

# Foreign Direct Investment



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# Foreign Direct Investment

- Why is FDI increasing in the world economy?
- Why do firms often prefer FDI to other market entry strategies?
- Why are certain locations favored for FDI?
- How does political ideology affect government FDI policy?
- What are key FDI related costs and benefits for receiving and source countries?



# Foreign Direct Investment

- **Involves ownership of entity abroad for**
  - **production**
  - **Marketing/service**
  - **R&D**
  - **Access of raw materials or other resource**
- **Parent has direct managerial control**
  - **Depending on its extent of ownership and**
  - **On other contractual terms of the FDI**
- **No managerial involvement = portfolio investment**



# FDI - Flow versus stock

- **FDI occurs when a firm invests directly in facilities to produce and/or market a product in a foreign country**
  - **Flow:** Amount of FDI over a period of time (one year)
  - **Stock:** Total accumulated value of foreign owned assets at a given point of time
- **FDI is not the investment by individuals, firms or public bodies in foreign financial instruments**



# Why is FDI important ?

- Firms want a presence in foreign markets
- Firms want control over growth of these foreign markets
  - To gain first mover advantages
  - To ward off competitors
  - To determine locations, advertising and other related strategic decisions in the firm's interest





# Trends in FDI

- Flow and stock increased in the last 30 years
- In spite of decline of trade barriers, FDI has grown more rapidly than world trade because:
  - Businesses fear protectionist pressures
  - FDI is seen as a way of circumventing trade barriers
  - Dramatic political and economic changes in many parts of the world
  - Globalization of the world economy has raised the vision of firms who now see the entire world as their market





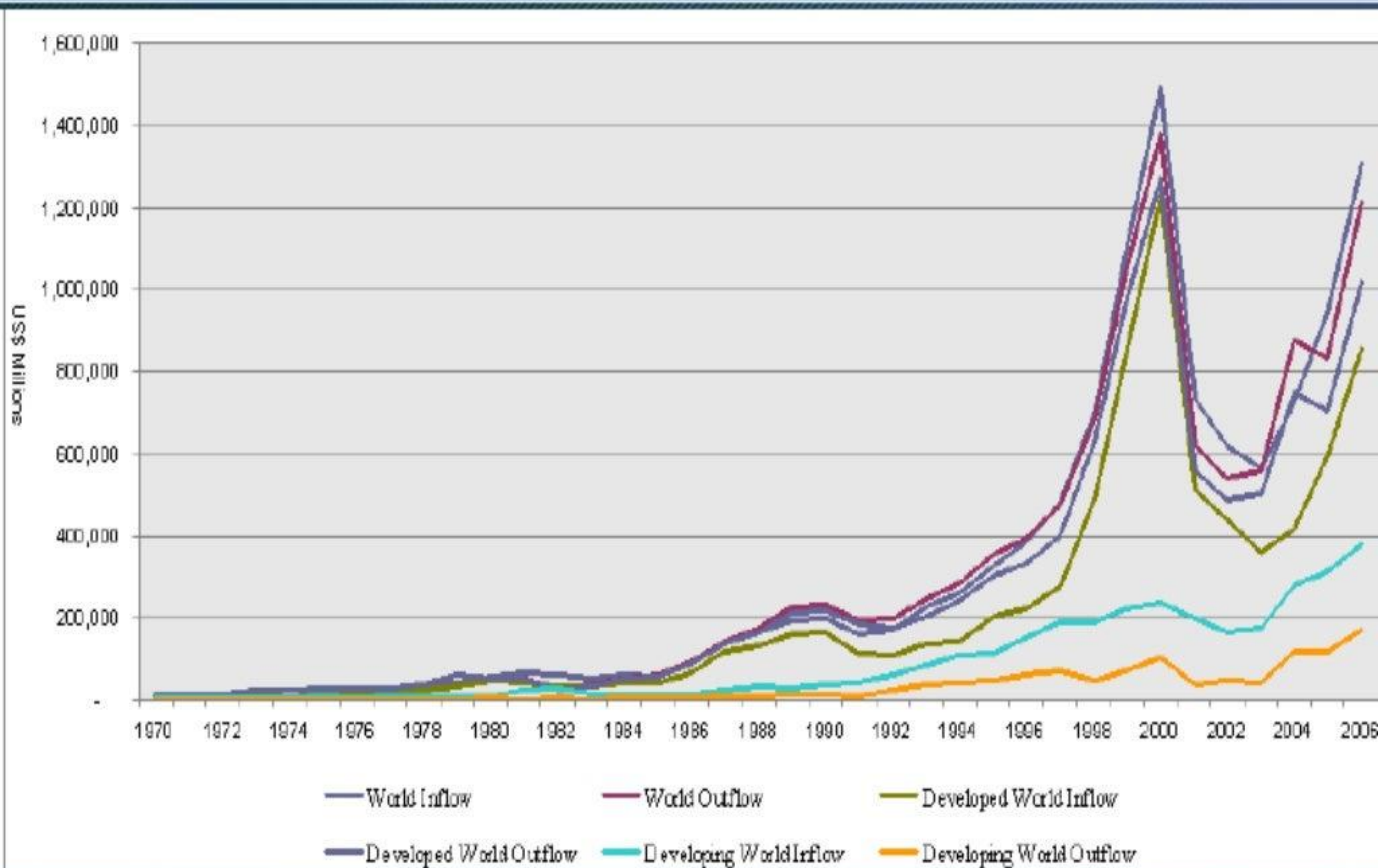
# FDI Growth in the World Economy

- **FDI Outflow:** \$35 billion in '75 to \$1.3 trillion in '00 to \$620 billion in '04
- **FDI Flow (from all countries):** from '92 to '04 up 260%, compared to trade up 100% and world output up 32%
- **FDI Stock:** \$3.5 trillion by '97 to more than \$ 8.1 trillion in '03
- **In '03:**
  - 61,000 MNEs had:
    - 9,00,000 foreign affiliates
    - 54 million employees
    - \$17.6 trillion in global sales
  - \$9.2 trillions global exports
- **Conclusion:**  
FDI flow growing faster than world trade and world output





# FDI- inflows & outflows





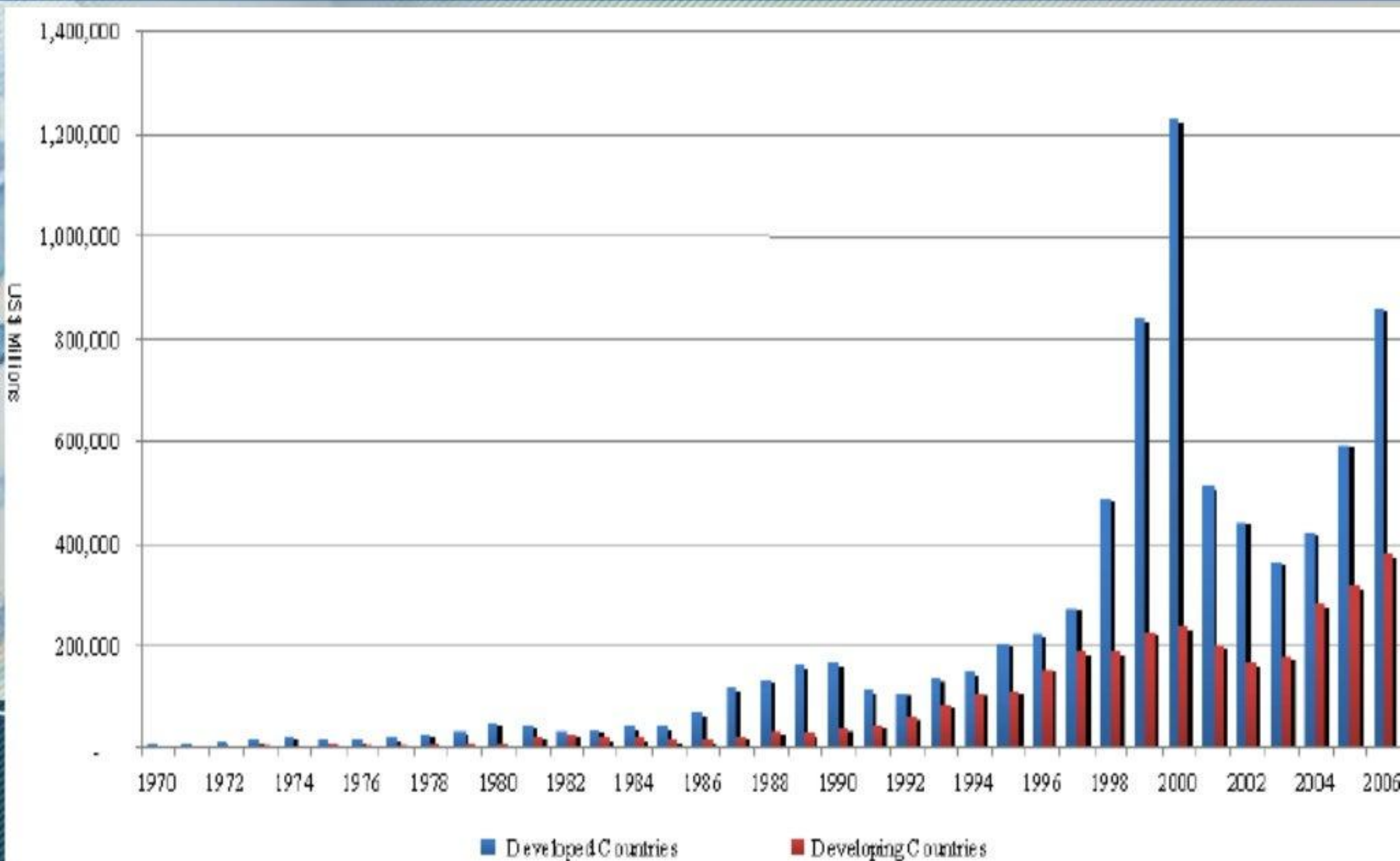
# Direction and Source of FDI

- Most FDI flow has been to developed countries from developed countries
  - Much to the US from EU, Japan
- FDI increase to developing countries since '85
  - Much to the emerging Asian and Latin America economies
  - Africa lagging



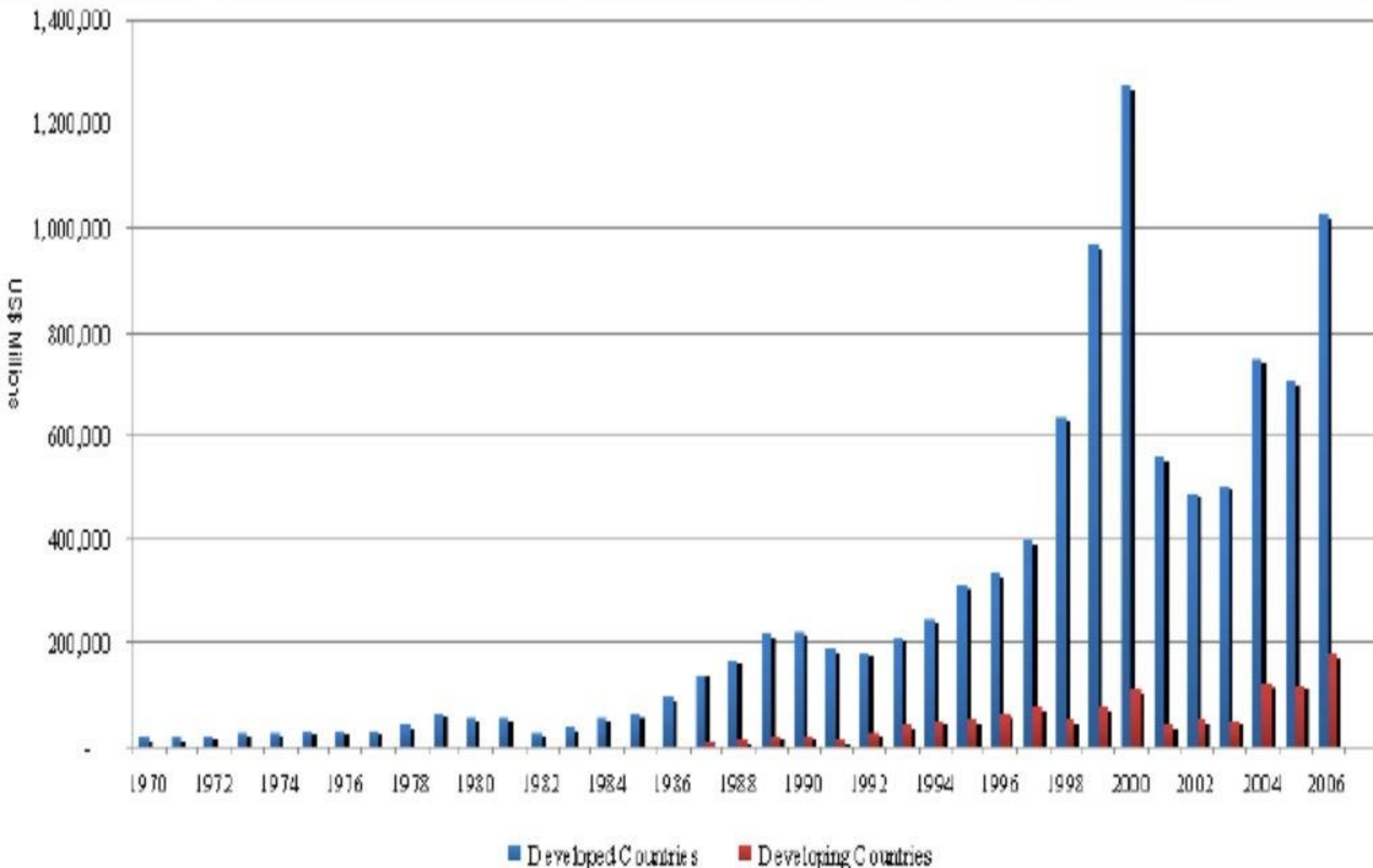


# Inflows in developed vs. developing countries





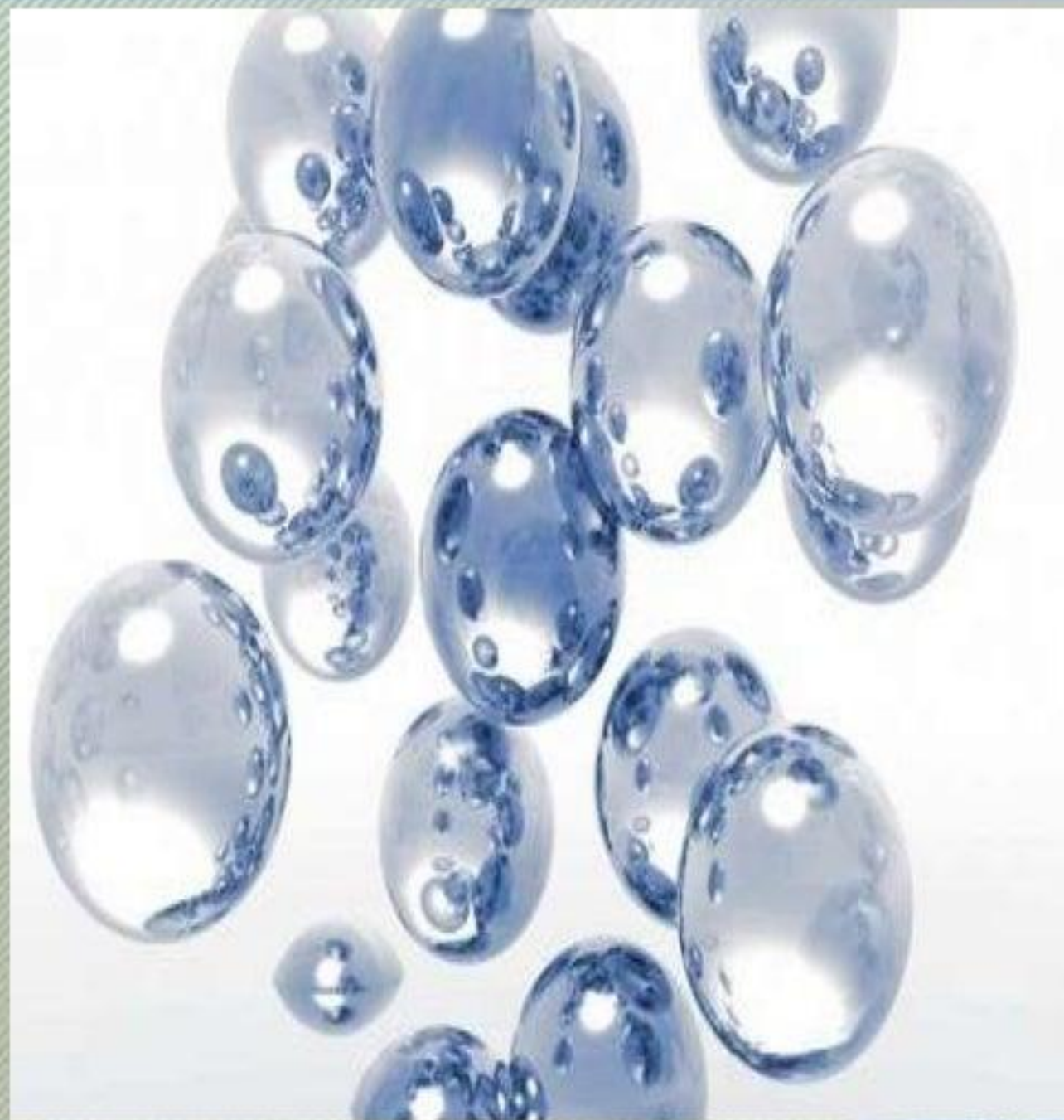
# Outflows in developed vs. developing countries





# FDI trends: 2001-2002

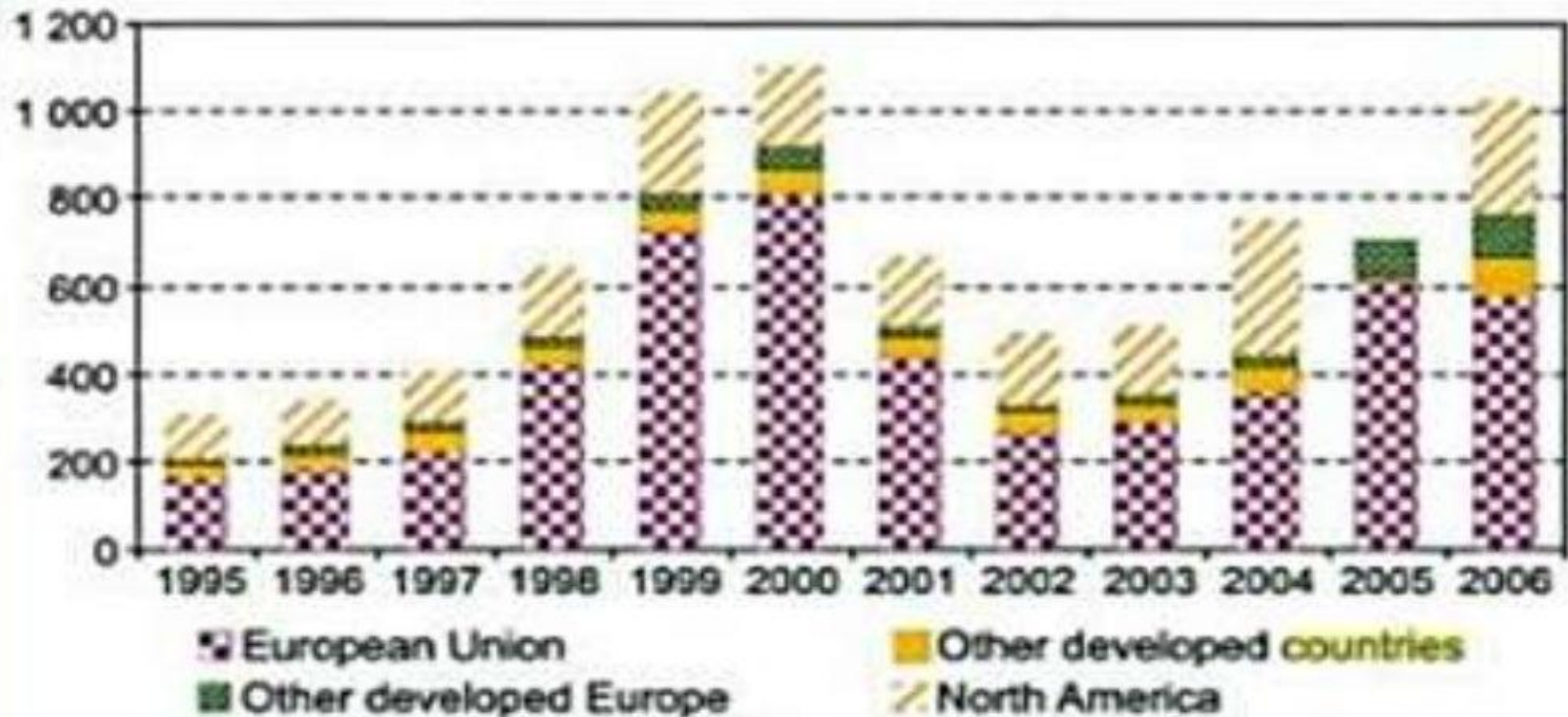
- **The value of FDI slumped almost 60 percent in 2001-2002**
  - Slowdown in world economy
  - Heightened geopolitical uncertainty since September 11, 2001
  - Bursting of the stock market bubble in the US





# Developed countries- FDI outflows

(Billions of dollars)

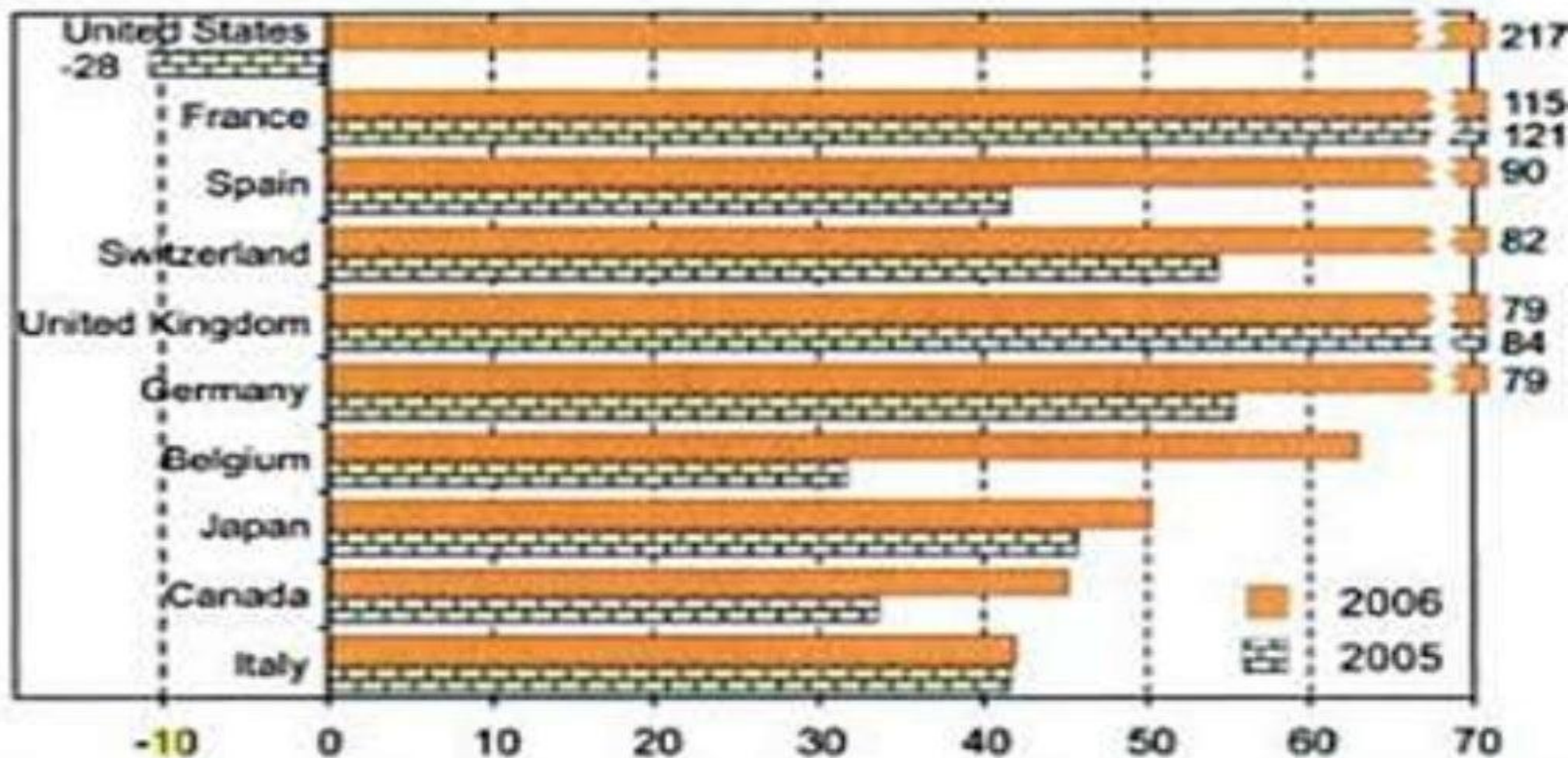


Source: UNCTAD, FDI/TNC database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)) and annex table B.1.



# Top 10 sources of FDI outflows, 2005-06

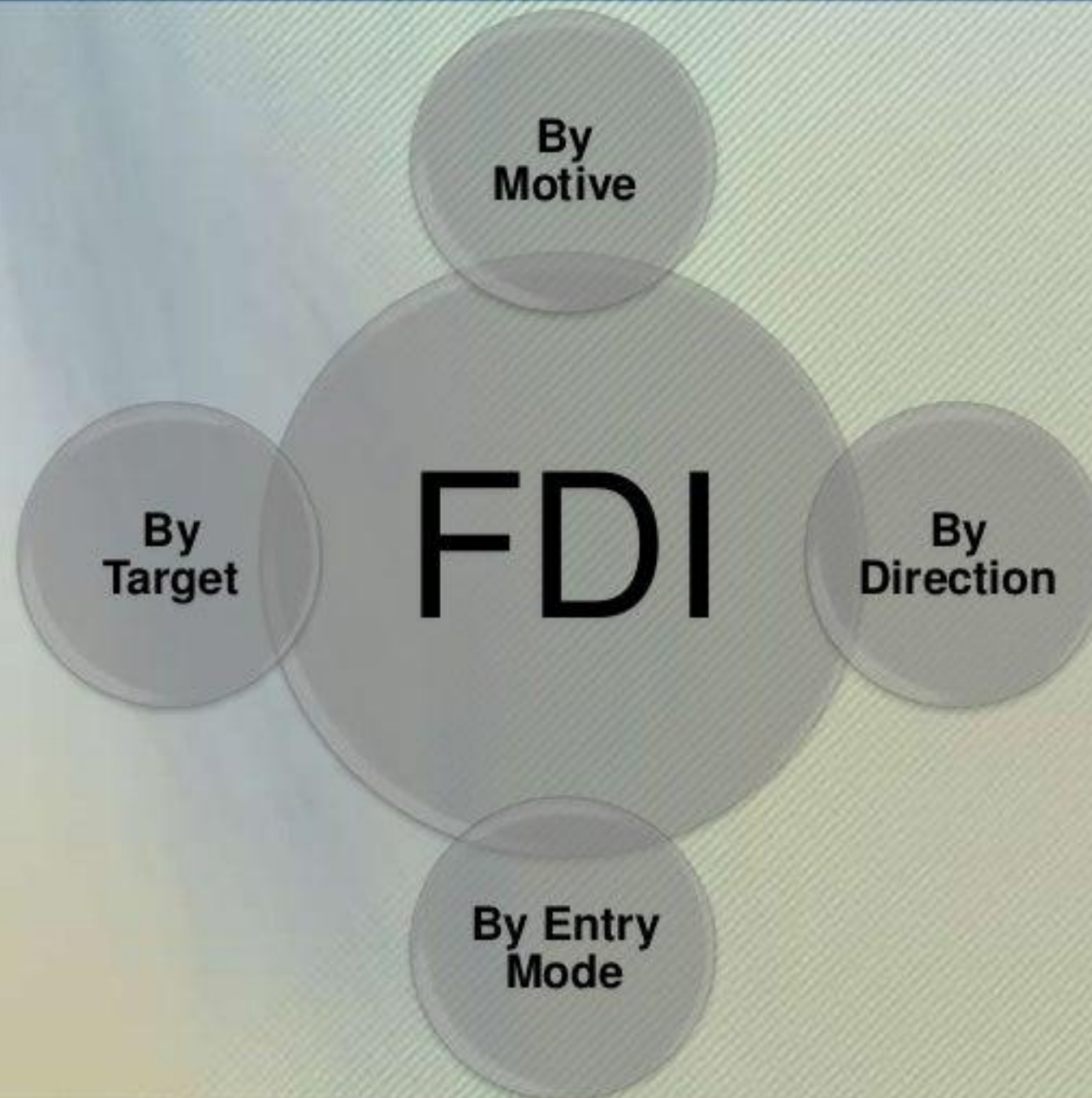
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# Types of FDI



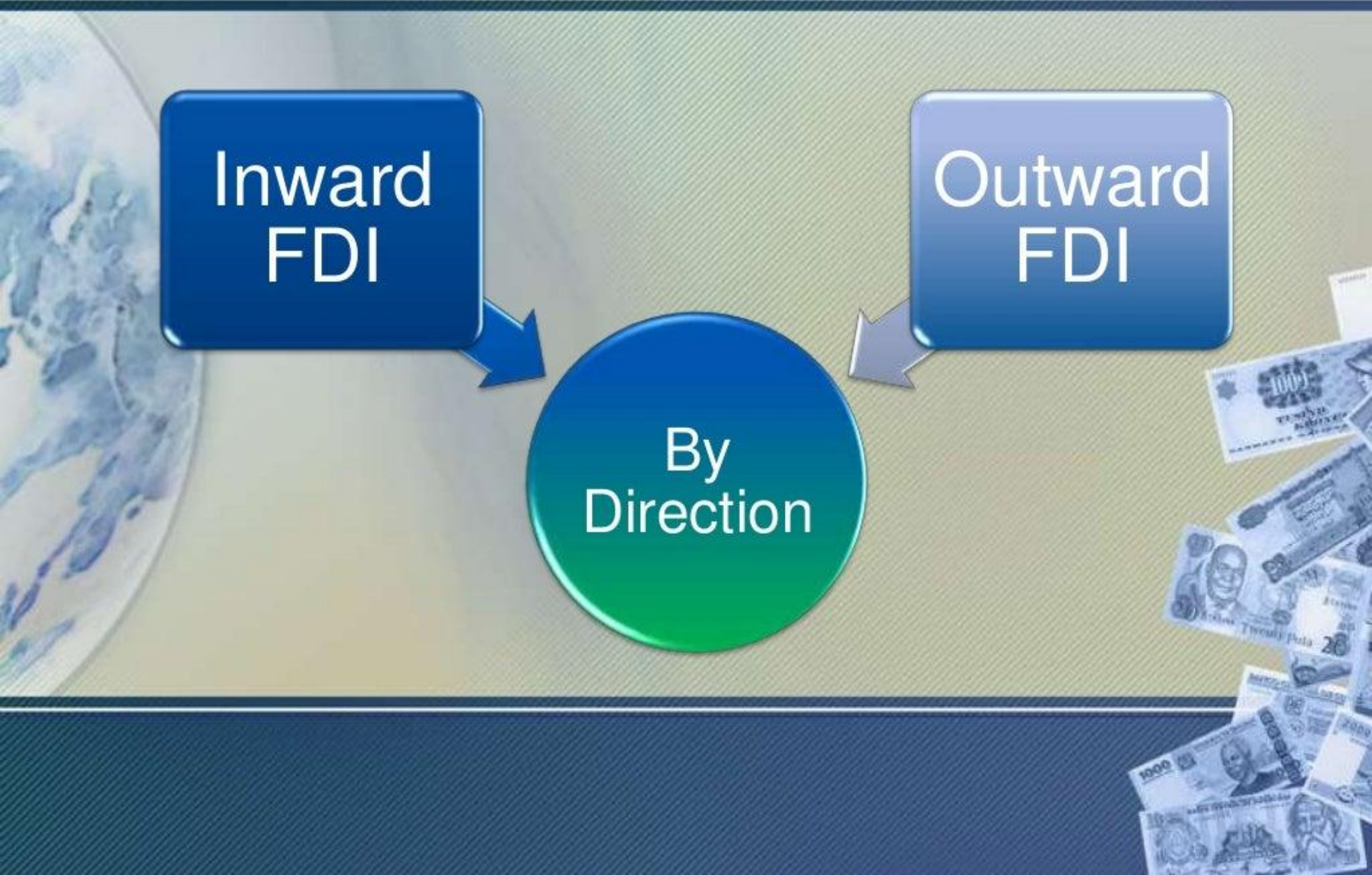


# Types of FDI

Inward  
FDI

Outward  
FDI

By  
Direction





# Types of FDI

Horizontal  
FDI

Vertical  
FDI

By  
Target





# Types of FDI

- **Horizontal FDI:**
  - Investment in the same industry abroad as a firm operates in at home
- **Vertical FDI:**
  - **Backward Vertical FDI:** investment in an industry abroad that provides inputs for the firm's domestic production processes eg: oil refining, Royal Dutch/shell, British petroleum etc.)
  - **Forward Vertical FDI:** investment in which an industry abroad sells the outputs of the firm's domestic production processes eg: Volkswagon in U.S.





# Types of FDI





# Types of FDI: By Motive

- **Resources seeking** - looking for resources at a lower real cost.
- **Market seeking** - secure market share and sales growth in target foreign market.
- **Efficiency seeking** - seeks to establish efficient structure through useful factors, cultures, policies, or markets.
- **Strategic asset seeking** - seeks to acquire assets in foreign firms that promote corporate long term objectives.

