



GREYSTONE COLLEGE
OPENING UP GLOBAL CAREER OPPORTUNITIES

A photograph of a factory or warehouse interior. In the foreground, a woman wearing a yellow hijab and a blue long-sleeved shirt is working at a table. She is wearing red gloves and is handling several white, cylindrical objects, possibly components or parts. In the background, other workers are visible, some wearing blue shirts. The environment is filled with cardboard boxes and industrial equipment. The lighting is bright, and the overall atmosphere is one of a busy manufacturing or logistics facility.

Foreign Direct Investment - FDI

Unit 5

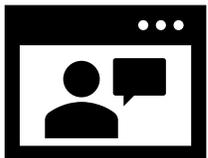
International Business & Logistics

Reference and complementary reading

- Chapter 8 Globalization of Global Business Today 12th Edition

Definition of FDI

- **Foreign Direct Investment (FDI)** occurs when a firm invests directly in new facilities to produce or market a good or service in a foreign country.
 - A firm engaged in FDI is a multinational enterprise.
 - According to U.S. Department of Commerce, FDI occurs when there is a 10 percent interest taken in a foreign business entity.
 - Globally, it can be the purchase of physical assets or significant amount (10 – 25% minimum) of ownership (stocks) of a company in another country to gain some measure of management control



Foreign Direct Investment in Canada's Economy

<https://www.youtube.com/watch?v=9-ICb5o4zSI>

Opening Case

Canadian Solar Inc in Pernambuco

Read about the Canadian Solar Inc project in Pernambuco

<https://investors.canadiansolar.com/news-releases/news-release-details/canadian-solar-won-1905-mwp-solar-power-projects-brazil>

What do you think of the project?
Is it a good example of FDI?





Foreign Direct Investment in the World Economy

The impact of FDI on the global economy today

Terminology When Discussing FDI

Flow of FDI: amount of FDI undertaken over a given time period.

Stock of FDI: total accumulated value of foreign-owned assets in a country at a given time.

Outflows of FDI: the flows of FDI out of a country (i.e., local companies opening bases and operations in foreign markets).

Inflows of FDI: the flows of FDI into a country (i.e., foreign companies opening bases and operations within the country).

Trends in FDI

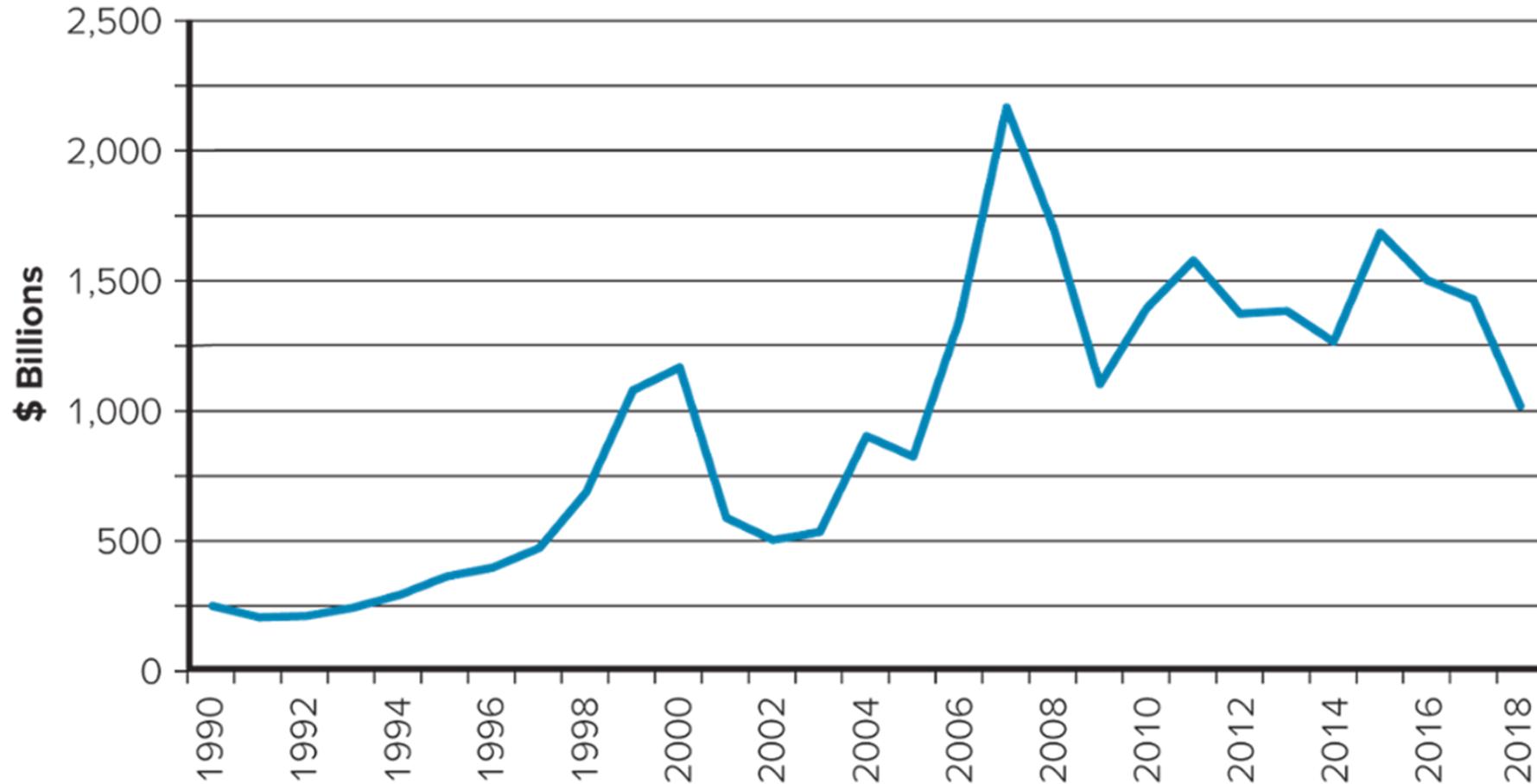
- Both the flow and stock of FDI in the world economy have increased over the last 35 years
- FDI has grown more rapidly than world trade and world output because:

Firms still fear protectionist policies – having a base in a market makes it a local company and is thus less subject to trade barriers

The shift toward democratic political institutions and free market economies encourages FDI

Globalization is prompting firms to ensure they have a significant presence in many regions of the world

FDI Outflows, 1990 to 2019 (\$ billions)



The Direction of FDI

- Historically, most FDI has been directed at the developed nations of the world
 - The United States and European Union were favourite targets
- More recently, developing nations have been the recipients of FDI, including:

South, East, and Southeast Asia, and particularly China

Latin America

China is becoming a major investor in Africa, especially in the extraction industries

The Source of FDI

- Since World War II, the U.S. has been the largest source country for FDI
- Other important source countries: the United Kingdom, the Netherlands, France, Germany, and Japan
- Chinese firms have recently emerged as major foreign investors, especially in Africa

Two Types of FDI

Greenfield Investments

- Establishing new operation in a foreign country using entirely the company's own resources
 - High risk as all investment and capital is undertaken by the company
 - Higher profit potential if it succeeds
 - Can be challenging at the beginning as the company learns how to operate in the foreign market

Acquisitions

- Purchasing another company that operates in a foreign market
 - Quicker to execute than greenfield investments
 - Easier and less risky for a firm to acquire desired assets than build them from the ground up
 - Firms often believe they can increase the efficiency of an acquired unit by transferring capital, technology, or management skills



Theories of FDI

Three perspectives to explain why and where companies engage in FDI

Theories That Explain FDI

- Three sets of perspectives help to explain how FDI works in the world. They offer insights into:



Why firms favour FDI over exporting and licensing



Why companies in a single industry take on FDI at the same time and favour certain locations



The location choice of FDI outflows

1 Why firms favour FDI

*While **exporting** and **licensing** are popular ways to enter a foreign market, they aren't always ideal...*

Exporting

- Limited by transportation costs and trade barriers
- When transportation costs are high, exporting can be unprofitable, especially with low value-to-weight ratio items

Licensing

- **Internalization theory** (also known as **market imperfections**)
 - Could result in a firm's giving away valuable technological know-how to a potential foreign competitor
 - Does not give a firm the tight control over manufacturing, marketing, and strategy in a foreign country
 - May be difficult if the firm's competitive advantage is not amenable (e.g., you can get another company to produce Toyota's cars, but can they do so with the same efficiency that Toyota has?)

1 Why firms favour FDI

FDI will be favored over **exporting** when

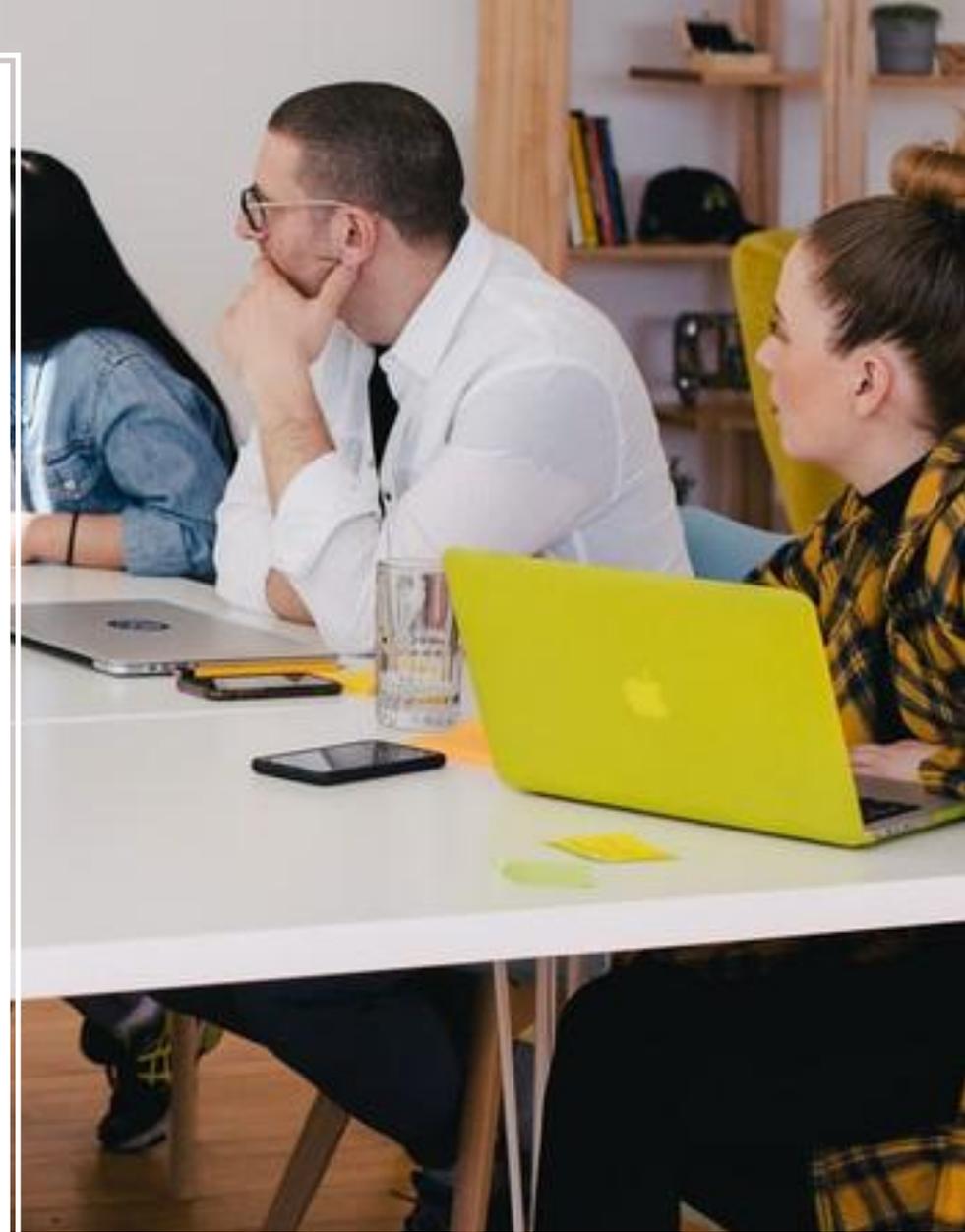
- Transportation costs are high
- Trade barriers are high
- There is a concern that future trade barriers will be implemented

FDI will be favored over **licensing** when

- The firm wants control over its technological know-how
- The firm wants control over its operations and business strategy
- The firm's capabilities are not amenable to licensing

Activity: Burberry Shifts Its Entry Strategy in Japan

- Read the Management Focus on p. 248
 1. Discuss the problems associated with Burberry's licensing arrangement in Japan. What were the benefits of establishing a relationship with Sanyo Shokai in the country?
 2. Reflect on the new strategy that Burberry is undertaking in Japan. Given that this is a shift away from Sanyo Shokai's past strategy, what can you expect in the near future concerning performance in the country? What is Burberry's goal in the long term?



2

Why companies in a single industry take on FDI at the same time and favour certain locations

Strategic Behavior

- In **oligopolistic** industries (industries composed of a limited number of large firms), companies will often copy each others' foreign investments
- This leads to **multipoint competition** (when two or more enterprises encounter each other in different regional markets, national markets, or industries)
 - Firms will try to match other's moves in different markets to try to hold each other in check

3 The location choice of FDI outflows

- The **Eclectic Paradigm** consists of two pieces:

Location-specific advantages: advantages gained from the resource endowments and assets of a specific region

- Company's only get value from resources and assets of a foreign location when they are physically operating in that region
 - **Example:** simply licensing a local company to produce semiconductors in South Korea will not actually allow the company to take advantage of the skills and lower labour costs that this market offers.

Externalities: knowledge spillovers that occur when companies in the same industry locate in the same area

- Firms can benefit from externalities by opening operations in these highly concentrated industry areas
 - **Example:** Silicon Valley for the tech industry (knowledge of design and manufacture of computers and semiconductors)

3 The location choice of FDI outflows

- The **Eclectic Paradigm** thus shows that...
 - Companies often favor FDI compared to other entry methods because this is how they maximize their location-specific advantages. Other methods will grow the business but not provide such advantages.
 - Companies will choose countries based on externalities, regions in the world where the industry they operate in is concentrated



Politics and FDI

How governments tend to view FDI

Political Perspectives Towards FDI



The Radical View

- MNEs are a form of imperialist domination for exploiting host countries to the exclusive benefit of their capitalist-imperialist home countries



Pragmatic Nationalism

- FDI has benefits and costs
- FDI should be allowed only if the benefits outweigh the costs



The Free Market

- Countries should specialize in the production of whichever goods and services they can produce most efficiently



Shifting Ideologies

- The radical view has been in retreat due to:

The collapse of
communism in Eastern
Europe

The poor economic
performance of those
countries that had
embraced the policy

The strong economic
performance of
developing countries
that had embraced
capitalism

- This perspective still lingers in some countries, such as Venezuela.
- In recent years, there has been a strong shift toward the free market stance



Benefits and Costs to FDI

The arguments in favour of and
against foreign investment

Host Country vs. Home Country

Host-Country

- The country that is receiving the foreign company

Home-Country

- The country that the company is headquartered in



Host-Country Benefits

Resource Transfer Effects

- FDI can bring capital, technology, and management resources that would otherwise not be available

Employment Effects

- FDI can bring jobs that would otherwise not be created there
- This doesn't mean the jobs are always beneficial

Economic Growth

- FDI in the form of greenfield investment increases the level of competition in a market
- This drives down prices and Improves the welfare of consumers

Increased Competition

- Increased productivity growth
- Product and process innovation
- Greater economic growth

Host Country Costs

1. Negative Effects on Competition

- The subsidiaries of foreign MNEs may have greater economic power than indigenous competitors because they may be part of a larger international organization
 - The MNE could draw on funds generated elsewhere to subsidize costs in the local market
 - Doing so could allow the MNE to drive indigenous competitors out of the market and create a monopoly position

2. Possible Effects on National Sovereignty and Autonomy

- FDI can mean some loss of economic independence
 - Key decisions that can affect the host country's economy will be made by a foreign parent that has no real commitment to the host country, and over which the host country's government has no real control

Home Country Benefits

1. The effect on the capital account of the home country's balance of payments from the inward flow of foreign earnings

2. The employment effects that arise from outward FDI

3. The gains from learning valuable skills from foreign markets that can subsequently be transferred back to the home country

Home Country Costs

1. Employment effects of outward FDI

- If the home country is suffering from unemployment, there may be concern about the export of jobs

2. International Relations with Other Countries

- FDI can increase political tensions due to favoring/prioritizing investment in one country over another

International Trade Theory and FDI

- Home country concerns about the negative economic effects of **offshore production** (FDI undertaken to serve the home market) may not be valid
 - FDI may actually stimulate economic growth by freeing home country resources to concentrate on activities where the home country has a comparative advantage
 - Consumers may also benefit in the form of lower prices



Government Policy Instruments and FDI

What governments can do to
incentivize or prevent FDI

Host-Country Policies

- **To ENCOURAGE Inward FDI**

- Governments offer incentives to foreign firms to invest in their countries such as tax credits, subsidies, and reduced tariffs for trade

- **To RESTRICT Inward FDI**

- *Ownership restraints*: exclude foreign firms from certain sectors on the grounds of national security or competition
- *Performance requirements*: require certain levels of output, investment; used to maximize the benefits and minimize the costs of FDI for the host country

Home-Country Policies

To ENCOURAGE Outward FDI

- Have government-backed insurance programs to cover major types of foreign investment risk
- Have special funds or banks that make governmental loans to firms investing in developing countries
- Have eliminated double taxation of foreign income

To RESTRICT Outward FDI

- Manipulate tax rules to make it more favorable for firms to invest at home rather than going abroad
- Restrict firms from investing in certain nations for political reasons
 - Restrictions may be formal or informal
 - **Examples:** Cuba and Iran

International Institutions and the Liberalization of FDI

- Until recently there has been no consistent involvement by multinational institutions in the governing of FDI
- The formation of the World Trade Organization in 1995 changed this
 - The WTO has had some success in establishing a universal set of rules to promote the liberalization of FDI
 - Agreements reached in 1997 for liberalization of trade in telecommunications and financial services



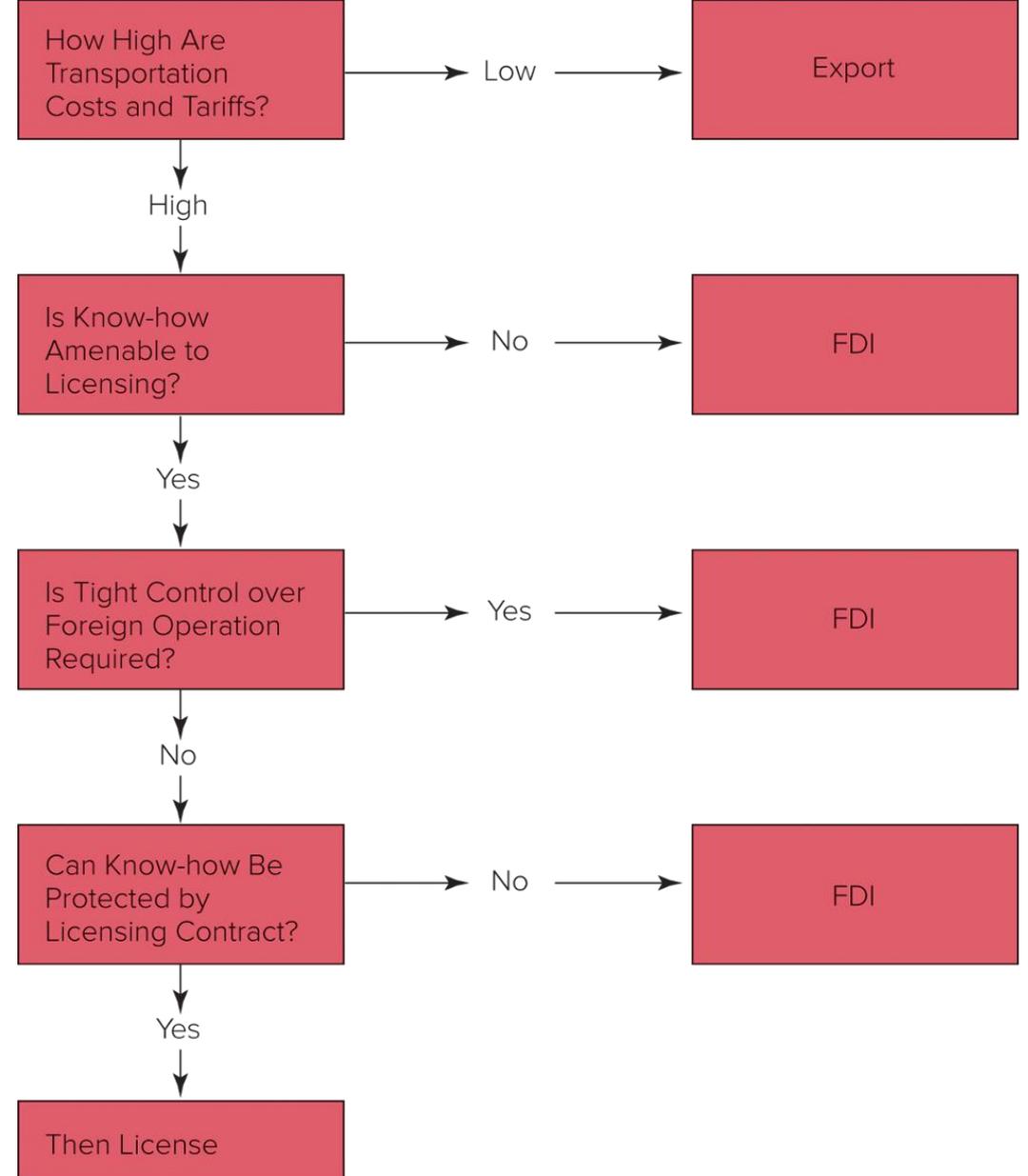
WORLD TRADE
ORGANIZATION



Managerial Implications of FDI

How managers should assess
opportunities for FDI

Should we invest directly in a foreign market? A Decision Framework



FDI and Government Policy

- A firm's bargaining power with the host government is highest when...
 1. The host government places a high value on what the firm has to offer
 2. When there are few comparable alternatives available
 3. When the firm has a long time to negotiate



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