Investing Abroad Directly

Chapter 6
Objectives

What is Foreign Direct Investment (FDI)?

Why invest directly?

- Ownership, Location, Internalization

Political views regarding FDI

Considerations
Foreign Investment

**Foreign Portfolio Investment** – holding securities, such as stocks or bonds, of firms in other countries
- Not a controlling interest
- Foreign Indirect Investment

**Foreign Direct Investment** – Investing in, controlling, and managing value-added activities in other countries
- Multinational Enterprises (MNEs)
- Appoint key managers and establish control mechanisms
Types of FDI

**Horizontal FDI** – produce same products or services in host country as home

- Example: Heineken – 125 breweries in 70 countries
Reasons to undertake Horizontal FDI

- Global expansion
- Proximity to customers
- Diversify geographic and political risk
Upstream

Design
Sourcing Materials
Components
Assembly
Marketing
Sales
Post Sales Service
(Downstream end)

(Upstream end)

Downstream
Types of FDI

Vertical FDI – FDI in which a firm moves upstream or downstream in different value chain stages

- **Upstream FDI**: Product Design, Sourcing Materials and Components, Manufacturing and Assembly
- **Downstream FDI**: Distribution, Marketing and Sales, Post Sale Service
Reasons to undertake Vertical FDI

- **Upstream**
  - Secure access to raw materials
  - Control over component supply

- **Downstream**
  - Control over or access to distribution
  - Global expansion
Why Engage in FDI?

Foreign Direct Investment

Ownership Advantages

Internalization Advantages

Location Advantages
Why Engage in FDI?

Alternative to licensing

Licensing may not secure property
- Contracts are difficult
- Licensing transfers *explicit knowledge* - written

FDI places capital at risk but:
- Transfer of *tacit knowledge*
  - Knowledge that is hard to write down
- Reduces dissemination risk
Why Engage in FDI?

Ownership Advantage

- Control
- Aggressiveness of operation

Location Advantage – firm specific

- Proximity to markets, agglomeration, raw materials…
- Choose location when investing directly

Internalization Advantage

- Internalize activity, reduce transaction costs
- Reduce uncertainty – secure retailers or raw materials
## Politics of FDI

<table>
<thead>
<tr>
<th>Radical View</th>
<th>Free Market View</th>
<th>Pragmatic View</th>
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<tr>
<td>FDI tool for imperialism</td>
<td>Enables countries to tap comparative advantage</td>
<td>Recognize pros and cons</td>
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<td>Foreign exploitation</td>
<td>Few Restrictions on direct investment</td>
<td>Approves of FDI when beneficial</td>
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<td>Ban inbound FDI</td>
<td>Many developing countries moving in this way (finally)</td>
<td>May block takeovers of domestic companies</td>
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<td>Nationalize MNEs and resources</td>
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<td>May require joint ventures</td>
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FDI Benefits and Costs: Host Country

**Benefits**

- Capital inflow initially
- Technology inflow/technology spillovers
- Management know-how (tacit knowledge)
- Jobs

**Costs**

- Loss of economic sovereignty
  - Foreign managers making decisions for domestic ops
- Competition for local firms
- Capital outflow over time
  - profits repatriated, components
Benefits and Costs: Home Country

Benefits

- Repatriated earnings
- Increased exports of components to host countries
- Learning from operations abroad (tacit knowledge)

Costs

- Capital outflow initially
- Job losses (not really…)
Implications for Action

FDI has benefits and risks (capital)
- Determine if FDI is justified
  - Alternatives – outsource, exports, licensing

Location, Location, Location
- Location must match firm’s strategic goals

Don’t take FDI friendly policies for granted
- Can change very quickly