International Expansion of Nigerian Banks
Which Theories of Internationalization Prevailed?

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Abstract

This paper compares the internationalization pattern of Nigerian banks to the predictions of thetheories of internationalization. The research examines the foreign market entry strategies of Nigerian banks by identifying factors that influenced the decision of the banks to establish international operations and those factors also that determined their entry mode choices.

The study was underlined by a positivist philosophy that tended towards realism and adopted a mixed qualitative and quantitative approach. Multiple case studies were used and five Nigerian banks were purposively sampled. Primary data was collected using Likert scale questionnaires and interviews, while secondary data was obtained from multiple sources. Primary data was analyzed using the normal distribution fitting algorithm approach.

The research found that foreign market entry was triggered by the success of banking sector reforms in Nigeria, a shift in the strategic scope of the banks and a desire to exploit tangible and intangible assets in less developed, but profitable banking markets in sub-Saharan Africa (SSA). It was also found that environmental uncertainties in host countries influenced entry through high equity commitment modes. Furthermore, it was found that the internationalization of Nigerian banks conformed to the predictions of the eclectic theory, the resource-based-view and the views of scholars of the transaction cost analysis who propose hierarchies in host locations with high environmental uncertainties.

This study offers an idiosyncratic contribution to the study of bank internationalization.

Introduction

In the past decade, Nigerian banks have become a one of the greatest facilitators of foreign direct investment (FDI) in SSA by their expansion into over twenty countries in the region. Presently there are nine international banks, according the classification of the Central Bank of Nigeria (CBN). This study examines the factors that motivated the banks to seek new markets and those factors also that influenced the entry mode strategies adopted by the banks. The findings of the research are then compared with the predictions of the various theories of internationalization to find which best captures the Nigerian reality. These theories include the eclectic theory, the process theory of internationalization, the resource-based view and the transaction cost analysis.

Studies on Multi-National Banks (MNBs) have been carried out mainly on banks from developed countries. There is hardly any studyon the international expansion strategies of MNBs from SSA. This study attempts to bridge that gap.

Research question, aim and methodology

This study observed the internationalization Nigerian banks between the period 2005 to 2012.The aim was to identify factors that influenced the decision of the banks to enter foreign as well as factors that influence the entry mode choices of the banks.It was to also tocompare the findings of the research to the predictions of theories of internationalization. The study adopted a positivist philosophy and a mixed quantitative and qualitative research approach. A multiple-case study approach was also adopted with managers involved in the internationalization decision of five Nigerian banks providing primary data through questionnaires and interviews. Theories were identified from the literature and variables (dependent and independent) were also noted. Data was defined, specified, and their sources (primary and secondary) identified and stated.

Literature review

Banks embark on international market entry for most of the reasons that Multi-National Enterprises (MNEs) in general internationalize, but some scholars have noted that the nature and characteristics of banking engender slight variations in their internationalization.

Banks and theories of internationalization

Scholars have, in seeking a better understanding of the determinants of the internationalization of firms, formulated a number of theories to explain the process. These theories include the eclectic theory, resource based view (RBV), and transaction cost analysis (TCA) among others.

The eclectic theory emphasizes Ownership advantage (O-) of the firms, Location (L-) advantage of the host country, and Internalization (I-) advantages that make firms decide on what mode of entry to adopt in a host country. The eclectic theory states that firms must possess some O-advantage, which enables it to profit from extending its operations into other national markets. For banks, these O-advantages include; specialized banking services, reputation or efficiency, managerial skills, technological edge, size and international experience (Cho, 1986).Accordingly, host countries poses L-advantages that make them attractive to MNBs, these include regulations that make banking easier, less risky and less uncertain. It also includes the market size, profit opportunities and level of governance in the host country. I-advantage makes banks internalize their operations in foreign markets. Cho (1986) stated that I-advantages include, availability and the cost of fund transfers within the MNB, efficient customer contracting, and transfer price manipulation which potentially reduces variability.

The Resource Based View (RBV) supports the notion that firms are able to leverage unique, valuable and rare resources for competitive advantage (Barney, 1991). For banks, their managerial capabilities, brand name, reputation, size and organizational culture are all assets that can confer competitive advantages.A Transaction Cost Analysis (TCA) approach is more focused on factors that hamper a bank’s ability to mitigate the cost of information on borrowers

and enforce contracts (Cull and Peria, 2010). These factors include environmental uncertainty brought about by macroeconomic instability and political risk as well as by regulatory, geographic, cultural and institutional distance (Outreville, 2007).

Process theory of internationalization states that increased knowledge of foreign markets allows firms to increase their commitment of resources to the market (Johanson and Vahlne, 1977). It may also be at the heart of the internationalization of banks that seem to enter foreign markets with low commitment modes of entry and increase their investment with increased knowledge of the market.

Determinants of foreign market entry by banks

Studies have noted that banks follow their clients that have made international market entries. Host country opportunities, e.g. a higher expected rate of economic growth are also some of the main determinants of outward banking FDI (Buch and Lipponer, 2004). Furthermore, tax, interest and exchange rate differentials between a bank's home and host countries may create opportunities for arbitrage and transfers which banks seek to exploit. Banks sometimes possess qualities and assets that give them an advantage when operating in a foreign market, because it is able to operate more efficiently. These include the bank's size, distribution channel and managerial competence. Banks may also react to the actions of their competitors and follow them to markets, or avoid some markets that their competitors have already entered (Williams, 1997).

When there are restrictions in the home country limiting a bank's home operations, growth or expansion, they might want to "escape" to expand internationally. In the same vein, a host country's openness to the establishment of new foreign branches and subsidiaries as well as tax incentives may also be important (Goldberg and Johanson, 1990). Aggarwal and Durnford (1989) noted that banks can diversify their income base by operating in a foreign country and obtain their gains in terms of their risk/return profile. A common cultural background may also facilitate bank international expansion into a particular geographic market (Guillén and Tschoegl, 1999).

Entry mode strategies of banks

A bank's motivation for its presence abroad links with the product market it seeks to operate in and considerations relating to a bank's strategic objective, host country regulations and transaction costs - including environmental uncertainty, costs of information, macroeconomic stability and political risk. All these affect a bank's choice of mode of entry into a foreign market. Banks enter new markets by all forms of entry mode choice, namely, JVs, strategic alliances, acquisitions and other equity ventures but Tschoegl (2001) observed that banking, being a service, creates licensing difficult because of the intangibility of some of the assets such as relationships with home-country firms. However, even where control modes are high, equity commitment modes vary and can be divided into low, medium and high equity commitment modes (Anderson and Gatignon, 1986). Low level equity commitment includes

representative offices and agencies, while medium level equity commitment modes of entry include JVs, strategic alliances and minority equity acquisitions of host country bank and wholly-owned branches. A high commitment mode of entry may involve the establishment of subsidiaries either through the majority equity acquisition of a local bank (brownfield acquisition) or the establishment of greenfield operations.

A bank's characteristics, including its size, Degree of Internationalization (DoI) and possession of tangible and intangible assets, influence entry mode choice. Focarelli and Pozzolo (2001) found that the largest banks (by assets and number of employees) preferred market entry as subsidiaries. A bank's business orientation, and the product market it seeks to trade in, also may influences market entry choice. Banks seeking to trade in investment and wholesale product markets in the host country usually enter with low and medium equity commitment modes while those seeking to trade in the retail sector enter with high equity modes, e.g. subsidiaries.Laws governing banking also influence entry mode choice as home country laws apply for most low commitment modes of entry, (representative office and agency) while a high commitment mode of entry (subsidiary) subjects a bank to host country banking regulations. Branches are subject to both the home and host country laws. Thus, a bank's entry mode choice can be influenced by the laws it chooses to be governed by.

Host country regulations, economic and political risk profile, size of banking market, level of governance, cultural and geographic distance, and legal origin, all influence the timing, pace and choice of market entry.Studies have found that when transaction costs are increased in a foreign market due to environmental uncertainties banks enter with low commitment equity entry modes or probably adopt a "wait-and-see" attitude (Nacken*et al.*, 2012). Environmental uncertainties are heightened by factors that include macroeconomic instability, political risks, low levels of development of institutions like credit rating agencies and the judiciary and weak rule-based governance. But some other studies have noted that, with increased macroeconomic instability in the host country, banks would enter as high equity commitment subsidiaries in order to ring-fence the parent bank from the failures and liabilities of the subsidiary, since subsidiaries are subject to the laws of the host country (Cerrutti*et al.*, 2007).

Theoretical Framework and Propositions

The theoretical framework and propositions are important aspects of positivist case study research. They are used in identifying the unit of analysis, boundary and scope of the research. The theory identifies the various concepts in the literature and propositions are declared statements about causation. The concepts, when developed for measurement, become variables with the causal (independent) and outcome (dependent) variables identified. Yin (2009) advocates that propositions should be declared from the theory and investigated and (sometimes) falsified through empirical findings.This research used a synthesis of the eclectic theory, the resource based view and TCA as its framework and the empirical findings relating to them, from the literature. In this light, the dependent variables, namely, (1) international market entry decision and (2) the entry mode choicesare the main focus of the research. The aim was to identify salient factors that influenced these choices. These factors were indentified from the

literature and are thus the independentvariables. After a review of the literature, theories and empirical findings from the literature, the following propositions were declared.

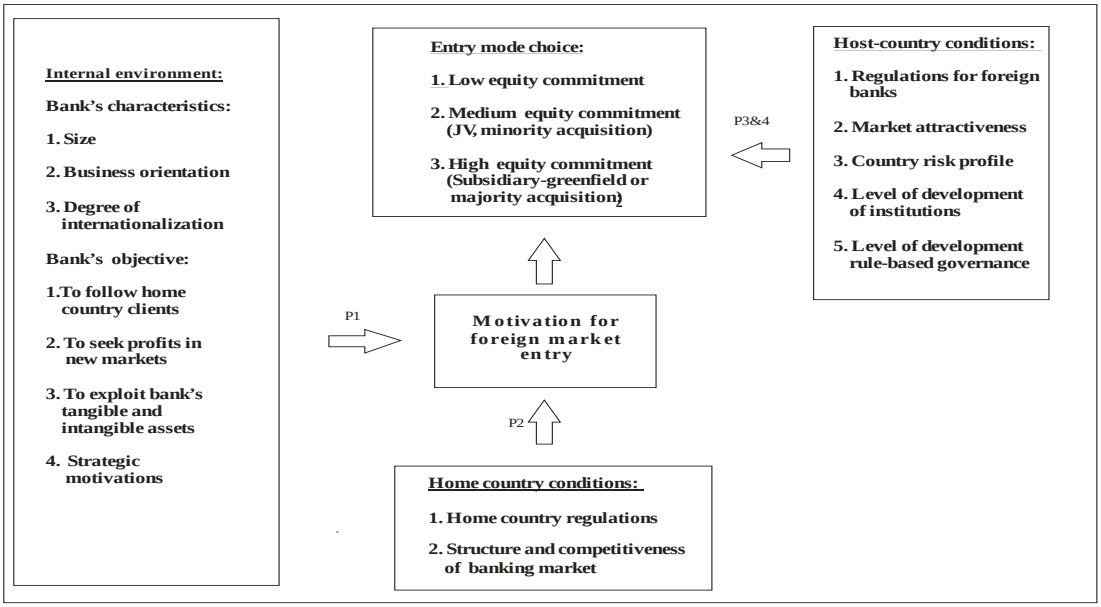
P_1 *A bank's desire to expand internationally will be influenced by a need to follow its clients into foreign markets, seek growth and profit opportunities, exploit its O-advantage, and fulfil the strategic aspirations of its managers.*

P_2 *A bank's motivation to expand internationally will be influenced by home country regulations and competitive pressure in the domestic banking market.*

P_3 *A bank's choice of mode of entry into foreign market will be influenced by the host country's regulations and market attractiveness.*

P_4 *A bank's choice of mode of entry into a foreign market will be influenced by the level of environmental uncertainty in the host country.*

Figure 1.Framework of the research with propositions



Data collection and analysis

At the end of 2012 there were 21 commercial banks in Nigeria of which nine were licensed by the CBN to have international operations. From this population, five banks were chosen as the cases for this study by purposive sampling. Between them they made up forty of the fifty-three total foreign entries made by Nigerian banks between 2005 and 2012. Thus, the sampled banks made up seventy-five percent (75%) of all foreign entries by Nigerian banks between 2005 and 2012. The sampling of respondents and interviewees was by snowball sampling. Emphasis was placed on top management in the strategy or corporate planning departments at the banks' headquarters and managing directors of international subsidiaries.

Likert scale questionnaires were sent to four managers in each bank for their response. The questionnaire was designed to appraise how important stated factors were to a bank's management decision to embark on foreign market entry. Responses to the questions ranged

from “not important,” “less important,” “important,” “very important.” and “extremely important” (An ordinal range of 1-5).

Primary data was analyzed using the Normal Distribution Fitting Algorithm (NDFA) approach. According to Stacey (2005) constructs such as attitudes, perceptions and preferences are generally impossible to evaluate through direct observation, therefore researchers resort to indirect data sources, typically using some sort of self-report methodology. Stacey (2005) showed the NDFA approach to be more reliable and valid in converting ordinal level data into interval level data, thus creating numeric scale. Along this numeric measurement scale, there are then threshold values that separate participants’ responses into ordinal categories. Secondary data was collected from a variety of sources including bank documents and website and compared with the primary data for triangulation.

Results

From the analysis of the primary and secondary data,factors that influenced the decision of the banks to enter foreign markets and those that influenced their entry mode choices into those markets were identified according to their relative importance.

Proposition 1

From primary and secondary evidence gathered and analyzed, it has been found that the client following was a “very important” motive for international market entry by the banks. Client following was supported by data on intra-African trade flows which shows significant presence of Nigerian banks in countries with the most imports from Nigeria.Economic growth in host countries was found to attract Nigerian banks, just as evidence on profit opportunities in host countries showed that exchange and tax rates differentials between Nigeria and host countries were “less important” factors in a bank’s decision making process. On the other hand, profitability of a host country banking market was an “important” motivation for entry by Nigerian banks.

Primary and secondary evidence showed that Nigerian banks sought to exploit their tangible and intangible assets in host countries. These assets included their size, reputation, management know-how, risk appraisal capabilities and technology.Regarding strategic motivation for internationalization, primary evidence suggested that risk diversification was an “important” motivation for internationalization. Evidence also indicate that Nigerian banks reacted to foreign market entry by their rivals as entry by one bank into a particular market seemed to trigger swift entry into the same market by other rival banks in a manner that suggested a “bandwagon effect”.This so called “bandwagon effect” may be the reason for the large concentration of Nigerian banks in some SSA countries. Primary and secondary evidence showed that managerial intentionality was a “very important” strategic motivation for internationalization. From the evidence, therefore, Proposition 1 was largely supported.

Table 2: Primary and secondary evidence of Proposition 1

P1: Questions	Primary Evidence	Secondary Evidence	Conclusions on P1
1. Client- following	Very Important	Consistent	Consistent
2. GDP growth rate of host	Very Important	Consistent	Consistent
3. Interest rate differentials	Important	Consistent	Consistent
4. Exchange rate differentials	Less important	Contradictory	Inconsistent
5. Tax rate differentials	Less important	Contradictory	Inconsistent
6. Profitability of host banking market	Important	Consistent	Consistent
7. To exploit bank's size	Very important	Consistent	Consistent
8. To exploit bank's reputation	Important	Consistent	Consistent
9. To exploit bank's management skill	Important	Consistent	Consistent
10. To exploit credit appraisal know-how	Important	Consistent	Consistent
11. To exploit bank's knowledge of host country's business culture	Less Important	Contradictory	Inconsistent
12. To exploit bank's technology assets	Very important	Consistent	Consistent
13. Strategic motivation to diversify risk	Important	Consistent	Consistent
14. Strategic reaction to competitor action	Important	Consistent	Consistent
15. Management's desire to expand brand	Very important	Consistent	Consistent

Proposition 2

The CBN issued guidelines in the year 2000 that allowed Nigerian banks to embark on foreign market entry. Another set of guidelineswere issued in 2010 that increased the regulatory capital required by banks seeking licenses to run international operations. Managers found these regulations to be "important". According to respondents the structure and competitiveness of the Nigerian banking market had "less importance" in influencing international expansion by some banks. A series of empirical studies on the structure and competitiveness of Nigerian banks carried out between 2000 and 2009 found the Nigerian banking market to be oligopolistic (Zhao and Murinde, 2011; Okulue et al. 2012). An oligopolistic market structure suggests that the Nigerian banking market was not sufficiently competitive to force some banks to seek new foreign markets. Thus, with the evidence gathered, Proposition 2 was only partially supported.

Table 3:Primary and secondary evidence on Proposition 2

P2 Questions	Primary Evidence	Secondary Evidence	Conclusions on P2
1. Home country regulations	Important	Consistent	Consistent
2. Structure and competitiveness of home country banking market	Less Important	Contradictory	Inconsistent

Proposition 3

A bank's entry mode choice into a foreign market has been found to be significantly influenced by the regulations of host countries. The organizational form for entry is sometimes stipulated and evidence shows that most SSA regulators favor the establishment of retail subsidiaries by foreign banks (Barth et al. 2012). Nigerian banks entered most markets in SSA by the establishment of high equity brownfield or greenfield subsidiaries, mainly because host country regulators had policies that eased entry for foreign banks.

Host country factors that increase transaction and entry costs and which makes a country's banking marketless attractive to foreign banks seem to have had little influence on the entry mode choice of Nigerian banks as entry into most SSA markets was by high equity subsidiaries regardless of these factors.This was the case whether the host country shared the same language with Nigeria or not. Entry into French and Portuguese speaking SSA countries like Côte d'Ivoire and Mozambique were by the establishment of high equity brownfield or greenfield subsidiaries.In the same vein, differences in the origins of legal codes between Nigeria and host countries were expected to lead to low equity entry by Nigerian banks. Yet entry into countries with different legal originsto Nigeria was also by high equity subsidiaries.Furthermore, Nigerian banks, being from a more developed banking market than most SSA countries, entered SSA banking markets by establishing subsidiaries while entry into the sophisticated South African market was by low equity representative offices.

Entry by Nigerian banks into geographically distant countries was dichotomous. Regardless of the distance between host countries and Nigeria, entryinto countries in SSAwas mainly by high equity subsidiaries rather than the low equity entry modes predicted in several empirical studies, while in other regions like Asia and Middle East, entry was by low equity representative offices. Additionally, it was found that trade barriers in other regions of SSA did not stop Nigerian banks from entering countries in those regions with high equity subsidiaries. Thus, from the findings, Proposition 3 was only partially confirmed**.**

Table 4: Primary and secondary evidence on Proposition 3

P3: Questions	**Primary Evidence**	**Secondary Evidence**	**Conclusions on P3**
1. Home and Host country Regulations	Very important	Confirmatory	**Consistent**
2. Other financial Activities	Important	Confirmatory	**Consistent**
3. Same Language	Important	Mixed	**Insignificant**
4. Common legal origin	Important	Mixed	**Insignificant**
5. Geographic distance	Less important	Contradictory	**Inconsistent**
6. Depth of host country banking market	Less important	Mixed	**Insignificant**
7. Trade barriers	Less important	Contradictory	**Inconsistent**

Proposition 4

Environmental uncertainty in a host country is due to many factors including the host country's risk profile, the level of development of institutions and the level of rule-based governance. Country risk due to macroeconomic instability and political risk in host countries was mentioned by managers to be "important" factors that determined entry mode choice by banks. Several empirical studies have found that the level of development of institutions and rule-based governance in host countries influence foreign banks' entry mode choices. Entry as high commitment subsidiaries by MNBs is found to be higher in countries with high levels of

development of institutions and rule-based governance (Buch and Lipponner 2004; Outreville, 2007).

Evidence shows that while managers found these factors to be important in making their entry decisions into many host markets, Nigerian banks entered almost every country in SSA with high equity brownfield and greenfield subsidiaries. This is despite the low level of development of institutions and rule-based governance, as well as a high level of corruption, in most of these countries.Managers interviewed pointed out that the institutional and governance challenges in host markets are familiar to them as these factors are similar to those in Nigeria. Indeed, secondary evidence shows that measures of institutional development and rule-based governance between Nigeria and most SSA countries are similar and in some cases are worse in Nigeria

Table 5: Primary and secondary evidence on Proposition 4

P4: Questions	**Primary Evidence**	**Secondary Evidence**	**Conclusions on P4**
1.Macroeconomic stability	Important	Contradictory	**Inconsistent**
2.Political risk	Very Important	Contradictory	**Inconsistent**
3. Level of development of institutions	Important	Contradictory	**Inconsistent**
4. Level of development of rule-based governance	Very Important	Contradictory	**Inconsistent**

Findings and modification of propositions

Primary and secondary evidence showed that foreign market entry by Nigerian banks was driven mainly by managerial intentionality, client-following, exploitation of the tangible and intangible assets that the banks possessed as well as profit opportunities in most SSA banking markets. Internationalization was a deliberate strategic objective of Nigerian banks to become dominant players in the financial services sector in Africa. Africa became the strategic scope of most Nigerian banks and strategic mission and vision statements were focused on the African banking market. Additionally, Nigerian banks possessed tangible and intangible assets that they sought to exploit in SSA markets and which helped them to overcome the liability of foreignness. These assets include: bank's size and capital; reputation and brand name; management skills; credit appraisal know-how; and technological assets.

Regarding profit opportunities in the host countries, some factors that previous studies had identified as being important in determining foreign market entry by MNBs were found to be less important to Nigerian banks in their foreign market entry decisions. Arbitrage from differentials in interest, exchange and tax rates between home and host countries were found to be less important, while the profitability of the host country banking market was found to be important. Evidence on the strategic motivation for foreign market entry show that banks found the diversification of risk and the need to respond to competitors' actions to be "important" regarding foreign market entry. But managerial intentionality on the other hand was found to be "very important". Managerial intentionality was manifested by the desire of Nigerian banks to be dominant financial services providers across Africa. Proposition 1 was found to be largely supported. But, on the evidence gathered, the proposition has been reordered to reflect the most important factors that prompted foreign market entry by the banks.Thus Proposition 1 was revised (changes in italics) to suggest that:**"A bank's motivation to expand internationally will be influenced by a need to *follow its clients into foreign markets, seek profit opportunities in hosts banking markets,* and *fulfill the strategic aspirations of its managers*.**

Home country regulations were "important" in determining foreign market entry. On the other hand competitive pressure in the home country banking market was found to be less important. However, it was found that the level of financial development of most SSA countries was low. This created growth opportunities for Nigerian banks. From the evidence therefore, Proposition 2 was only partially supported and was revised to suggest that:**"A bank's motivation to expand internationally will be influenced by home country regulations and competitive pressure in the domestic banking market*, unless the banks are from home countries with low levels of financial development."***

Some factors that influence entry mode choice of the banks were found to be consistent and others inconsistent with the Proposition 3, and yet others were insignificant. Regulations in the host country that eased entry for foreign banks and the level of development of host banking markets seem to have encouraged Nigerian banks to establish subsidiaries in most SSA countries. On the other hand differences in language, colonial heritage, legal origin and high geographic distance, between Nigeria and host countries and the existence of regional trade barriers did not limit entry by the banks to low commitment modes of entry as predicted by the literature. This can be explained by the fact that Nigerian banks may have viewed host countries in SSA as having similar levels physical and institutional development as Nigeria. On the other hand, the ease of entry due to regulations and high profitability of most SSA banking markets might offset entry and transaction costs and thus encourage entry with high equity subsidiaries. Thus, after reviewing the evidence, Proposition 3 was revised to state that:***"If a host country's banking market is highly profitable and a foreign bank possesses significant O-advantages,* its choice of *mode of entry will be influenced by the host country's regulations, but may not be affected by diminished market attractiveness due to high transaction costs*".**

Primary and secondary evidence showed inconsistencies with Propositions 4. These inconsistencies may have been due to differences in the different contexts within which previous research was conducted and on whose findings most internationalization theories was based. This is so because the findings of previous research, which showed a clear link between high transaction costs and high environmental uncertainty in host countries and low commitment entry mode choices by banks, were inconsistent with the findings of this research.

High economic growth rates and profitability of host country banking markets, possession of significant resources and O-advantages by the banks and similarity in measures of environmental uncertainty between Nigeria and host countries encouraged Nigerian banks to enter SSA countries with high commitment equity subsidiaries. This is inconsistent with Proposition 4. From the evidence therefore, the proposition 4 was modified to state that;***"A bank's choice of mode of entry into a foreign market will be influenced by the level environmental uncertainty in the host country, unless the foreign banks are from countries that share similar levels of environmental uncertainty with the host country."***

Theories of internationalization and Nigerian banks

Regarding the predictions of the internationalization theories that formed the framework of this research, it was found that Nigerian bank's posses significant O-advantages while many SSA countries possessed L-advantages that made them attractive to Nigerian banks. Furthermore, as anticipated by the eclectic theory, Nigerian banks chose to internalize their operations by establishing retail subsidiaries because of high environmental uncertainties in most host countries in SSA. Thus, the internationalization pattern of the banks conformed to the eclectic theory. The banks also chose to internalize their operations in most host countries due to

their possession of unique resources which includes capital, management competences, capabilities and know-how, brand name and reputation. This conforms to the dictates of the RBV.On the other hand, it was found that increased transactions costs in most host countries, caused by high levels of environmental uncertainty, influenced the decision of Nigerian banks to enter these markets with high commitment entry modes. This finding lends support to those TCA researchers who dictate that firms enter environmentally uncertain countries with high equity commitment modes.

Additionally, the internationalization pattern of Nigerian banks did not follow the predictions of the process theory of internationalizationas foreign market entry by the banks was an explosive phenomenon that happened mainly between the period of this research (2005-2012.)Many Nigerian banks established multiple subsidiaries in several SSA countries almost simultaneously and without the benefit of experiential learning.

Conclusion

This research has shown that the theories of internationalization and their predictions might be influenced by context.The institutional and environmental context of sub-Saharan African countries presents challenges to firms seeking entry into the region. Yet,familiarity with this context seems to have emboldened Nigerian banks to enter host countries in SSA with high equity commitment subsidiariescontrary to the findings and predictions of previous research conducted in developed countries of Europe and America.

International and managerial implication

The metaphor of “distance” in international business research (institutional, cultural and geographic) can be extended to include “uncertainty distance”. Low uncertainty distance between Nigeria and host countries of the banks means it was easy for Nigerian banks to enter these markets with high equity retail subsidiaries. This study has also shown thata strong understanding of context is factor of note for managers. A strong understanding of the SSA context has engendered a number of MNEs from Africa. These include the Nigerian cement manufacturer, Dangote Industries, the South African telecommunications firm, MTN and the Egyptian conglomerate, Orascom. These firms have invested heavily and extensively across SSA in countries withpoor institutions and high environmental uncertainties. In most cases, these African MNEs entered SSA countries by the establishment of high equity commitment subsidiaries. The biggest incentive for these African MNEs seems to be high economic growth rates and high profit opportunitiesin the countries which they enter.

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