

Module: International Business Management  
Class: 1st Year Master Business Management

## LECTURE FOUR: FOREIGN DIRECT INVESTMENT AND INTERNATIONALIZATION

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*“Investment is more than just capital flows and project pipelines. It’s a signal of where we’re placing our bets as a society.”*

**Rebeca Grynspan** Secretary-General of UN Trade and Development (UNCTAD)

### 3 Foreign Direct Investment Theory and Application

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## 1- Introduction

In economics, **internationalization** refers to a company expanding its market share internationally beyond its home country. The trend of internationalization has interconnected world economies through cross-border trade, leading to globalization. As such, they are greatly impacted by each others' national activities and economic well-being.

**Internationalization** refers to a company's strategy of extending its activities outside its home country to compete in global markets. It can take many shapes, such as:

- Exporting goods or services
- Licensing or franchising
- Strategic alliances
- Establishing subsidiaries or production units abroad

**Internationalization** is the process by which firms expand their operations beyond domestic borders, while **Foreign Direct Investment (FDI)** is a specific mode of internationalization where a company invests directly in business interests abroad to establish lasting influence.

## 2- What is Foreign Direct Investment (FDI)?

**Definition:** FDI occurs when a company or individual from one country **invests** in business interests located in another country, with the intent of exerting control or significant influence over the foreign enterprise.

### Forms of FDI: (How FDI works?)

- **Greenfield investment:** Establishing new facilities abroad (e.g., factories, offices).
- **Mergers & acquisitions:** Buying or merging with existing foreign firms.
- **Joint ventures:** Partnering with local firms to share ownership and control.

**Importance:** Why to move abroad??? FDI is a major driver of *globalization, fostering technology transfer, job creation, and integration of economies.*

**Motivations:** Companies invest abroad *to access resources, reduce production costs, enter new markets, or gain strategic advantages.*

**Though FDI is important, it has also disadvantages... see the following table:**

ADVANTAGES OF FDI	DISADVANTAGES OF FDI
1. Capital Infusion and Job Creation	1. Risk of Political Instability
2. Transfer of Technology and Skills	2. Negative Effects on Domestic Firms
3. Increased Competition and Productivity	3. Dependence on Foreign Investment
4. Access to New Markets and Resources	4. Cultural and Legal Differences
5. Economic Growth and Development	5. Possible Exploitation of Labor and Resources

Source: <https://www.aplustopper.com/fdi-advantages-and-disadvantages/>

### 3- Specific considerations/entry modes of FDI

#### A. difference between FDI and FPI

What's the Difference Between Foreign Direct Investment and Foreign Portfolio Investment?

- **Foreign portfolio investment (FPI)** is the addition of international assets to the portfolio of a company, an institutional investor such as a pension fund, or an individual investor. It's a form of portfolio diversification achieved by purchasing a foreign company's stocks or bonds.
- **Foreign direct investment (FDI)** requires a substantial and direct investment in or the outright acquisition of a company based in another country, not just its securities. FDI is generally a larger commitment made to enhance a company's growth.

\***FPI and FDI** are typically regarded as beneficial forms of capital inflow in emerging economies. FDI involves a greater responsibility to meet the regulations of the country that hosts the company receiving the investment.

#### B. Important terms in the context of Foreign Direct Investment (FDI)

##### Host Country

**Definition:** The country that receives the investment.

**Role:** Provides the location, labor, infrastructure, and regulatory environment for the foreign investor.

**Example:** If Toyota builds a factory in Italy, Italy is the host country.

##### **Benefits:**

- Job creation and wage growth.
- Access to new technologies and management practices.
- Increased tax revenues.

##### **Challenges:**

- Risk of foreign control over strategic industries.
- Cultural or governance clashes.
- Pressure on local firms to compete.

##### Foreign Country (Home Country)

**Definition:** The country where the investing firm originates.

**Role:** Supplies the capital, expertise, and technology that flows abroad.

**Example:** In the same case, Japan is the foreign (home) country, because Toyota is headquartered there.

##### **Benefits:**

- Access to new markets and resources.
- Global brand expansion.
- Diversification of risk.

##### **Challenges:**

- Possible “hollowing out” of domestic industries if too much production shifts abroad.
- Political backlash if jobs are perceived to be “exported.”

- **Developed economies:** the member countries of the OECD (other than Chile, Colombia, Costa Rica, Mexico and Türkiye), European Union member countries that are not OECD members (Bulgaria, Croatia, Cyprus, Malta and Romania) plus Albania, Andorra, Belarus, Bosnia and Herzegovina, Liechtenstein, Monaco, Montenegro, North Macedonia, the Republic of Moldova, the Russian Federation, San Marino, Serbia and Ukraine, plus the territories of of Bermuda, Faroe Islands, Gibraltar, Greenland, Guernsey and Jersey.

- **Developing economies:** in general, all economies not specified above. For statistical purposes, the data for China do not include those for Hong Kong Special Administrative Region (Hong Kong SAR), Macao Special Administrative Region (Macao SAR) or Taiwan Province of China..

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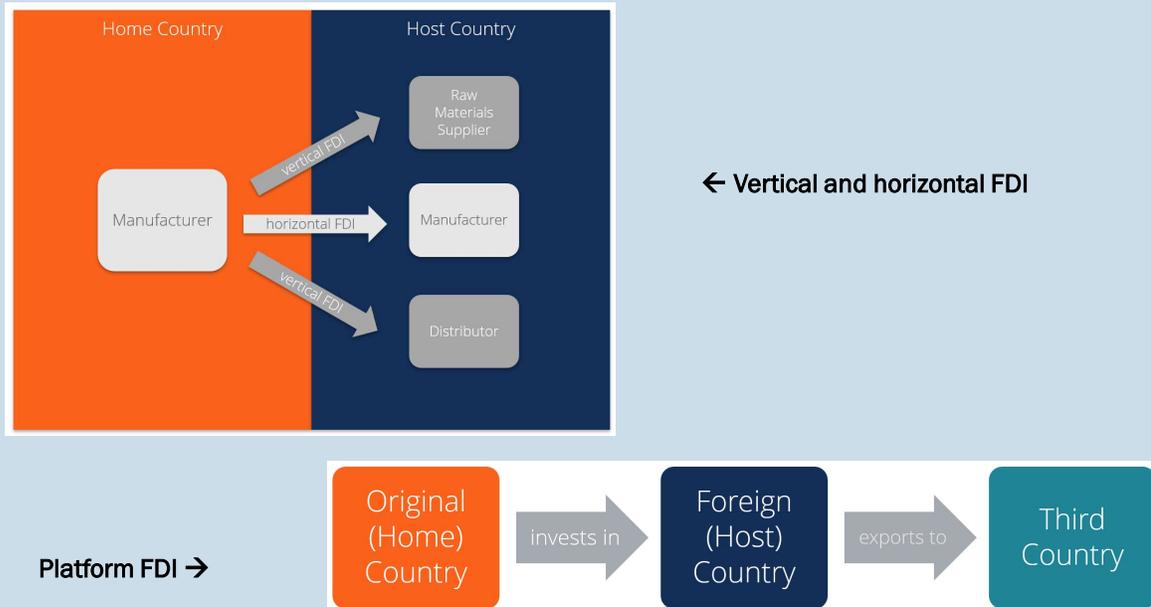
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## 4- Forms of FDI

FDI and international trade are the main features of modern globalization. FDI refers to the investment made by a company or an individual from one country in a business or company located in another country. This investment can take different forms, such as acquiring a foreign company, establishing a new business in a foreign country, or expanding an existing business in a foreign country. FDI can take different forms; **Horizontal FDI** which involves a company establishing a business that manufactures products and services in a foreign country similar to those it produces in its own country; **Vertical FDI** which is the investment made in a different business in a foreign country but is related to the investor's main business activities; **Conglomerate** which is when the FDI is not linked directly to the investor's core business. We can also categorize FDI into **Market-Seeking**, which is undertaken to gain access to new markets or to increase the company's market share in existing markets, or **Resource-Seeking FDI** which is undertaken to acquire access to natural resources, such as raw materials, energy, or other natural resources. Quintessential to FDI is not the transfer of funds, but the managerial control established through the transfer of the fund. Foreign capital flow is only considered FDI if it establishes long-lasting managerial control. A lasting interest or control is established when an investor obtains at least **10% of the voting power** in a firm.



<https://corporatefinanceinstitute.com/resources/economics/foreign-direct-investment-fdi/>

### Types and Examples of Foreign Direct Investment

Typically, there are two main types of FDI: horizontal and vertical FDI.

- **Horizontal:** a business expands its domestic operations to a foreign country. In this case, the business conducts the same activities but in a foreign country. For example, McDonald's opening restaurants in Japan would be considered horizontal FDI.
- **Vertical:** a business expands into a foreign country by moving to a different level of the supply chain. In other words, a firm conducts different activities abroad but these activities are still related to the main business. Using the same example, McDonald's could purchase a large-scale farm in Canada to produce meat for their restaurants.

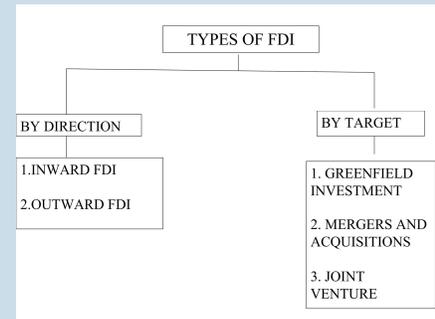
However, two other forms of FDI have also been observed: conglomerate and platform FDI.

- **Conglomerate:** a business acquires an unrelated business in a foreign country. This is uncommon, as it requires overcoming two barriers to entry: entering a foreign country and entering a new industry or market. An example of this would be if Virgin Group, which is based in the United Kingdom, acquired a clothing line in France.
- **Platform:** a business expands into a foreign country but the output from the foreign operations is exported to a third country. This is also referred to as export-platform FDI. Platform FDI commonly happens in low-cost locations inside free-trade areas. For example, if Ford purchased manufacturing plants in Ireland with the primary purpose of exporting cars to other countries in the EU.

<https://corporatefinanceinstitute.com/resources/economics/foreign-direct-investment-fdi/>

## 4- Types of FDI

### A. Types of FDI by Direction



#### Inward FDI

**Definition:** Foreign Direct Investment coming into a country from abroad.

**Example:** A German car company builds a factory in Japan. That's inward FDI for Japan.

#### Impact:

- Brings capital, technology, and jobs.
- Can stimulate innovation and competition.
- Sometimes raises concerns about foreign control of strategic sectors.

#### Outward FDI

**Definition:** Foreign Direct Investment made by domestic firms abroad.

**Example:** A Japanese electronics company acquires a plant in the United States. That's outward FDI for Japan.

#### Impact:

- Helps firms access new markets and resources.
- Strengthens global supply chains.
- Can lead to concerns about "hollowing out" domestic industries if too much production shifts overseas.

## B. Types of FDI by Target

Greenfield investment, mergers & acquisitions (M&A), and joint ventures are all forms of [foreign direct investment \(FDI\)](#), but they differ in how a company expands internationally.

A **greenfield investment** involves building new operations from the ground up in a foreign country, while an **M&A** is when one company buys or combines with an existing foreign company.

A **joint venture** is a separate partnership formed between two or more companies for a specific project, which can sometimes be established using a greenfield method

GREENFIELD INVESTMENT	MERGERS & ACQUISITIONS	JOINT VENTURE
<p><b>Definition:</b> Building new business operations from scratch in a foreign country, such as constructing a new factory or office.</p> <p><b>Control:</b> The parent company has complete control over the new operations unless foreign ownership is restricted by the host country.</p> <p><b>Key features:</b></p> <ul style="list-style-type: none"> <li>Creates jobs and facilities from the ground up.</li> <li>Can be a riskier strategy due to unknown costs, but offers greater long-term control and potentially higher returns.</li> <li>Often involves a detailed business plan and financial model for the new venture</li> </ul> <p>Eg: 🚗 Toyota in the United States</p>	<p><b>Definition:</b> One company buys another company (acquisition) or two companies combine to form a new company (merger).</p> <p><b>Control:</b> The acquiring company gains control of the target company's existing assets, operations, and market share.</p> <p><b>Key features:</b></p> <ul style="list-style-type: none"> <li>Allows for rapid market entry by acquiring an existing company.</li> <li>The acquiring company pays a fee for the target company's assets and business.</li> <li>Benefits can arise from synergies between the merged companies.</li> </ul> <p>Eg: Alitalia's successor, ITA Airways, entered into a major Foreign Direct Investment (FDI) merger when Lufthansa acquired a 41% stake in the Italian airline in 2025.</p>	<p><b>Definition:</b> Two or more companies agree to work together on a specific project or business, sharing the risks and rewards, while remaining separate entities.</p> <p><b>Control:</b> Control is shared between the partner companies, and decision-making is a result of the partnership agreement.</p> <p><b>Key features:</b></p> <ul style="list-style-type: none"> <li>Often used to share resources, expertise, or market access for a specific project.</li> <li>No side-payments are involved, as the partners cooperate instead of one partner acquiring the other.</li> <li>Can be structured as a greenfield project, where partners jointly create a new entity from scratch.</li> </ul> <p>Eg: 📱 Example: Sony Ericsson</p>

## 5- Examples of FDI

- **Japan changes its mind about FDI, but needs to do more**

Japan once prioritized shielding domestic champions and relying on homegrown capital. Today, it's inviting foreign investors—cautiously. The promise is innovation, productivity, and regional revitalization. The risk is security, control, and culture clash. This opening case frames Japan's evolving stance on foreign direct investment (FDI), the policy tools behind it, and the execution gaps that still hold it back.

- Read the example of Japan on this link: <https://hayinsights.com/fdi-in-japan-outbound-and-inbound-details/>

### Conclusion:

Foreign Direct Investment (FDI) constitutes a strategic mechanism through which host economies not only acquire capital inflows but also benefit from the *transfer of advanced technologies, specialized skills, and managerial practices*. Such multidimensional contributions can enhance productivity and foster long-term economic development.

In contrast, **portfolio investment** is limited to the acquisition of financial assets—such as equities or bonds—without conferring managerial influence or control over the foreign enterprise.



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