & D production and marketing.
   Economic system and policies of government; the institutional framework for resource allocation.

Figure 1.2. OLI-advantages

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
The eclectic paradigm theorises that a firm will engage in foreign direct investment when three conditions are met and suggest that “all forms of international production by all countries can be explained” by reference to the conditions (Dunning, 1988):

1) That it possesses ownership (O) advantages that give it a competitive position compared to other firms in particular markets.

2) If the first condition is satisfied, it must be more effective for the firm to utilize these advantages itself rather than sell or lease them. These advantages are referred to as internalization (I) advantages.

3) As the first two conditions are met, it must be in the interest of the firm to utilize these advantages together with factor inputs outside of its home country. These advantages are called location (L) advantages.

Dunning later revisited his theory (1995) to take into account academic research that had been produced after the formation of the theory. He then concluded that (Dunning, 1995 pg. 14) “the role of innovation in sustaining and upgrading the competitive advantages of firms and countries needs to be better recognized.” He also amended the eclectic paradigm to take into account that multinational enterprises might engage in FDI in order to acquire O-specific advantages. In 2001 Dunning again visited his theory and emphasized the growing importance of this aforementioned asset seeking FDI and redefined the model to be better suited to explain the changing characteristics of international production, rather than determining its level and composition during a certain time period.

According to Dunning’s IDP the propensity of nations to be either outward or inward direct investors depends upon three main factors. Firstly, on the extent and pattern of the competitive or ownership specific (O-) advantages of the indigenous firms in the economy relative to the firms of other countries. Secondly, on the competitiveness of the location-bound resources and
capabilities of that country, or its L-specific advantages. And finally on the extent to which firms functioning in that economy utilize their O-specific advantages jointly with location bound advantages of domestic or foreign markets through internalizing the cross-border market for these advantages, or in other words the level to which internalization advantages are taken advantage of. (Dunning & Narula, 1996)

Before examining the different stages of the model and their characteristics, there is one more distinction to make. The location specific advantages of an economy have been mentioned to have a unique role in an economies movement along the investment development path. It is important to note, that these location bound resources do not rest solely upon the natural assets of a nation, such as minerals or land, but that the created assets, such as technological capacity or human resources, play an increasingly important role as the economy develops.

1.2.1 Stage One

Stage one is characterised with very little or no inward or outward direct investment.

In the first stage of development the L-specific advantages of a country are presumed to be insufficient to attract inward direct investment (Dunning and Narula, 1996), this is in exception to those location bound advantages that arise from a country’s possession of natural assets. The deficiency in L-specific created assets may be a reflection of a limited domestic market. One or all of the following factors can lead to low demand levels and a limited domestic market; low per capita income, inappropriate economic systems, inadequate infrastructure and a poorly educated trained or motivated labour force.
In terms of direct investment, there is likely to be very little outward or inward investment. Of specific advantages of indigenous firms tend to be rare, there is little or no indigenous technology accumulation and very few created assets that exist. Those created assets that do exist will be in labour-intensive manufacturing and the primary product sector and may be government influenced through infant industry protection such as import controls. (Dunning & Narula, 1996) Mainly due to this lack of created assets, foreign firms will prefer to export and import from this market rather than invest directly in it.

At this stage it is likely that there will be only limited government involvement in the upgrading of the economy’s created assets. Government intervention in stage one is usually one or both of two kinds; providing basic infrastructure and upgrading of human capital via training and education or a variety of economic and social policies like import protection, domestic content prices and export subsidies (Dunning & Narula, 1996).

1.2.2 Stage Two

In the second stage inward direct investment starts to slowly rise, while outward investment remains low or non-existent.

While progressing to the this next stage of development the domestic market may have grown in either size or purchasing power, making some local production by foreign firms an option. Initially inward foreign direct investment is likely to be based upon the investing firms’ possession of tangible assets, like technology, trademarks, managerial skills and the like (Dunning & Narula, 1996). A country must, however, possess some desirable L-characteristics to attract inward direct investment. In the case of export oriented industries inward investment will still be in natural resources and primary commodities, but there will possibly be some forward vertical integration into labour-intensive low
technology sectors and light manufacturing. A decisive factor in this stage is likely to be the extent to which the host country is able to provide the infrastructure needed, for instance transportation communications facilities and supplies of skilled and unskilled labour.

Providing that national government policies have managed to generate a virtuous circle of created asset accumulation, O advantages of domestic firms will have increased from the previous stage (Dunning & Narula, 1996). The O advantages are likely to exist due to the development of support industries clustered around primary industries, and assuming the training and education investments by the government have been successful, production will move towards semi-skilled and moderately knowledge intensive consumer goods. However, although L-advantages and O-advantages of indigenous firms have developed and increased from the previous stage, frequently inbound FDI is stimulated by host governments imposing tariff and non-tariff barriers, that Multinational enterprises then aim to avoid by investing directly in the economy.

Outward direct investment also tends to emerge at this stage and is likely to be either market seeking or trade-related in nearby economies or strategic assets seeking in developed territories. At this stage strategic asset seeking outward FDI is usually undertaken in countries that are either lower along the Investment Development Path than the home country or when the acquisition of created assets is the primary motive (then it can be directed at countries higher on the path) (Dunning & Narula, 1996).

The level of outward direct investment in stage two, is influenced by the home country government-induced ‘push’ factors, such as subsidies for exports and technology development or acquisition (Dunning & Narula, 1996), which influence the internalisation advantages of domestic firms. However, outward direct investment is also encouraged by non-government induced factors, like L-advantages such as relative production costs in other countries.

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
Although it is likely that outward direct investment grows in stage two, the growth is unlikely to be steep enough to offset the rising rate of growth of inward direct investment (Dunning & Narula, 1996). Thus, during the second stage of development, countries tend to increase their net inward investment, and have a poor NOIP. Towards the latter part of the stage the growth rates of outward FDI and inward FDI will, however, begin to converge.

1.2.3 Stage Three

In Stage Three a gradual decrease in the growth rate of inward direct investment can be detected. Concurrently, there is an increase in the rate of growth of outward direct investment. This leads to an increasing NOI position.

The initial O-advantages of foreign firms; tangible assets, such as technology, trademarks and managerial skills, will begin to diminish as indigenous firms develop their own competitive advantages and are thus able to compete in the same sectors. This will lead to a gradual change in the O-advantages of the exogenous firms. The new advantages are likely to be based on intangible assets and geared towards areas such as new technological innovation, managerial or marketing skills (Dunning & Narula, 1996). This will allow the foreign firms to once again compete against the national ones. As indicated to earlier, the ownership advantages of domestic firms will also have changed. The advantages will now be based, less on government –induced action and more on the firms’ ability to manage and coordinate geographically dispersed assets (Dunning & Narula, 1996). The ownership advantages of domestic firms that are based on proprietary assets, in other words brands, trademarks, copyrights or patents, will be similar to those of firms’ originating from developed countries in all sectors but the technology-intensive ones.
The significance of created L-advantages will rise relative to those of natural assets, and increasing location bound created advantages, such as a growing enlarged market, will lead to economies of scale. This will lead to more technology-intensive manufacturing, and the technological capabilities of the economy will gravitate towards the production of standardized goods (Dunning & Narula, 1996). As domestic wages rise, comparative advantages in labour-intensive activities will decrease and as a consequence, outward direct investment will be directed into countries at lower stages in the Investment Development Path. Additionally there will be increased market seeking outward investment into stage one and two economies. Market seeking investment will also be targeted at economies further along the path, but outward direct investment into stage three and four countries will also be partly in order to acquire assets to protect or increase the investing firms O-advantages. Inward direct investment will shift to efficiency seeking production and away from import substituting production (Dunning & Narula, 1996). In some industries, where indigenous firms have a competitive advantage, some strategic asset acquiring inward direct investment may arise.

Prior government expenditure on education, vocational training and innovatory activities will have contributed into a growing stock, and also the significance of, created assets. In stage three government policies will continue to be directed to reducing structural market imperfections in resource-intensive industries (Dunning & Narula, 1996). Governments may also encourage FDI in order to enhance the O and L-specific advantages within the economy. This can be done by for example trying to attract inward direct investment into sectors where increased domestic firms’ ownership advantages are desired, thus encouraging spillover effects, or by encouraging efficiency seeking outward direct investment in sectors where national L-advantages are comparatively low. Structural adjustment will be required for the economy to move to the next, and fourth stage, of development (Dunning & Narula, 1996).
1.2.4 Stage Four

In stage four the net outward investment position becomes positive as the outward direct investment stock exceeds or becomes equal with the inward direct investment stock. The growth rate of outward FDI is also rising faster than the rate of inward FDI (Dunning & Narula, 1996).

At this stage location specific advantages will be based almost solely on created assets and indigenous firms will increasingly seek to internalize the market for their O advantages by foreign direct investment rather than exporting (Dunning & Narula, 1996). Domestic firms are now, not only able to compete with international counterparts in domestic sectors, but also able to progress into foreign markets.

The ownership specific assets that foreign firms investing in the economy now possess tend to be more ‘transaction’ rather than assets related (Dunning, 1993) and derived from their multinationality. Inward direct investment tends to be from other stage four countries and asset seeking, limited market, trade and assets seeking inward investment will also generate from economies at lower stages of development. Outward investment, as stated, will grow increasingly as domestic firms offshore into economies lower along the development scale in order to maintain competitive advantage and respond to trade barriers.

Intra-industry production and trade will become relatively more important as will the tendency for this to be conducted within multinational enterprises (Dunning & Narula, 1996), thus the formation of industry clusters might become more pronounced in this stage of development.

The role of government is also likely to change during stage four. According to Dunning and Narula (1996) “While continuing its supervisory and regulatory function, to reduce market imperfections and maintain competition, it will give

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
more attention to the structural adjustment of its location-bound assets and technological capabilities, e.g. by fostering asset upgrading in infant industries (i.e. promoting a virtuous circle) and phasing out declining industries (i.e. promoting a vicious circle).” In other words the government is now aiming to facilitate markets to operate efficiently.

1.2.5 Stage Five

In this final stage both inward and outward FDI continue to increase, initially inward investment grows slightly more rapidly leading to a decrease in the economy’s net outward investment position, but this evens out and the NOI position begins to fluctuate around the zero level.

There are two key features of stage five (Dunning & Narula, 1996):

1) A tendency for firms to internalize cross-boarder transactions through MNE activity

2) As economies become more similar in the structures of their location bound assets, their international direct investment positions are also likely to become more evenly balanced.

Especially as the latter happens, the activity between nations gradually shifts from trade between nations producing different goods and services (Hechsher-Ohlin trade) to trade within hierarchies or cooperative ventures between countries producing similar products (Dunning & Narula, 1996). At times it is possible that one country be a net outward investor compared to another, but over time, depending on the speed at which created assets are transferable, the investment gap will again close leading to a fluctuating investment position around an equilibrium level. This is the condition in which stage five exists. During this state, firms also become increasingly globalized and as a
consequence their nationalities become blurred. The more globalized a firm, the more likely that its assets have become firm specific rather than dependant on the economic, political and cultural conditions of their home country (Dunning & Narula, 1996).

The tendency is that there are two kinds of inward direct investment in stage five; market and knowledge seeking investment seeking investment from countries at lower stages of development and plant and product specialization from stage four and five economies (Dunning & Narula, 1996).

The ownership advantages of firms become less dependant on their home country’s natural resources and more dependant on their ability to organize advantages efficiently and exploit benefits of multinationality. The primary motivation for FDI also switches from utilizing existing O-advantages to the acquisition of new ownership advantages. However, this does not diminish the role of government in affecting the development of an economy, on the contrary countries which offer the location bound advantages that facilitate this acquisition can attract FDI. As the ability of a country to upgrade its technological and human capabilities is a function of a nations location-bound assets and it has been noted by Cantwell and Dunning (1991) “that the prosperity of modern industrial economies is increasingly dependent on their capacity to upgrade continually”, government policy plays a key role in structuring the characteristics of an economy’s markets and setting of macro-organizational strategies. In this final stage of the IDP, governments will progressively, like strategic oligopolists, take into account what other economies are emphasising in the formation of their own macro-organizational strategies.
1.3 Methodology

At the moment of writing a consensus on how the model should be evaluated has not been reached. The numerous studies (Akoorie 1996, Barry, Görg & McDowell 2003, Bellak 2001, Campa & Guillén 1996, Calderón, Mortimore & Peres 1996, Castro 2004, Clegg 1996, Durán & Ubeda 2001, Durán & Ubeda 2005, Graham 1996, Hoesel 1996, Kumar 1996, Ozawa 1996, Zander & Zander 1996 and Zhang & Van Den Bulke 1996) that have been made into how a country or countries fit into the investment development path have utilised a multitude of tactics in doing so. Dunning & Narula (1996) state that in their opinion the factors that affect a nation’s investment development path are so complex that a thorough empirical analysis has severe limitations. They also argue that the analysis is best performed on a country-by-country basis. The majority of the previous studies examining a country and the investment development path have been a combination of both statistical analysis, at times econometric, and a historical overview of the economy and foreign direct investment. This study will also approach the questions at hand from several different angles. Statistical data on foreign direct investment flows and stocks relative to gross domestic product will be examined for Small Developed Economies and Finland specifically. As the study puts focus on Finland and how its relationship with foreign direct investment relates to the investment development path, a historical study into Finland and FDI will also be conducted. Additionally, an attempt will be made at identifying OLI advantages as well as the government’s role. Based on the aforementioned methods the study will attempt to assess to which extent Finland’s development fits into the investment development path and relates to the other small developed economies which relationship to the IDP have been studied by academics.
1.4 Data

The cross-country statistics used in this study have been extracted from the key data published yearly by United Nations Conference on Trade and Development (UNCTAD) in their World Investment Report. The data used in this study was published in combination with the World Investment Report 2006 FDI from Developing Economies: Implications for Development. The UNCTAD statistics are a suitable source as not only does it combine data from across national borders into one combined source, but also validation is performed and checks on the methodology on the gathering of data. From Finland the Bank of Finland supplies UNCTAD with the data for the report. Therefore, in the one country examination section of this report statistics from the Bank of Finland are also used.

There are however, some limitations one must consider when examining FDI data and making conclusions based on it. Firstly, as mentioned UNCTAD gathers their data from the individual countries in question. The question of the reliability and comparability of this data arises quite logically. Not only are there several different views on what the level of investment for controlling interest should be differing as widely as from five to fifty percent in the most extreme cases, but also how accurate the figures from all reporting countries to UNCTAD is.

There are also some factors that might seem to inflate FDI figures, for example much of FDI activity is usually mergers and acquisitions (M&A) activity. If one is not aware of the possible merger activity causing an increase in national FDI figures, it could easily be misinterpreted. Also it has been speculated that certain countries like the Netherlands and Ireland might have a high proportion of what is referred to as indirect FDI. Indirect FDI is when investment into a certain region is made through an economy for example due to taxations reasons, that is to say...
that the investment is moved on to another economy and does not stay in that economy.

Another challenge when analysing or using FDI data is that stocks and flows of FDI are used interchangeably in studies. This causes confusion as flows are movements that have happened during the time period in question, while stocks have accumulated over time. These facts can be used interchangeably, but that they are causes the need for caution from the reader.

SECTION TWO: THE INVESTMENT DEVELOPMENT PATH AND SMALL DEVELOPED ECONOMIES

This section examines the relationship of FDI and the Investment Development Path in small developed economies.

2.1 Definition of Small Developed Economies

In order to determine which countries can be classified as Small Developing Economies (SDEs) they must first be defined in some manner. The following criteria and definition is borrowed from Dr. Joanna Scott Kennel and has been used in her work on FDI and Small Developed Economies. Small Developed Economies can be defined as countries which have a Human Development Index (HDI) higher than 0.9, a nominal GDP of less than $600 billion, a nominal GDP/capita higher than $15 000 per annum, a population between 2-20 million and where tertiary and quarterly sectors dominate are Small Developed Economies. Based on the United Nations Conference on Trade and Development (UNCTAD) data this gives us Austria, Belgium, Denmark, Finland,
2.2 Foreign Direct Investment Data for Small Developed Economies Compared and Discussed

In order to further understand the relationship of these countries in relation to FDI and the IDP, statistical FDI data of the countries is compared and contrasted. Belgium however is not included in this analysis as UNCTAD reported the FDI data for Belgium together with that of Luxemburg until 2002, and UNCTAD data is used for all other countries to best be able to compare the figures. First, these economies’ Inward and Outward FDI as a % of GDP are compared to determine the relative importance of FDI.

Figure 2.2.1 Small Developed Economies Inward Stock as a percentage of GDP. Data source: UNCTAD WIR 2006

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
As extreme values (over 100%) appear for some countries (Ireland, Singapore, Hong Kong and the Netherlands), these countries’ data is removed in order to better be able to examine the graph of the data of the other countries.

Figure 2.2.2 Small Developed Economies Inward Stock as a percentage of GDP, extreme value countries removed. Data source: UNCTAD WIR 2006

From Figure 2.2.2 it can be seen that in past two decades all countries in question have had a considerable amount of inward FDI as compared to their GDP. There seems to be clear increase trends in early 90s, mid-90s and beginning of millennium. The countries, in addition to Ireland, Singapore, Hong Kong and the Netherlands, which appear to have very high levels of inward FDI (over 50%) are New Zealand, Switzerland and Sweden.

When examining the outward flowing stock again extreme values make it difficult to see the more subtle trends, Hong Kong, Norway, Switzerland, the Netherlands and Sweden all have outward stock of over one hundred percent of GDP. These countries are removed from the figure in order to better be able to analyse the differences in the other countries’ data.
Figure 2.2.3 Small Developed Economies Outward Stock as a percentage of GDP. Data source: UNCTAD WIR 2006

Figure 2.2.4 Small Developed Economies Outward Stock as a percentage of GDP, extreme value countries removed. Data source: UNCTAD WIR 2006
In Figure 2.2.4 peaks are harder to see than for the equivalent figure for inward stock, but there seems to have been one in early 1990s, again in mid-1990s and in the beginning of the millennium as well. The trends thus predictably have occurred at the same time, but for some reason are not as clearly visible when looking at outward FDI data. This can reflect that a portion of the inward investment into SDEs and from SDEs is invested into countries that cannot be classified as Small Developed Economies according to the definition used here.

The development of Ireland's graph is very erratic with high peak in 1985 and then clear decline until the beginning of the twenty-first century when it entered into growth again. Sweden seems to steadily have grown into quite a large investor and Finland and Denmark also seem to be noteworthy investors.

On the basis of these figures it can be deduced that Hong Kong, Singapore and the Netherlands, and Switzerland to a lesser degree, have such a high percentage for both inward and outward FDI that it is likely that the proportion of indirect FDI is quite high. In other words the data indicates that these countries are used as a type of vehicle for FDI, that is to say that for some reason investment is made through that country to other countries due to for example legislative or taxation reasons. Sweden seems to have active foreign involvement both inwards and outwards FDI, but not high enough to suspect significant indirect FDI. Ireland and New Zealand seem to be net receivers of FDI, while Norway is an active investor abroad. Finland and Denmark also seem to invest considerably abroad.

Although this analysis gives us an indication of the importance of FDI in the SDEs and their relation to each other, this analysis on its own does not reveal much about how these countries fit into the IDP.

Not all of the SDEs have had their IDP discussed, but Duran & Ubeda (2001) have ranked some of the countries into stages of the IDP:
2.3 Literature Review on Countries that Individual Investment Development Path Studies have been Performed for.

As mentioned detailed study on the IDP in a SDE can only be found on six countries; New Zealand (Akoorie, 1996), Spain (Campa & Guillén, 1996), Sweden (Zander & Zander, 1996), Austria (Bellak, 2001), Ireland (Barry, Görg & McDowell, 2003) and Portugal (Castro, 2004). In this section these studies will briefly be reviewed to provide further understanding into SDEs and the IDP and the methods used to study the IDP.

Bellak’s (2001) study on Austria and the IDP as well as Barry, Görg and MacDowell’s (2003) study on the Irish case both try to determine the IDPs aided by polynomial models and econometric testing. In the Irish case a short historical overview is also presented to aid in determining the IDP. Austria is tested econometrically on the macro level, but as data for Ireland’s macro FDI is lacking, Barry, Görg and MacDowell (2003) test the bi-lateral IDP of Ireland and

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
the United States, the country’s largest FDI partner. Some bi-lateral studies are also done for Austria and in addition Bellak tests new variables for structural studies under the hypothesis that GDP/capita is not a sufficient measure of development for the structural level. While the result for Ireland appears consistent with the stylised IDP, Bellak does not find that Austria’s IDP follows the stylised IDP on a macro level. Bellak also concludes that the single variable approach must be replaced when measuring IDP on the structural level and that inward and outward investment seem to be driven by different factors, which possibly even vary across industries and that thus further research should examine the drivers behind inward and outward IDP separately.

Castro’s (2004) article on Portugal's IDP is a revision of a polynomial model performed by Buckley and Castro (1998). Castro also gives a detailed historical overview of Portugal’s FDI movements to attempt to determine whether Portugal is in fact at stage four or stage five of the IDP. Although the historical overview clearly defines Portugal’s development from a stage one to a stage two country and then the development to a stage three country, Castro remains unsure of Portugal’s current position.

Manuel Campa and Guillén (1996) on the other hand attempts to test for the ownership, location and internalisation advantages in Spain and thus understand Spain’s standing within the IDP. They also present a historical overview and look closer at R&D and asset creation in Spain. The article demonstrates the difficulty in examining internalisation advantages as the authors struggle to find relevant data.

The studies on New Zealand (Akoorie, 1996) and Sweden (Zander and Zander, 1996) have used a slightly different approach to examining the countries’ IDPs, rather than performing an econometric analysis the authors have studied the historical developments of FDI in the two countries in order to clarify their IDP. Akoorie (1996) attempts to identify FDI and non-FDI induced changes and thus
classify the different stages in New Zealand’s development. Zander and Zander on the other hand focus on how Sweden transitioned to an advanced, diversified economy by concentrating on the creation of assets. Both articles emphasize the importance of government policy to the countries’ development along the IDP, in New Zealand’s case it seems to have hindered development (Akoorie, 1996) while Sweden seems to be an example where the government has aided the country’s path through-out history. One of the areas of government policy that is notably different between the countries is their approach to education of a skilled workforce. While Sweden has supported it strongly (Zander & Zander, 1996), New Zealand’s weak support lead to the lack of technically competent managerial cadre in the 1940s and 1950s (Akoorie, 1996). Zander & Zander (1996) concluded that their results compare favourably with the predictions of the IDP, but are vague on actually defining the time span according to which Sweden developed along the IDP. Akoorie (1996) conversely, suggests clear periods for when New Zealand went through the different stages, but presents as her main conclusion that New Zealand’s case confirms that changes in the OLI configuration of firms occur as a result of changes which began in the preceding period (Akoorie, 1996).

### 2.4 Net Outward Investment Position Statistics for Small Developed Economies Compared and Discussed

Based on the statistical data available from UNCTAD, the Net Outward Investment values can be calculated. As mentioned in section one the NOI value is generated by subtracting the inward stock of FDI from the outward stock.

Figure 2.4.1 aptly illustrates the idiosyncrasy of countries and the Investment Development Path. Although, according to previous econometric studies and the definition of Small Developed Economies, these economies should be at similar
stages of development, there is great variation in the NIOP curves over time. While interpreting NOIP curves, it is however, important to note that although drops and growth trends are visible in the figures, these do not reflect the state of development in the economy, but purely the development of the NOIP.

Figure 2.4.1 Small Developed Economies Net Outward Investment Position. Data source: UNCTAD WIR 2006

As can be seen in the figure, Norway has always had a very positive NOIP, as has Switzerland. The Netherlands has also always been positive and experienced a significant increase in 2002. Sweden and Finland have similar patterns compared to the other economies, although Sweden’s curve starts growing earlier in the timeline, which could be a reflection of legislative differences, both have fairly stable and balanced NOIPs. The reasons behind the
similarities in Finland’s and Sweden’s similar development trends may lie in the similarity of the two countries economic development. In addition to the fact that Finland has previously been a part of Sweden, Finland and Sweden continue to make similar decision in regard to economic policy when compared to many economies internationally. New Zealand’s net outward investment position seems to fluctuate somewhat, however stays negative. Hong Kong’s curve also fluctuates, and has also remained negative since 1997. Singapore’s NOIP curve on the other hand, does not vary greatly form one year to the other, but has a general declining trend. Ireland’s net outward investment stayed quite stable, from the late 1980s to the beginning of the millennium and then started to vary with significant declines.

Austria, Denmark, Israel and Portugal all have fairly similar patterns of the Net Outward Investment Development Path, each of them being quite balanced and stable. However, according to Duran & Ubeda (2001) three of these countries are on different level of the Investment Development Path (Portugal -3, Austria -4, Denmark -5). The question arises that if a similar NOIP pattern can be observed between countries in different stages of development, do the NOIPs of countries in the same stage of development have any similarities.

Figures 2.4.2 and 2.4.3 map the NOIP curves of stage four and five nations, according to Duran and Ubeda (2001), respectively together so that both similarities and differences can better be observed. Although the Net outward Investment Position curves of countries in the same stages of development do not seem greatly similar, it does appear that the countries in stage four of the IDP have negative NOIP patterns, while countries in stage five have positive ones.
Figure 2.4.2 Small Developed Economies Stage Four Economies (Dunning & Ubeda 2001) Net Outward Investment Position. Data source: UNCTAD WIR 2006

Figure 2.4.3 Small Developed Economies Stage Five Economies (Dunning & Ubeda 2001) Net Outward Investment Position. Data source: UNCTAD WIR 2006

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
It is possible that the economic histories of the countries in question could explain some of this. As was pointed out in the literature review in section two New Zealand and Ireland, possibly also Austria, have at some point had had great surges of inward FDI. Even if outward FDI grew at a much greater rate, its stock might have difficulty catching up to the already existing stock of inward FDI that was built up during these surges. (For these countries examining the growth of inward stock and the growth of outward stock over time can give a more accurate picture of the current position."

As also discussed earlier, Hong Kong, Singapore and the Netherlands as well as Switzerland to a lesser degree, are likely to have notable amounts of indirect FDI distorting their NOI positions. According to Bellak (2001) Ireland’s figures are also affected by indirect FDI to some degree. The abnormally high outward investment form Norway poses many questions, especially the sudden peak in 1996.

Figure 2.4.4 Small Developed Economies Net Outward Investment Position as a % of Gross Domestic Product. Data source: UNCTAD WIR 2006

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
Although the economies compared here are all classified as small developed economies, they still differ in size when compared to each other rather than other economies. Therefore, the net outward investment positions as a percentage of Gross Domestic Product (GDP) are compared for further investigation.

When the NOIP figures as a percentage of GDP are mapped together, it can be observed that the differences between nations become smaller. The nations that still differ significantly from the other economies are Ireland, Hong Kong, Singapore and Norway. Also New Zealand and Switzerland have some what altering patterns.

![NOIP as a % of GDP Stage 4 countries](image)

**Figure 2.4.5 Small Developed Economies Stage Four Economies (Dunning & Ubeda 2001) Net Outward Investment Position as a percentage of Gross Domestic Product. Data source: UNCTAD WIR 2006**

We then group the net outward investment positions as a percentage of gross domestic product curves together in the same manner as earlier according to the
stage four and five (figures 2.4.5 and 2.4.6). The stage four figure (2.4.5) gives us little less clarity than earlier interpretations. Although Spain and Austria’s patterns may be similar, New Zealand and Ireland’s patterns still differ greatly.

![NOIP as % of GDP Stage 5 countries](image)

Figure 2.4.6 Small Developed Economies Stage Five Economies (Duran & Ubeda 2001) Net Outward Investment Position as a percentage of Gross Domestic Product. Data source: UNCTAD WIR 2006

The stage five figure (2.4.6) however, shows that many of the countries do have similar patterns with only Norway’s curve differing significantly. As all of the other countries show quite stable and balanced NOIP patterns this could suggest that all of these countries have been stage five countries since the mid 1980s. This seems somewhat unlikely, Dunning & Narula (1996) hypothesised that most developed countries were transitioning into stage five during the later part of the 1990s and when Duran and Ubeda revisited the Investment Development Path model in 2001 and redefined stage four, they actually calculated that some developed countries still were in the fourth stage of development. This shows

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
that, although examining net outward investment positions maybe be indicative of how a nation has moved along the investment development path, more factors must be taken into account in order to determine where the countries lie.

SECTION THREE: FINLAND AND THE INVESTMENT DEVELOPMENT PATH

In this section Finland's relation to FDI and the Investment Development Path are examined. Based on examining statistical data on FDI and Finland and a historical overview on FDI in and from the Finnish economy an attempt is made to understand the nature of FDI in and from Finland. Ultimately the study aims at understanding whether the Investment Development Model is applicable to Finland and if so where along the path Finland lies.

3.1 Foreign Direct Investment and Net Outward investment Position Data for Finland

In Figure 3.1.1 below, it can be seen that FDI in Finland really only started in the late 1980s or early 1990s. Since then, FDI stock has quite steadily grown until the mid of the current decade. A first look into the statistics for Finland also shows, that the development of FDI has not followed the traditional path outlined in the Investment Development path model. As illustrated in the figure, from a very early stage the stock of outward FDI has outweighed the inward stock. There are several reasons for this, the least of which are not the legislation regarding foreign investment within the economy discussed further later within the study.
The proportionally higher level of outward investment has also lead to the high and growing NOI position in the past. It can however, be seen (below) that the growth has calmed down during the 21st Century and that the NOIP has remained more stable, even with some decline which indicates that the gap between the outward and inward FDI stocks is beginning to reduce.

Although Finland was a latecomer in respects to significant foreign direct investment, both inward and outward, the in national terms large scale increases in the late 1980s and early 1990s allowed Finland to catch up with the rest of the developed world in terms of foreign direct investment levels.
As seen in Figure 3.1.3 Finland’s reputation as a latecomer in terms of inward direct investment is justified. Until the 1990s inward stock as a percentage of GDP in Finland was well below the world average. The figure also shows that strong increases in the level of inward investment in the nineties led to Finland catching up with the rest of the world and the developed economies in terms of investment relative to GDP. In the 21st Century the relative level in Finland surpassed the world and developed economies average. In Figure 3.1.3 it can also be seen that in terms of the level of inward direct investment as a percentage of GDP Finland’s trend has followed the one of the European average, but although the development trend has been similar there has been a gap due to the initially low levels of inward FDI into Finland. Since the late 1990s, with the increase of inward investment into Finland, this gap has decreased.
How then does the proportionate level of inward investment compare to the other small developed economies that have been examined in this study? These relationships can be compared in Figure 3.1.4. Here it can be seen, that in relation to the other small developed economies examined, Finland’s level of inward investment as a percentage of GDP remains low. In fact, only Norway and Spain have lower levels of proportionate inward investment.

The general development trends for all the economies, but New Zealand, are similar and this shows that often national trends for inward FDI follow international trends.
Inward Stock as a % of GDP SDEs

Figure 3.1.4 Inward FDI Stock as a percentage of Gross Domestic Product, Small Developed Economies. Data source: UNCTAD WIR 2006

The stocks of FDI are built up by the flows in investment yearly. In Figure 3.1.5 the inward and outward flows of investment to and from Finland are mapped out. Here it can be seen how the flows of investment to and from Finland were nearly nonexistent until the 1980s. The reasons behind the levels of these flows will be discussed further in the next section, but the figure illustrates why Finland’s NOIP has been positive from the start. Contrary to how the Investment Development Path model suggests, Finland had higher levels of outward investment than inward investment from the start. As the flows of outward investment were so much higher than the inward investments in the 1980s, when the Finnish economy began opening up to foreign direct investment, the stock of outward investment from Finland accumulated so that although levels of inward investment flows began to grow in the nineties and actually were higher than the levels of outward flows from the economy from 2001 onwards, the level of outward stock has grown to such levels that the stock of inward investment has
not yet caught up. This can also be seen in the first figure examined in this section, Figure 3.1.1., where also the affects of this on the NOIP of the economy can be seen.

![Finland Inward and Outward FDI Flows 1970 - 2005](image)

**Figure 3.1.5 Inward and Outward Flows of Foreign Direct investment, Finland 1970 – 2005. Data source: The Bank of Finland**

As might be expected most of the foreign direct investment into Finland has been from within Europe. The study of inward flows of FDI by geographical region (Figure 3.1.6) does not necessary show much the information of several countries is bunched up per region, but what is noteworthy is the peak of inward investment in 2003 from Central and South America. This influx is likely to be from a nation lower down along the IDP and could thus help in clarifying where Finland lies along the curb.
Figure 3.1.6 Inward Flows of Foreign Direct investment into Finland by Geographical Region.
Data source: The Bank of Finland

Figure 3.1.7 Inward Flows of Foreign Direct investment into Finland by Country, Top Investors.
Data source: The Bank of Finland

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
When looking at the inward flows in more detail, by country (Figure 3.1.7) it is clear that Sweden has been the biggest investor into Finland. There has also been a significant amount of investments from the Netherlands, but as the Netherlands has been identified as a nation with a high proportion of indirect investment, the true home economy of the investment is unclear. The economies included in the figure were picked as they were the largest investors. Out of the top investors, only the ‘other Central and South America’, which has not been specified in the data from the Bank of Finland, is one that can be assumed to lie further down along the IDP. As can be seen in the appendix, there has been investment from more countries likely to be further down along the path, but not at a significant enough level to compare to the economies which investment is portrayed in the graph. Most of this investment has happened since 2000. When then looking at FDI flows from the Finnish economy (Figure 3.1.8), as expected most of the investment has been to European economies. It can be seen however, that since the 1990s there has been a steady investment stream into Central and South America as well as Asia.

![Graph](image-url)

Figure 3.1.8 Outward Flows of Foreign Direct Investment from Finland by Geographical Region.

Data source: The Bank of Finland

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
Figure 3.1.9 Outward Flows of Foreign Direct Investment from Finland by Country, Top Host Economies. Data source: The Bank of Finland

Figure 3.1.10 Outward Stock of Foreign Direct Investment from Finland by Country, Top Host Economies. Data source: The Bank of Finland 1) Preliminary figures for 2005

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
Taking a closer look by country (Figure 3.1.9) Sweden rises as the host economy that most investment has gone to. What is notable is that there are proportionately more economies from outside of Europe that have made it into the top destinations, than there are home countries in Figure 3.1.7. Another curious fact is that Russia and the Baltics are not in a more prominent position, one could easily assume that there would be more direct investment from Finland to these countries. In 2005, however, as few flows show up as positive Estonia is the destination with the second most investment, so perhaps if we examined the figures for the later part of the decade there would be more flows into the Baltics.

When the host economies of investment from Finland are examined as stock figures for 2005, Figure 3.1.10, it is interesting how many of the host economies that have significant enough stocks of FDI to be able be included in this figure of top destinations that are likely to lie at a earlier stage of the IDP (e.g. China, Russia, Estonia, Hungary, South Korea, Latvia, Lithuania).

<table>
<thead>
<tr>
<th>Matrix of inward FDI performance and potential, 2002-2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>High FDI performance</strong></td>
</tr>
<tr>
<td><strong>Front-runners</strong></td>
</tr>
<tr>
<td>Australia, Bahamas, Brunei, Bulgaria, China, Czech Republic, Dominican Republic, Estonia, Hong Kong (China), Hungary, Iceland, Iran, Jordan, Kazakhstan, Latvia, Lebanon, Lithuania, Luxembourg, Malaysia, Malta, Netherlands, New Zealand, Panama, Poland, Portugal, Qatar, Singapore, Slovakia, Slovenia, Sweden, Trinidad and Tobago and United Arab Emirates.</td>
</tr>
<tr>
<td><strong>Above potential</strong></td>
</tr>
</tbody>
</table>

Figure 3.1.11 Matrix of Inward FDI performance and potential, 2002-2004 Source: UNCTAD 2005

An interesting fact is that although Finland is referred to as a latecomer in FDI (e.g. Bellak and Luostarinen, 1994), UNCTAD ranks Finland as a front runner in

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
the World Investment Report 2006 with high performance and high potential with regards to inward FDI. This shows the need for another type of investigation into the subject, rather than just statistics. Therefore the next section will focus on a historical overview of Finland and FDI, to shed further light into the reasons behind the statistics examined in this section and gain further understanding in where Finland lies on the IDP.

3.2 FDI and Finland – A Historical Overview

Like Castro (2004) for Portugal, Manuel Campa and Guillén (1996) for Spain, Akoorie (1996) for New Zealand and Zander and Zander (1996) for Sweden, this sub-section will present a historical overview of Finland and FDI. In this section light is brought upon the statistical data presented earlier and government policy affecting FDI is discussed.

Finland is considered to be one of the “latecomers” when it comes to FDI, Finland is frequently referred to as being late in internationalising and the time period when internationalisation began is considered to be the 1980s. This is not strictly true.

It is difficult to say much about investment into Finland before 1809, as Finland was then a part of the Swedish Empire. After Finland became an autonomic part of Russia, more of the foreign investment development has been documented.

3.2.1 The Early Years – Autonomy and Industrialisation

Finland’s industrialisation began in the 19th Century and there is evidence that foreign entrepreneurs, and inward FDI, played an important role in the economy’s industrialisation process (Ylä-Anttila, Ali-Yrkkö & Nyberg, 2004). During the
century the attitude toward foreign firms and entrepreneurs was largely positive, when they were considered to bring with them attributes that benefited the young economy, such as technological know-how or investment funds. The attitude towards importers of goods for the Finnish market were frowned upon, due to their feared impact on the balance of trade (Pajarinen, 1997). From very early on, there has also been a somewhat protectionist position in Finland regarding the Forestry industry and natural assets.

During this time it could be stated that Finland experienced it first influx of FDI. Although the influx was not big enough to really be referred to as a boom, this is the first period in time when it has been clearly documented that both enterprises and entrepreneurs invested in the Finnish economy. Most of the firms that invested in Finland at the time, did so to access the Russian market due to favourable tariffs from Finland into Russia (Hjerppe and Ahvenainen, 1986). It does not seem as though there was much interest in Finland as a market.

The majority of foreign investment, however, came from private entrepreneurs that had expertise in a certain area and set up organisations in Finland capitalising on that expertise and developing it into their competitive advantage. Often these entrepreneurs did not bring with them a great deal of investment, but rather just their expertise. An example of this was the Scottish James Finlayson, who established a cotton factory in Finland that later became one of the country’s larger enterprises. In general these firms, like Finlayson, eventually came under Finnish ownership. The expertise had often by then, however, spilled over into the organisation and its stakeholders aiding in the overall development of the Finnish economy and industries. According to sources (Ahonen 1984, Hjerppe & Ahvenainen 1986). It has been documented that foreign firms and their know-how, played an important role in the development of both the textile- and saw industries, but especially a few firms came to Finland to establish electrical production plants and aided in developing the electrical network. The Swedish Ericsson and the U.S. originated Bell were also involved in the creation of a

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
telephone network (Pajarinen, 1997). All in all, however, inward FDI into Finland was modest compared to many other small industrialised countries of the time (Ylä-Anttila, Ali-Yrkkö & Nyberg, 2004).

During this time there was some outward FDI as well, Finnish firms had distinguished somewhat of a competitive advantage in industries related to the natural assets available, namely forestry and saw mills and established a few operations in countries close by to take advantage of this created advantage, there was not much of this activity however.

3.2.2 The First Decades of Independence to Beyond the Second World War – Very Little International Activity

Much of the little international investment activity that had built in Finland during the autonomy either became Finnish owned or left the country after independence. The reasons for this were many-fold. As one of the reasons for establishing operations in Finland, the low tariffs to Russia, had diminished some companies pulled their investments in Finland. Also the First World War had cut off business relations in general and there was some political instability in Finland (Pajarinen, 1997). Also, the attitude towards foreigners became increasingly negative in the newly independent Finland. Many of the investments were sold to Finnish actors, some to private enterprises and others were purchased by the state.

There were, however, still some industries were foreign investment continued and continued to develop Finnish industries further. These were namely in industries were indigenous knowledge was not as developed, such as the electricity- and electronics industries, were firms like Siemens, LM Ericsson and Philips were active (Lovio, 1992).
In the 1930s the attitudes toward foreign players in the Finnish market, became yet more negative. This was in accordance with a general trend of nationalisation of the time, but also due to the fact that there was now increased international interest in Finnish natural assets, such as nickel and other minerals (Pajarinen, 1997). In 1939 the Restriction Act was set. The new legislation restricted the purchase of real property or shares of Finnish companies (Bellak & Luostarinen, 1994). The act was essentially a protection act, designed to restrict foreign ownership in sensitive sectors such as the forest industry, transportation, securities trading, forwarding agencies, the real estate business, communication energy and publishing and required government permission for foreign ownership.

The few international companies that invested in Finland during the first decades of independence were typically subsidiaries of multinational corporations that had extensive support in investment, production and marketing from their parent companies (e.g. Unilvever and AGA). The strategy that these firms followed was often to produce and market their products in the Finnish domestic market (Pajarinen, 1997). The trend had clearly shifted, from using Finland as a ticket to the Russian market, into market-seeking investment to gain actual sales from the Finnish market. This can also be a result of the other restrictions of the era in Finland, such as import tariffs on finished products. This implies that although the end market had changes, the primary motivation behind investments was still essentially the same, to overcome barriers to trade set by policy.

After the Second World War the situation was further aggravated by the fact that Finland was seen as politically unstable. As a result of these factors the share of foreign enterprises in manufacturing was lower between the word wars than during the autonomy (Pajarinen, 1997) and at the end of the 1950s the level of international investment was as low as it had been two decades earlier (Hjerppe & Ahvenainen, 1986).
3.2.3 The 1960s to the 1980s – Attitudes Towards Internationalisation begin to Change

Investment in and out of Finland remained low throughout the 1960s, the majority of the foreign businesses established continues to be sales and marketing companies that operated on a small amount of capital (Ylä-Anttila, Ali-Yrkkö & Nyberg, 2004). During the 1960s the attitudes of the Finnish government towards foreign investment, however, started to slowly change for the more positive. Part of this attitude change might have been the large number of the Finnish labour force migrating to Sweden to work (Pajarinen, 1997). In 1967 a new organisation was established to attract international firms setting up operations in Finland, the Restriction Act was not abolished, however (Pajarinen, 1997). A factor that aided foreign investment into Finland at the time was that labour was comparatively cheap compared to nearby economies at the time (Ylä-Anttila, Ali-Yrkkö & Nyberg, 2004). This was not a sustainable motivator for inward FDI, as low labour costs rarely are. The phenomenon which has later been referred to as the Race to the Bottom also happened in Finland as relative cost of labour cost began to rise. Most of the firms that had been attracted to lower labour costs quickly divested in the late 1970s and 1980s.

The time period from the 1940s to the 1970s has been referred to as the first wave of internationalisation of Finnish owned enterprises by Kotiranta, Lundan and Ylä-Anttila (2008). They describe the time to be export driven and that only a few Finnish firms had production facilities abroad. In 1948 Finland joined the World Bank, which granted loans that helped rebuild production and infrastructure in the economy, and the International Monetary Fund (Kaitila, Koski, Routti, Tiihonen and Ylä-Anttila, 2006). As referred to earlier, there was a strong will to hold on to domestic ownership and many protectionist measures by the government that lasted long into the 1980s. Many of these protectionist actions centred around protecting the forest industry and industries linked to it as well as numerous natural resources. This could be seen as protecting infant
industries and nurturing them to become strong enough to later compete internationally, but no direct evidence has been found at the time of writing that refers to the clear motives of the protectionist action.

During these years Finland took some clear steps to internationalise, in 1961 Finland became an associate member of the European free trade area ETA and in 1973 the EEC free trade agreement as signed (Kotiranta, Lundan & Ylä-Anttila, 1973). The FDI levels in Finland still remained low throughout this period. In the 1960s inward flows were still only under 0.2 percent of GDP, these inflows started to grow in the 1980s as for example the amount of manufacturing operations began to grow (Pajarinen, 1997), these amounts still stayed modest. Until the beginning of the 1980s the amount of outward FDI also stayed small when compared internationally, the stock sat around 2 percent of GDP (Kotiranta, Lundan & Ylä-Anttila, 2008).

According to Kotiranta et. al (2008) the second wave of internationalisation of Finnish enterprises came in the 1980s, at this point investments abroad grew rapidly. During the 1980s and to some extent into the 1990s Finnish firms tended to internationalise in stages, in a pattern which started with exporting and after several years of experience within the exporting more demanding international operations, like production facilities were set up (Ylä-Anttila, Ali-Yrkkö and Nyberg, 2004).

Clear reasons for this could not be found in the literature, most of the investments were however made by large Finnish enterprises mainly in the strong traditional industries such as the forestry industry and those surrounding it (Bellak and Luostarinen, 1994). Pajarinen and Ylä-Anttila (2008) have also studied the largest Finnish firms and note that many of these were largely state owned in the 1980s. It is known that the Finnish government encouraged internationalisation of Finnish firms in the 1980s and the assumption can be made that they possibly used their influence over these firms and encouraged
the internationalisation process. The literature does not take a clear point on what the motives behind these investments were from the firm strategy point of view, either. Based on the extensive research done around the subject and the authors own knowledge of the Finnish economy, as well as the fields that most of the large corporations in Finland at the time operated in, the impression formed is that these outward investments were made into manufacturing units in the belief that these would increase efficiency. Most of the investment was made in the form of mergers and acquisitions of firms operating in the same field as the, at times still quite diversified, Finnish investing firms and often aimed at economies of scale (Pajarinen & Ylä-Anttila, 2008). However, as there is little evidence proving this view, there is also the distinct possibility that these firms were following a larger management trend of the time. Indeed, there is some evidence pointing to this as most of the international operations of Finnish firms remained unprofitable until the mid 1990s (Kotiranta, Lundan & Ylä-Anttila, 2008).

3.2.4 The 1990s – A Clear Turn in the FDI Environment in Finland

In the 1990s what can be described as a boom happened with foreign direct investment in Finland, both inward and outward flow grew notably. There are several reasons that contribute to this. In general, worldwide, the 1990s increased FDI activity, mergers and acquisitions activity activated and hence a global increase in FDI flows can be detected. In Finland, a large contributing factor was the abolishment of the Restriction Act of 1939. The policy was gradually changed from the late 1980s to 1996, but the biggest relief happened in 1993. Finland also joined the European Union in 1995 and finally also the European Monetary Union in 2000.

In 1993 Finland reached the world average in outward FDI compared to GDP (Kotiranta, Lundan & Ylä-Anttila, 2008) and the trend has continued. Today
organisations of Finnish origin are highly internationalised and international operations of Finnish organisations have reached the same level as for example Swedish firms, where the internationalisation process began significantly earlier than Finland (Kotiranta, Lundan & Ylä-Anttila, 2008).

Another reason adding to the influx of inward direct investment, was increasing interest in to Finland’s neighbouring markets; Russia and the Baltics. Finland was viewed as a more politically stable environment close to these markets to invest in, where indigenous firms were seen to have knowledge and understanding into these emerging markets. Finland had again become a vehicle for investment into its Eastern neighbours, gaining form its geopolitical location.

Another significant change in the Finnish economy was, that in the 1990s Finland’s reputation as a high technology society started to grow, and many foreign enterprises became interested in Finland as an investment destination due to the knowledge accumulated in the market especially in technology intensive fields such as information technology and communications (Ali-Yrkkö, Lindström, Pajarinen and Ylä-Anttila, 2004).

During the 1990s other changes also happened in the Finnish economy. Accelerated by the fall of the Soviet Union, Finland fell into a recession and a result the currency of the time, the Finn Mark fell in value. Simultaneously, many of the Finnish enterprises that had been quite diversified, began to focus their strategies on core competencies and divest other functions. As a result foreign investors were able to access Finnish firms, at times with significant technological know-how for what could be described as good value for their investments. The government also began encouraging inflows of foreign investment, in 1992 for example the organisation Invest in Finland was established and started work on marketing the economy as an investment location. The de-regulation and proactive attraction of investment has led to
Finland becoming one of the most permissive OECD nations of foreign direct investment (Kotiranta, Lundan & Ylä-Anttila, 2008).

3.3 FDI and Finland – By Economic Activity and Sector

As the economy of Finland has changed through time, so has the composition of the main industries. By understanding how FDI flows have changed form one sector or industry to another we can form an understanding of whether the type of FDI has changed with time.

In the historic overview it was discussed how FDI into Finland began within the manufacturing industries, such as the forestry industry and the sectors surrounding it. During the autonomy many of the new businesses in manufacturing were started by foreign immigrants, the proportion of foreigners was greatest in the paper and chemical sectors (Joronen, Pajarinen and Ylä-Anttila, 2002), which function as part of the forestry industry. In the late 19th century, when the demand for electrical power technologies grew, the focus of investment switched to the energy sector and when the telephone network was being built Ericsson from Sweden and Bell of America took part in the process (Joronen, Pajarinen and Ylä-Anttila, 2002). Figure 3.3.1 shows the flows of FDI activity into Finland by economic activity or industry from 1992 to 2005 (Bank of Finland). Unfortunately the statistics available only distinguish between manufacturing, services, other sectors and household investment.
Figure 3.3.1 Flows of Inward Foreign Direct Investment into Finland by Economic Activity 1992 - 2005 Data source: The Bank of Finland

Figure 3.3.2 Flows of Inward Foreign Direct Investment into Finland in Manufacturing by Sector 1992 - 2005 Data source: The Bank of Finland

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
The figure shows that until the late 1990s the main industry of investment was manufacturing. Since 1998 however, services have received the majority of investment every year but 1998. It can also be seen that the influx of investment into services has had a few high peaks, namely in 1998, 2000 and 2002.

When examining the inflows into the manufacturing industry more closely (Figure 3.3.2), one can see that metal and engineering and other sectors have received the most inward investment flows during the time period outlined. Investment into the chemical sector is significant enough to warrant it to be reported separately, but has stayed quite stable and low from 1992 to 2005.

![FDI Flows to Finland by Sector in Services 1992 - 2005](image)

Figure 3.3.3 Flows of Inward Foreign Direct Investment into Finland in Services by Sector 1992 - 2005 Data source: The Bank of Finland

When examining the inward flows of investment into services more closely it can be seen that two of the peaks in influx of investment were in finance and institutions and one in others. Peaks such as these are likely to be large mergers and acquisitions. Time wise the two in finance and institutions coincide with the

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
merger of the Finnish bank Merita and the Swedish Nordbanken in 1997 and the joining of the Danish Unidanmark in 2000. The investment influx in other in 2002 on the other hand coincides with the telecommunications merger of the operator Sonera to the Swedish Telia. If we go back to Figure 3.1.7, we can also see that these peaks occurred simultaneously as peaks of investment inflows from Sweden occurred.

Figure 3.3.4 Flows of Outward Foreign Direct Investment from Finland by Economic Activity 1992 - 2005

Data source: The Bank of Finland

The historical overview also showed that many of the initial direct investments out of the Finnish economy were within the manufacturing sector seeking lower production costs or new markets for sales. Figure 3.3.4 however, shows how the emphasis has changed in the late 1990s to be in services and others.
Figure 3.3.5 Flows of Outward Foreign Direct Investment from Finland in Manufacturing by Sector 1992 - 2005 Data source: The Bank of Finland

Figure 3.3.6 Flows of Outward Foreign Direct Investment from Finland in Services by Sector 1992 - 2005 Data source: The Bank of Finland

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
When observing the manufacturing sector outflows of investment in more detail, we can see that the biggest traditional industry in Finland, the forestry industry, has been responsible for the bigger peaks even in the late 1990s and in the last decade. The services side shows similar peaks in outflows as were visible in figure 3.3.3 for inflows. There are peaks in finance and institutions and others while trade has remained fairly consistent.

Unfortunately, partly due to insufficient statistical data, no clear patterns of switching in investment behaviour beyond a switch to services can be detected overall. The next part of the study will discuss the motives of FDI both in and out of Finland, with the expectation that this will shed more light on the development of the Finnish economy and the role of foreign direct investment.

### 3.4 Motives of Foreign Direct Investment into and out of Finland

The historical overview covered some of the earlier motives for FDI into Finland. During the autonomy many MNEs invested in Finland in order to serve the Russian market, as Finland had favourable terms to trade with the economy. Later as the terms of trade changed and Finland became an independent economy, FDI into Finland dropped and the little investment into the economy was motivated by actually reaching the internal market. At this point in time Finland had strong restrictions on FDI and partly due to this much of the investment was in the form of sales and marketing operations and thus within trade. For a short period in the 1960s some FDI also seemed to efficiency seeking, as labour costs in Finland were relatively low, this kind of investment was however short lived as most of the firms that had invested in the economy to reach lower labour costs, started divesting in the 1970s when labour costs again rose.
3.4.1 Investment Motives for Investment into the Finnish Economy

In the 1970s Finnish research started to look into FDI in Finland (Paasonen, 1994). Since then, some studies have attempted to gain understanding into the motives of FDI into Finland (like Puhakka, 1995 and Lindström, 2004). Paasonen (1994) conducted an extensive study into FDI in Finland for his Masters Thesis. The empiric part of this study was a questionnaire to MNEs operating in Finland. The study confirmed that most of the firms operated within the trade sector and that they had been established in order to sell their products on the Finnish market (Paasonen, 1994), the main motive was to reach a wider market in order to increase demand and thus grow operations, but also buying out a competitor was stated as a motive. Encouragingly, some of the respondents were also investing in Finland in order to reach other markets, and a sort of headquarters for several economies, namely the Baltic nations, Russia and in some cases other Nordic countries, were set up in Finland (Paasonen, 1994). When asked for the factors encouraging investment to Finland the responses included the ease of regulation and lack of bureaucracy (Paasonen, 1994) and indeed, it has been stated that Nordic countries, including Finland, have lower levels of bureaucracy and regulation (Kaitila, Koski, Routti, Tiihonen and Ylä-Anttila, 2006). Finland was also seen as a politically stable environment, this political stability had been reached in the time succeeding the Second World War, as as was stated in the historical overview, after the wars Finland was initially view as a politically unstable environment. The respondents were also asked what they viewed as positive in Finland. The responses centred around the business environment, the demand of products and the availability of highly trained employees (Paasonen, 1994), these positive aspects can also be seen as future or subliminal motivators for FDI. There were, naturally, also some aspects the firms viewed as negative. The monopolies, largely owned by the state, and the limited size of the Finnish market, as well as the paradoxal bureaucracy of governmental employees and the labour organisation, were seen a possible de-motivators to FDI (Paasonen, 1994).
Puhakka’s study in 1995 conducted a renewal questionnaire study to foreign owned firms in Finland. The study compared results with an earlier questionnaire from 1991 and conducted the questionnaire to the same organisations to ensure comparability. Nearly all of the firms were still in Finland with the same motive as they originally entered, for sales and marketing organisations this was market seeking, to reach the Finnish market, while for manufacturing organisations it was horizontal integration (Puhakka, 1995). A majority of the firms questioned were of the opinion that their experiences in Finland had been positive, there was however some difference by sector. The experiences of the manufacturing firms had continued to become more positive encouraged by the changes in regulatory and taxation changes, while the recession in Finland had taken a toll on the demand of the products of the sales and marketing organisations and thus some of them did not view their recent experiences as positive as they had before (Puhakka, 1995). The changes in taxation could also be seen in the results for the questions centring around issues in operating in Finland, and indeed Finland changed corporate taxation in the 1990s to become favourable in comparison to many European economies. In 1991 problems linked to taxation and the Finnish tax system were common while in 1994 the issues had shifted to the rigidity of the labour market (Puhakka, 1995).

Factors that encouraged investment into Finland were still lead by the Finnish market in 1991, in 1994 this had shifted to the geographical proximity of the Eastern European markets (Puhakka, 1995). In this aspect, the studies of Paasonen (1994) and Puhakka (1995) strongly support each other. A significant turn from 1991 to 1994 was also the switch within the second most important factor motivating investment. In 1991 this had been utilising the firm’s competitive advantage in the Finnish market, while in 1994 the focus had shifted to the technical know-how and competitive advantages of Finnish firms (Puhakka, 1995). This indicated that the motives for investment into Finland during the
1990s shifted from a pure market seeking perspective to an also asset seeking perspective.

Curiously, Puhakka’s (1995) study also found that the environmental awareness in Finland was seen as potential for the future and an at the moment lower cost structure in Finland. While the lower cost structure is a motive that is likely to have dispersed as the economy recovered from the recession of the 1990s, the environmental awareness as potential for the future is one that is likely to have grown. As issues, the interviewed firms stated the high income taxation rates in Finland, many firms believed that it was difficult to attract upper level experts and management to Finland due to the high income tax rate (Puhakka, 1995).

In 2004 another quantitative questionnaire to the management of MNEs operating in Finland was conducted by Maarit Lindström, the results are compared to earlier studies in the mid 1990s. in the study, she found that for Greenfield investments, the majority of which operated in warehouse- or retail trade and are the clear minority compared to M&As, the major motives were to better serve the clients in the Finnish market (Lindström, 2004). Motives for these Greenfield investments were mainly market seeking, and focusing on the Nordic markets.

For the investments that were acquisitions the results were more multi-factorial. The main reasons stated for the investment were still market seeking, namely growing their market and the Nordic market, but also the acquired firms marketing and business know-how was an important factor (Lindström, 2004). Thus, for mergers and acquisitions an important motive is strategic assets seeking. This confirms the general hypothesis that, firms seeking strategic assets as a motive for their FDI, mostly invest where suitable candidates for acquisitions are available (Granfelt, Haaparanta, Nuotio and Jonninen, 1993). Although there are no definite figures regarding to the share of mergers and acquisitions of foreign direct investment into Finland, mergers and acquisitions clearly amount
the major part of investment into Finland (Lindström, 2004), also according to Ali-Yrkkö, Lindström, Pajarien and Ylä-Anttila (2004) foreign enterprises have purchased more firms from Finland than from many other countries.

![Value of Inward FDI Flows and Cross Border M&As into Finland 1987-2005](image.png)

Figure 3.4.1 Flows of Inward Foreign Direct Investment into Finland and Value of Cross Border Mergers and Acquisitions where the seller is from Finland 1987 - 2005 Data source: UNCTAD WIR 2008

Lindström’s (2004) study also showed that the importance of the acquired firms level of technological know-how had significantly grown in importance from the nineties. A distinction was also made, that this factor was far more important for investments in the manufacturing sector and especially for investments from North America (Lindström, 2004). Perhaps the part of the study where the manufacturing firms questioned stated that by acquiring the Finnish firm they have acquired technologically intensive know-how that now serves the entire international enterprise (Lindström, 2004), best supports the hypothesis of strategic asset seeking FDI.

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
As the studies prior, also Lindström’s (2004) study asked about the strengths and weaknesses of Finland as an investment destination. The clear strengths that are seen by most of the respondents are the honesty and reliability of Finns, a developed infrastructure and technological know-how, but also the level of education, people’s initiative, flexible working culture and marketing and business know-how are mentioned. Manufacturing firms view the co-operation with Universities in R&D and the knowledge of the Russian market as important factor, while Greenfield operations rate the stability and functionality of society, high education level, people’s initiative and marketing and business know-how higher (Lindström, 2004). The weaknesses remain much the same as the respondents of Puhakka’s study stated (1995), income taxation and corporate taxation to a lesser degree (Lindström, 2004).

Lindström’s study thus shows somewhat of a shift in the motives of FDI into Finland. Although firms are still interested in serving the Finnish market, despite its relatively small size, the level of know-how, both technological and business, has become an increasingly important factor when choosing to invest in the Finnish economy.

In 2004 there was also another study that examined the motivation of FDI in Finland (Ali-Yrkkö, Lindström, Pajarinen and Ylä-Anttila, 2004). The results of this study, largely compliment the earlier studies. The motives for establishing regional head quarters centred around political stability, infrastructure and co-operation networks with Universities. The study also further shows, that in more recent years motives for investing in Finland have more often included the attempt to benefit from the know-how of Finnish enterprises.

### 3.4.2 Investment Motives for Investment out of the Finnish Economy

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
Much of outward investment since the early 1980s has been investment in production facilities abroad (Ali-Yrkkö, Joronen, Ylä-Anttila, 2002). Finnish firms also tended to internationalise in stages, investments usually started as sales and marketing efforts to the countries that had been traditional export attraction, like Sweden and Germany, and only later did firms move into more demanding international operations such as overseas production (Ali-Yrkkö, Joronen, Ylä-Anttila, 2002 and Ali-Yrkkö, Lindström, Pajarinen and Ylä-Anttila, 2004). During this decade many Finnish firms, especially those in the ICT sector, being globalising at a very early stage of operations (Ali-Yrkkö, Joronen, Ylä-Anttila, 2002), recently these firms have become a great interest in Finnish research and are being referred to as Born Globals, forms that view the entire world as their potential market from the start.

The most important push factors explaining the internationalisation of Finnish firms (Luostarinen, 1994) have been stated to be the small size of the Finnish market and the geographical location of the economy compared to target markets (Ali-Yrkkö, Lindström, Pajarinen & Ylä-Anttila, 2004). There have been three studies specifically into the motives of Finnish enterprises investing abroad by the Confederation of Finnish Industry and Employers (1998, 2001 and 2004). The studies showed that the most important factors overall have been being close to end markets and clients (Confederation of Finnish Industry and Employers 1998, 2001 and 2004). Although overall this has stayed the main reason in all the studies, important motivating factors differ by industry and host economy.

In the metal, forest and chemical industries transportation costs play an important role, while cost of labour is important for the textile industry (Confederation of Finnish Industry and Employers 1998, 2001 and 2004). By host region the motives also differed significantly. Investment into Western Europe and North America was mostly market seeking, investment into Eastern Europe and Russia is made more difficult by regulation and other customs but the motive has also been to have a presence in these growing markets. The notable difference is with
Many Finns fear that as Finnish firms internationalise Finnish jobs will be lost abroad. The evidence in the studies do not support this. In fact far less Finnish jobs have been moved abroad through off shoring (Kotiranta, 2008). A clearly lacking motive for investment of Finnish firms investing abroad is strategic asset seeking. According to Ali-Yrkkö (2006) very few firms have moved research and development (R&D) activities abroad, which to some extent reflects Finland competitive advantage as a knowledge economy with high R&D know-how. This notion is also supported by Ali-Yrkkö and Palmberg (2006) who state that “In comparison to large firms in other small open economies it seems that, measured in terms of inventors, the innovative activities of the Finnish firms are less internationalised”. (Ali-Yrkkö and Palmberg, 2006 pp.17).

To summarise, the motives for Finnish enterprises investing abroad seem to be both market seeking and efficiency seeking, while the motives for foreign enterprises investing into Finland are primarily market seeking and strategic asset seeking.

3.5 Ownership Location and Internalisation Advantages in Finland and the Affects of Foreign Direct Investment in Finland

The historical overview discussed the development of FDI and Finland over time and the part of the study opened up the motives which firms have had to invest in of from Finland. This part of the study will combine issues discussed in these to sections with additional information from various studies in order to better
understand the location advantages in Finland and the Ownership advantages of Finnish firms. The economy’s transformation from an economy exploiting its natural resources to a knowledge based economy, will also be discussed as will the factors leading to this and foreign direct investment’s role in this. There will also be discussion on the affects of FDI on the Finnish economy.

Finland as an economy is geographically some what sizeable, comparable to for example Japan, however, the population of just over five million inhabitants leads the economy to have a location disadvantage of sorts in the form of a small national market. Yet, Finland has during the 21st Century constantly been ranked as one of the most competitive economies in the world (www.webforum.org) and attracts a high proportion of inward foreign direct investment as a share of GDP. What then are the location advantages that might be contributing to this and has FDI, as theorised by the Investment Development Model, aided the economy in developing created assets that make the economy attractive?

From the 1800s to present day, Finland has undergone a transformation from an agriculture-based society through industrialisation to highly knowledge-driven economy (Koski and Ylä-Anttila, 2006). During the 19th Century much of the Finnish economy was centred around the natural resources available and abundant in the country. At the time the most important natural location advantage, was forests and timber. Finland still has the highest level of forest resources per capita in Europe (Paija and Palmberg, 2006). Other important natural assets include extensive hydro power resources and cheap nautical transportation routes leading to and around the Baltic Sea (Paija and Palmberg, 2006). As mentioned in the historical overview, there is evidence that foreign entrepreneurs and inward FDI, played an important role in the economy’s industrialisation process (Ylä-Anttila, Ali-Yrkkö and Nyberg, 2004). At the time these foreign players were actively bringing new innovation into Finland (Joronen, Pajarinen and Ylä-Anttila, 2002).
Most activity concentrated around the forestry industry, and the economy absorbed the technological know-how being brought in from Germany, amongst others, well. Often German expertise was brought in by the firms to run the mills and German expertise did spillover into Finnish society on more than one level, the Finnish educational model was developed based on the German model and by the beginning of the 20th century German engineering expertise had started to spillover into Finnish Universities (Paija and Palmberg, 2006). Machinery and equipment was also imported from Germany, Sweden and the U.K. and Finnish expertise also grew using and maintaining this equipment. Due partly to Finland’s cold winters and geographical location during the winter months when the main routes of transportation, the seas were frozen over, Finns had to develop the skills to maintain the machinery themselves. The strength of the forestry industry led to many supporting activities developing and supporting industries of chemical pulp and paper bleaching, machinery, and related automation developed, and Finland gained competitive advantage within those fields. These were the early steps of Finland’s largest and, until recently undoubtedly most important, industry clusters formation. The natural resources of forest and timber were used to achieve created assets within technological knowledge within the industry and creating surrounding industries. This process was started off by immigrants and inward foreign direct investment and spillovers from these investments, but some of the restriction policies actually helped Finland create competitive advantage in this cluster. After Finnish independence in 1917, the was a strong nationalistic movement, striving to self-sufficiency, and many of these the enterprises were nationalised and the market became protected by high tariffs. A forestry research institute was established, faculties related to forestry were set up in the Universities (Paija and Palmberg, 2006) and a climate where Finnish expertise within and surrounding the forestry industry could arise. Therefore the strength of the forestry cluster, the development of ownership advantages for large Finnish firms operating multinationally within the industry and the development of created assets around the sector is partly due to foreign influence, but also largely due to Finnish policy.

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
Another important industry cluster based on natural resources in Finland is the metal cluster. The production of metals and further processing of metals remained largely Finnish owned, although the supporting industries have become increasingly internationalised from the 1980s onwards (Pajarinen and Ylä-Anttila, 1998). This is a cluster where Finnish firms, like Outokumpu, have created ownership assets steaming from the natural assets available to them indigenously.

During the time of autonomy also the electrical sector and telephone lines were developed by foreign enterprises investing in Finland. The energy cluster is one of the clusters in Finland that has remained largely in foreign ownership in Finland (Pajarinen and Ylä-Anttila, 1998) and where there is evidence that foreign direct investment has aided in the development of the sector.

After the Second World War Finland had to pay heavy war reparations in the form of exports (Paija and Palmberg, 2006). As the reparations concentrated largely in heavy engineering industry products this external factor actually aided Finland’s development to the knowledge-driven economy it is today by forcing the development of indigenous engineering capabilities.

The cluster that is today arguably the most important cluster for the Finnish economy, the information technology (ICT) and telecommunications cluster, has little roots within history, its origin is however linked to the forestry cluster. There was a desire to indigenously develop the process control and automation hardware and software to support the growing exports of the cluster in the late 1960s. The government followed and encouraged the discussions around automated data processing and gradually the forest-related process control and automation systems became a business area for emerging electronics and ICT sectors in Finland (Paija and Palmberg, 2006).
The development of the strong ICT cluster in Finland has been aided by basic circumstances in the Finnish economy like, sufficient supply of qualified labour, a tradition of close collaboration between users and producers of technology, and an advanced home market (Paija and Palmberg, 2006). The formation of these created assets is largely due to the Finnish welfare economy providing a stable and secure environment to function in and an infrastructure for a knowledge economy, such as investing in education and research as well as in information and telecommunications (Dahlman, Routti and Ylä-Anttila, 2006) Finland was the first country in the world to accept universal suffrage in 1906 and welfare services have largely expanded from the 1960s onwards. Pensions available to everyone, free basic and higher level education, unemployment benefits and health care for all (Kaitila, Koski, Routti, Tiihonen and Ylä-Anttila, 2006) have created an environment which discourages corruption and builds the base for a highly educated labour force. The fact that Finland is ranked as one of the least corrupted countries in the world by Transparency International (www.transparency.org) creates the view of political stability and encourages foreign direct investment.

As with the Finnish egalitarian society in general, the Finnish education system is rooted in equality. Everybody has the possibility for the same education, regardless of gender, region, and socioeconomic background. The emphasis on education in society has a long background in Finland and the system has been adapted in different times to best serve the Finnish market. The law creating common schools was passed in 1866, in 1921 attending school was made a right and duty for anyone aged 7 to 12, in the 1960s and 1970s education reform resulted in the current basic education system with nine years of school for everyone (Koski, Leijola, Palmberg and Ylä-Anttila, 2006), the high level of this basic education is acknowledged by the Program for International Student Assessment (PISA) which scores Finnish students among the top countries in skills. The higher education system on the other hand has clearly been sculpted by economic trends; in the 1960s and 1970s the system provided social...
scientists and public employees for the welfare system, in the 1980s the number of students admitted to study to become engineers for the forestry industry were increased and in the 1990s to number of students admitted to study in ICT related fields grew by nearly 130% (Koski, Leijola, Palmberg and Ylä-Anttila, 2006). An education is not only available to all in Finland, but it is public funded and thus free of charge for all who attend. In addition to this, to encourage higher education students receive grants, so that ones socioeconomic standing cannot influence the possibility for a higher education. As a result of Finnish education policy, 40% of each age group complete tertiary education, one of the highest percentages in the world (Dahlman, Routti, Ylä-Anttila, 2006), and with over 20% of total graduates in being engineers, Finland has one of the greatest shares of engineers among the EU countries (Koski, Leijola, Palmberg and Ylä-Anttila, 2006).

Innovation and R&D has also been clearly encouraged by the government financially. A key factor has been said to have been its commitment to developing innovation, even through the recession in the 1990s when spending on R&D and innovation was increased, according to earlier pledges, instead of being cut (Koski, Leijola, Palmberg and Ylä-Anttila, 2006). Unlike nations like the U.K., Finnish technology policy does not provide tax incentives for R&D, but a significant proportion of government support to enhance innovation are direct subsidies (Koski, Leijola, Palmberg and Ylä-Anttila, 2006). Interestingly these subsidies are also linked to networking, typically a firm can receive subsidies through the National Technology agency, TEKES, only for projects that are networked, in collaboration with other companies or universities (Koski, Leijola, Palmberg and Ylä-Anttila, 2006). In other words the government is ensuring that there is the possibility of spillovers to others and thus further encouraging the growth of the knowledge-based cluster and further collaboration between the users.
Naturally, much of the ICT cluster developing in Finland must be accredited to the firms involved in the industry, and particularly Nokia as a driver of the industry in Finland. As it was necessary for the higher education system to shift admissions of students to the appropriate faculties to provide the firms in the economy with the right kind of graduates, it was important for many of the firms to adopt and alter their strategies to services the ICT sector. When large Finnish conglomerates started divesting in the 1990s, the specialisation of Nokia, amongst others, took place. An ownership advantage of the Finnish enterprises of the time was selecting a strategy that took advantage of the location advantages available to them and following ‘quick strategy’, constantly altering their micro strategies to respond to the market.

According to Ali-Yrkkö and Palmberg:

“Finland’s locational advantage relates to a combination of the availability of highly skilled engineers at relatively low costs, straight-forward co-operation especially with Universities, as well as pragmatism in decision-making and trust through out networks of firms and their actors.” (Ali-Yrkkö and Palmberg, 2006 pp.18)

Similarly, if the motives for inward FDI and benefits of investing in Finland discussed in section 3.4 are summarised, it can be seen that the majority of the location advantages in Finland currently are created assets. The questionnaires by Paasonen (1994), Puhakka (1995) and Lindström (2004) found the following factors to attract FDI into Finland:

- Geographical approximation to Russia and the Baltics, as well as understanding of operating in these markets
- Ease of regulation and lack of bureaucracy and infrastructure in Finland
- Politically stable environment and honesty and reliability of Finns
- Availability of highly trained employees and co-operation with Universities
• Technical know-how and competitive advantage of Finnish firms
• Lower corporate taxation rate

The existence of these created asset today maybe due to a combination of the existence of natural assets, government policy and the foreign-owned firms operating in the market. It is difficult to distinguish between how much each of these factors have influenced the development of the created assets. After deregulation and increased FDI into the Finnish economy since the 1990s, there have been studies into the multinational enterprises operating in Finland.

In the 1990s many companies that were in crisis due to the economic recession were purchases and fell under foreign ownership. Often the foreign-owner than initiated typical restructuring measures, employees were made redundant and use of capital was made more efficient, there is also evidence that foreign-ownership outsourced lower level roles (Pajarinen and Ylä-Anttila, 1998). According to studies, the return on investment in multinational enterprises, both foreign and Finnish owned, is usually better and profitability higher (Pajarinen and Ylä-Anttila, 2006 and Pajarinen and Ylä-Anttila, 1998). These profitability differences might be due to organisational culture differences (Pajarinen and Ylä-Anttila, 1998), but it is also likely that it is due to the managerial skills in the multinational enterprises. Not only are organisational cultural and managerial strategies of multinational firms often different from Finnish firms, but studies have also shown that the increasing number of multinational enterprises within the Finnish national market has triggered major changes in corporate governance towards the US model (Ylä-Anttila, Ali-Yrkkö and Nyberg, 2004). With more emphasis put on efficiency and value to share holders in multinational enterprises in the market the competitive environment changes. According to a study by Maliranta and Nurmi (2004), this change to the competitive environment is not necessarily negative. The study showed that foreign-owned enterprises crowd out local entrepreneurship, especially local entrepreneurs that are not very profitable. However, having foreign-owned enterprises in the market place
seemed to enhance the likelihood of profitable entrepreneurs surviving in the market. (Maliranta and Nurmi, 2004). Thus, the presence of multinational enterprises in the market place aided in making the market place more competitive, which encourages firms operating in that market to become more competitive and develop their competitive advantage, whether they be indigenous or exogenous.

There is a fear that the multinational enterprises will have an unfair advantage competing in the newly more competitive market place. According to the studies performed on the subsidiaries of multinational enterprises in Finland there is some evidence that they have benefited from being part of a multinational corporation, for example through new marketing and distribution channels and increased technology streams (Ali-Yrkkö, Lindström, Pajarinen and Ylä-Anttila, 2004). Subsidiaries of multinational enterprises also believe that they have benefited from being a part of an MNE. Over 60% believe they have benefited form the enterprises technological know-how and financing and over half believe they have benefited from the foreign affiliates marketing channels. (Lindström, 2004). It is however, one sighted to see only that these benefits have lead to an unfair advantage. Many indigenous firms have had the chance to benefit from the protectionist policies that were in the affect for decades. Also, as stated earlier the inclusion of multinationals in the Finnish market place has made it more competitive and thus encouraged also the indigenous firms to develop their competitive advantage.

Figure 3.5 shows how intertwined the location advantages, government involvement and foreign direct investment are in the Finnish economy. Each of the natural assets have lead to either inward or outward foreign direct investment. Then foreign direct investment has aided in developing some of the created assets in the economy.
Figure 3.5 The Relationship between Natural and Created Assets and Foreign Direct Investment and Government Involvement in the Finnish Economy.

For example early FDI helped develop the electrical and telephone systems, multinational firms that operate in the Eastern markets have brought knowledge on those markets into the economy and increased competition has encouraged indigenous firms to develop their competitive advantage. However, the marketplace alone has not developed the created assets present, government involvement and policies have also had a significant impact on their development. In turn these created assets are now motivators of foreign direct investment. The intertwined nature of this involvement presents support for the investment development path and the following section will in more detail assess the fit of the model to the Finnish economy and the development of it.

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
3.6 Finland and the Investment Development Path – Assessing the Fit of the Model to the Economy and where Finland might Lie on the Path

Although the development of foreign direct investment in and out of Finland has not been typical, with outward direct investment growing earlier than inward foreign direct investment, it is possible to find elements of the different stages along the investment development path in Finnish history.

![Investment Development Path Diagram](image)

Figure 3.6 The Investment Development Path and the Development of Foreign Direct Investment in Finland – a time line.

According to the theory, there is very little or no foreign direct investment in stage one. There is a limited domestic market and the location advantages are almost solely based on natural assets. The host market is typically undeveloped, with low per capita income, inappropriate economic systems, inadequate infrastructure and a poorly educated, trained or motivated labour force. There is also limited government involvement. The descriptive factors of this stage best fit with the era of autonomy and industrialisation in Finland. At the time there was little foreign direct investment activity in Finland, however, FDI played an important role in the industrialisation of the Finnish economy. Most of the inward
investment centred around the natural assets available in the market, like forest and timber and the availability of labour. As Finland was still a part of Russia, albeit an autonomic part, there was very little government involvement centred on developing the Finnish economy. The domestic market was limited, which is also supported by that fact that the majority of the inward FDI was motivated by serving the Russian market. As infrastructure was still undeveloped, foreign-owned enterprises took apart in developing the electrical and telephone networks.

As Finland became independent, the economy became nationalistic and protectionist regulations were set. This phase lasted for quite some time and protectionism only really started to lift in the 1960s and 1970s. Thus the second stage of development in Finland lasted for approximately seventy years. Many of the previously foreign-owned enterprises were nationalised and in accordance with the IDP model, the little inward investment that did take place was either to avoid tariff and non-tariff barriers to trade, like Unilever’s market seeking investment to enter the market, or to exploit the multinational enterprises competitive advantages which were no present in indigenous firms, like Ericsson and Siemens’ presence in the electrical network sector. The very protected market of the time allowed indigenous firms to develop. The firms were partly forced to develop technically as there was very little outside influence that could spillover, simultaneously these firms had a protected market to compete in and therefore had the chance to invest in long term plans rather than constantly fear short term competition. During these years the Finnish welfare society was also built up and the educational system was developed. The government involvement of the time thus aided in developing the created assets in the economy. Towards the end of the period of protectionism the government’s attitude toward foreign investment also started to gradually change and outward foreign direct investment was encouraged.
As attitudes towards foreign direct investment became increasingly positive in the 1980s, the economy transitioned into the third stage along the investment development path. According to the theory, some descriptive elements of stage three are: an increase in the rate of, especially market seeking, outward FDI, more developed competitive advantages of indigenous firms, a change in the ownership advantages of exogenous firms to managerial and marketing skills, a growing domestic market and government encouragement for FDI in order to enhance ownership and location advantages. This fits in with the developments in Finland during the 1980s. The economy was going through an economic boom of sorts and consumers were in a spending cycle, the domestic market had grown. The government strongly encouraged outward FDI and internationalisation of Finnish enterprises and was starting to encourage inward FDI as well by granting more exceptions to allow foreign investment into Finland. The first steps of outward direct investment of Finnish firms were to establish sales and marketing offices in the markets were exports had been strong, and were thus market seeking in nature. The government actions in the decades prior had also developed many of the created asset set that now sets the Finnish economy apart from others.

In figure 3.1.1 we can see the net outward investment position of Finland truly starting to grow in the beginning of the 1990s, the heating up of inward and outward FDI activity fits in with the fourth stage of the investment development path. According to the model, the location specific advantages are almost solely based on created assets in stage four. The formation of industry clusters is likely to become more pronounced, and the government's role focused on structural adjustment of location-bound assets. During the 1990s the formation of the ICT cluster in Finland strengthened and the government aided in this extensively, education admittance was skewed towards the industry and R&D and innovation subsidies were allocated, regardless of the economical recession of the time. FDI was also encouraged by other policy as the Restriction Act was abolished and policies like making corporate taxation more appealing were put in force. One of

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
the descriptive factors of stage four is also the growth of outward FDI flow as domestic firms being to offshore and respond to trade barriers, in the 1990s outflows from Finland were very high (Figure 3.1.5) and the motives also began to be more efficiency seeking.

In the 21st Century inward FDI into Finland became increasingly strategic asset seeking, as the ICT cluster also became more and more developed and firms involved in the cluster became more and more involved in outward FDI. These characteristics fit in with the final and fifth stage of the model. During this period the net outward investment position of Finland also began to even out (figure 3.1.1), which a key element of the fifth stage of the investment development path.

Based on the discussion above, it can be deduced that Finland’s development can be fitted into the investment development path model. There is some evidence supporting the model found in the case of Finland, however, it is not overwhelmingly strong evidence and the FDI development in Finland is still largely a typical compared to how the model outlines it.
Dunning’s Investment Development Path stipulates that foreign direct investment and multinational enterprises in a market place, along with government involvement, can aid an economy in transitioning its natural assets to created assets and thus function as a catalyst in developing an economy. Most of the studies in literature on foreign direct investment and its affects on host economies have, however, been on either large economies or developing economies. This study focuses on Finland a small developed economy, and how its development fits into the IDP and how that relates to other small developed economies.

Duran and Ubeda (2001) have ranked some small developed economies into the stages of the investment development path and came to the conclusion that Finland, along with Denmark, The Netherlands, Norway and Sweden, currently lies in the fifth and final stage of development of the IDP. However, this was an econometric multi-economy study and a consensus has not yet been formed on how the model should be evaluated. Dunning and Narula (1996) state that the factor’s that affect a nation’s investment development path are so complex that empirical analysis has severe limitations. According to them, analysis is best performed on a country-by-country basis. This study therefore, concentrates specifically on Finland and evaluates the fit of the model to Finland’s development and whether or not the country-specific analysis supports Duran and Ubeda's finding that Finland is in the fifth stage of development.

When analysing statistical data on foreign direct investment in small developed economies it was shown that the development trends of inward stock as a percentage of gross domestic product were similar for small developed economies, barring Ireland, Singapore, Hong Kong and the Netherlands, which have a very high percentage of FDI. This does not support the hypothesis that
these countries should be at an array of stages. The examination of outward stock as a percentage of GDP, on the other hand supports the theory of the economies being in different stages more as the development patterns are more erratic. Denmark’s development trend is similar to Finland’s, but the other countries that Duran and Ubeda ranked in the same stage have significantly higher percentage of outward investment. This does not present a great deal of support for the similarity of these economies, but Duran and Ubeda do not stipulate on at which time these economies entered the fifth stage, so this could indicate that the Netherlands, Norway and Sweden entered the fifth stage earlier than Finland and Denmark. When then looking at the net outward investment trends there are again no clear patterns through out. This is further evidence of the idiosyncrasy of the results of the model. What can be detected, however, is that Finland and Sweden have similar patterns, although Sweden’s NOIP growth began at an earlier stage. This could further support that Sweden entered the fifth stage earlier than Finland.

There have been other country-by-country studies of the investment development path and small developed economies. The developments of New Zealand, Spain, Sweden, Austria, Ireland and Portugal have been mapped earlier. The results of these studies are ambiguous. The fit of the model is not straightforward for any of the countries, although each study does find support for the model. The model might be better suited for developing countries, which also seem to be the economies that Dunning has had in mind when the model was developed.

Moving on to the Finland specific material a combined method was chosen, based on the suggestions of Dunning and Narula and the practices adopted from the country-by-country studies of the other small developed economies. Statistical data was analysed to see if the NOIP pattern fits into the models predictions or if answers could be found by evaluating foreign direct investment by region or sector. Also, a historical overview was conducted and the motives of
FDI examined. Based on these, and understanding was formed of how foreign direct investment and government involvement has aided the transformation of Finland’s natural assets to created assets. At the end, and attempts made at mapping Finland’s development along the investment development path.

Finland’s development has been atypical. The economy is considered a latecomer in terms of FDI and outward FDI has been more pronounced and started growing earlier than inward FDI. This is not in accordance with the IDP model which stipulates that there will first be inward investment into an economy, and after that activity has stimulated the economy and enriched the indigenous firms outward FDI will begin. Part of the reason for Finland being such a latecomer has been protectionist regulation, and indeed after the regulation was abolished FDI activity in Finland grew at a tremendous speed.

In the study, evidence was found that early on inward foreign direct investment played an important role in the industrialisation of the economy. Technological know-how and managerial skills spilled over into the economy and helped develop domestic firms. Foreign-owned firms also played a part in developing Finnish infrastructure, FDI was involved for example in the building of electrical and telephone networks in Finland.

After independence the economy entered an era of nationalism and protectionism, where FDI had little chance on influencing the development of the economy. During this time government involvement played a big role in developing the created assets in Finland today. The creation of the Finnish welfare economy created an environment of political stability where there is little need for corruption. The education system, based on equality, built a highly skilled workforce that also partly due to the welfare economy is relatively low cost. Also, protectionist policy allowed indigenous firms operating around Finnish natural assets, for example those in the forestry cluster, to grow in a safe environment and develop competitive advantages. The created assets of political
stability and a highly skilled work force, as well as government policy and subsidies encouraging innovation helped form the competitive advantages of these domestic firms.

In the 1980s attitudes towards foreign involvement in the Finnish economy started to change. A government push for Finnish firms to internationalise began, and firms were encouraged to utilise their developed competitive advantages in the global market place. Also the natural dis-advantage of sorts, of a small national market pushed Finnish firms to internationalise.

Then in the 1990s protectionist policy was abolished and a boom in foreign direct investment came about. Despite of the small domestic market much of the inward investment was market seeking, but an increasing amount was also strategic asset, especially technology, seeking. Multinational enterprises in the market aided in further developing the competitive advantages and ownership advantages of Finnish firms by creating a more competitive market where firms must constantly develop to survive. Also spillovers of more U.S. style of corporate governance, focusing more on efficiency and managerial skills spread in the interaction of the multinational enterprises with domestic firms. Additionally the Finnish economy has enjoyed the benefits of the natural asset of its geographic location, being close to the growing Russian and Baltic markets. After years of trade and foreign direct investment into these markets the knowledge of functioning in these markets grew in Finland and the purely natural asset developed into a created asset.

It is concluded that the transformation from an economy relying heavily on its natural assets to a knowledge economy with mostly created assets is a complex web of affects of government involvement, inward FDI and outward FDI. This is demonstrated in the figure produced the section discussing the transformation and duplicated here below.
This figure confirms Dunning and Narula’s (1996) opinion that the development of a nation’s created assets is so complex, analysis of purely empirical material is too limited.

The study also concludes, that even though Finland’s development along the investment development path has not been typical, it can be mapped in accordance with the model. Stage one was in the time of autonomy and as the economy industrialised, stage two was during the era of protectionism from independence to the 1970s, stage three was in the 1980s when attitudes began to change, stage four was in the 1990s during de-regulation and the boom of foreign direct investment and stage five began at the turn of the century.

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
One of the goals of this research was also to find whether inward foreign direct investment into Finland should continue to be encouraged by the government and organisations like Invest in Finland. It can be concluded that foreign direct investment has had positive affects on the development of the Finnish economy. However, as inward foreign direct investment is becoming increasingly strategic asset seeking, a straight forward answer to whether inward direct investment should be strongly encouraged cannot be given. Government involvement, through subsidies and investments into the development of the economy’s created assets, has been significant in creating the technology rich, knowledge intensive, innovative Finnish firms operating today. Thus, there is a risk that if many of these fall purely into foreign ownership, that the return from these investments will leak out of the economy. It is suggested that more research is conducted into the current motives for acquisition based FDI into Finland are conducted, to be able to formulated suggestions for future policy.


This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.


This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.


This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.


This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.

Hood N and Young S (1979). “The Economics of Multinational Enterprise” *Longman 1979*


This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.


Lindmark, Magnus and Vikström, Peter (2002). “Growth and structural change in Sweden and Finland 1870-1990. – A story of convergence”. Department of Economic History, Umeå University

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.


Maliranta, Mika and Nurmi, Satu (2004). "Do Foreign Players Change the nature of the Game Among Local Entrepreneurs?”. ETLa Elinkeinoelmän tutkimuslaitos (The Research Institute of the Finnish Economy), Keskusteluaheiita – Discussion papers No.942.


This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.


This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.

ETLA Elinkeinoelmän tutkimuslaitos (The Research Institute of the Finnish Economy), Keskusteluaiheita – Discussion papers No.530.


ETLA Elinkeinoelmän tutkimuslaitos (The Research Institute of the Finnish Economy), Keskusteluaiheita – Discussion papers No.904.


This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.


This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.

This thesis was written as a part of the Master of Science in Economics and Business Administration program – Major in International Business. Neither the institution, nor the supervisor is responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.