

International Business Economics

2. FDI: Theory and Practice



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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 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?

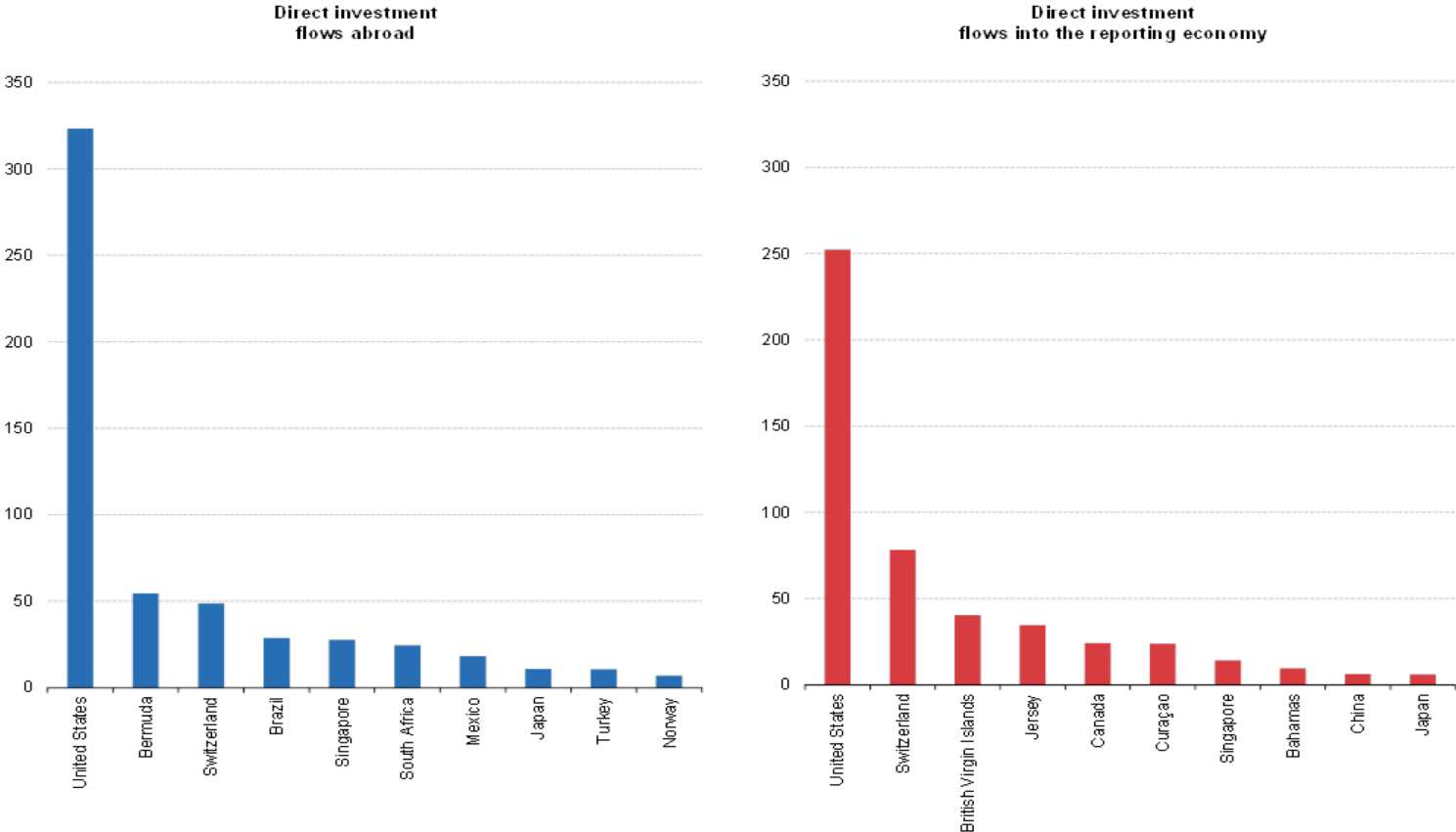
FDI Theories - market imperfections

- 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

FDI Theories – When

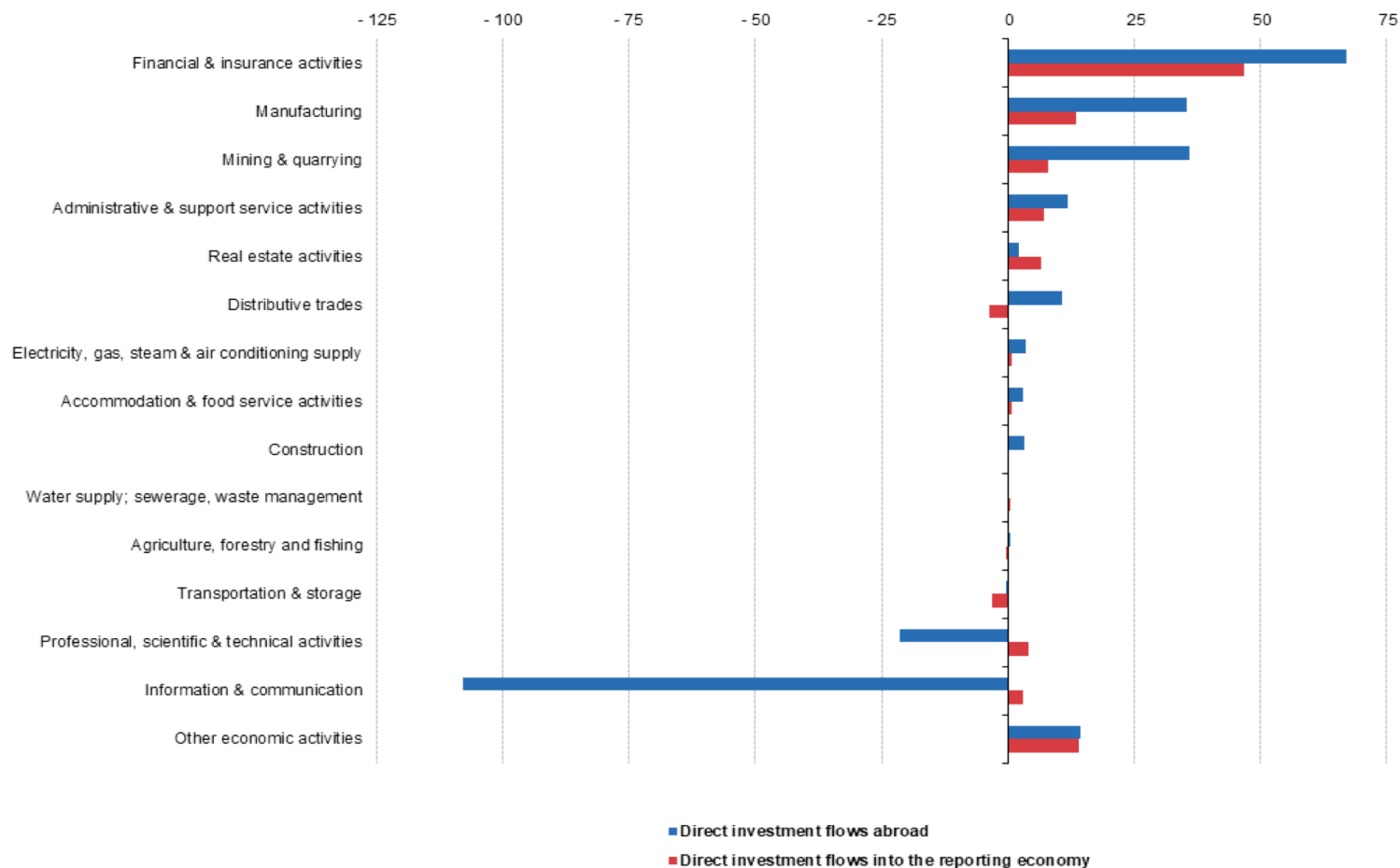
- Transportation costs for a product are high
- Market Imperfections (Internalization Theory)
 - Impediments to the free flow of products between nations
 - Impediments to the sale of know-how
- Follow the lead of a competitor - strategic rivalry: Product Life Cycle - however, does not explain when it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

FDI in practice: Top flows of extra-EU foreign direct investment (EU-28 2015)



Note: the sum of FDI flows to the top 10 partners may be greater than the total value of extra-EU flows due to divestment being greater than investment for some partners that are not shown.
Source: Eurostat (online data code: bop_fdi6_geo)

FDI in practice: Extra-EU foreign direct investment flows by economic activity (EU-28 2014)

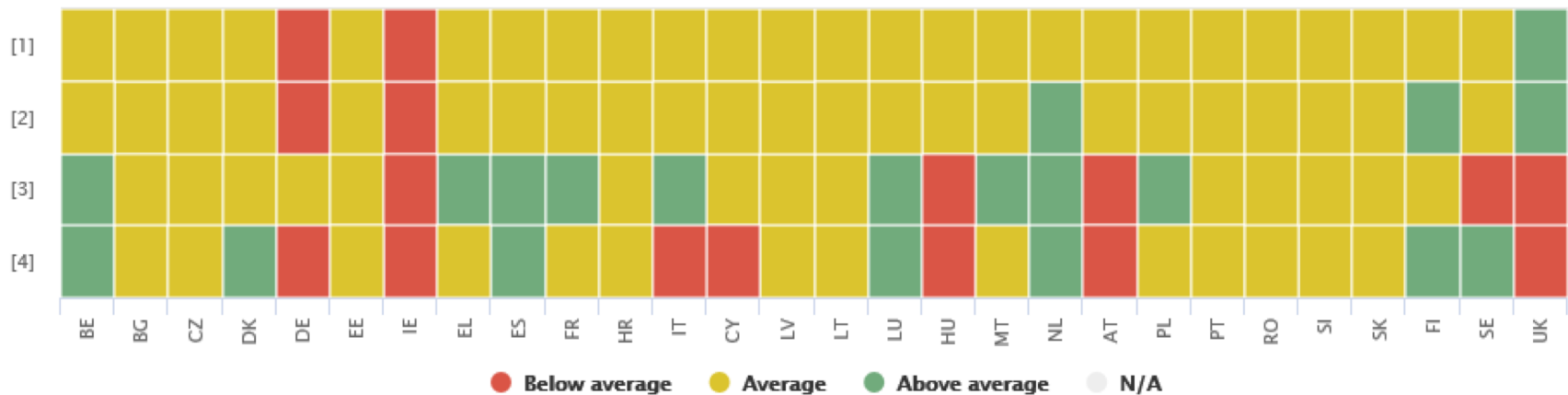


Note: ranked on the average value of direct investment abroad and direct investment in the reporting economy. A negative value indicates that divestment was greater than investment.

Source: Eurostat (online data code: bop_fdi6_flow)

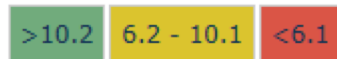
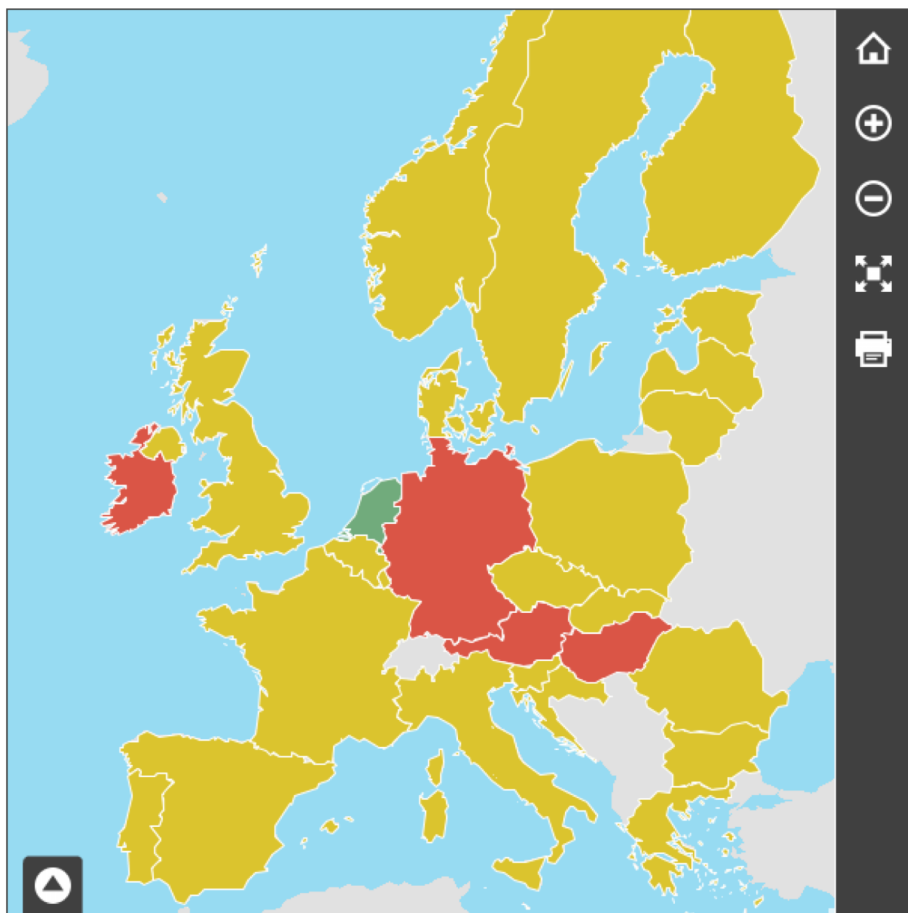
FDI in practice: FDI performance in the EU

1. by indicator



[1] Change in inward FDI flows	<-5 ppts	-5 – 5 ppts	>5 ppts
[2] Change in outward FDI flows	<-5 ppts	-5 – 5 ppts	>5 ppts
[3] Change in inward FDI stocks	<0 ppts	0 ppts	>0 ppts
[4] Change in outward FDI stocks	<0 ppts	0 ppts	>0 ppts

FDI in practice: FDI performance EU – aggregate index



FDI in practice: FDI drivers and trends from a EU perspective

- Joining the EU is estimated to have boosted bilateral FDI flows among members by significant amounts.
- Restrictions on inward FDI across the EU are, overall, lower than in OECD countries.
- The Great Recession triggered by the financial crisis of 2007-08 has adversely affected the EU's capacity to attract FDI.

FDI in practice: FDI drivers and trends from a EU perspective

- EU countries are increasingly investing in EMEs.
- The latest challenge the EU is facing is the UK Brexit: some studies have estimated a reduction in FDI into the UK of about 12-28% (see, e.g., Dhingra et al, 2016)

References

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