UNIT – III

THEORIES OF INTERNATIONAL INVESTMENT

Monopoly Theory of Advantage

The monopoly theory of advantage states that the investing firm possesses a relative monopolistic advantage abroad against the competitive local firms.

This theory talks about a horizontal foreign investment where a company makes an investment in a foreign country in a similar business prevailing in the foreign country.

According to this theory, when a firm goes through this theory enjoys a monopolistic advantage on two counts – economies of scale (cost reduction technique) and superior knowledge and advanced technology. It refers to all intangible skills-intellectual capital plus advanced technology which permits the firm to create unique product differentiation.

Empirically, it suggests horizontal foreign direct investments of the US firms' knowledge in technology-intensive industries such as petroleum referring, pharmaceuticals, chemicals, and transport equipment. It was also observed in the case of US firms in high-level marketing skill-oriented industries such as cosmetics and fast food abroad.

Oligopoly Theory of Advantage

The oligopoly theory of advantage theory of FDI explains vertical foreign investment. This means a company invests in a foreign country other than the business prevailing in that country.

Through vertical direct foreign investment, they tend to capture and enlarge market share in the global market

The oligopolistic big firms tend to dominate in the global market on account of entry barriers such as the big firms intend to retain their monopoly power by sustaining the entry barriers. They do not want new competitors to enter by allowing the market vacuum.

This theory explains the defensive investment behavior of a multinational firm. For this reason, petroleum companies tend to land invested in crude oil refineries as well as marketing outlets.

International Product Life Cycle (IPLC) Theory

Raymond Vernon's IPLC theory explains both international trade and foreign direct investment. It explains that FDI is a natural stage in the life of a product.

It further explains a firm shift from exporting to foreign direct investment.

Initially, a firm that innovates a product and produces at home enjoys its monopolistic advantage and starts the export market, thus, specializing and exporting. This theory says FDI occurs when the product life cycle moves to the third and fourth stages i.e. maturity and decline stages.

The firm may tend to invest abroad and export from there to retain its monopoly power. The rivals from the home country may also follow to invest in the same foreign country's oligopolistic market explaining both trade and FDI.

Eclectic Theory

This theory is Propounded by John Dunning (1988), is a holistic, analytic approach for FDI and organizational issues of the MNCs relating to foreign production.

Eclectic paradigm considers the significance of three variables.

- **Ownership Specific** – Technology, knowledge, economies of scale, monopolistic advantage, managerial effectiveness, and structure.
- **Location Specific Advantage** – More profit due to special factors like political, physical, social, economic, etc. in foreign markets.
- **Internalization Advantage** – Higher return in licensing, franchising, or exportation rather than functioning in full operation.

FDI:
Learning value:
1. Meaning and correct trends of FDI
2. Benefits to host countries through FDI
3. Destinations of FDI flow
4. Criteria of attracting FDI
5. Major challenges for FDI in various countries

Definition and Importance

Investment is "the flow of funds one destination to another", for any activity, including industrial development, infrastructure and
manufacturing. When the investment goes from the home country to another country it is defined as 'investment outflow' and when theforeign investment comes from other countries to home country it is termed as 'investment inflow'. Both inwardand outward movements are encouraged in majority of the countries. All developing countries produce primary goods, and to exploit them financial resources are necessary. Developed countries are also in need of FDI for further development of technology and modernization.
The current Foreign Direct Investment (FDI) is related to investment in developing countries and Less Developed Countries (LDCs)require huge investments in other activities, such as infrastructure, healthcare, housing, power generation etc.

Financial resource is crucial, time bound and critical. If it is not available in right time from anywhere, the probable results are bankruptcy, decline and loss of status whether it is a nation or company or individual.

With the liberalization of the Indian economy, a large Indian market is being opened up to foreign investors. Practically, FDI represents foreign assets in domestic structures, equipment and organizations. It does not include foreign investment in the stock markets. Foreign direct investment in useful to a country if the focus is more on projects rather than investments in the equity of companies because equity investments are potentially “hot money” which can leave at the first sign of trouble. South Korean, South African and Argentinean crisis were partially due to such problems.

When a firm invests directly in facilities in a foreign country it is said to be FDI. It involves the active control of the investment not really determined by level of stock ownership. Many multinational enterprises become involve in FDI with the ultimate objective of reaping short term as well as long term benefits. Ownership may become transnational, i.e., ownership in more than one country. Factors influencing FDI are related to increasing business opportunities across national borders and their involvement could be in the following functional areas.

aterials or other resources

The parent company has direct managerial control, but the degree of control may depend on the type of country and company policy. Prior to their investment decisions it is necessary to carry out risk analysis and interpretations of the same. MNCs do not develop blind faith in any country. A team of experts analyse risks carefully and invest gradually.

CHARACTERISTICS OF FDI

FDI is an activity by which an investor, who is resident in one country, obtains a lasting interest in, and is a significant influence on the management of an entity in another country. This may involve either creating an entirely new enterprise, so-called “Greenfield” investment or, more typically, changing the ownership of existing enterprises via mergers and acquisitions. Other types of financial transactions between related enterprises, like reinvesting the earnings of the FDI enterprises or other capital transfers, are also defined as foreign direct investment.

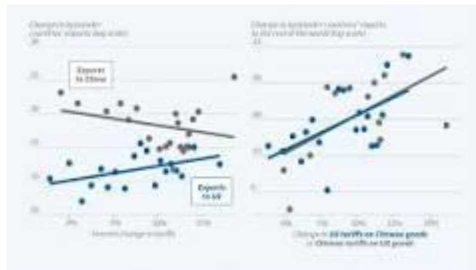
MEANING OF TRADE AND INVESTMENT

Trading refers to the trading of securities, i.e. bonds, buying and selling of shares, futures, options, debentures, etc., between merchants, for the intention of obtaining a profit. Investing refers to distributing money to either a project, policy, plan or a scheme which is capable of generating future returns. Term.

ROLE OF TRADE AND INVESTMENT

Trade and cross-border investment are crucial drivers of economic growth and development, yet support for international economic cooperation falters, and existing rules and institutions are strained.

TRADE AND INVESTMENT IN INTERNATIONAL BUSINESS



Share. The International Trade and Investment Program examines the causes and consequences of trade between and among nations and regions. It considers how transportation costs, tariffs, and other factors affect geographic specialization and commercial flows.

What Are the Types of Trade? Generally, there are two types of trade—domestic and international. Domestic trades occur between parties in the same countries. International trade occurs between two or more countries.

The major differences between investing and trading are approaches, risk, and time involved. It is okay to do both, and it depends on the risk-taking ability and patience of the person to choose between either of these or both of these. Investing is long-term and involves lesser risk, while trading is short-term and involves high risk. Both earn profits, but traders frequently earn more profit compared to investors when they make the right decisions, and the market is performing accordingly.