Chapter 12
Foreign Direct Investment: Advanced Issues and Approaches

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ABSTRACT

This chapter indicates the overview of Foreign Direct Investment (FDI); FDI entries and export; FDI and spillover effects; FDI, human capital, and absorptive capacity; and the significance of FDI in the global economy. FDI is an investment in a business by an investor from another country for which the foreign investor has control over the company purchased. FDI offers a source of external capital and increased revenue. FDI can be a tremendous source of external capital for the developing countries, which can lead to economic development. Through FDI, capital goes to whatever businesses have the economic growth anywhere in the world. FDI helps in increasing the output through the utilization of advanced technology and management techniques. FDI benefits investors, businesses, and the global economy. FDI contributes to foreign exchange earnings, employment creation, and the increases in incomes in the global economy.

INTRODUCTION

Attracting foreign direct investment (FDI) has become an important objective for developed economies (Anderson & Sutherland, 2015). FDI is an important channel for diffusing the advanced international technology and transferring the capital across national borders (Chen, Kokko, & Tingvall, 2011) and involves the establishment of a new company, the acquisition of an existing company, and the increase of one’s capital in foreign countries (Gür, 2016). FDI promotes economic growth in the host country by providing the transfer of new knowledge and technologies (Eryigit & Eryigit, 2015). The host country’s government chooses its FDI policy to affect the multinational company’s entry mode to achieve the maximum social welfare for the domestic country (Qiu & Wang, 2011).

FDI across sectors is associated with varying policy environments, with service and primary resource investment attracted to hosts with policies concerning the economic and political contexts (Hecock & Jepsen, 2013). FDI is considered as one of the major sources of employment generation, technology
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transfer, and the increasing market efficiency in any country (Abdin, 2015) and becomes the most important source of finance that can contribute to economic development (Shahmoradi, 2012). FDI flows have positive effects on the less developed countries (i.e., South countries), and that the effect of FDI flows from the developed countries (i.e., North countries) is stronger than that from the less developed countries (Kim, Lee, & Lee, 2015).

FDI is found to be positively related to economic growth and negatively related to foreign portfolio investment, trade openness, the exchange rate, and the foreign real interest rate (Kirchner, 2012). FDI in Asia are mainly export-oriented, while FDI in the United States and Europe are mostly for meeting local market demand (Tsai, Mukherjee, & Chen, 2016). The capacity of regions to attract FDI is affected by the own-country effect, which can take two different forms: the first perspective relates to the relative performance of the country of which the region is part (the between-country effect); the second perspective concerns the relative performance of regions within their own countries (the within-country effect) (Casi & Resmini, 2014).

This chapter aims to bridge the gap in the literature on the thorough literature consolidation of FDI. The extensive literature of FDI provides a contribution to practitioners and researchers by indicating the advanced issues and approaches in FDI in order to maximize the impact of FDI in the global economy.

BACKGROUND

After 1980s, most developing economies reduced restriction on crucial areas, such as trade and finance (Bakır & Eryılmaz, 2015). By doing that, FDI easily comes into domestic economy, which can be defined as an inflow. Since the 1980s, FDI flows have significantly increased worldwide and at the same time, the share of these flows going into developing countries has followed an upward trend (Sönmez & Pamukçu, 2013). Since the 1990s, in developing countries, the significant increase in FDI has been accompanied with a strong tendency to open economies and the natural reduction and elimination of trade barriers (Ramirez, 2016). Among developing countries, China is the world’s largest FDI destination. A significant portion of the FDI in China comes from the multinational corporations’ subsequent investments of retained earnings or additional capital contribution (Luo, Luo, & Liu, 2008).

One of the main features of the modern economy is the internationalization of economic operations, which is connected with globalization and regionalization (Dorożyński & Kuna-Marszałek, 2015). The theories of international investment based on the experience of the companies from the industrially advanced countries suggest that the competitive advantage allows companies to expand business and secure higher returns (Singh & Jain, 2010). The rate of direct FDI in the PRC (prior to the current worldwide economic crisis) raises the important issues with respect to employment and talent management issues (Venero & Lian, 2014). FDI causes higher productivity and increased demand for skilled labor (Peluffo, 2015). Countries with well-developed financial markets gain significantly from FDI through total factor productivity (TFP) improvements (Alfaro, Kalemli-Ozcan, & Sayek, 2009).

FDI is linked to regionalization and globalization, particularly when it comes to the selection of investment localization (Dorożyński & Kuna-Marszałek, 2015). The interest in location aspects of FDI stems from the fact that most countries compete with each other to attract a major share of FDI inflows; therefore, changes that can be made by host countries are important for attracting FDI (Boateng, Hua, Nisar, & Wu, 2015). Managers in different countries are giving different importance to the distance factors when making FDI decisions (Drogendijk & Martin, 2015). The distance plays an important role