University Center Abdelhafid Boussouf-Mila

Faculty of Economics, Commercial &

Management Sciences

Lecture five: Foreign Direct Investment (FDI)

Addressed To master one Students-Semester 1

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Academic Year 2024-2025

Foreign Direct Investment (FDI)

What is Foreign Direct Investment (FDI)?

Foreign Direct Investment (FDI) refers to the investment made by a company or individual in one country into business interests located in another country. This typically involves the investor gaining a significant degree of control or influence over the foreign business. Unlike Foreign Portfolio Investment (FPI), which only involves the purchase of stocks or bonds in a foreign country without control, FDI usually means owning a substantial portion of the foreign company, typically 10% or more of its shares, or establishing new operations like subsidiaries, branches, or joint ventures.

FDI is an important component of the global economy and involves both the inflow of capital and the transfer of technology, skills, and management expertise from the investor's country to the host country.

Types of Foreign Direct Investment

- **Greenfield Investment:**

A form of FDI where a company builds new facilities in the foreign country. This can include the construction of factories, offices, or other physical infrastructure from the ground up.

Example: A U.S. company builds a new factory in India.

- **Mergers and Acquisitions (M&A):**

Involves a company in one country purchasing or merging with a company in another country. This allows for an immediate entry into the market, often with established infrastructure.

Example: A European company buys a controlling stake in a Chinese business.

- **Joint Ventures:**

A partnership between a foreign investor and a local company, where both share ownership and control over the operations of the business. Joint ventures are common when there are regulatory barriers or cultural differences that make full ownership difficult.

Example: A U.S. company enters a joint venture with a local Chinese firm to manufacture products.

Importance of FDI

- **Economic Growth:**

FDI brings capital into the host country, which can stimulate growth and development. It helps build infrastructure, create jobs, and develop industries that may not have been possible with domestic capital alone.

For example, FDI can improve the manufacturing sector, increasing output and employment.

- **Technology and Knowledge Transfer:**

Foreign investors often bring advanced technologies, managerial expertise, and new business practices to the host country. This helps local businesses become more competitive and efficient.

Example: A technology firm might establish a research and development center in another country, leading to technological advancements and skill development in the local workforce.

- **Improved Access to Markets:**

FDI can allow foreign companies to access new markets and customers in the host country. It also opens up the host country's products to international markets.

Example: A Japanese car company may set up production facilities in Mexico to export cars to the U.S.

- **Capital Formation:**

FDI is an important source of capital for developing countries where domestic savings may be insufficient to fund large-scale infrastructure projects or industrial growth.

- **Job Creation:**

FDI typically leads to the creation of new jobs in the host country, both directly (in the foreign-invested companies) and indirectly (in sectors that supply goods and services to those companies).

Factors Influencing FDI

- **Market Size:**

Larger markets are attractive for foreign investors because they offer more opportunities for sales and growth. Companies are more likely to invest in countries with growing consumer demand.

Example: China and India have attracted large amounts of FDI due to their massive consumer markets.

- **Labor Costs:**

Lower labor costs in the host country can be an incentive for FDI, especially in labor-intensive industries.

Example: Many multinational companies outsource production to countries like Vietnam or Bangladesh because of lower wages.

- **Government Policies and Regulations:**

Host country policies, such as tax incentives, subsidies, and regulations regarding foreign ownership, can either encourage or deter FDI.

Example: The government of Singapore has policies that are very conducive to FDI, such as low corporate taxes and incentives for foreign businesses.

- **Political Stability:**

Political stability and a predictable legal environment make a country more attractive for foreign investment. Investors prefer to avoid countries with unstable governments or uncertain laws.

Example: Many investors have avoided countries with frequent political turmoil, such as Venezuela.

Infrastructure and Business Environment:

Good infrastructure (roads, ports, energy supply, telecommunications) and a favorable business environment (ease of doing business, low corruption) attract more FDI.

Example: Countries with developed infrastructure like Germany and the U.S. consistently attract FDI.

Benefits and Challenges of FDI

Benefits for the Host Country:

- **Economic Development:** FDI can boost GDP, create employment, and support industries.
- **Improved Balance of Payments:** FDI increases exports and generates foreign exchange, improving the host country's balance of payments.
- **Development of Human Capital:** FDI often involves training and skill development for local workers.

Challenges for the Host Country:

- **Loss of Control:** The foreign company may have significant influence over domestic markets or industries, leading to concerns about national sovereignty.
- **Profit Repatriation:** Multinational companies may repatriate profits to their home countries, which can reduce the long-term benefits for the host country.
- **Environmental Impact:** In some cases, foreign investors may prioritize profit over environmental concerns, leading to environmental degradation.

The Role of FDI in Globalization

FDI is a key driver of globalization, as it allows companies to expand beyond their home countries, integrate into international markets, and tap into global supply chains. By investing in foreign markets, companies not only gain access to new consumers and labor forces but also encourage the cross-border flow of ideas, technologies, and capital.

Terminology

- Foreign Direct Investment (FDI) - الاستثمار الأجنبي المباشر
- Multinational Corporation (MNC) - الشركة متعددة الجنسيات
- Greenfield Investment - الاستثمار من الصفر
- Merger and Acquisition (M&A) - الاندماج والاستحواذ
- Joint Venture - المشروع المشترك
- Capital Flows - تدفقات رأس المال

- Host Country - الدولة المستضيفة
- Home Country - الدولة الأم
- Investment Climate - مناخ الاستثمار
- Repatriation of Profits - إعادة الأرباح إلى الوطن
- Market Access - الوصول إلى الأسواق
- Technology Transfer - نقل التكنولوجيا
- Risk Assessment - تقييم المخاطر
- Foreign Portfolio Investment (FPI) - الاستثمار الأجنبي في الأوراق المالية
- Tax Incentives - الحوافز الضريبية
- Trade Liberalization - تحرير التجارة
- Transfer Pricing - تسعير التحويل
- Capital Controls - قيود رأس المال
- Economic Integration - التكامل الاقتصادي
- Sovereign Wealth Fund - صندوق الثروة السيادية