

Theories of foreign direct investment

[Finance](#), [Investment](#)



Theories of Foreign Direct Investment Foreign Direct Investment, or FDI, is a type of investment that involves the injection of foreign funds into an enterprise that operates in a different country of origin from the investor. Foreign direct investment has many forms. Broadly, foreign direct investment includes " mergers and acquisitions, building new facilities, reinvesting profits earned from overseas operations and intracompany loans". Foreign direct investment incentives may take the following forms: • low corporate tax and individual income tax rates • tax holidays • other types of tax concessions preferential tariffs • special economic zones • EPZ – Export Processing Zones • Bonded Warehouses • Maquiladoras • investment financial subsidies • soft loan or loan guarantees • free land or land subsidies • relocation & expatriation • infrastructure subsidies • R&D support • derogation from regulations Once firms have decided to enter a foreign market, they have to choose the best mode of entry. Firms can use six different modes to enter foreign markets: 1. Exporting, being a temporary strategy is like a stepping stone in the international expansion process for most firms.

In the past, Seagate was a well know example which concentrated its manufacturing operations in one location enables it to move down the experience curve and achieve location economies. 2. Turnkey projects, are popular because firms can continue with normal business operations while the contractor handle the time consuming and resource intensive projects for a foreign client. Singapore shipyard is reputable for handling sophisticated turnkey projects regardless of is complex requirements and other considerations.

This industry is well known in the economic development for the last 40 years and will continue to play the critical role in our economy in order to achieve the goal for Singapore to become a leading international maritime link. Another example would be Sitra Holdings (International) Limited, the international producer of integrated wood based products and turnkey services, secured several turnkey design and build contracts in November 2009. Amongst these contracts, the single largest contract is worth S\$3. 24 million at the Marina Bay precinct. 3.

Licensing, enables a firm to gain access into new markets otherwise inaccessible, hence to facilitate the growth of licensing activities in Singapore with additional focus on brand licensing, character licensing and know-how licensing, the Franchising and Licensing Association (FLA) aims to encourage the adoption of licensing as a growth strategy by producing a report to raise the awareness of how licensing can translate to income stream for companies. 4. Franchising, in Singapore has grown tremendously and is a preferred strategy for SMEs, as it involves minimal investment and staff, thus reducing costs.

Local entrepreneurs have successfully made their mark internationally through franchising like BreadTalk, Charles & Keith, and OSIM. Larger companies can also make use of the networks of their established franchise partners to grow globally. 5. Joint ventures enable firms to share the benefit of the work process from a local subsidiary's knowledge of the host country such as the competitors, culture, political and business systems and access to greater resources including staff specialized intechology, finance, and so on.

In November 2009, QATARQatar Petroleum International (QPI) and Shell Eastern Petroleum Pte Ltd have sealed agreements in which QPI takes stakes in two Shell Chemicals joint ventures in Singapore. The deal, to be completed in December, Shell will sell its existing shareholdings in two companies to a new joint venture called QPI and Shell Petrochemicals (Singapore) Pte Ltd. 6.

Establishing new wholly owned subsidiaries would be best adopted by firms pursuing the global and transnational strategies, for instance, Temasek Holdings (Private) Limited invested approximately S\$900 million in Fraser & Neave Limited ("F&N") through its wholly-owned subsidiary Seletar Investments Pte Ltd¹ in December 2006. The investment would represent approximately 15 % of the total shares outstanding of F on a fully-diluted basis. This investment marks Temasek's most substantial investment in the food and beverage space in recent years.

Temasek Holdings Limited (2006) Country Focus - political economy and cultural factors of Singapore Political and economic systems of Singapore The Government of Singapore (GOS) is substantially consigned to maintaining an open economy and taking a leadership role strategize Singapore's future economic development. The government does that by adopting a free enterprise, open door policy to attract foreign investors from all types of services sector involving finance, business, tourism, telecommunication and consultancy services.

As such, Singapore has exports hitting 186% of 2008 GDP. While Singapore's stock of foreign direct investment (FDI) increased by 23. 4% from \$370. 5 billion in 2006 to \$457. 0 billion in 2007. United States, Netherlands, United Kingdom, and Japan were the top sources of FDI in Singapore. Evidently, the <https://assignbuster.com/theories-of-foreign-direct-investment/>

high FDI index reflects Singapore's role as a manufacturing base for foreign multinationals (MNCs) and as a financial, transportation, logistics, and trading hub. Also, with high real growth rate and low inflation played a great role in shaping the Singapore economy.

Singapore is one of the most enterprising and dynamic economies in the world. In this section, we compare Singapore's recent trade performance with its performance in past crises, namely the 1997-1998 Asian Financial Crisis where many countries and industries were affected by the deep fall of exports during the recession and the 2001-2002 Dot-Com Bust where IT industries around the world were affected by the large scale cancellation of electronic orders due to the over-investments by IT firms. In 2008 till present, Singapore is experiencing a slow down in the economy due to the US subprime crisis.

The main issue is that the US Subprime Market is generating an extension of recessions in some economies and accelerating global recession in a way. Thus, Singapore's total output of the country has decreased and the export of electronics goods has reduced significantly. Background to Singapore's FDI strategy Singapore's assertive efforts to attain FDI for more support of its economic strategy have enabled the country to develop into a basis for multinational corporations (MNCs). Singapore's investment promotion agency, the Economic

Development Board (EDB), focuses on obtaining major investments in highly valued services and/or manufacturing activities, deepening its industrial and export structure, using selective interventions to capture cross-industry externalities and move away from labour intensive to capital-skill and

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technology-intensive activities, by acquiring and upgrading the modern technologies in highly internalized forms. From Ijaz Nabi and Manjula Luthria. (2002). This strategy allowed the country to concentrate in specific phases in the production process, depriving from the flow of innovation and investing lesser in its own innovative effort.

Singapore's FDI policies were based on liberal entry and ownership conditions, easy access to expatriate skills and generous incentives for the activities that it was seeking to promote. The EDB was mainly set up to synchronize policy, offer incentives to lead foreign investors into targeted activities, acquire and construct industrial estates to attract MNCs. The public sector played an important role in launching and promoting activities selected by the government, acting as a catalyst to private investment or entering areas.

Often it was the efficiency, effectiveness and flexibility of government response that gave Singapore the edge over competing host countries. The importance of inward FDI to Singapore FDI has played a crucial role through the years in accelerating the economic development in Singapore. Being a small country with no natural resources, Singapore had depended on leading international companies not only in bringing in capital funds to broaden her economic base, but also in upgrading the technology and skill content of her industries.

Since FDI is one way that Singapore can tap foreign technology, therefore a substantial amount of capital is required to help generate GDP. Furthermore, exchange rate will also play a role in determining GDP. A slow appreciation of the currency will increase the confidence of those who are investing in <https://assignbuster.com/theories-of-foreign-direct-investment/>

Singapore and help to attract more investment. The Singapore dollar appreciation will also curb imported inflation. The importance of FDI in Singapore is reflected in the country's ratio of inward FDI stock to GDP: at 72%, the ratio is the highest in the world.

From Wendy Dobson & Chia Siow Yue (1997). That importance is also reflected in the fact that 90% of value added in Singapore's electronics industry (remarkable growth in exports and income) is accounted for by foreign investors, and that FDI accounts for fully two-thirds of equity capital in the country's manufacturing sector. From Wendy Dobson & Chia Siow Yue (1997). In addition, Singapore's productivity increased fastest in those industries in which FDI was concentrated. The rank correlation coefficients between increases in value added per worker and increases in FDI share and FDI level were . 2 and . 45. Moreover, because foreign direct investors' profits and outward remittances have tended to move in close tandem with the general performance of Singapore's economy and the health of its balance of payments, while the economic risk taking function is also borne by those investors, time and again Singapore's exceptional reliance on FDI has effectively cushioned its economy from the balance of payments and debt crises that have hurt many other developing economies. David M, Marchick & Matthew J. Slaughter (2008) Host Country policies

FDI is attracted to Singapore mainly due to Singapore's favourable investment climate and strategic geographical location. Some other reasons include non-fiscal advantages, Singapore's small domestic market combined with no tariffs on most imports and low corporate tax rates have made Singapore into a popular low-risk high-return FDI destination. In general,

corporate taxes, or taxes imposed on corporate income, is an important determinant of MNCs' location decisions, just as individual income tax rates is an important determinant of where a person decides to work and live.

Theoretically, other things equal, MNCs would prefer countries with lower corporate tax rates over countries with higher rates. Furthermore, a wide range of new incentives have been added over the years to promote FDI inflows. Burdensome regulations and performance requirements for FDI can offset a generous package of tax incentives. However, in Singapore's case, the restrictions and regulations governing both the entry and operation of foreign enterprises and personnel are minimal.

Overall, foreign investors are subject to the same government regulations as local investors, and both have a lot of freedom in pursuing their profit objectives. In addition to the general absence of performance requirements, Singapore has also signed a large number of avoidance of double taxation agreements, which mutually protect countries for a specific time against war and non-commercial risks of expropriation and nationalization.

The four areas of Singapore's government regulations in different areas relevant to foreign investors are the foreign exchange regime, equity ownership, performance requirements and human resources. First, the foreign exchange regime is highly liberal and freely allows repatriation of capital and remittance of profits, dividends, interests, royalty payments and technical licensing fees, as well as the free importation of goods and services for consumption, investment and production purposes.

Second, foreign participation is permitted in most sectors of the economy except for some limitations in the monetary sector, areas of trained and skilled personnel. However, 100% foreign equity ownership is readily permitted. Third, there are no performance requirements for foreign investors such as domestic value-added content and local sourcing of inputs, no restrictions on borrowing from the domestic capital market, and no regulations and restrictions governing the transfer of technology.

Fourth, there are only minimal restrictions on the recruitment of foreign personnel; employment passes are required but the government issues these quite liberally. However, the government does encourage foreign companies to hire local managerial and technical personnel. Singapore's non-fiscal advantages for foreign investors include strategic location, physical and financial infrastructure, human resources, political and social stability, good governance and a foreign investment policy that is liberal, comprehensive and well co-ordinated.

Singapore's location astride major sea and air routes and in the heart of Southeast Asia - an economically dynamic region rich in natural resources - gives it a significant locational advantage in trade and investment. Singapore's highly liberal trade regime has further reinforced its natural locational advantage and turned it into Southeast Asia's undisputed trade hub, which, in turn, facilitates the export and import activities of foreign firms locating in Singapore.

In addition, Singapore's time zone advantage, straddling East Asia and Western Europe, enables its financial markets and institutions to perform transactions with Japan, Europe and the US within its working hours.

Singapore had reinforced and exploited its strategic geographical location through large investments in physical infrastructure. Comprehensive air and sea transport and telecommunications link the city-state with the rest of the world.

The domestic land transportation network is also well-developed and efficiently connects the airport and sea port to the business and financial districts. Singapore's airport and sea port are world-class facilities that are consistently ranked as among the best in the world. Its advanced telecommunications infrastructure facilitates business transactions with the outside world. Singapore has achieved world-class status in information and communications technology (ICT), while the government has ensured a reliable supply of power and water.

Charles Oman (2000) Industrial estates, business parks and science parks provide ready access to land and factory/office space and industrial, commercial and research facilities and amenities -reduces the capital investment requirements of foreign investors, enables quick start-ups, and promotes external economies of industrial clustering. Singapore is a major Asia-Pacific financial centre, and its well-developed financial markets, large inflows of capital, and abundance of national savings all contribute to the low cost of capital. Charles Oman (2000) .

The government's human resource policy focuses on improving the productivity of the labour force through education and training. Singapore has adopted one of the most liberal immigration regimes in the world in order to expand its quantity as well as enhancing its quality. In terms of education, the government emphasizes technical and vocational education below

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tertiary level to provide a growing pool of technically competent workers, along with rapid expansion of engineering, business and computer science education at the tertiary level.

Women were also encouraged to enter the workforce in a bid to boost the female labour force participation rate. Another major selling point of Singapore for foreign investors is its well-known socio-political stability and good governance. Its political background is well-secured and there is no history of incidents concerning politically motivated damage to foreign investments in Singapore. Not to mention that Singapore ranks as one of the least corrupt country in the world. Singapore has, and dynamically enforced, strong and solid anti-corruption laws.

Political stability and an honest and effective political leadership and government have always been key elements in Singapore's favourable business environment. A pro-business government policy environment and high-quality civil service complements Singapore's excellent infrastructure and public capital. A remuneration system of paying relatively high salaries to civil servants attracts a constant stream of talented individuals to work for the government. World-class infrastructure and world-class government combine to offer a highly favourable environment for doing business.

Singapore is consistently ranked among the most competitive countries in the world terms of providing a sound business environment. According to the World Competitiveness Yearbook (WCY) 2005 by the Institute for Management Development (IMD), which ranks nations' business environments by analyzing their ability to provide an environment in which

enterprises can compete effectively, in 2005 Singapore ranked 3rd among the sample of 60 major industrialized and emerging economies.

The FDI has increased and better enhanced the quality of Singapore's entrepreneurial, managerial, marketing, technological and manpower resources. FDI had significantly contributed to higher exports and economic growth. However, further investigation also suggests that continuing large inflows of FDI may not be fully absorbed by the economy due to the scarcity of land and shortage of labour. This may lead to crowding out of domestic entrepreneurs.

In order to overcome this problem, more domestic entrepreneurs are needed to emerge and invest outward so as to reduce the reliance on FDI. The outcomes of Singapore's strategies at attracting inward FDI Recent FDI Since 2003, one of the most active sectors in attracting FDI is the chemical sector. Through its subsidiary Faci Asia Pacific Private Ltd. , Faci SpA, has invested approximately US\$5 million in a second metal stearate plant on Jurong Island, Singapore's chemical complex.

And in 2006, GlaxoSmithKline (GSK) has developed a special relationship with the country, opening a number of ventures, with its investment in an antibiotics plant in the Tuas Biomedical Park. Not to mention, the Integrated Resorts have unnoticeably boost the foreign investments scene in Singapore and the many efforts made by the government to attract and sustain FDI such as, the revamping of Orchard Road for reportedly \$40 million and establishing of the Circle line to facilitate travelling which completes just in time for the Youth Olympic games in 2010.

Conclusion For Singapore to attract and sustain FDI in all aspects, the structure that supports innovative activities must be further reinforced such as increasing research ability in public and private sectors, the availability of skilled human resources, policies to strengthen R&D infrastructure and so on, so as to foster innovation and local development. Although Singapore's education system and its no tariffs on most imports and low corporate rates are its main elements of attraction, there is always room for improvement.

Summing up, the study of the strategies adopted by Singapore to attract inward FDI, the challenges that occurred, results and future directions were critically analyzed and supported with references and findings. Although Singapore is a very attractive destination of FDI, it still has a few areas where improvements can be made in order to maximise economic growth, profits and strategic development.

So long as Singapore keep up with trends in the shift towards services, develop cross cultural literacy to avoid being ill informed, sustain its competitive advantage, ensure accessibility of government information to foreign investors and continue to invest in the up and coming, biotechnology industries, it will continue to prosper. REFERENCES: Ijaz Nabi and Manjula Luthria. (2002) Building competitive firms, incentives and capabilities, Washington, DC, The World Bank.

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