

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

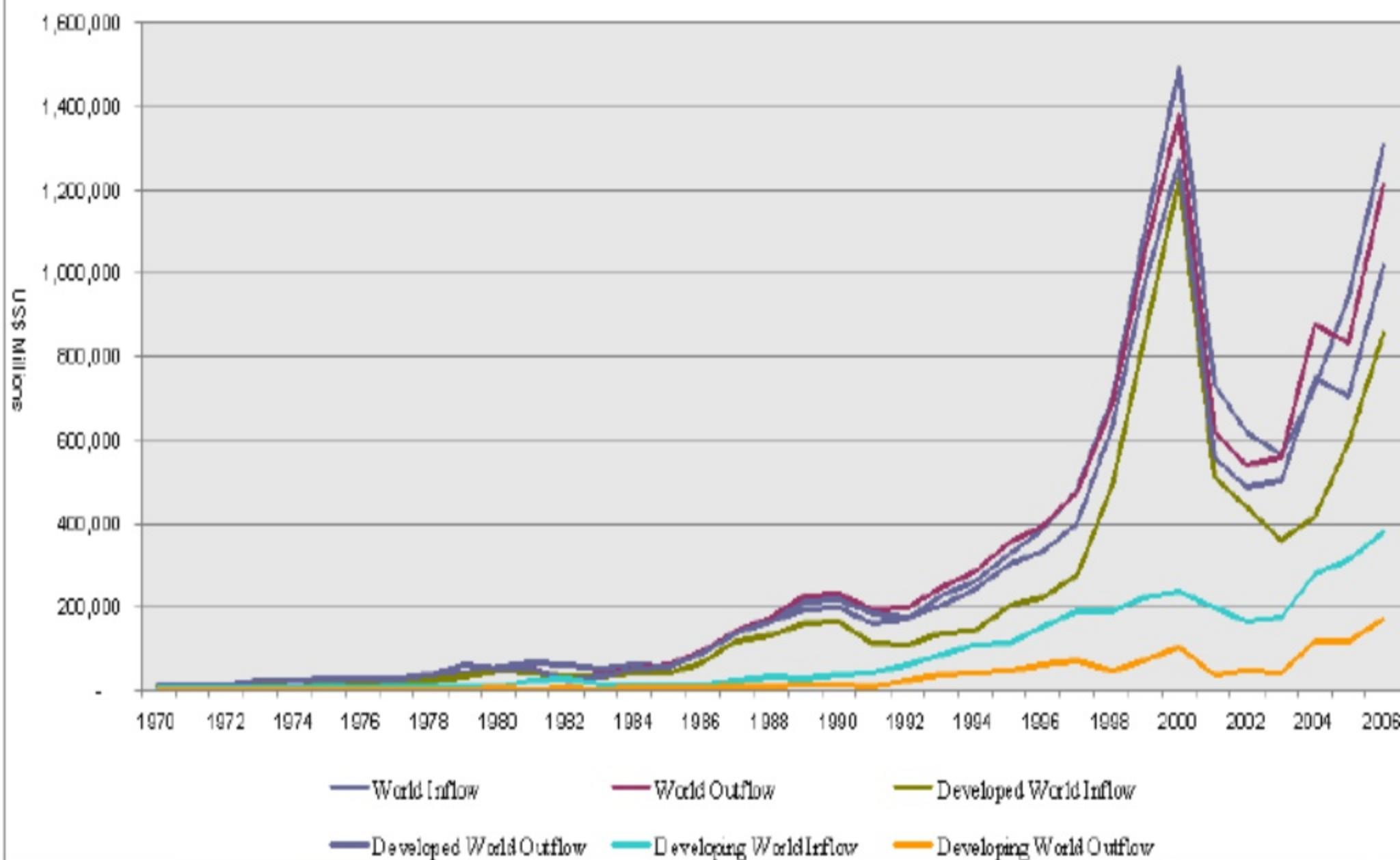
Trends in FDI

- 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

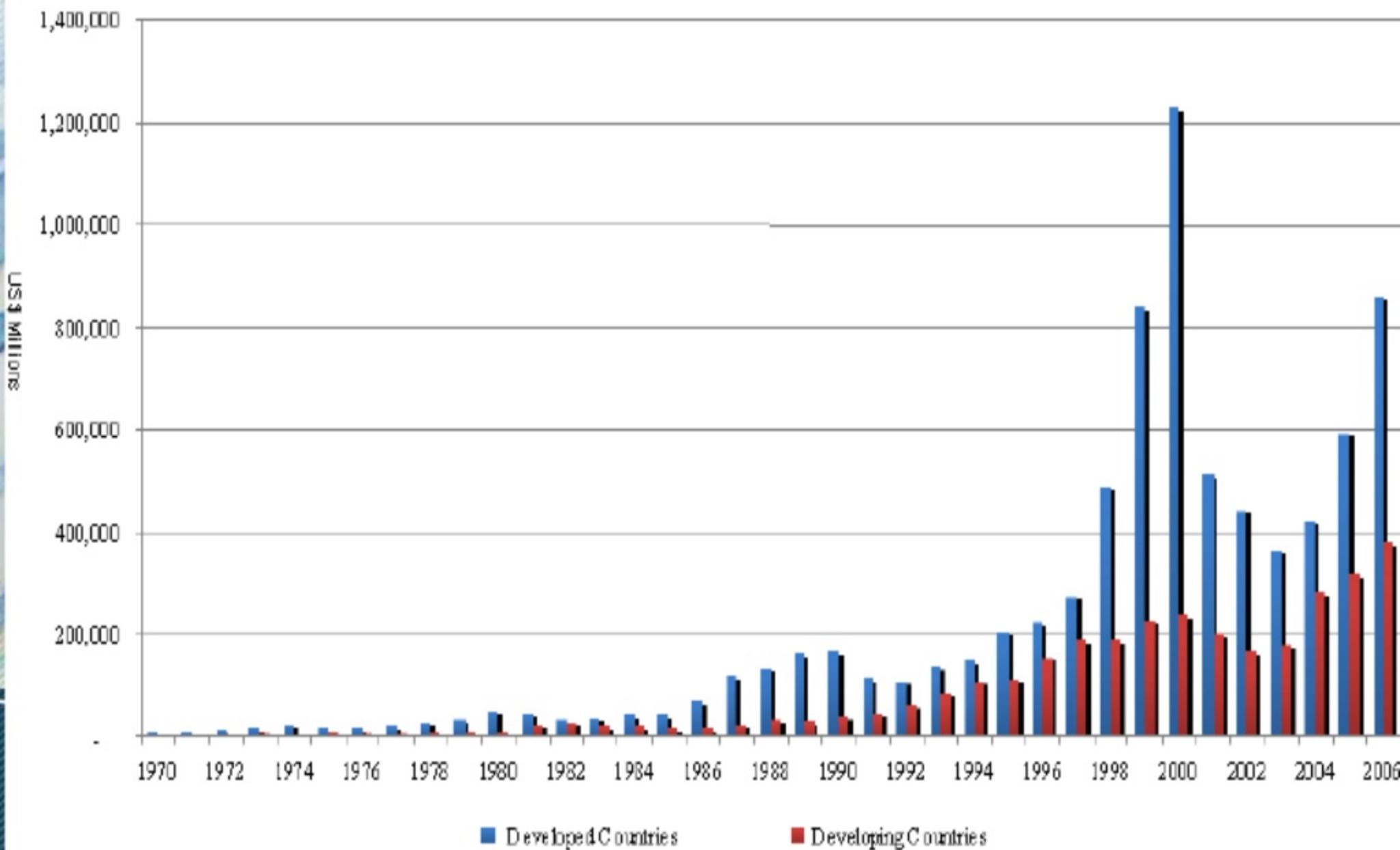
FDI- inflows & outflows



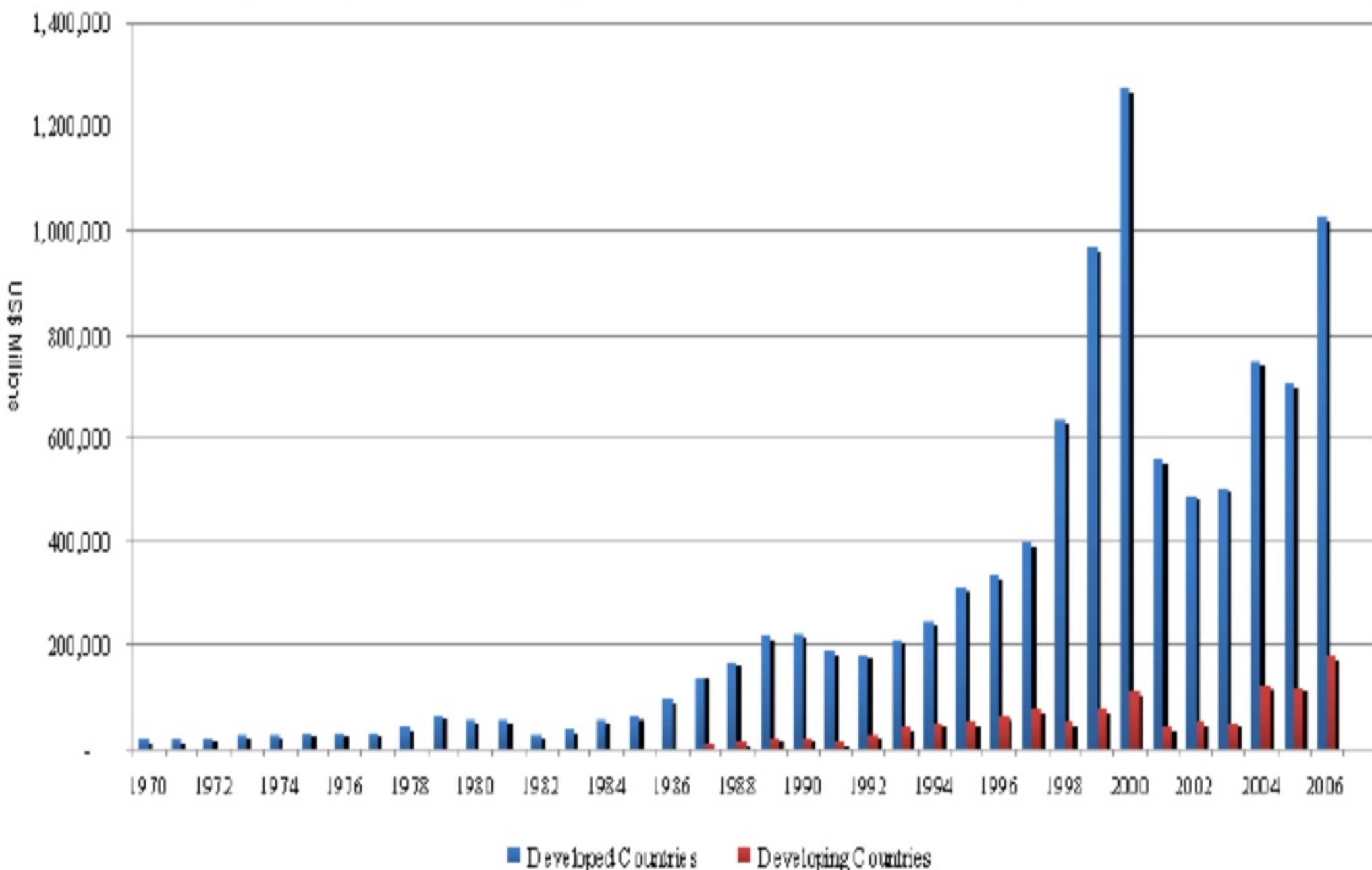
Direction and Source of FDI

- 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

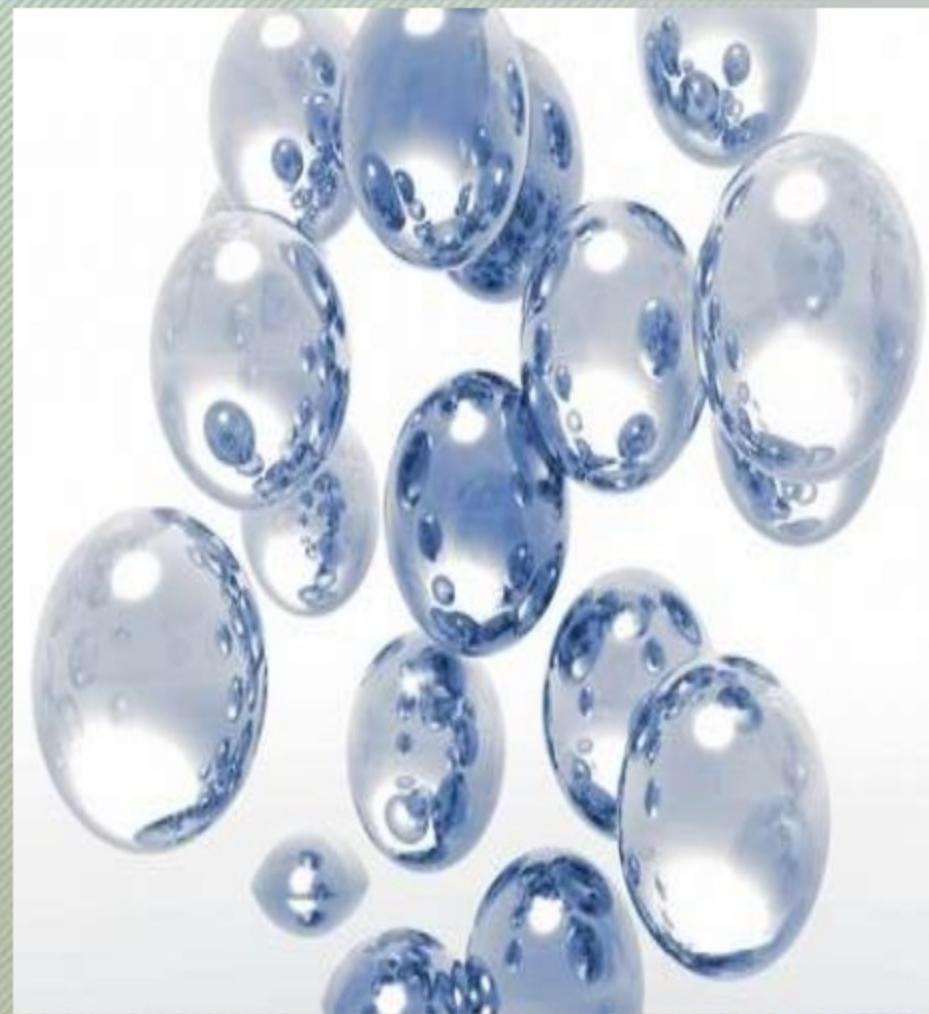


Outflows in developed vs. developing countries



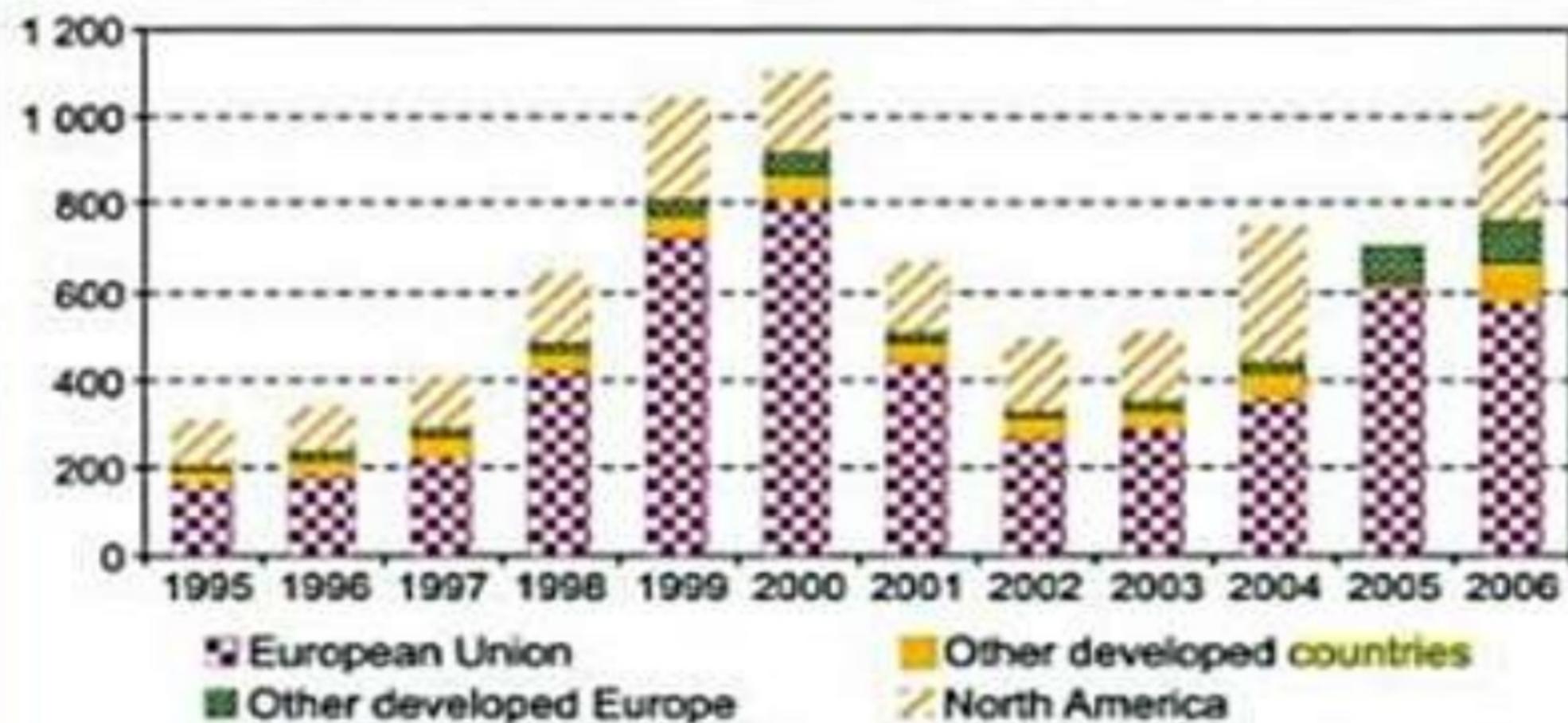
FDI trends: 2001-2002

- 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

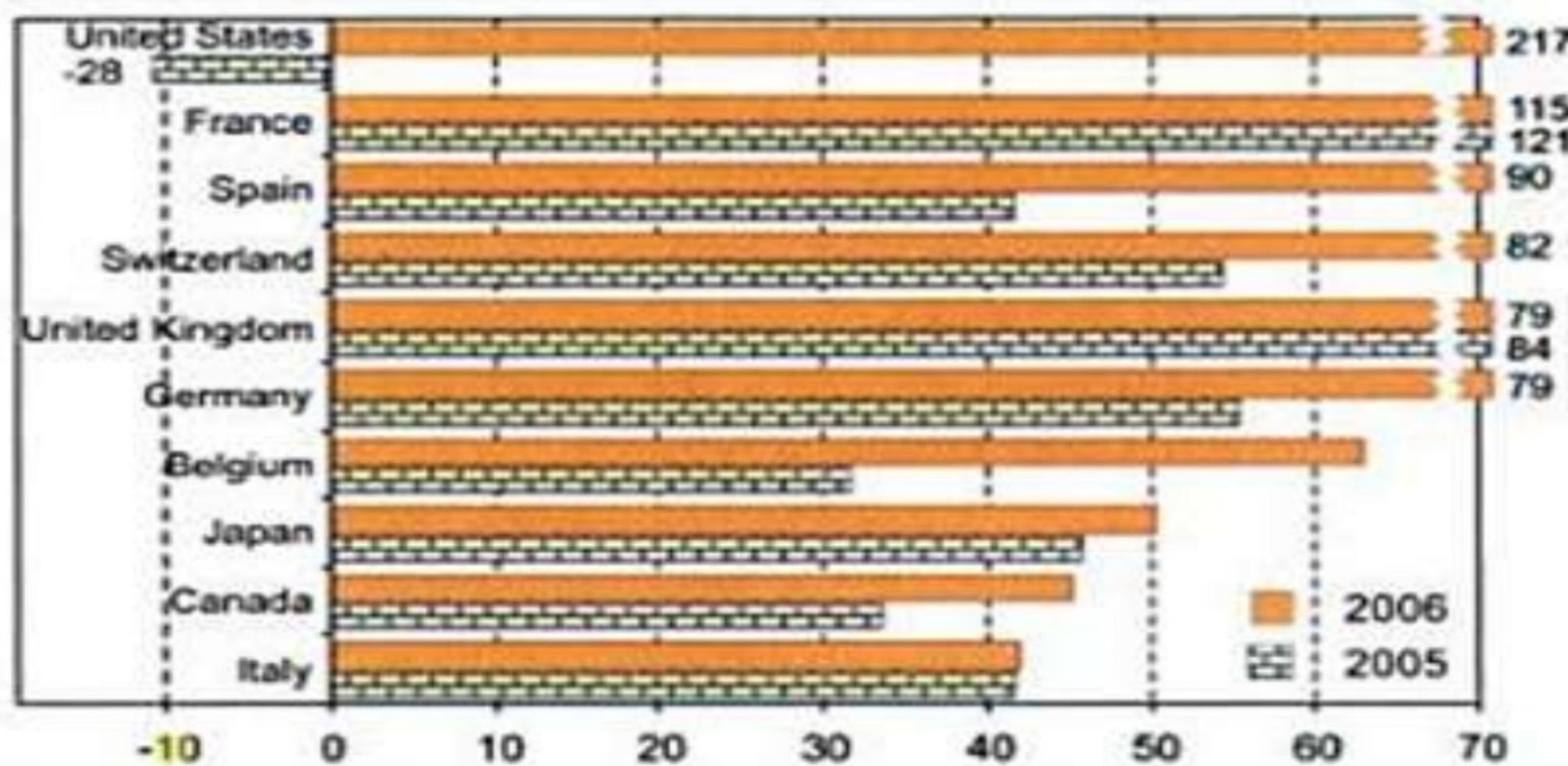
(Billions of dollars)



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

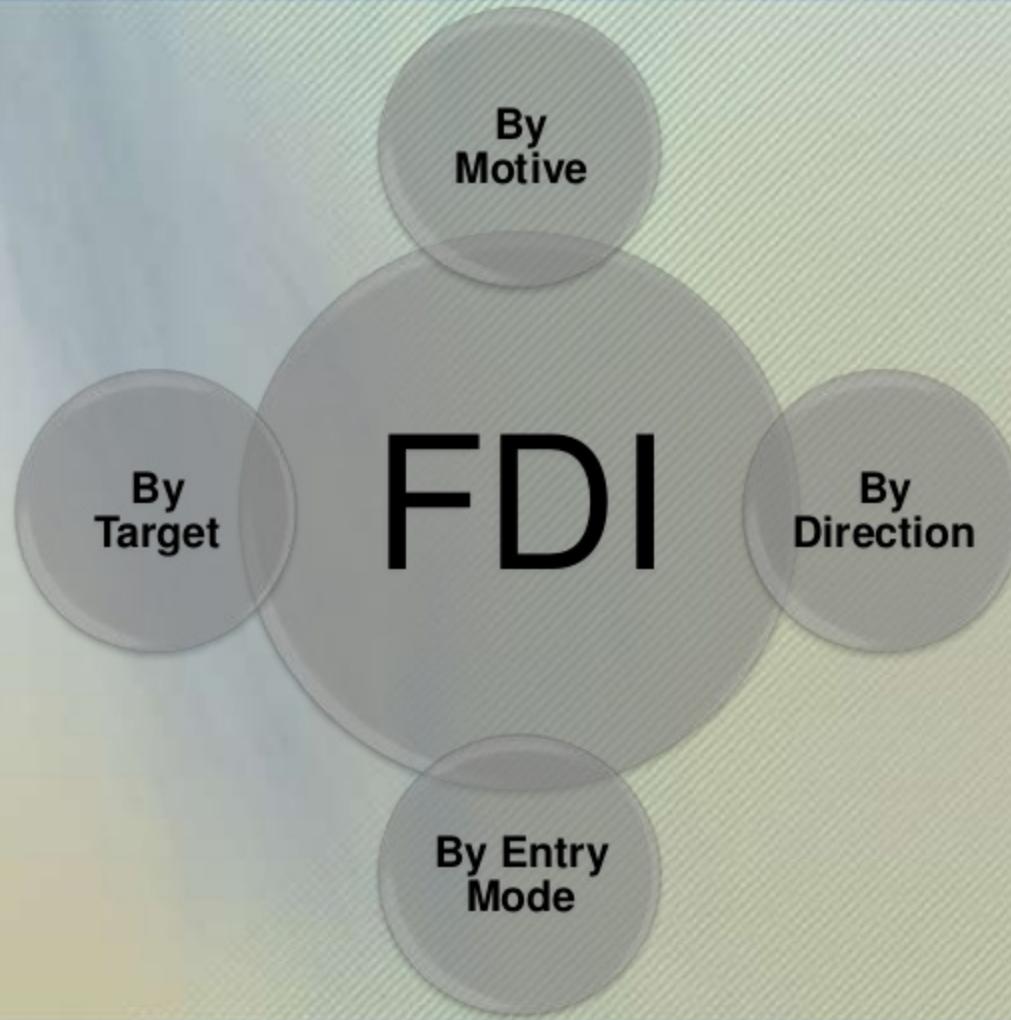
Top 10 sources of FDI outflows, 2005-06

(Billions of dollars)



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

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: Volkswagen 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.