

# Chapter 6 investing abroad directly`

Business, Management



Chapter 6 Investing Abroad Directly` Foreign direct investment (FDI) Putting money in activities that control and manage value-added activities in other countries Direct , hands-on management of foreign operations. An equity of 10% or more in a foreign-based enterprise. Multinational enterprise (MNE) Firms that engage in FDI Foreign portfolio investment (FPI) Investment in a portfolio of foreign securities such as stocks and bonds. Holding securities, such as stocks and bonds, of companies in countries outside one's own but does not entail the active management of foreign assets Management control rights Authority to appoint key managers and establish control mechanisms. Horizontal FDI A type of FDI in which a firm duplicates its home country-based activities at the same value chain stage in a host country. Producing the same products or offering the same services in a host country as firms do at home Vertical FDI A type of FDI in which a firm moves upstream or down stream at different value chain stages in a host country. Firm moves upstream or downstream in different value chain stages in a host country through FDI Upstream vertical FDI A firm engages in an upstream stage of the value chain in a host country. Downstream vertical FDI A firm engages in a downstream stage of the value chain in a host country. FDI flow The amount of FDI moving into a given period(usually a year)in a certain direction. FDI inflow Inbound FDI moving into a country in a year. FDI outflow Outbound FDI moving out of a country in a year FDI stock Total accumulation MNE versus non-MNE Exporting, importing, licensing and franchising, outsourcing, or engaging in PFI. What sets MNEs apart from non-MNEs is FDI. Why do firms become MNEs by engaging in FDI. OLO advantages

- Ownership advantage An MNE's possession and leveraging

of certain valuable, rare, hard-to-imitate, and organizationally embedded assets overseas. 1. A product or a process others do not have access to (patents, blueprints, trade secrets, trademarks, reputation for quality, etc.) 2. (Knowledge-based) firm-specific assets 3. Intangible assets

- Location advantage Advantage enjoyed by firms operating in a certain location. Features unique to a place, such as its natural or labor resources or its location near particular markets, that provide certain advantages to firms doing business there
- Internalization advantage Replacement of cross-border markets (such as exporting and importing) with one firm (the MNE) locating and operating in two or more countries
- Sell technology to other country, non-FDI-based market entry mode, called licensing. Market imperfection(market failure) The imperfect rules governing international transactions. Why firms prefer FDI to licensing? 1. FDI reduces dissemination risks. 2. FDI provides tight control over foreign operations. 3. FDI facilitates the transfer of tacit knowledge through " learning by doing".

Three political views on FDI

- Radical view on FDI A political view that is hostile to FDI Instrument of imperialism and a vehicle for exploiting domestic resources and people by foreign capitalists and firms.
- Free market view on FDI A political view that suggests that FDI unrestricted by government intervention is the best.
- Pragmatic nationalism on FDI A political view that only approves FDI when its benefits outweigh its costs.

Effects of FDI on home and host countries

- Host(recipient) countries Benefits capital inflow: improve a host country's balance of payment. Technology: more advanced technology from abroad
- Technology spillover technology diffused from foreign firms to domestic firms. Demonstration(contagion or imitation)effect The reaction of

local firms to rise to the challenge demonstrated by MNEs through learning and imitation. Managementi¼šknow how to reach a world-class level job creation: local supplier increase hiring Cost loss of sovereigntyä, » æf some but not all competition capital outflow â Home(source) countries Benefits: earnings, exports, learning from abroad Costs: capital, outflow, job loss

Tutorial questions 1. What is the primary difference between FDI and FPI? FDI requires a significant equity ownership position. Equity ownership rights and management control rights. 2. How does horizontal FDI compare to vertical FDI?