

THE INFLUENCE OF U.S. JOINT VENTURES IN ASIA ON SHAREHOLDER WEALTH

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INTRODUCTION

U.S. direct investment in Asia has almost doubled from 1990 to 1995. U.S. investment in China alone has increased sixfold during this period. Further, today about \$1 in every \$5 invested abroad by U.S. investors is invested in Asia (Department of Commerce, 1996). Obviously, Asia is more and more becoming an attractive target for U.S. investors. The predominant method for U.S. business to enter Asia is through the joint venture. Motives for joint ventures are presented by Harrigan (1985), Hennert (1988) and Taggart and McDermott (1993). A few studies have examined the wealth effects of U.S. joint ventures in specific countries of Asia (Lee and Wyatt (1990), Hu, Chan and Shieh (1992), and Chung, Koford and Lee (1993)). Nevertheless, there is still some uncertainty about the overall effect of U.S. joint ventures in Asia on U.S. shareholders. Given the significant growth of U.S. direct investment in Asia, the purpose of this paper is to reexamine the issue of U.S. joint ventures in Asia and measure their overall impact on shareholder wealth. This study extends earlier research by examining a considerable sample of joint ventures over a long time period.

LITERATURE REVIEW

Some of the first evidence on the shareholder wealth effects was presented by McConnell and Nantell (1985). Based upon a sample of 136 U.S. domestic joint ventures from 1972 to 1979, they find evidence of significant positive excess returns around the time when the joint ventures were announced. Thus, their evidence supports the idea that joint ventures are value creating decisions.

Quite a few studies have exclusively examined international joint ventures and found that joint ventures were value enhancing. Lummer and McConnell (1990) studied a sample of joint ventures with many countries. Crutchly, Guo, and Hansen (1991) and Gupta, McGowan, Misra, and Missirian (1991) used a sample of U.S. joint ventures in Japan and the People's Republic of China, respectively.

Hu, Chan, and Shieh (1992), in a study of U.S. joint ventures in China, found that the impact on shareholders wealth depended upon the degree of international involvement. Low international involvement, as reflected by a small percentage of foreign sales and a fewer number of foreign subsidiaries, yielded on average positive effects on shareholder wealth. Companies with high international involvement received no significant positive or negative effects.

On the other hand, several studies find evidence of a significant negative effect of joint ventures abroad. Lee and Wyatt (1990) studied the wealth effects of 109 joint ventures from 1974 to 1986. For the full sample they found that the companies suffered significant wealth losses around the announcement. Joint ventures in less developed countries resulted in positive effects on shareholder wealth, while joint ventures in developed countries and newly developed countries had negative effects. Chung, Koford, and Lee (1993), using a sample of 230 joint ventures formed by U.S. companies from 1969 to 1989, found that the announcements have a negative impact on shareholder wealth. They also divided their sample into two groups based on the country status of the U.S. company partner, developed and less developed countries. In contrast to Lee and Wyatt (1990), the abnormal returns for both groups was negative. However, U.S. stockholders with partners from less developed countries suffered larger wealth losses than with partners from developed countries.

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Given the inconclusive nature of previous findings, this paper will deal with the following questions:

1. What overall impact do U.S. joint ventures in Asia have on shareholder wealth?
2. Has the shareholder wealth effect of U.S. joint ventures in Asia changed over time?
3. Does the degree of country development influence the shareholder wealth effects of joint ventures in Asia?

DATA AND METHODOLOGY

The sample for this study is composed of U.S. companies undertaking joint ventures in developing countries in Asia. The choice of country location of the joint ventures is based on the largest amount of foreign direct investment from the United States in Asian countries. The countries are Singapore, Hong Kong, Taiwan, South Korea, China, India, Indonesia, Malaysia, Thailand, and Philippines.

The announcements of U.S. companies engaging in joint ventures in these Asian countries, were found on Lexis/Nexis. The stock returns of those companies making the announcements of joint ventures had to be available on the data files on the Center for Research Study in Security Prices (CRSP) during the selection period. The selection process resulted in exactly 300 joint venture announcement dates during the sample period.

The countries chosen as the location of the joint ventures are divided into two groups, following the classification of International Monetary Fund: Less Developing Countries (LDC) and Newly Industrialized Countries (NIC). China, India, Indonesia, Malaysia, Thailand, and the Philippines are classified as LDC, while Singapore, Hong Kong, Taiwan, and South Korea are in the NIC group. Table 1 shows the distribution of the sample by country, group of countries, and period.

TABLE 1

		1972-1983	1984-1988	1989-1993	TOTAL
N.I.C.					
	SINGAPORE	2	7	22	31
	HONG KONG	2	3	18	23
	TAIWAN	10	3	16	29
	S. KOREA	7	13	10	30
	SUB-TOTAL	21	26	66	113
L.I.C.					
	CHINA	13	16	39	68
	INDIA	0	0	43	43
	INDONESIA	11	1	14	26
	MALAYSIA	1	2	13	16
	THAILAND	1	2	21	24
	PHILIPPINES	6	1	3	10
	SUB-TOTAL	32	22	133	187
TOTAL		53	48	199	300

The number of joint venture announcements was dominated by announcements in LDC with 187 announcements reported in the entire period. Within the LDC group, China and India were the countries with the largest number of announcements. They accounted for about 60 percent of the total announcements in LDC sample. The period with the most joint venture announcements is the last five-year period. During this last period, two-thirds of the joint venture announcements occurred. In addition, there were more joint ventures in the last five-year period in the LDC group than in NIC. It appears that during that time period, the LDC area was more attractive than NIC. This trend could be explained by greater economic incentives, lower costs, and/or greater growth opportunities in LDC's.

In this study, as in other studies, the day that the joint venture announcement appeared in the newspaper was classified as day zero in event time, $t=0$. The trading days prior to that day are numbered as event days $t=-1$, $t=-2$,

etc. The subsequent trading days are numbered $t=+1$, $t=+2$, etc. The daily returns of the stocks are obtained from the Center for Research in Security Prices (CRSP) daily returns file. The test period covers 33 days, 16 days before the event, the announcement date of the joint venture and 16 days after the announcement date.

The standardized market model is used to determine the predicted returns and to calculate the abnormal returns for each company in the sample. For each company, the standardized market model used to calculate the returns is as follows:

$$r_{jt} = a_j + b_j r_{mt} + e_{jt}$$

where:

r_{jt} = the return on security j for period t ,

a_j = the intercept term,

b_j = the covariance of the returns on the j th security with those of the market portfolio, divided by the variance of the market portfolio's returns,

r_{mt} = the return on CRSP market portfolio for period t ,

e_{jt} = the residual error term on security j for period t .

The parameters of this market model (a_j and b_j) were estimated using the estimation period of 220 days in length and ends 30 days before the event date, $t=(-250, -30)$. The variance of the residuals during this estimation period was calculated as:

$$s_i^2 = \sum_{(t=1)}^T \frac{e_{jt}^2}{T-2}$$

where T is the estimation period.

The maximum likelihood estimate of variance is:

$$s_{it}^2 = s_i^2 \left[1 + \frac{1}{T} + \frac{(r_{mt} - r_m)^2}{\sum_{(t=1)}^T (r_{mt} - r_m)^2} \right]$$

The abnormal return (ABR_{jt}) is the difference between the actual return (R_{jt}) and the expected return ($a_j + b_j r_{mt}$) and is calculated using the following equation:

$$ABR_{jt} = R_{jt} - (a_j + b_j r_{mt})$$

The average normal return (AAR) is the mean of all the companies' abnormal returns for that date:

$$AAR_t = \sum_{(j=1)}^n \frac{ABR_{jt}}{N}$$

where N is the number of companies.

The standardized average abnormal return (SAR) is calculated as:

$$SAR_t = \frac{1}{N} \sum_{(j=1)}^n \frac{ABR_{jt}}{s_{it}}$$

The cumulative average return (CAR) for each event interval is:

$$CAR_{T_1, T_2} = \sum_{T_1}^{T_2} AAR_t$$

The standardized cumulative abnormal return is:

$$SCAR_{T_1, T_2} = \frac{1}{\sqrt{L}} \sum_{t=1}^L \frac{AAR_{it}}{s_{it}}$$

where L is the length of interval in the prediction period.

TABLE 2
Average Abnormal Returns (All Countries)

DAY	1972-1993 n=300		1972-1988 n=101		1989-1993 n=199	
	ARR	Z	AAR	Z	AAR	Z
-16	0.11%	0.13	-0.07%	-0.33	0.20%	0.40
-15	0.12%	0.74	0.12%	-0.22	0.13%	1.07
-14	0.17%	1.72	0.27%	1.63*	0.12%	0.10
-13	0.00%	0.37	0.10%	0.40	-0.05%	0.18
-12	-0.29%	-2.70**	-0.45%	-2.10**	-0.21%	-1.82**
-11	0.04%	0.30	-0.07%	-0.14	0.09%	0.47
-10	0.06%	1.32*	0.15%	0.89	0.01%	0.98
-9	-0.06%	-0.58	-0.34%	-2.07**	0.09%	0.76
-8	-0.12%	-1.06	-0.03%	-0.04	-0.17%	-1.27
-7	-0.07%	-0.60	-0.27%	-1.47*	0.03%	0.31
-6	-0.11%	-1.60*	-0.01%	-0.10	-0.18%	-1.89**
-5	-0.03%	0.04	-0.17%	-0.63	0.05%	0.50
-4	-0.11%	-0.57	-0.05%	0.34	-0.15%	-0.10
-3	-0.10%	0.02	-0.48%	-3.05***	0.40%	2.20**
-2	0.11%	1.73**	0.26%	1.75**	0.03%	0.88
-1	-0.08%	-0.31	0.09%	-0.23	-0.07%	-0.22
0	0.08%	1.43*	-0.21%	2.01**	0.02%	0.32
+1	-0.06%	-0.34	-0.29%	-1.57*	0.06%	0.70
+2	-0.06%	-0.73	-0.04%	-0.30	-0.08%	-0.68
+3	-0.01%	-0.56	-0.11%	-0.94	0.03%	-0.02
+4	0.05%	0.67	0.03%	0.38	0.07%	0.55
+5	0.32%	2.13**	0.15%	1.08	0.41%	1.85**
+6	-0.07%	-0.87	-0.24%	-1.86**	0.02%	0.26
+7	-0.09%	-0.95	-0.15%	-0.70	-0.06%	-0.66
+8	-0.10%	0.98	0.08%	0.24	0.11%	1.03
+9	-0.16%	-1.35*	-0.02%	-0.02	-0.24%	-1.65**
+10	-0.09%	0.33	-0.18%	-0.49	-0.04%	0.76
+11	-0.13%	-1.57*	-0.15%	-0.81	-0.12%	-1.35*
+12	0.00%	0.58	-0.04%	-0.36	-0.02%	0.98
+13	0.32%	2.57**	0.83%	3.73***	0.06%	0.48
+14	0.13%	0.98	0.23%	1.93**	0.07%	-0.18
+15	0.00%	-1.19	-0.08%	-1.37*	0.03%	-0.48
+16	-0.22%	-1.91**	-0.07%	-0.66	-0.06%	-1.88**

AAR = Average Abnormal Return

*=Significant at 10%, **=Significant at 5%, ***=Significant at 1%

EMPIRICAL RESULTS

In this section the results of the study are presented and analyzed. The results of the event study will consist of the result of the event study for the whole sample, the results of the event study for two sample sub-periods, and comparison between the results of the event study in LDC and NIC.

The major finding of the event study is on the day of the announcement date. The standardized average abnormal returns on the announcement date of a joint venture by a U.S. firm in these Asian countries is positive (+0.08%) and statistically significant at 10% as shown in Table 2. It shows the average abnormal returns from day $t=-16$ to $t=+16$. Table 2 indicates that for the 16 days before the announcement date there is no consistent pattern of abnormal returns of companies engaging joint ventures in Asia. On $t=-14$, $t=-10$, and $t=-2$, the average abnormal returns are positive and significant at 5%, 10%, and 5%, respectively. On $t=-12$ and $t=-6$ the average abnormal returns are negative and significant at 1% and 10%, respectively. On other days before the announcement date there are no significant abnormal returns.

The days after the announcement date show no consistent pattern of the average abnormal returns. On $t=+5$ and $t=+13$ there are significant positive abnormal returns at 5% and 1%, while on $t=+9$, $t=+11$, and $t=+16$ the average abnormal returns are negative and significant at 10%, 10%, and 5%, respectively.

Standardized cumulative abnormal returns are negative one day around the announcement date, but are not statistically significant. As shown in Table 3, no cumulative abnormal return of any interval around the announcement date is found to be significant.

TABLE 3
Cumulative Abnormal Return (CAR)
For All Countries

DAYS	1972-1993 n=300		DAYS	1972-1988 n=101		DAYS	1989-1993 n=199	
	CAR	Z		CAR	Z		CAR	Z
0	0.08%	1.43*	0	0.20%	2.01**	0	0.01%	0.32
(-1,0)	0.00%	0.79	(-1,0)	0.11%	1.26	(-1,0)	-0.05%	0.07
(0,+1)	0.01%	0.77	(0,+1)	-0.08%	0.31	(0,+1)	0.07%	0.72
(-5,-1)	0.00%	0.41	(-1,+1)	-0.17%	0.13	(-1,+1)	0.00%	0.46
(+1,+5)	0.23%	0.53	(-10,-1)	-1.00%	-1.46*	(-10,-1)	0.04%	0.41
(-10,-1)	-0.30%	-0.51	(+1,+10)	-0.75%	-1.32*	(+1,+10)	0.27%	0.68
(+1,+10)	-0.07%	-0.21	(-5,+5)	-0.58%	-0.35	(-5,+5)	0.76%	1.55*
(-1,+3)	-0.13%	-0.22	(-10,+10)	-1.55%	-1.48*	(-10,+10)	0.34%	0.82
(-1,+1)	-0.05%	0.45	(-15,+15)	-0.71%	-0.73	(-15,+15)	0.43%	0.73

*=Significant at 10%, **=Significant at 5%

The only significant cumulative abnormal return is on the date of the announcement. Overall, the positive abnormal returns on the day of the announcement support the proposition that joint ventures in developing Asian countries increase shareholder wealth.

This result is consistent with the Crutchley, Guo and Hansen (1991) and McConnell and Nantell (1985). Other studies by Gupta, McGowan, Misra and Missirian (1991) and Hu, Chen, and Shieh (1992) found a positive impact for joint ventures in the developing country of China. Nevertheless, these results are in contrast to Lee and Wyatt (1990) and Chung, Koford, and Lee (1993).

The announcements were also divided into two periods, before and after 1989. In 1989, a significant event, the Tiananmen Square massacre, occurred in China. It may influence the joint venture returns. By dividing the sample into an early and later period, one can also examine shareholder reaction to announced joint ventures over time.

Table 2 shows the average abnormal returns for the period of 1972 to 1988 and 1989 to 1993. It is obvious that the positive abnormal returns came during the earlier period (1972-1988). The abnormal returns on the day of the

announcement for the earlier period is positive (+0.21%) and significant at 5%. During the late period (1989-1993) the abnormal returns are positive (+0.02%) but, much smaller and statistically insignificant.

The cumulative abnormal returns for the earlier years (Table 3) shows negative abnormal returns for three intervals around the announcement date: day (-10,-1), day (+1,+10), and day (-10,+10). Results are statistically significant at 10% level. In the later period, the cumulative abnormal returns show only one interval around the announcement date that has a significant result. It shows positive cumulative abnormal returns at day (-5,+5) of +0.76% which is significant at 10% (see Table 3). Therefore, the positive abnormal returns for the whole period on the announcement date basically came from the earlier years (1972-1988).

TABLE 4
Average Abnormal Return (AAR): 1972-1993
Newly Industrial Countries (NIC) and Less Developed Countries (LDC)

DAY	NIC n=113		LDC n=187	
	AAR	Z	AAR	Z
-16	-0.05%	0.44	0.21%	-0.18
-15	0.36%	0.95	-0.02%	0.20
-14	0.12%	0.85	0.19%	1.52*
-13	-0.03%	-0.17	0.01%	0.61
-12	-0.36%	-1.96**	-0.25%	-1.90**
-11	0.02%	-0.04	0.05%	0.41
-10	0.06%	0.37	0.06%	1.38*
-9	-0.30%	-2.21**	0.09%	0.97
-8	-0.26%	-2.06**	-0.03%	0.26
-7	-0.42%	-2.2**	0.14%	0.95
-6	-0.15%	-1.17	-0.09%	-1.11
-5	0.02%	0.05	-0.05%	0.02
-4	-0.13%	-0.24	-0.10%	-0.54
-3	0.18%	-0.14	0.06%	0.13
-2	0.19%	1.6*	0.06%	0.94
-1	0.03%	0.23	-0.14%	-0.57
0	-0.14%	-0.03	0.21%	1.83**
+1	-0.02%	-0.63	-0.08%	0.06
+2	-0.22%	-1.29*	0.03%	0.08
+3	0.01%	-0.67	-0.03%	-0.19
+4	0.10%	0.59	0.02%	0.39
+5	0.27%	1.49*	0.35%	1.54*
+6	0.03%	-0.93	-0.13%	-0.38
+7	-0.30%	-2.09**	0.04%	0.44
+8	-0.02%	-0.09	0.17%	1.31*
+9	0.03%	0.02	-0.28%	-1.73**
+10	-0.26%	-1.39*	0.01%	1.52*
+11	-0.05%	0.15	-0.18%	-2.12**
+12	0.15%	1.31*	-0.09%	-0.29
+13	0.59%	2.26**	0.15%	1.49*
+14	0.11%	0.44	0.13%	0.90
+15	-0.13%	-0.99	0.07%	-0.74
+16	-0.22%	-1.33*	-0.22%	-1.38*

*=Significant at 10%, **=Significant at 5%

An explanation for the difference in the two period results is that after most Asian countries have been open for international joint ventures for a period of time, the incentives for the subsequent incoming companies are reduced. The incentive reduction causes the decrease in expected future cash flow generated by the joint venture. In addition, developing countries in Asia are improving economically. Therefore, the cost of operating a company in those countries is also increasing. It is also possible that the companies involved in joint ventures in later periods have been involved in joint venture agreements before. The marginal benefit of the later joint venture is perceived to diminish over time.

The average abnormal returns for NIC and LDC are shown in Table 4. Before the announcement date, the joint ventures in NIC show mostly negative abnormal returns which are statistically significant at 5%. The negative abnormal returns are $-0.36%$ ($t=-12$), $-0.30%$ ($t=-9$), $-0.26%$ ($t=-8$), and $-0.42%$ ($t=-7$). The only positive return before the announcement date is at $t=-2$ ($+0.19%$) which is significant at 10%. After the announcement date, at $t=+2$ the abnormal return is negative ($-0.22%$) and significant at 10%. But, no significant result appears on the announcement date, even though it shows $-0.14%$ abnormal return.

Table 5 shows that the cumulative abnormal returns for NIC are negative: $-0.79%$ at $t=(-10,-1)$ and $-0.37%$ at $t=(+1,+10)$. They are statistically significant at 5% before announcement date, and at 10% after the announcement date.

Table 4 indicates that the average abnormal returns for the LDC sample on the announcement date is positive ($+0.21%$) and significant at 5%. The other significant result is the cumulative abnormal returns (table 5) at $t=(0,+1)$. It has a positive $+0.13%$ abnormal return, which is statistically significant at 10%. Other cumulative abnormal returns show no significant results.

The evidence indicates that joint ventures in LDC are interpreted to be value enhancing activities. This result is basically consistent with Lee and Wyatt (1990), which shows that a joint venture in a LDC is preferable than a joint venture in a NIC. In contrast, these results are inconsistent with the conclusion of the study of Chung, Koford, and Lee (1993). In their study, virtually all the abnormal returns are negative and LDC suffered larger wealth losses.

TABLE 5
Cumulative Abnormal Return (CAR): 1972-1993
Newly Industrialized Countries (NIC) and Less Developed Countries (LDC)

DAYS	n = 113		n = 187	
	CAR	Z	CAR	Z
0	-0.13%	-0.03	0.21%	1.83**
(-1,0)	-0.10%	0.14	0.07%	0.89
(0,+1)	-0.16%	-0.47	0.13%	1.34*
(-5,-1)	0.28%	0.67	-0.18%	-0.01
(+1,+5)	0.14%	-0.23	0.29%	0.84
(-10,-1)	-0.79%	-1.82**	-0.01%	0.77
(+1,+10)	-0.37%	-1.58*	0.11%	0.96
(-1,+3)	-0.34%	-1.07	0.00%	0.55
(-1,+1)	-0.13%	-0.25	0.00%	0.77

*=Significant at 10%, **=Significant at 5%

SUMMARY AND CONCLUSION

This study investigates the impact of joint venture announcements on stockholders' wealth. The joint venture announcements were made by U.S. companies that engaged in joint ventures in developing countries in Asia. The result show that joint ventures in developing countries in Asia are value enhancing especially during the earlier period. The incentives and conditions provided by the host countries offered a more favorable effect on the joint ventures than during the later period.

Stockholders that are involved in joint ventures in Less Developed Countries (LDC) experienced higher abnormal returns than those involved in joint ventures in a Newly Industrialized Countries (NIC). The difference might be due to the fact that the cost of operating companies in NIC's is higher than operating in LDC's. Additional research should consider this issue. Other research should also be conducted to see whether the results of this study can be generalized to other developing countries in Latin America and Eastern Europe.

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