VALE COLUMBIA CENTER
ON SUSTAINABLE INTERNATIONAL INVESTMENT
A JOINT CENTER OF COLUMBIA LAW SCHOOL AND
THE EARTH INSTITUTE AT COLUMBIA UNIVERSITY

Columbia FDI Perspectives
Perspectives on topical foreign direct investment issues by
the Vale Columbia Center on Sustainable International Investment
No. 95 May 20, 2013
Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)
Managing Editor: Jennifer Reimer (jreimer01@gmail.com)

How do consumer-focused multinational enterprises affect emerging markets?

by

Terutomo Ozawa[*]

In *The Wealth of Nations*, Adam Smith identified the ultimate purpose of economic growth as consumption, and conceptualized its income-propelled progression from “necessaries” to “conveniencies” to “elegancies.”[1] Modern consumer-focused multinational enterprises (CF-MNEs) usually produce “conveniencies” and “elegancies,” though some develop the local supply of “necessaries” (e.g., milk for Nestle, and chickens and potatoes for KFC). Most CF-MNEs originated in the advanced world since the end of World War II, though several were spawned in prewar days.

In contrast, conventional old-style MNEs in extractive industries have been around ever since the Industrial Revolution led to the buildup of heavy and chemical industries in the industrialized world that process raw materials into industrial products. They hunt for overseas resources and once epitomized colonialism and industrialism -- as opposed to consumerism that underlies a motive of CF-MNEs to go abroad. Particularly, colonial MNEs and their home countries used to hinder industrialization in emerging markets by “kicking away the ladder”[2] in fear of fostering would-be rivals.

[*] Terutomo Ozawa (T.Ozawa@Colostate.EDU) is Professor Emeritus of Economics at Colorado State University and Research Associate for the Center on Japanese Economy and Business, Columbia Business School. An earlier and expanded version of this *Perspective* was presented at a workshop, the German Historical Institute, Washington D.C., November 2012. This essay is also woven into a book manuscript in progress: *The Evolution of the World Economy: The “Flying-Geese” Theory of Multinational Corporations and Structural Transformation* (Cheltenham, Glos., UK: Edward Elgar, forthcoming). The author is grateful to Matthias Kipping and Christina Lubinski for their comments and encouragement. The author also wishes to thank Thomas Jost, Herbert Oberhaensli and Ravi Ramamurti for their helpful peer reviews. **The views expressed by the author of this *Perspective* do not necessarily reflect the opinions of Columbia University or its partners and supporters. *Columbia FDI Perspectives* (ISSN 2158-3579) is a peer-reviewed series.**

[1] Adam Smith, *The Wealth of Nations, vol. 1, 2nd ed.* (London: UOP, 1880), pp. 404-405, available: http://archive.org/stream/aninquiryintothe01smituoft#page/n9/mode/2up.

[2] This phrase, attributed to Friedrich List, was adopted as the title of a book by Ha-Joon Chang, *Kicking Away the Ladder* (London: Wimbledon Publishing, 2002).

By comparison, CF-MNEs desire the growth of emerging markets simply because they need larger markets. Their home countries themselves are helping emerging markets industrialize via economic aid and technical support and opening up for trade and investment, especially by MNEs. After all, today's MNEs disseminate industrial knowledge and promote trade. In other words, developed countries are willingly "providing the ladder." China's successful catch-up strategy to capitalize on the modern-day opportunities attests to this distinctive sea change for emerging markets.

CF-MNEs' engagement in emerging markets normally begins with food and beverages and proceeds to personal care items, to white goods and electronics, to motorbikes and automobiles, to luxuries and leisure. Coca Cola, Heineken, KFC, McDonald's, and Pepsi and the like are usually among the first-wave investors. Coca Cola has already invested practically everywhere throughout the world. It is advancing into Myanmar, leaving only Cuba and North Korea still Coca Cola deprived.

Nestle and Kraft (the two largest processed food companies), P&G and Unilever (the two biggest personal-care product makers), and Avon, Revlon and Shiseido (beauty good producers) are usually among the second-wave MNEs. These MNEs react quickly to early signs of "middle class" growth -- a middle class defined, for instance, as those income earners with US$ 4 and up per day in sub-Saharan Africa. Even consumers in such low-income markets can afford "conveniencies," such as toothpaste, shampoo and low-end cosmetics. Local demand for private transportation normally moves from bicycles to motorcycles to passenger cars.

A McKinsey study summarized the evolutionary consumption pattern: "[S]nacks and bottled drinks…accelerate at a relatively early stage of the income curve, beauty products somewhat later, and luxury products, such as fashion and fine wines, later still."[3] This consumption sequence is, however, usually time-compressed because of sharp income inequality that accompanies catch-up growth for a variety of reasons (including corruption). Consequently, an emerging market's demand structure is vertically segmented. The rich indulge in conspicuous consumption ("elegancies"), and a growing middle class enjoys "conveniencies," while most people are still in poverty, subsisting on "necessaries." Thus, these divergent patterns occur *concurrently* at the macro-level, as well as *sequentially* at the individual level.

Since CF-MNEs seize on any growing emerging market, they are likely to steer host economies toward *domestic consumption-based* growth. New consumer goods are *incentives* to work (though "elegancies" often motivate bribery/theft) and "*modernize"* traditional consumption habits. New hotels, restaurants, shopping malls, and other amenities also cater to MNEs, businesspeople and tourists who pile into fast-growing countries, accelerating growth.

[3] "Winning the $30 trillion decathlon: Going for gold in emerging markets," *McKinsey Quarterly* 3, 2012, p. 9.

Furthermore, CF-MNEs' supply chains -- like those for Apple's iPad, Toyota's cars and Zara's apparel -- offer opportunities to participate in *intra-company/product* trade and production, as input suppliers or final assemblers. These supply chains are a *new* ladder of export-fueled growth with access to the advanced management know-how, technologies and marketing channels necessarily imparted to local partners for effective chain operations.[4]

Caveats are in order, nevertheless, lest host economies become too consumption-oriented in the early catch-up phases when scarce resources need to be allocated to infrastructure and industrial capacity building -- and when their balances of payments remain precarious. A lack of savings necessitates borrowing from overseas, exposing emerging host markets to the risk of currency/financial crises. Rampant consumerism leads to waste and environmental problems. Modern consumer goods/services often crowd out local cultures and traditions, although sometimes crowding in indigenous goods such as raw materials (e.g., coconuts for Nestle and palm oil for P&G). Any egregious consumption inequality stemming from income mal-distribution and whipped up by ostentatious consumerism evokes discontent in politically fragile emerging markets. Despite these risks of imported consumerism, however, CF-MNEs facilitate an income-ratcheted progression of consumption, thereby achieving the Smithian goal of growth in emerging markets.

The material in this Perspective may be reprinted if accompanied by the following acknowledgment: "Terutomo Ozawa, 'How do consumer-focused multinational enterprises affect emerging markets?,' Columbia FDI Perspectives, No. 95, May 20, 2013. Reprinted with permission from the Vale Columbia Center on Sustainable International Investment (www.vcc.columbia.edu)." A copy should kindly be sent to the Vale Columbia Center at vcc@law.columbia.edu.

For further information, including information regarding submitting to the *Perspectives*, please contact: Vale Columbia Center on Sustainable International Investment, Jennifer Reimer, jreimer01@gmail.com. In addition to her role as Research Associate for the VCC, Ms. Reimer is Legal Counsel for LG Electronics' Regional Headquarters for the Middle East and Africa.

The Vale Columbia Center on Sustainable International Investment (VCC), led by Lisa Sachs, is a joint center of Columbia Law School and the Earth Institute at Columbia University. It is the only applied research center and forum dedicated to the study, practice and discussion of sustainable international investment, through interdisciplinary research, advisory projects, multi-stakeholder dialogue, educational programs, and the development of resources and tools.

Most recent Columbia FDI Perspectives

- No. 94, Stephan Schill and Marc Jacob, "Common structures of investment law in an age of increasingly complex treaty-making," Columbia FDI Perspectives, May 6, 2013.
- No. 93, Xiaofang Shen, "How the private sector is changing Chinese investment in Africa," Columbia FDI Perspectives, April 15, 2013.
- No. 92, Vid Prislan and Ruben Zandvliet, "Labor provisions in bilateral investment treaties: Does the new US Model BIT provide a template for the future?," Columbia FDI Perspectives, April 1, 2013.

[4] "Chains of gold: Modern supply chains are making it easier for economies to industrialize," *Economist*, Aug. 4, 2012.

- No. 91, Anthony O'Sullivan and Alexander Böhmer, "The Arab Awakening, act II: Time to move more boldly on investment," Columbia FDI Perspectives, March 18, 2013.
- No. 90, Shaun E. Donnelly, "A business perspective on a China - US bilateral investment treaty," Columbia FDI Perspectives, March 4, 2013.
- No. 89, Joachim Karl, "Investor-state dispute settlement: A government's dilemma," Columbia FDI Perspectives, February 18, 2013.
- No. 88, Jarrod Wong, "The compensatory nature of moral damages in investor-state arbitration," Columbia FDI Perspectives, February 4, 2013.
- No. 87, Ralph Alexander Lorz, "Trying to change the rules for responding to arbitration unilaterally: The proposed new framework for investor-state dispute settlement for the EU," Columbia FDI Perspectives, January 22, 2013.
- No. 86, Catharine Titi, "EU investment agreements and the search for a new balance: A paradigm shift from laissez-faire liberalism toward embedded liberalism?," Columbia FDI Perspectives, January 3, 2013.
- No. 85, Karl P. Sauvant and Huiping Chen, 'A China – US bilateral investment treaty: A template for a multilateral framework for investment?,' Columbia FDI Perspectives, December 17, 2012.

All previous *FDI Perspectives* are available at http://www.vcc.columbia.edu/content/fdi-perspectives.