

International Business: a European Perspective

6. Foreign Direct Investment and Multinational Corporations



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**GOBIERNO
de
CANTABRIA**

1. Why FDI? FDI versus trade
2. FDI – definitions
3. FDI trends – volumes, forms, directions, composition
4. FDI – major trends: countries & sectors
5. FDI theories
6. Decisions from the firm perspective

FDI versus trade

- FDI v. Trade: the key question
- Also consider the option of licensing
- Why does a French automobile manufacturer set up in Spain (and not transport cars?)
- TATA in Santander
- Economists such as Paul Krugman claim the answer is in the “control” gained through FDI

FDI Definitions

- The flow of FDI refers to the amount of FDI undertaken over a given time period
- The stock of FDI refers to the total accumulated value of foreign owned assts at a given time
- The outflows of FDI refer to the flow of FDI out of a country
- The inflows of FDI refers to the flow of FDI into a country

FDI Definitions

- Multinational Corporations (MNCs): operating in at least two countries.
- MNCs: home and host economy Roots back to C19th and beyond. Both industrial and service sectors
- Greenfield v. Mergers & Acquisitions (M&A)

FDI Forms

- Mergers and acquisitions:
 - Quicker to execute
 - Foreign firms have valuable strategic assets
 - Believe they can increase the efficiency of the acquired firm
- More prevalent in developed nations
- Greenfield operation:
 - Mostly in developing nations

FDI Trends

- Flow and stock increased over the last 30 years
- And despite the elimination of many trade barriers (WTO), FDI has grown more rapidly than world trade. Why?
 - Greater liberalization of FDI regimes (“Globalization”)
 - 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 (risk of change)
 - New communication technologies facilitate firms seeing their market as potentially global

World FDI Trends

Figure 1. FDI inflows, global and by group of economies, 2005–2017
(Billions of dollars and per cent)

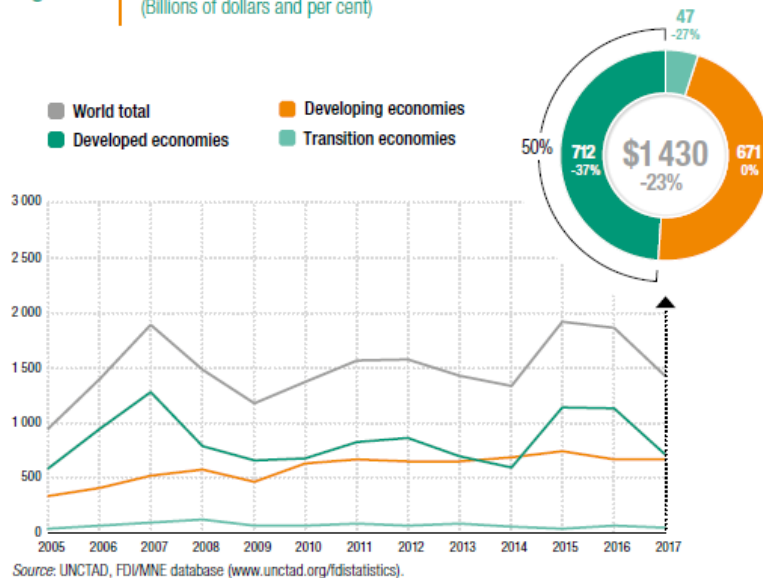
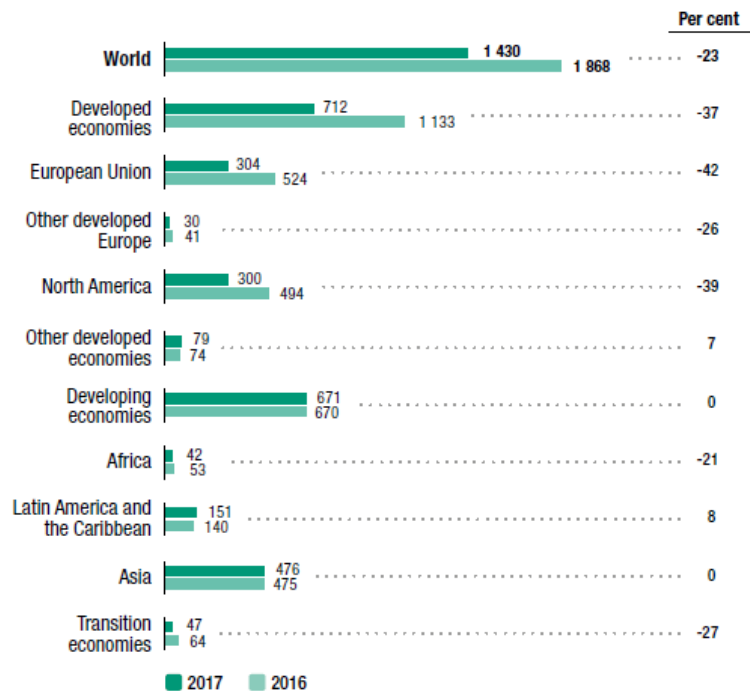
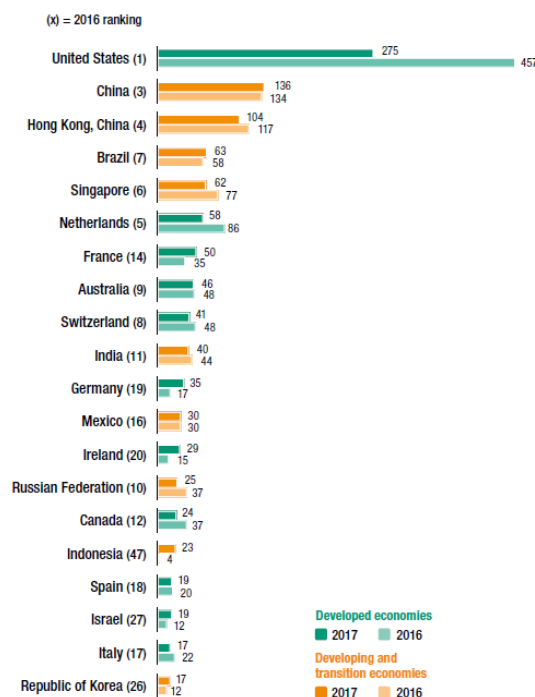


Figure 2. FDI inflows, by region, 2016–2017 (Billions of dollars and per cent)



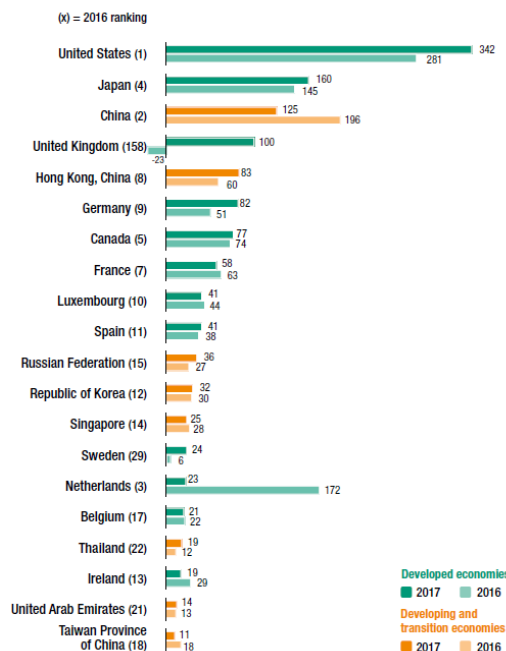
World FDI trends

Figure 3. FDI inflows, top 20 host economies, 2016 and 2017
(Billions of dollars)



Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

Figure 4. FDI outflows, top 20 home economies, 2016 and 2017
(Billions of dollars)



Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

Annex table 2. FDI stock, by region and economy, 2000, 2010 and 2017 (Millions of dollars)

Region/economy	FDI inward stock			FDI outward stock		
	2000	2010	2017	2000	2010	2017
World^a	7 380 453	20 279 391	31 524 356	7 409 630	20 981 762	30 837 927
Developed economies	5 782 408	13 480 300	20 331 171	6 699 287	17 554 729	23 498 002
Europe	2 457 352	8 208 848	10 362 403	3 174 007	10 380 324	12 108 503
European Union	2 322 122	7 357 407	9 123 982	2 907 116	9 136 663	10 631 707
Austria	31 165	160 615	185 938	24 821	181 638	241 158
Belgium	-	873 315	566 913	-	950 885	690 820
Belgium and Luxembourg	195 219	-	-	179 773	-	-
Bulgaria	2 704	44 970	47 838	67	2 583	2 817
Croatia	2 664	31 517	33 436	760	4 443	6 053
Cyprus	2 846	198 097	225 779	557	197 454	216 219
Czech Republic	21 644	128 504	153 468	738	14 923	23 655
Denmark	73 574	96 136	107 836 ^b	73 100	163 133	205 650 ^b
Estonia	2 645	15 551	23 148	259	5 545	7 700
Finland	24 273	86 698	85 980 ^b	52 109	137 663	136 392 ^b
France	184 215	630 710	874 521	365 871	1 172 994	1 451 663
Germany	470 938	955 881	931 285 ^b	483 946	1 364 565	1 607 380 ^b
Greece	14 113	35 026	32 371	6 094	42 623	22 563
Hungary	22 870	90 845	93 332	1 280	22 314	28 611
Ireland	127 089	285 575	880 157	27 925	340 114	899 479
Italy	122 533	328 058	413 246	169 957	491 208	532 910
Latvia	1 691	10 935	17 234	19	895	1 792
Lithuania	2 334	13 403	17 576	29	2 107	3 413
Luxembourg	-	172 257	178 048	-	187 027	241 421
Malta	2 263	129 770	203 571	193	60 596	74 024
Netherlands	243 733	588 077	974 706	305 461	968 105	1 604 884
Poland	33 477	187 602	234 441	268	16 407	30 982
Portugal	34 224	114 994	143 637	19 417	62 286	60 976
Romania	6 953	68 699	88 199	136	1 511	883
Slovakia	6 970	50 328	52 032	555	3 457	3 406
Slovenia	2 389	10 667	16 033	772	8 147	6 913
Spain	156 348	628 341	644 415	129 194	653 236	597 250
Sweden	93 791	352 646	334 974	123 618	394 547	401 013
United Kingdom	439 458	1 068 187	1 563 867	940 197	1 686 260	1 531 683

EU FDI

Figure B. FDI inflows, 2011–2017
(Billions of dollars and per cent)

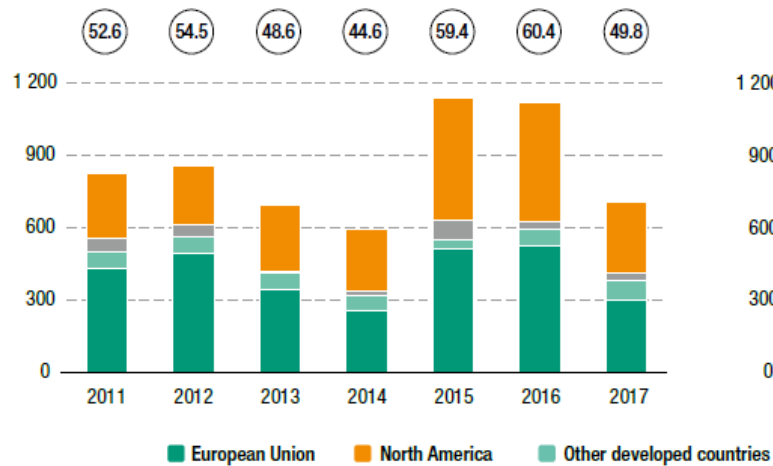
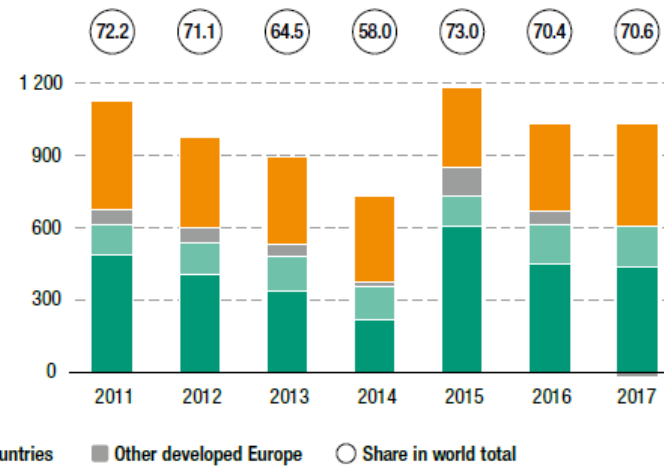


Figure C. FDI outflows, 2011–2017
(Billions of dollars and per cent)



EU FDI

DEVELOPED ECONOMIES

FDI flows, top 5 host economies, 2017 (Value and change)

2017 Inflows

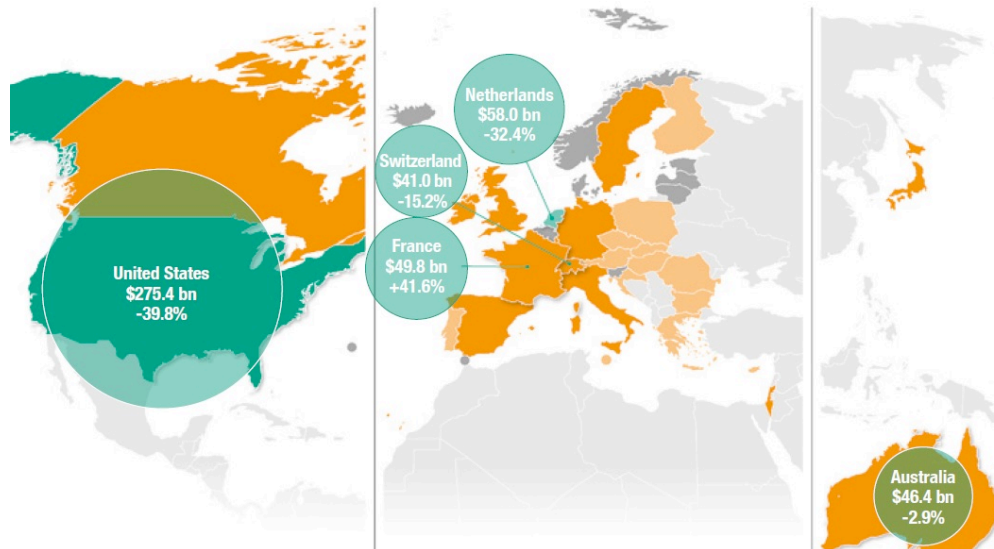
\$ 712.4 bn

2017 Decrease

-37.1%

Share in world

49.8%



FDI Theories

Four Perspectives on International Business and the Multinational Enterprise (MNE)

	<i>Economic</i>	<i>Managerial</i>	<i>Organizational</i>	<i>Sociopolitical</i>
Name of the literature(s):	IB (International Business).	IM (International Management).	OT (Organizational Theory)	Development Studies & International Relations
Research community:	AIB (Academy of International Business); AEA (American Economic Association).	AIB, and AoM (Academy of Management).	AoM, and ASA (American Sociological Association).	ASA, and APSA (American Political Science Association).
Research questions:	Why do firms go abroad? How do they go abroad? What are the welfare implications?	Why and how do firms go abroad? How are MNEs organized?	Why and how do firms go abroad? How are MNEs organized?	What role do MNEs play in economic & political development, and in international relations?
Assumptions & answers:	Rationality; constrained maximization; calculation of trade-offs.	Capability-based strategies; organizational structure follows strategy.	Only legitimate and environmentally fit organizing logics prevail; phenomenological.	Power & interest drive processes & outcomes.
Ways of doing research:	Deductive reasoning; formal modeling; large samples.	Conceptual framing; grounded theory; case studies & large samples.	Both inductive & deductive; grounded research; case studies & large samples.	Mostly inductive; grounded theory; case studies; comparative-historical method.
Key scholars:	Hymer [1960]; Caves (1971); Knickerbrocker (1973); Vernon ([1966] 1979); Buckley & Casson (1976); Dunning (1979); Kogut (1983).	Perlmutter (1960); Stopford & Wells (1972); Wells (1983); Prahalad & Doz (1987).	See Ghoshal & Westney eds. (1993).	Vernon (1971); Moran (1974); Kobrin (1982); Evans (1979); Haggard (1990).

Cited by Mauro Guillén

FDI Theories

- Theories on FDI tend to separate **horizontal** from **vertical** investment
- Horizontal Direct Investment
 - FDI in the same industry abroad as company operates at home
 - FDI is expensive because a firm must bear the costs of establishing production facilities in a foreign country or of acquiring a foreign enterprise
 - FDI is risky because of the problems associated with doing business in another culture where the rules of the game may be different
 - So why is it done?

FDI Theories Market Imperfections

- Market imperfections are factors that inhibit markets from working perfectly
 - In the international business literature, the marketing imperfection approach to FDI is typically referred to as internalization theory
- With regard to horizontal FDI, market imperfections arise in two circumstances:
 - When there are impediments to the free flow of products between nations which decrease the profitability of exporting relative to FDI and licensing
 - When there are impediments to the sale of know-how which increase the profitability of FDI relative to licensing (selling may increase risk of giving away know-how to competitors, know-how is not amenable to licensing, licensing means low control over entity).

Horizontal FDI – When?

- Transportation costs for a product are high
- Market Imperfections (Internalization Theory)
 - Impediments to the free flow of products between nations
 - Impediments to the sale of know-how
- Follow the lead of a competitor - strategic rivalry: Product Life Cycle - however, does not explain when it is profitable to invest abroad
- Location specific advantages (natural resources)

Vertical FDI

- Vertical FDI takes two forms
 - **Backward vertical FDI** is an investment in an industry abroad that provides inputs for a firm's domestic production processes
 - **Forward vertical FDI** occurs when an industry abroad sells the outputs of a firm's domestic production processes, this is less common than backward vertical FDI

Market Imperfections

- The market imperfections approach offers two explanations for vertical FDI
 - There are **impediments to the sale of know-how** through the market mechanism
 - Investments in **specialized assets** expose the investing firm to **hazards** that can be reduced only through vertical FDI