Foreign Direct Investment and Cross-Border Acquisitions

Chapter 16

Global Trends in FDI

- Foreign direct investment often involves the establishment of production facilities abroad.
- Greenfield investment involves building new facilities from the ground up.
- Cross-border acquisition involves the purchase of an existing business.

Global Trends in FDI (continued)

- Several developed nations are the sources of FDI *outflows*.
  - Most world-wide FDI comes from the developed world.
- This implies that MNCs domiciled in these countries should have certain comparative advantages in undertaking overseas investment projects.
- Both developing *and* developed nations are the recipient of inflows of FDI.
  - Some developing countries, like China and Mexico, have begun to undertake FDI, albeit on a modest scale.

EXHIBIT 16.1 Foreign Direct Investment–Outflows (Inflows) in Billions of Dollars

Country	2010	2011	2012	2013	2014	2015	Annual Average
Australia	19.8	1.7	6.7	1.6	0.0	−16.7	2.2
	(36.4)	(58.9)	(59)	(57)	(39.6)	(22.3)	(45.5)
Canada	34.7	52.1	55.9	54.9	55.7	67.2	53.4
	(28.4)	(39.7)	(43.1)	(71.8)	(58.5)	(48.6)	(48.3)
China	68.8	74.7	87.8	107.8	123.1	127.6	98.3
	(114.7)	(124)	(121.1)	(123.9)	(128.5)	(135.6)	(124.6)
France	48.2	51.4	31.6	25.0	42.9	35.1	39.0
	(13.9)	(31.6)	(17)	(42.9)	(15.2)	(42.9)	(27.2)
Germany	125.5	77.9	62.2	40.4	106.2	94.3	84.4
	(65.6)	(67.5)	(28.2)	(11.7)	(0.9)	(31.7)	(34.3)
Italy	32.7	53.7	8.0	25.1	26.5	27.6	28.9
	(9.2)	(34.3)	(0.1)	(24.3)	(23.2)	(20.3)	(18.6)
Japan	56.3	107.6	122.5	135.7	113.6	128.7	110.7
	(−1.3)	(−1.8)	(1.7)	(2.3)	(2.1)	(−2.3)	(0.1)
Mexico	15.1	12.6	22.5	13.1	8.3	8.1	13.3
	(26.4)	(23.6)	(20.4)	(45.9)	(25.7)	(30.3)	(28.7)
Netherlands	68.4	34.8	6.2	70.0	56.0	113.4	58.1
	(−7.2)	(24.4)	(20.1)	(51.4)	(52.2)	(72.6)	(35.6)
Spain	37.8	41.2	−4.0	13.8	35.3	34.6	26.5
	(39.9)	(28.4)	(25.7)	(32.9)	(22.9)	(9.2)	(26.5)
Sweden	20.3	29.9	29.0	30.1	8.6	23.7	23.6
	(0.1)	(12.9)	(16.3)	(4.9)	(3.6)	(12.6)	(8.4)
Switzerland	85.7	48.1	43.3	38.6	−3.3	70.3	47.1
	(28.7)	(28.3)	(16)	(0.6)	(6.6)	(68.8)	(24.9)
United Kingdom	48.1	95.6	20.7	−18.8	−81.8	−61.4	0.4
	(58.2)	(42.2)	(55.4)	(47.6)	(52.4)	(39.5)	(49.2)
United States	277.8	396.6	318.2	307.9	316.5	300.0	319.5
	(198)	(229.9)	(188.4)	(211.5)	(106.6)	(379.9)	(219.1)
World	1,391.9	1,557.6	1,308.8	1,310.6	1,318.5	1,474.2	1,393.6
	(1,388.8)	(1,566.8)	(1,510.9)	(1,427.2)	(1,277.0)	(1,762.2)	(1488.8)

EXHIBIT 16.2
Average Foreign Direct Investment per Year 2010–2015 ($ billions)

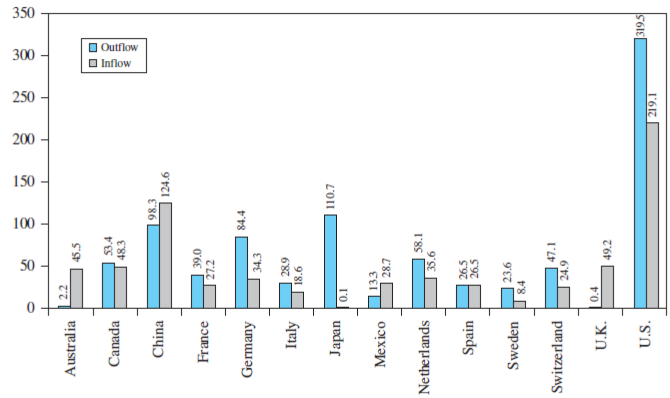

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EXHIBIT 16.3 Foreign Direct Investment Outward (Inward) Stocks in Billions of Dollars

Country	1990	1995	2000	2005	2010	2015
Australia	30.1	41.3	92.5	159.2	449.7	396.4
	(75.8)	(104.2)	(121.7)	(210.9)	(527.1)	(537.4)
Canada	78.9	110.4	442.6	399.4	998.5	1,078.3
	(113.1)	(116.8)	(325)	(356.9)	(983.9)	(756)
China	2.5	17.3	27.8	46.3	317.2	1,010.2
	(14.1)	(129)	(193.3)	(317.9)	(587.8)	(1220.9)
France	110.1	200.9	365.9	853.2	1,173.0	1,314.2
	(86.5)	(162.4)	(184.2)	(600.8)	(630.7)	(772)
Germany	151.6	235.0	483.9	967.3	1,364.6	1,812.5
	(111.2)	(134)	(470.9)	(502.8)	(955.9)	(1121.3)
Italy	56.1	86.7	170.0	293.5	491.2	466.6
	(58)	(64.7)	(122.5)	(219.9)	(328.1)	(335.3)
Japan	201.4	305.5	278.4	386.6	831.1	1,226.5
	(9.9)	(17.8)	(50.3)	(100.9)	(214.9)	(170.7)
Mexico	0.6	2.7	8.3	28.0	121.6	151.9
	(27.9)	(61.3)	(121.7)	(209.6)	(363.8)	(420)
Netherlands	109.1	158.6	305.5	641.3	968.1	1,074.3
	(73.7)	(102.6)	(243.7)	(463.4)	(588.1)	(707)
Spain	14.9	34.3	129.2	381.3	653.2	472.1
	(66.3)	(128.9)	(156.3)	(367.7)	(628.3)	(533.3)
Sweden	49.5	61.6	123.6	202.8	374.4	345.9
	(12.5)	(32.8)	(93.8)	(171.5)	(347.2)	(281.9)
Switzerland	65.7	108.3	232.2	394.8	1,041.3	1,138.2
	(33.7)	(43.1)	(86.8)	(172.5)	(610.9)	(833)
United Kingdom	230.8	319.0	923.4	1,238.0	1,574.7	1,538.1
	(218)	(244.1)	(463.1)	(816.7)	(1057.2)	(1457.4)
United States	435.2	705.6	1,316.2	2,051.3	4,809.6	5,982.8
	(394.9)	(564.6)	(1256.9)	(1625.7)	(3422.3)	(5588)
World	1,758.2	2,897.6	7,436.8	10,671.9	20,803.7	25,044.9
	(1950.3)	(2992.1)	(7488.4)	(10129.7)	(20189.7)	(24983.2)

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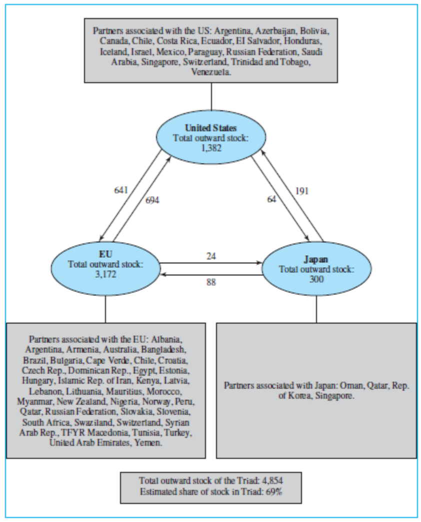
EXHIBIT 16.4 FDI Stocks among the Triad and Economies in Which FDI from the Triad Dominates, 2001 (billions of dollars)



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Why Do Firms Invest Overseas?

- Trade barriers
- Labor market imperfections
- Intangible assets
- Vertical integration
- Product life cycle
- Shareholder diversification

16-8

Trade Barriers

- Government action leads to market imperfections.
- Tariffs, quotas, and other restrictions on the free flow of goods, services, and people.
- Trade barriers can also arise naturally due to high transportation costs, particularly for low value-to-weight goods.

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Labor Market Imperfections

- Among all factor markets, the labor market is the least perfect.
  - Recall that the *factors of production* are land, labor, capital, and entrepreneurial ability.
- If there exist restrictions on the flow of workers across borders, then labor services can be underpriced relative to productivity.
  - The restrictions may be immigration barriers or simply social preferences.

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EXHIBIT 16.5 Labor Costs around the Globe (2012)

Country	Average Hourly Cost ($)
Switzerland	57.79
Belgium	52.19
Sweden	49.80
Australia	47.68
Germany	45.79
France	39.81
Canada	36.59
United States	35.67
Japan	35.34
Italy	34.18
United Kingdom	31.23
Spain	26.83
Singapore	24.16
Korea, Republic	20.72
Israel	20.14
Brazil	11.20
Taiwan	9.46
Mexico	6.36
Philippines	2.10
China	1.64
India	1.45
Indonesia	1.15
Vietnam	0.73
Bangladesh	0.37

Intangible Assets

- Coca-Cola has a very valuable asset in its closely guarded “secret formula.”
- To protect that proprietary information, Coca-Cola has chosen FDI over licensing.
- Since intangible assets are difficult to package and sell to foreigners, MNCs often enjoy a comparative advantage with FDI.

Vertical Integration

- MNCs may undertake FDI in countries where inputs are available in order to secure the supply of inputs at a stable accounting price.
- Vertical integration may be backward or forward:
  - Backward: *e.g.*, a furniture maker buying a logging company.
  - Forward: *e.g.*, a U.S. auto maker buying a Japanese auto dealership.

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Product Life Cycle

- U.S. firms develop new products in the developed world for the domestic market, and then markets expand overseas.
- FDI takes place when product maturity hits and cost becomes an increasingly important consideration for the MNC.

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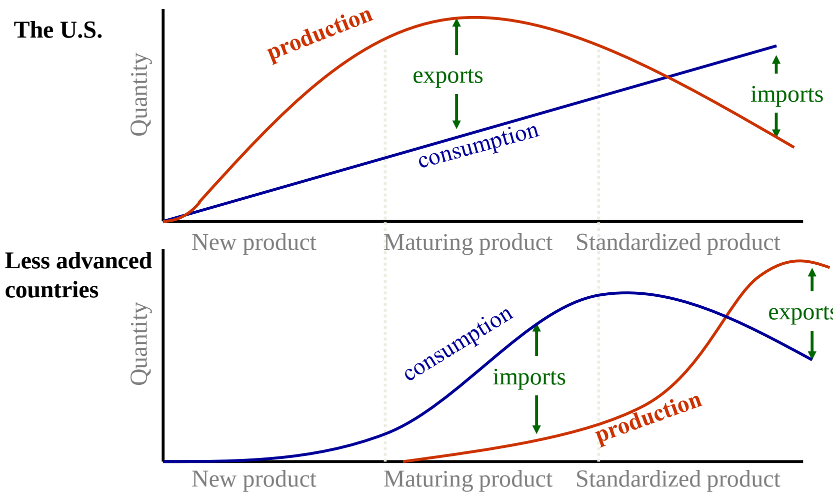
Product Life Cycle



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Product Life Cycle (continued)

- It should be noted that the product life cycle theory was developed in the 1960s when the U.S. was the unquestioned leader in R&D and product innovation.
- Increasingly, product innovations are taking place outside the United States as well, and new products are being introduced simultaneously in many advanced countries.
- Production facilities may be located in multiple countries from product inception.

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Shareholder Diversification

- Firms may be able to provide indirect diversification to their shareholders if there exists significant barriers to the cross-border flow of capital.
- Capital market imperfections are of decreasing importance, however.
- Managers, therefore, probably cannot add value by diversifying for their shareholders, as the shareholders can do so themselves at lower cost.

Cross-Border Mergers & Acquisitions

- Greenfield investment
  - Building new facilities from the ground up.
- Cross-border acquisition
  - Purchase of existing business.
  - Represents 40-50% of FDI flows.
- Cross-border acquisitions are a politically sensitive issue:
  - Greenfield investment is usually welcome.
  - Cross-border acquisition is often unwelcome.

EXHIBIT 16.7 Top 40 Cross-Border M&A Deals Completed during 1998–2015

No	Year	Deal Value ($ Billion)	Acquiring Company	Home Economy	Industry of the Acquiring Company	Acquired Company	Host Economy	Industry of the Acquired Company
1	2000	202.8	Vodafone Air Touch PLC	United Kingdom	Radiotelephone communications	Mannesmann AG	Germany	Radiotelephone communications
2	2014	130.3	Verizon Communications Inc	United States	Telephone communications, except radiotelephone	Verizon Wireless Inc	United States	Radiotelephone communications
3	2007	98.2	RFS Holdings BV	United Kingdom	Investors, nec	ABN-AMRO Holding NV	Netherlands	Investors, nec
4	1999	74.3	Royal Dutch Petroleum Co	Netherlands	Crude petroleum natural gas	Shell Transport & Trading Co	United Kingdom	Crude petroleum natural gas
5	2015	68.4	Actavis PLC	Ireland	Pharmaceutical preparations	Allergan Inc	United States	Pharmaceutical preparations
6	1998	60.3	Vodafone Group PLC	United Kingdom	Telecommunications	Air Touch Communications	United States	Telecommunications
7	2008	52.2	InBev NV	Belgium	Malt beverages	Anheuser-Busch Cos Inc	United States	Beverages and packaging
8	1998	48.2	British Petroleum Co PLC (BP)	United Kingdom	Oil and gas; petroleum refining	Amoco Corp	United States	Oil and gas; petroleum refining
9	2009	46.7	Roche Holding AG	Switzerland	Pharmaceutical preparations	Genentech Inc	United States	Biological products, except diagnostic substances
10	2000	46.0	France Telecom SA	France	Telephone communications, except radiotelephone	Orange PLC (Mannesmann AG)	United Kingdom	Telephone communications, except radiotelephone
11	2015	42.7	Medtronic Inc	United States	Electromedical and electrotherapeutic apparatus	Covidien PLC	Ireland	Surgical and medical instruments and apparatus
12	2014	42.2	CITIC Pacific Ltd	Hong Kong, China	Steel works, blast furnaces and rolling mills	CITIC Ltd	China	Investment advice
13	1999	40.5	Daimler-Benz AG	Germany	Transportation equipment	Chrysler Corp	United States	Transportation equipment
14	1999	40.4	Vivendi SA	France	Water supply	Seagram Co ltd	Canada	Motion picture and video tape production
15	2007	37.6	Rio Tinto PLC	United Kingdom	Gold ores	Alcan Inc	Canada	Aluminium, Alumina producer
16	1999	34.6	Zeneca Group PLC	United Kingdom	Drugs	Astra AB	Sweden	Drugs
17	1999	32.6	Mannesmann AG	Germany	Metal and metal products	Orange PLC	United Kingdom	Metal and metal products
18	2006	32.2	Mittal Steel Co NV	Netherlands	Steel works, blast furnaces and rolling mills	Arcelor SA	Luxembourg	Steel works, blast furnaces and rolling mills
19	2006	31.7	Telefonica SA	Spain	Telephone communications, except radiotelephone	O2 PLC	United Kingdom	Radiotelephone communications
20	2001	29.4	VoiceStream Wireless Corp	United States	Radiotelephone communications	Deutsche Telekom AG	Germany	Radiotelephone communications
21	2000	27.2	BP Amoco PLC	United Kingdom	Petroleum refining	ARCO	United States	Petroleum refining
22	2013	27.0	OAO Neftyanaya Kompaniya Rosneft	Russian Federation	Crude petroleum and natural gas	TNK-BP Ltd	British Virgin Islands	Crude petroleum and natural gas
23	2013	27.0	OAO Neftyanaya Kompaniya Rosneft	Russian Federation	Crude petroleum and natural gas	TNK-BP Ltd	British Virgin Islands	Crude petroleum and natural gas
24	2007	26.4	Investor Group	Italy	Investors, nec	Endesa SA	Spain	Public utility
25	2000	25.1	Unilever PLC	United Kingdom	Creamery butter	Bestfoods	United States	Dried fruits, vegetables and soup mixes
26	2011	25.1	International Power PLC	United Kingdom	Electric services	GDF Suez Energy Europe & International	Belgium	Natural gas transmission
27	2008	23.1	Government of the Netherlands	Netherlands	National government	Fortis Bank Nederland(Holding) NV	Belgium/Netherlands	Banking
28	2014	23.1	Numericable Group SA	France	Cable and other pay television services	Societe Francaise du Radiotelephone SA	France	Telephone communications, except radiotelephone
29	2007	22.8	Shareholders	United States	Investors, nec	Tyco Healthcare Group Ltd	United States	Healthcare
30	2011	22.4	VimpelCom Ltd	Netherlands	Radiotelephone communications	Weather Investments Srl	Italy	Telephone communications, except radiotelephone
31	2007	22.2	Iberdrola SA	Spain	Electrical services	Scottish Power PLC	United Kingdom	Electrical services
32	1999	21.9	Rhone-Poulenc SA	France	Chemicals and allied products	Hoechst AG	Germany	Chemicals and allied products
33	2006	21.8	Airport Development	Spain	Special purpose finance company	BAA PLC	United Kingdom	Airports and airport terminal services
34	2013	21.6	SoftBank Corp	Japan	Radiotelephone communications	Sprint Nextel Corp	United States	Telephone communications, except radiotelephone
35	2011	21.2	Sanofi-Aventis SA	France	Pharmaceutical preparations	Genzyme Corp	United States	Biological products, except diagnostic substances
36	2007	21.0	Bank of America Corp	United States	National commercial banks	ABN AMRO North America Holding Co	United States	Banking
37	2015	20.6	Holcim Ltd	Switzerland	Cement, hydraulic	Lafarge SA	France	Cement, hydraulic
38	2015	20.4	Genesis International Holdings NV	Netherlands	Metal household furniture	Steinhoff International Holdings Ltd	South Africa	Metal household furniture
39	2007	19.6	AB Acquisitions Ltd	United States	Investors, nec	Alliance Boots PLC	United Kingdom	Pharmaceuticals, Healthcare, Beauty
40	2000	19.4	Zurich Allied AG	Switzerland	Life insurance	Allied Zurich PLC	United Kingdom	Life Insurance

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EXHIBIT 16.8 Average Wealth Gains from Cross-Border Acquisitions: Foreign Acquisitions of U.S. Firms

Country of Acquirer	Number of Cases	R&D/Sales (%)		Average Wealth Gains (in Million U.S.$)		
		Acquirer	Target	Acquirer	Target	Combined
Canada	10	0.21	0.65	14.93	85.59	100.53
Japan	15	5.08	4.81	227.83	170.66	398.49
U.K.	46	1.11	2.18	−122.91	94.55	−28.36
Other	32	1.63	2.80	−47.46	89.48	42.02
All	103	1.66	2.54	−35.01	103.19	68.18

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Political Risk and FDI

- Unquestionably this is the biggest risk when investing abroad.
- A more important question than normative judgments about the appropriateness of the foreign government's existing legislation is, "Does the foreign government uphold the rule of law?"
- A big source of risk is the non-enforcement of contracts.

Political Risk and FDI (continued)

- Macro risk
  - All foreign operations are put at risk due to adverse political developments.
- Micro risk
  - Selected foreign operations are put at risk due to adverse political developments.

Political Risk (concluded)

- Transfer risk
  - Uncertainty regarding cross-border flows of capital.
- Operational risk
  - Uncertainty regarding the host country's policies on a firm's operations.
- Control risk
  - Uncertainty regarding expropriation.

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Measuring Political Risk

- The host country's political and government system
  - A country with too many political parties and frequent changes of government is risky.
- The track records of political parties and their relative strength
  - If the socialist party is likely to win the next election, watch out.

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Measuring Political Risk (continued)

- Integration into the world system
  - North Korea and Iran are examples of isolationist countries unlikely to observe the "rules of the game."
- Ethnic and religious stability
  - Look at recent genocides around the world.
- Regional security
  - Kuwait is a nice enough country, but it's in a rough neighborhood.

Measuring Political Risk: Key Indicators

- Key economic indicators
  - Political risk is not entirely independent of economic risk.
  - Severe income inequality and deteriorating living standards can cause major political disruptions.
  - In 2002, Argentina's protracted economic recession led to the freezing of bank deposits, street riots, and three changes of the country's presidency in as many months.

Political Risk Analysis: Vietnam

Sovereign Rating: Moody's: B2, Outlook: Stable; S&P: BB-, Outlook: Negative

Political Strengths	*Economic Strengths*
• Political Stability with Communist Party in government since end of the country's civil war in 1975 • Widespread support for the CPV (Vietnam Communist Party) reflects its success in raising living standards and creating and maintaining security	• Transformation to market oriented economy since late 1980s • High GDP growth facilitated by foreign investment • Well educated and cheap labor force • Sizeable natural resources and advantageous location
Political Weaknesses	***Economic Weaknesses***
• Inconsistent and evolving regulations • Unreliable legal system and corruption • A lack of financial transparency, insufficient protection for minority owners, and poor corporate governance	• Large fiscal and trade deficits and weak banking system • Plethora of state-owned enterprises and less diversification • Industry and credit policies favor state-owned enterprises
Political & Governance Indicators	***Economic Indicators***
• World Bank Ranking- Ease of doing business 78th/183 • Freedom House - Political rights and civil liberties Not Free • Transparency International Ranking – Corruption Perception Index 116th/180 • OECD country risk rating 5 (Scale: 0-7, 0 is least risk, 7 is highest risk)	• GDP ($US bn) 104 • GDP per capita ($US) 1,174 • Real GDP growth (15 year average, %) 7.3 • Fiscal balance (% of GDP) -6.4 • Public debt (% of GDP) 53.0 • Foreign direct investment (% of GDP) 6.6 • Current account (% of GDP) -3.8 • External debt (% of GDP) 42.1 • Foreign reserves (% of GDP) 11.6

Source: http://www.efic.gov.au ; 2011 figures

Political Risk Analysis: Turkey

Sovereign Rating: Moody's: Ba1; Outlook: Positive; S&P: BB, Outlook: Positive

Political Strengths	*Economic Strengths*
• Transition to democracy at the end of 1970s • Significant liberalization and stabilization by a drive to join European Union	• Key dimensions of economic performance on par with central and eastern European countries • Was able to weather the recent global economic crisis • Debt is highly sought after by foreign investors • Healthy growth forecast
Political Weaknesses	***Economic Weaknesses***
• Instability fuelled by conflict between the army and the civilian government • Strained relations between religious conservatives and secular modernists	• Mounting macroeconomic imbalances and major reliance on foreign financing • Widening current account deficit, surging credit growth and building inflation pressures • High business cycle and currency risk • Lira is a volatile emerging market currency
Political & Governance Indicators	***Economic Indicators***
• World Bank Ranking - Ease of doing business 65th/183 • Freedom House - Political rights and civil liberties Partly Free • Transparency International Raking- Corruption Perception Index 56th/180 • OECD country risk rating 4 (Scale: 0-7, 0 is least risk, 7 is highest risk)	• GDP ($US bn) 742 • GDP per capita ($US) 10,399 • Real GDP growth (15 year average, %) 4.0 • Fiscal balance (% of GDP) -3.6 • Public debt (% of GDP) 42.3 • Foreign direct investment (% of GDP) 1.2 • Current account (% of GDP) -6.5 • External debt (% of GDP) 42.5 • Foreign reserves (% of GDP) 14.3

Source: http://www.efic.gov.au ; 2011 figures

Hedging Political Risk

- Geographic diversification
  - Simply put, don't put all your eggs in one basket.
- Minimize exposure
  - Form joint ventures with local companies.
    - Local government may be less inclined to expropriate assets from their own citizens.
  - Join a consortium of international companies to undertake FDI.
    - Local government may be less inclined to expropriate assets from a variety of countries all at once.
  - Finance projects with local borrowing.

Hedging Political Risk: Insurance

- Insurance
  - The Overseas Private Investment Corporation (OPIC), a U.S. government federally-owned organization, offers insurance against:
    1. The inconvertibility of foreign currencies.
    2. Expropriation of U.S.-owned assets.
    3. Destruction of U.S.-owned physical properties due to war, revolution, and other violent political events in foreign countries.
    4. Loss of business income due to political violence.

EXHIBIT 16.9
Frequency of Expropriations of Foreign-Owned Assets

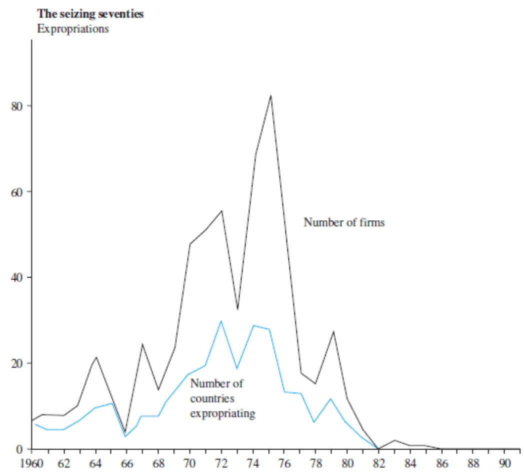

EXHIBIT 16.12 Corruption Perceptions Index 2015—Transparency International (Excerpt)

Rank	Country/Territory	Score	Rank	Country/Territory	Score	Rank	Country/Territory	Score
1	Denmark	91	58	Romania	46	112	Honduras	31
2	Finland	90	60	Oman	45	112	Malawi	31
3	Sweden	89	61	Italy	44	112	Mauritania	31
4	New Zealand	88	61	Lesotho	44	112	Mozambique	31
5	Netherlands	87	61	Montenegro	44	112	Vietnam	31
5	Norway	87	61	Senegal	44	117	Pakistan	30
7	Switzerland	86	61	South Africa	44	117	Tanzania	30
8	Singapore	85	66	Sao Tome and	42	119	Azerbaijan	29
9	Canada	83		Principe		119	Guyana	29
10	Germany	81	66	The FYR of	42	119	Russia	29
10	Luxembourg	81		Macedonia		119	Sierra Leone	29
10	United Kingdom	81	66	Turkey	42	123	Gambia	28
13	Australia	79	69	Bulgaria	41	123	Guatemala	28
13	Iceland	79	69	Jamaica	41	123	Kazakhstan	28
15	Belgium	77	71	Serbia	40	123	Kyrgyzstan	28
16	Austria	76	72	El Salvador	39	123	Lebanon	28
16	United States	76	72	Mongolia	39	123	Madagascar	28
18	Hong Kong	75	72	Panama	39	123	Timor-Leste	28
18	Ireland	75	72	Trinidad and	39	130	Cameroon	27
18	Japan	75		Tobago		130	Iran	27

Summary

- Firms become *multinational* when they undertake FDI.
- FDI may involve either the establishment of new production facilities in foreign countries or acquisitions of existing foreign businesses.
- During the six-year period 2010–2015, total annual worldwide FDI out-flows amounted to about $1,394 billion on average.
  - The United States is the largest recipient, as well as initiator, of FDI.
  - Besides the United States, Japan, China, and Germany are the leading sources of FDI outflows, whereas the United States, United Kingdom, China, Canada, and Australia are the major destinations for FDI in recent years.

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Summary (continuing)

- The *internalization* theory of FDI holds that firms that have intangible assets with a public good property tend to invest directly in foreign countries in order to use these assets on a larger scale and, at the same time, avoid the misappropriations that may occur while transacting in foreign markets through a market mechanism.
- According to the product life-cycle theory, when firms first introduce new products, they choose to produce at home, close to their customers. Once the product becomes standardized and mature, it becomes important to cut production costs to stay competitive. At this stage, firms may set up production facilities in low-cost foreign countries.

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Summary (continued)

- In recent years, a growing portion of FDI has taken the form of cross-border acquisitions of existing businesses.
  - *Synergistic* gains may arise if the acquirer is motivated to take advantage of various market imperfections.
- Imperfections in the market for intangible assets, such as R&D capabilities, may play a key role in motivating cross-border acquisitions. The internalization may proceed *forward* to internalize the acquirer's intangible assets or *backward* to internalize the target's intangible assets.

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Summary (concluded)

- In evaluating political risk, experts focus their attention on a set of key factors such as the host country's political/government system, historical records of political parties and their relative strengths, integration of the host country into the world political/economic system, the host country's ethnic and religious stability, regional security, and key economic indicators.
- In evaluating a foreign investment project, it is important for the MNC to consider the effect of political risk, as a sovereign country can change the *rules of the game.*
  - The MNC may adjust the cost of capital upward or lower the expected cash flows from the foreign project. Or, the MNC may purchase insurance policies against the hazard of political risks.

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