The benefits of fdi to mncs

Globalisation commenced after the World War II, but grew explicitly after the mid-1980s driven by the technological progress as well as rising liberalization of trade and capital markets.

However, according to Hood and Young (2000) globalisation began at the time of World Economic Crisis in 1970 (Asian crisis, oil crisis, post-Vietnam war). During that time Western industrialized countries experienced slow down in economies, reduction in profits as well as strong competition. As a result, the following strategies were used in order to tackle these problems: cheap labor usage in manufacturing process, new market exploration as well as strategic alliances formation.

MNCs began to cut their costs by utilizing cheap labor from developing countries, such as Mexico, Tunisia and Taiwan. (Hood and Young, 2000)

According to Strange (1997) observations globalization has increased mobility of capital, knowledge and information. (Hood N. and Young S., 2000)

The globalization process has let multinationals' desire to optimize market competitive variable and costs within a liberalizing trade and investment environment. (Hood N. and Young S., 2000).

During the process of globalisation following institutions were established: the World Bank, International Monetary Fund (IMF), General Agreement on Tariffs and Trade (GATT), as well as World Trade Organisation (WTO). The later played a significant role in favouring free trade, instead of protectionism.

FDI deregulation…has played an important role for investment into privatezed firms as well as the domestic economy growth and price stabilization. . (Hood N. and Young S., 2000) will research more…More information in terms of deregulation should be at beginning when you start the globalization

Benefits of FDI

MNCs may be motivated to undertake foreign direct investment to get more demand as well as get into the markets where they could generate greater profits. Both these motives are usually based on opportunities to get higher revenues in foreign markets. Other motives are related to the cost efficiency, when using foreign factors of production: raw materials or technology. Moreover, MNCs may be involved in FDI in order to protect foreign to protect their foreign market share, to respond to exchange rate changes, or to evade trade restrictions (can be used in conclusions)

For instance, a company considering FDI in Asia or USA may still be attracted by Asia due to higher growth potential for a company as well as higher profit margins. Moreover, if case the local currency depreciates there will be less costs necessary to establish a subsidiary.

MNCs may decrease its exposure to economic conditions by expanding their business activities between different economies.

When foreign direct investment occurs, constant reassessment is needed in order to anticipate whether further expansion should take place. The decision is influenced by the economic conditions in the subsidiary’s country, parent's country, host country government as well as MNCs experience in operating abroad.

MNCs which will not experience problems will be the ones which will employ local labour as well as manuacture the goods that have no direct substitutes in a foreign country.

Usually the ideal FDI is the one by the means of which the problems of local unemployment and technological scarcity is solved with no threat to the local firms.

Global markets join those who may offer capital and those who require capital, hence promoting economic growth. Moreover, global markets create pleasant conditions for mutually beneficial trading.

Economists tend to favour free flow of capital due to the following reasons:

Get the highest rate of return

Reduce the risk by diversifying the lending and investment.

Huge corporations, like Coca-Cola, Nestle, and Gillette took advantage of the globalisation by spreading their international operations across boarders, hence to become more competitive, meet global demand as well as cut their production costs.[1]Investing into emerging markets has brought much of success to these companies.

Like any investor, an MNC is valuating its risk and return, when forming international projects. The portfolio of all projects determines the MNC as a whole.

In fact, the riskier the country, the less probably the investors will invest, however this might anticipate higher returns.

In fact, risky project may offer negative returns, however a high-risk alliance might be successful and bring high returns, for example, Google. Lower risk investment is likely to offer positive returns. Therefore, when choosing a portfolio a company should evaluate how much extra return is needed in order to offset the extra risk or how much extra return the company is ready to sacrifice in order to have lower risk. Project portfolios generate higher returns than the individual ones due to the diversification characteristics. The less the correlation in project returns the less should be the project portfolio risk.

Along the efficient frontier of project portfolios, there is no portfolio to be said as an optimal for all MNCs. This is due to the fact that MNCs differ in readiness to accept risk. If the MNC is very cautious and may select between the portfolios reflected by the frontier it will probably favour one that shows low risk. However, more risk tolerant strategy would be to undertake the projects risk return close to the top of frontier.

In fact, the location of frontier is determined by the business MNC is undertaking. For example, Eurosteel plc trades steel only to European markets, then its frontier of efficient project portfolios indicate high risk, as this company sells only one product as well as it trades with countries whose economies are correlated. However, Uniliver plc sells variety of products worldwide, hence due its diversified range is less exposed to the project portfolio risk.

Here is assumed that the Uniliver plc is well informed about all the products as well as the markets where it operates.

MNCs may get more attractive risk-return from the projects portfolios if they enough diversify among products as well as geographic markets. Moreover, it may

However if it is a new company it international investment activity is affected by the country risk. The risks may overtake the returns. For example:

Conclusions:

Usual motivation for foreign direct investment relates to international diversification. This lets MNC to stabilise its cash flows as well as lessens its risk exposure. Such a goal is desirable because it may reduce the firm’s cost of financing. International projects may let the company to be exposed to lower risk than if undertaking solely domestic projects and not sacrificing its expected returns.

International diversification impacts risk reduction if FDI is performed in countries whose economies are low correlated to MNC’s home country economy.