Institute of Business Administration Karachi
Leadership and Ideas for Tomorrow

Business Review

Article 5

Volume 4 Issue 1
January-June 2009

1-1-2009

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Recommended Citation

Khan, M. S. (2009). Foreign Direct Investment (FDI) - destination India. *Business Review, 4*(1), 81-114.
Retrieved from https://doi.org/10.54784/1990-6587.1167

https://ir.iba.edu.pk/businessreview/vol4/iss1/5
DOI: https://doi.org/10.54784/1990-6587.1167

ARTICLE

Foreign Direct Investment (Fdi)-Destination India

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ABSTRACT

Foreign Direct Investment (FDI) is becoming more and more revolutionary and happening phenomenon across the globe. The FDI is giving new hope and height to the economy of the nations across the frontiers of the countries. It is adding extra pace of economic growth and sustainability in terms of capital, human skills, machineries and equipment. FDI is not only enriching the Balance of Payments (BOP) but at the same time helping the nations in establishing the social bonds with other nations. The recent approval made on March7'2008 by the Ministry of Finance, Govt. of India, clearing 18 FDI proposals worth Rs. 15.5326 billions indicate the seriousness and willingness of the Govt. of India to bring more financial resources through FDI.

This research paper has attempted to find out the factors that may be responsible for attracting more and more foreign investors. Some light has also been thrown on the issues concerning the security of investment and the likely return on their investment (ROI)

Key Words: FDI, IMF, OECD, In-bond FDI & Out-bond FDI

INTRODUCTION

The term Foreign Direct Investment (FDI) is also called Direct Foreign Investment, or more simply, Direct Investment or Foreign Investment. It is an activity where foreigners come to a particular country to set up or run a factory, hotel, farms, or other business enterprise. Foreign Direct Investment is defined as International interest in which a resident in one country obtains a lasting interest in an enterprise resident in another. It is a situation where a foreign country creates a subsidiary to provide goods and services. Some of the most precise definition of Foreign Direct Investment can be given as below:

Definition 01: Direct Investment refers to investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the

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https://ir.iba.edu.pk/businessreview/vol4/iss1/5
DOI: https://doi.org/10.54784/1990-6587.1167

investor, the investor's purpose being to have an effective voice in the management of the enterprise. (IBM balance of payment manual, 4th ed, 1977, p.36)

Definition 02: The balance of payment (BOP) accounts define Direct Investment as that part of capital flows that represents a direct financial flow from a parent company to an overseas firm that it controls. (E.M.Graham & P.R. Krugman, The Surge in The FDI)

Definition 03: Direct Investment is intended to comprise investment involving a certain degree of control (by the investor) over the use of the funds invested, whereas portfolio investment lacks such control (Rivera –Batiz & Rivera Batiz)

Definition 04: Foreign Direct Investment is an international finance flow with the intention of controlling or participating in the management of an enterprise in a foreign country. (Dr.Shakil, 2006)

International guidelines for the compilation of balance of payment and international involvement position statistics appear in the international monetary fund's balance of payments manual and the OECD's bench -mark definition of Foreign Direct Investment. This body of recommendation provides comprehensive and detailed international standards for recording both positions and flows related to FDI. The recommendations cover a wide range of issues, including concepts and definitions, time of recording, collection methods, dissemination etc.

ACCORDING TO IMF/OECD RECOMMENDATION

Direct investment is the category of international investment that reflects the objective of a resident entity in one economy of establishing a lasting interest in an enterprise resident in another country.

A direct investment is defined as an individual, an incorporated or unincorporated public or private enterprise, a government, a group of related individuals, or a group of related incorporated and/ or unincorporated enterprises which have a direct investment enterprise that is a subsidiary, associate or branch, operating in a country other than the country or countries of residents of the direct investors.

A direct investment enterprise is defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10% or more of the ordinary shares or voting powers of an incorporated enterprise or the equivalent of an unincorporated enterprise. Ownership of 10% or more of the ordinary shares or voting stock is the guidelines for determining the existence of a direct investment relationship. An effective voice in the management as evidenced by at least 10% ownership, implies that a direct investor is able to influence or participate in the management of an

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DOI: https://doi.org/10.54784/1990-6587.1167

enterprise but absolute controls by a foreign investor is not required. Direct investment enterprise may be subsidiaries, associates and branches.

Thus, a firm undertakes FDI in a foreign country if it possess an ownership advantage over the local competitors. The ownership of the foreign investment usually remains in the investing country (home). FDI represents the primary means of transfer of private capitals (i.e. physical or financial), technology personnel and access to brand names and marketing advantage. In most countries, FDI serves as one of the means of successful transitions.

United Nations Conference on Trade and Development (UNCTAD, 1999) findings reveal that FDI continues to increase at a global level as multinational corporations (MNCs) integrate their business operations throughout the world. The report confirms that the FDI transfer technology as well as firm specific assets to host countries. The foreign investors, e.g. USA, Japan, E.U. (Triad) and other countries penetrate global markets through FDI. Despite the dominance of market seeking motives, foreign entities or foreign affiliates turn out to be more export oriented than local firms. These investors have better access to internal production and distribution networks.

INWARD This term refers to direct investment in the reporting country.

OUTWARD This term refers to direct investment made abroad.

REASONS FOR THE FLOW OF FDI

It is well known fact that FDI is expensive and risky when compared to exporting and licensing. FDI is expensive because a firm must bear the cost of establishing production facilities in a foreign country or of acquiring a foreign enterprise. FDI is risky because of the problem associated with doing business in another culture, where the rules of the game may be different. Yet, the firms go for FDI. The reasons for the FDI can best be explained with the help of the following factors that have been detected during my research period.

- Transportation cost
- Market imperfection
- Competition
- Product life cycle
- Location advantage
- Developing countries

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DOI: https://doi.org/10.54784/1990-6587.1167

1. **TRANSPORTATION COST** From the transportation cost perspective, goods may be of low value to weight ratio type or the opposite, namely high value to weight ratio type. In the former, transportation cost is considerable and it is unprofitable to shift them over long distances. They can also be produced in almost any location. In products of this type, relative to either FDI or licensing, the attractiveness of exporting decreases. For products with a high value to weight ratio, however, transport costs are a minor component of total landed cost. In these products, transportations costs have little impact on the relative attractiveness of exporting, FDI and licensing.

2. **MARKET IMPERFECTION** The market imperfection theory offers a major explanation why firms prefer FDI to exporting or licensing. Alternatively called internationalization theory in the literature on global business. This approach highlights two major impediments:

- **BARRIER TO EXPORTING** Impediments to the free flow of products between nations decrease the profitability of exporting, relative to FDI, and licensing. Governments are the main source of impediments to the free flow of products between nations. By imposing tariffs on imported goods, governments can increase the cost of exporting relative to FDI and licensing. Similarly, by restricting imports through the impositions of quotas, govt. increases the attractiveness of FDI and licensing.

- **BARRIERS TO THE SALE OF KNOW-HOW** Sale of know-how takes place through licensing; impediments to the sale of know-how increase the profitability of FDI relative to the licensing. Though licensing is less expensive and less risky, firms do not prefer it because of the following reasons.
  a. First, licensing may result in a firm giving away its know-how to a potential foreign competitor.
  b. Licensing does not give firm the right control over manufacturing, marketing and strategy in a foreign country that may be required to profitably exploit its advantage in know-how.
  c. A company's know-how itself may not be for licensing. This is particularly true of management and marketing know-how. It is one thing to license a foreign firm to manufacture a particular product, but quite another to license the way a firm does its business –how it manages its process and market its products.

3. **COMPETITION** FDI flows are often a reflection of rivalry among firms in the global market place.

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4. **THE PRODUCT LIFE CYCLE THEORY** Product Life Cycle theory was considered earlier to explain the flow of trade between countries. But the theory has implications for FDI too. Vernon argues that often the same firms that pioneer a product in their home markets produce a product for consumption in foreign market. Vernon's view is that firms undertake FDI at particular stages in the life cycle of a product. They have pioneered. They invest in other advanced countries when local demands in those countries grow large enough to support local production. They subsequently shift production to developing countries when product standardization and market saturation give rise to price competitiveness and cost pressures. Investment in developing countries, where labour costs are lower, is seen as the best way to reduce costs.

5. **LOCATION ADVANTAGES** The location specific advantages include natural resources such as oil and other minerals, which are by nature specific to certain locations. A firm must undertake FDI to exploit such endowments. This explains the FDI undertaken by many of the world's oil companies, which have to invest where oil is located. Another example is the valuable human resources such as low cost highly skilled labour force.
   The argument that location specific advantages attract FDI is propounded by the British economist John Dunning. Dunning believes that market imperfections make licensing and exporting difficult and thereby rendering FDI an obvious choice to globalization.

FDI IN DEVELOPING NATIONS

The nature of FDI to developing countries does appear to have changed somewhat over the last decade. In the past, it was often assumed that multinationals enterprise invest in developing countries in order to gain access to resources or to integrate low wage locations into their global value chains. However, there has been an increasing tendency for companies to invest in the largest developing countries, as part of strategies to serve local clients or to acquire a strategic position in markets that could become prosperous in future. This trend was further underpinned by the privatization programme of many high and medium income developing countries in the 1990's, whereby national utilities were transferred into the hands of private strategic investors.

The world's second largest country, India is no where near the rivaling China's success with attracting investment, but it has made considerable progress over the last decade. Owing chiefly to a policy change to allow foreign investment into a growing number of sectors, inward FDI rose from almost Zero in 1990's, and annual inflows have been consistently above USD 2 billion since 1995. The 2003 inflows at USD 4 billion were only a fraction beneath the peak year 2001.

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India's cumulative outbound FDI that stood barely USD 0.6 billion in 1996 crossed the USD 10 billion mark in 2005, and seems to take a big leap forward in the coming years. Most foreign direct investment are made through acquisitions of existing firm, because the alternative route of starting and building a new company would be more time consuming and possibly more expensive. The size of the acquisitions deals ranged from USD 5700 million to as little as USD 0.05 million and the range of equity stake acquired varied from 100% to as little as 2.5%.

DESTINATIONS OF FDI FROM INDIA

(Figures indicate the no. Of acquisition in each country)

Country	2001	2002	2003	2004	2005	Total
USA	25	19	19	21	20	104
UK	8	5	8	7	8	36
Germany	2	1	3	2	2	10
Spain	1	-	-	-	2	3
Romania	1	-	-	-	2	3
Portugal	1	-	-	-	-	1
Ireland	1	-	-	1	2	4
Belgium	–	1	–	2	1	4
France	-	-	3	2	1	6
Russia	-	-	-	-	1	1
Singapore	1	1	2	1	3	8
Australia	1	4	1	2	2	10
China	–	1	2	1	3	7

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INDUSTRY WISE ANALYSIS OF INDIA'S OUT BOND INVESTMENT

Industry	No. Of acquisition	% of total
Computer & IT	78	35.29
Drugs & pharmacy		35
	15.84	
Cement	2	0.90
	3	1.38
Steel	7	3.17
Chemicals	10	4.52
Textiles & garments	4	1.80
Oil & gas	10	4.52
Trading	4	3.17
Media/communication	7	3.17
BPO/ outsourcing	9	4.07
Electrical & electronics	4	1.80
Auto & ancillary	17	7.69
Mining	5	2.26
Cosmetics	4	1.80
Paints & varnishes	4	1.80
Tea & coffee	3	1.38
Telecommunication	3	1.38
Banking	3	1.38
Consultancy	4	1.80
Miscellaneous	15	6.78
Total	221	100

(Source: Indian Management-June'2006)

SIZE WISE ANALYSIS OF INDIA'S OUTBOUND INVESTMENTS

Industry	No.of Acquisitions	% of total
0-10 million	80	61.54
10-25 million	26	20.00
25-50 million	13	10.00
50-100 million	–	nil

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7100 million	11	8.46
Total	130	100

(Source: Indian Management, June'2006)

OUTBOUND DRIVERS

Indian companies have been investing abroad for many years. But the new phase of foreign acquisitions as a trend setting phenomenon probably started when TATA acquired Tetley (European Firm), a firm larger than itself in 2000 and in the process emerged as the world's biggest tea company. Since then, buoyed by an encouraging government policy, many cash rich Indian companies (both manufacturing as well as service oriented, large and small) have acquired a wide spectrum of businesses around the globe. Having been exposed to severe competition from multinationals corporations (MNCs), the opening up of the Indian economy began in 1991 (NIP); the Indian corporate have gained much confidence and learnt to succeed in the global competitive environment. They have developed a taste for competition and a self-confident mind set. Going by the premise "aggression is the best defense", they have learnt that the quickest way to achieve global competitiveness is through purchasing businesses abroad. Clearly, growth in O-FDI would not have been possible without an enabling and liberal foreign exchange policy followed by the government, which has in turn been made possible by the huge foreign exchange resources of the country (around 140 billion) in 2005. Favourable capital markets and liberalization of FDI rules in host countries have also contributed to this trend.
From an investing company's point of view, overseas investments have several potential advantages, which may be grouped into two categories.

- Strategic reasons
- Economic reasons

STRATEGIC REASONS

The strategic reasons could be either of defensive or aggressive types. Defensive reasons include the fear of losing a market competitor' of the foreign country and the need to protect patents and intellectual rights /property.

AGGRESSIVE REASONS

The aggressive reasons could include such factors vas the search for cheaper labour or other resources, need to access foreign knowledge or natural resources, search for more profitable uses of scarce resources, escape from domestic market or just the urge to expand beyond domestic market for the prestige attached to being a multinational.

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The category of economic incentives relate to the economies of scale and better risk management achieved from diversified and larger scale of operations. Increasing scale of operations in areas such as production, purchasing, marketing and distribution are typically accompanied by lower average cost per unit, thus increasing profit margins. Company operating in several countries can reduce the volatility of its cash flows, and to a single economy or a block of parallel moving economies. The foreign investments by Indian companies in recent years have been driven by a combination of strategic and economic reasons. Some of them are discussed at length here.

1. Accessing Foreign Markets and Brand Names: The acquisition of Tetley for GBP 271 million in 2000 provided TATA tea an access to the Tetley brand name and the European markets. This is one of the main reasons behind a majority of foreign acquisition by Indian companies. The acquisition of a reputed foreign firm often results in shifting of the established set of clients to the newly merged firm, establishing goodwill and bringing strong revenues from existing clients. Infosys technologies acquired expert information services of Australia in 2003 to gain access to the Australian market and clients of the acquired company. Such acquisitions also brings in economies of scale and help in hedging risk

2. Access to Technology and Knowledge: This is one of the main strategic reasons that have driven several Indian firms from the IT, Pharmaceuticals and other industries to acquire foreign companies specializing in IT and research and development. For instance, Wipro acquired Nerve Wire Inc (USA) in 2003 to gain deep domain knowledge, I-Flex acquired Supersolutions corporations (USA) to gain access to technologies and knowledge and Ranbaxy has acquired R& D companies abroad. In 2005, Jubilant Organosys acquired Target Research Associate Inc (USA) to access clinical research knowledge and technology. Similarly, Matrix Laboratories of India acquired 43% stake in Explora Laboratories (Switzerland) to access Explora's expertise in the area of Bio catalysis.

3. Securing Natural Resources and Production Assets: ONGC acquired stake in Sudanese, Russian and Myanmar oil and gas fields to ensure future supply of valuable natural resources. Essar steel has bought two Korean steel making units in 2005 that would be dismantled and shipped to India for use in any of Essar's steel plants.

4. Backward Integration: Acquisition of Australian and Canadian mining companies by steel authority of India and Hindalco are examples of backward integration, in addition to the benefits of securing resources.

THE REGULATORY FRAMEWORK

Since 2000, the Govt. of India and the Reserve Bank of India have pursued a more liberal policy towards overseas investments with the objectives of promoting Indian companies to reap the benefits of globalisation. This will have a statutory impact on the growth of the Indian O –FDI flows. Some of the salient developments in this policy are as follows:

1. INVESTMENT LIMIT RAISED

In 2005, the RBI, raise the limit of investment overseas from 100% net worth of an Indian entity to 200% net worth of the investing company. Accordingly, under the automatic routing for overseas investment, eligible entities are now permitted to invest in joint ventures or wholly owned subsidiaries up to 200% of their net worth.

2. INVESTMENT OUT OF ACCOUNTS

The above ceiling is not applicable to investments made out of balances held in exchange earner's foreign currency (EEFC) accounts. Thus, Indian companies in special economic zones can freely make overseas investment up to any amount if such investments are financed out of the exchange earner's foreign currency account balances.

3. INVESTMENT OUT OF ADR/GDR ISSUES

The above ceiling of 200% of the net worth of the investing entity is also not applicable to investments made out of the proceeds of ADR/GDR issues. Overseas investments are thus lowered to be financed up to 100% by ADR/GDR proceeds (up from the previous limit of 50%)

4. INVESTMENT IN UNRELATED AREAS

Indian companies can now invest or make acquisitions abroad in areas unrelated to their core business at home. Earlier they were allowed to invest in or acquire only such businesses that were related to their core activities at home.

5. OTHER RELAXATIONS

Several other rules concerning overseas investments have been simplified, including those related to the following.

a. Investments by registered partnership firms
b. Investment through special purpose vehicles, under the automatic route, and

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DOI: https://doi.org/10.54784/1990-6587.1167

c. Investment by way of share swaps.

To sum up, given the favourable environment, the growing competitiveness of Indian firms coupled with their increasing desire to venture abroad, outward FDI seems all set to grow rapidly in the medium to long term; and may overtake several other developing economies in the number as well as the volume of foreign investments. If theses investments help in the achievement of development objectives that are expected of them, it could be a win-win situation for all concerned.

TOP 15 OUTWARD INVESTING DEVELOPING ECONOMIES

Rank	Economy	Value ($ Billions)
1.	Hong Kong	336
2.	Singapore	90.9
3.	Taiwan	65.2
4.	Brazil	54.6
5.	China	37
6.	Republic of Korea	34.5
7.	Malaysia	29.7
8.	South Africa	24.2
9.	Argentina	21.3
10.	Mexico	13.8
11.	Chile	13.8
12.	Venezuela	8.00
13.	Islamic Republic of Iran	6.8
14.	India	5.1
15.	Nigeria	4.6

(SOURCE: Word Investment Report, UNCTAD)

INBOUND FOREIGN DIRECT INVESTMENT (I-FDI)

China remains the most popular FDI destination but ASEAN also continues to be an important production location. Some firm worries about too much concentration in China. Thailand, India and Vietnam are the most popular destination to diversify the China risk. However, while many firms, have actual expansion plans for Thailand, they don’t have concrete ideas for India and Vietnam, they are only potentially popular. Indonesia has gone down in popularity in recent years while Russia has become a little more popular than before.
As per my own survey during the research process I asked the following question from the respondent and their views are like:

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Where do you plan to expand business in the next three years?

1.	China (central coast)	68.9%
2.	Thailand	47.8%
3.	China (southern coast)	47.6%
4.	North America	44.3%
5.	China (northern coast)	35.00%
6.	EU 15	31.5%
7.	Korea	24.2%
8.	Taiwan	21.3%
9.	Eastern Europe	17.4%
10.	Vietnam	15.9%
11.	India	15.5%
12.	Malaysia	15.5%
13.	China (north-east)	13.7%
14.	Singapore	12%

China remains a very popular FDI destination in the near future, but Thailand is also very popular as the ASEAN production base. India comes at the bottom of the list.

As per the risk of doing business in India my next question from the respondents was,

What is the risk of doing business in India?

Shortage of electric supply	60%
• Price increase in energy and materials	38%
• Violation of intellectual property rights	33%
• Logistic and transportation problem	25%
• Frequent changes in FDI policy	10 %
• Market shrinkage.	2%

When I asked regarding the merits and demerits of investing countries, the responses were as:

Country	Top 3 Merits.	Top 3 Demerits.
1. China	Future Market Potential	Ambiguity of Laws
	Cheap labour	Violation of Intellectual Property Rights
	Supporting Industries Property Rights	Unrecoverable Receivables
2. Thailand	Future Market Potential	Competition with other Firms
	Cheap Labour	Rising Labour Cost
	Stable Policies and Societies	Lack of Managers
3. India	Future Market Potential	Lack of Infrastructure,
	Cheap Labour,	Crime & Social Instability,

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https://ir.iba.edu.pk/businessreview/vol4/iss1/5
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	High quality human resources	lack of Information
4. Vietnam	Cheap Labour,	Undeveloped Legal System
	Future market potential,	Ambiguity of Laws
	High Quality of Human Resources	Lack of Infrastructure
5. USA	Current Market Size	Competition with other Firms
	Future Market Potential	Rising Labour Cost
	Good Infrastructure	Labour Problems
6. Russia	Future Market Potential	Crime & Social
	Cheap labour	Instability
	High quality human resources	Lack of Information
		Undeveloped legal system.
7. Indonesia	cheap labour	crime and social
		Instability
	Future market potential	competition with other
	Export base for third market	firms.

Japanese firms are generally attracted by market size and low labour cost. On the demerit size, legal uncertainty is a big problem in China and Vietnam, and lack of infrastructure is a problem in India, Vietnam, and Russia. Social instability and personal safety is a problem in India, Russia, and Indonesia.

FDI INFLOWS IN INDIA ($Million)

1990-1991	1 97
1991-1992	129
1992-1993	315
1993-1994	586
1994-1995	1314
1995-1996	2144
1996-1997	2821
1997-1998	3557
1998-1999	2462
1999-2000	2155
2000-2001	2633

(Source: Word Investment Report, 1999, UNCTAD)

GLOBAL FDI

Developed Countries	1997
USA	109
UK	37
France	23
Luxemburg	12
Netherlands	9

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https://ir.iba.edu.pk/businessreview/vol4/iss1/5
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Canada	11
Italy	4
Switzerland	5
Japan	3
Developing Countries	1997
China	44
Brazil	19
Mexico	13
Malaysia	5
Thailand	4
India	3
Hong Kong	6
S. Korea	3

(Source: World Investment Report 1999, UNCTAD)

DETERMINANTS OF FOREIGN DIRECT INVESTMENT (FDI)

Caves (1982) have found that the MNCs tend to be a multiple firm. Its key decision is to find the boundary between the allocation of resources in either an internal market or a regular market. Caves says that MNCs occur when their internal market experience lower transaction cost than those that arise in operating in a distant market. As a result MNCs are generally of three types.

- Horizontally Integrated MNCs
- Vertically Integrated MNCs
- Diversified Integrated MNCs

1. Horizontally Integrated MNCs: Usually each MNC has a special firm specific advantage or asset. The firm specific advantage can be in the form of technological knowledge, management skills, or marketing know-how. In some cases, the firm specific advantage can be protected by patents, trademarks or brand names. In other cases, the firm specific advantages may lie in a market intelligence network, channels of distribution, or sourcing, expertise in marketing or service or organization. Each and every MNC operates to gain, maintain and utilize unique firm specific advantages, which give it a competitive edge over other MNCs.

   Caves (1971,1982) identifies two general types of natural market imperfections facing horizontally integrated MNCs- the public goods nature of knowledge and the extent of information impact and buyer uncertainty aspects of market failure. Theses market imperfections are the fundamental reasons for the internationalization of market by MNCs. As an example of the application of the concept of internationalization to FDI, it is of interest to study the pricing of pharmaceuticals by horizontally integrated MNCs.

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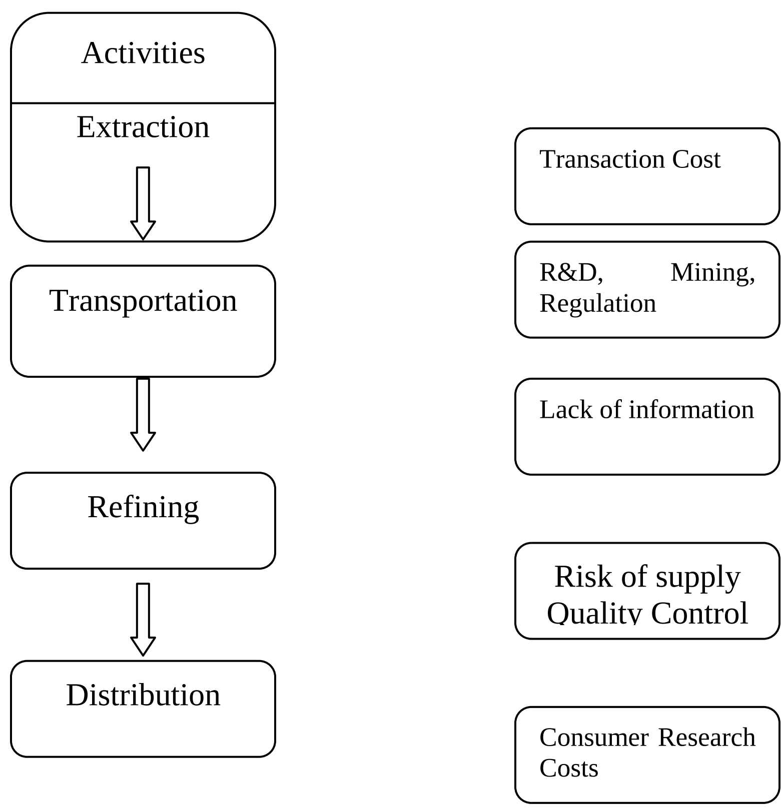
There is an externality in the production and pricing of pharmaceuticals. Multinational firms have to incur huge expenditure in R&D. In order to recover these huge cuts; the government gives them patent rights and create conditions for monopoly profit.

2. Vertically Integrated MNCs. The second type of MNCs are vertically integrated MNCs, such as oils, minerals resources firms. In the case of vertically integrated multi-plant firms, the internal market can be used to establish control and minimize transactions costs. This gives another sort of FSA **(abbrev)** to the MNCs. We can consider oil firms as a case study of vertically integrated MNCs.

Petroleum firms engage in vertical integration in response to both natural and government included market imperfections. Their control over sources of supply and market is justified when an FSA needs to be generated in order to bypass a host of transaction costs involving supply uncertainties, logistics and search costs.



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VERTICAL INTEGRATION OF OIL MNCs

3. **DIVERSIFIED MNCS** The third type of multi-plant MNC identified by Caves (1982) is the diversified MNC. Multinational enterprises of this type are explained by the principles of international diversifications. By the very nature of their international operations, MNCs are engaged in risk pooling. They are exposed to less variation in sales than are uni-national firms confined to a single market. Although international diversification is an explanation based on financial factors instead of real asset factors, it is still relevant for FDI; since risk pooling is an excellent reason for cross industry investments.

The version of international diversification of relevance here is that in which market imperfection in the international capital market constraints simple portfolio diversification. Multinational enterprises rather than individuals assemble an efficient world portfolio by buying into the stock markets of various nations. This is because the individual has to bear information and search costs; and has also to consider political risks, exchange risks, and other environmental uncertainties.

The MNC is a potential surrogate vehicle for individual financial assets diversification. Since it is already operating internationally and the business cycles of nation do not move in perfect tandem. The advantages of real asset diversification of MNCs arise since MNCs avoid market imperfections by internationalizations. There is a type of FSA involved in the financial diversification achieved by the specific MNC. Each MNC is a portfolio asset, with an FSA, which is unique to each individual MNC. There has been a close linkage between then role of the MNC as an international diversifier and the growth of FDI in recent years.

The unpredictability of autonomous FDI flows, in both scale and direction, has generated a substantial research effort to identify their major determinants. An extensive literature based generally on three approaches – aggregate econometric analysis, survey appraisal of foreign investors' opinion, and econometric study at the industry level – has failed to arrive at a consensus. This can be partly attributed to the lack of reliable data, particularly at the sectoral level, and to the fact the most empirical work has analysed FDI determinants by pooling of countries that may be structurally diverse. The remainder of this paper is mainly concerned with examining the factors influencing the destination of the investment: host-country determinants, rather than industry-specific factors.

SIZE OF MARKET

Econometric studies comparing a cross section of countries indicate a well-established correlation between FDI and the size of the market (Proxied by the

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DOI: https://doi.org/10.54784/1990-6587.1167

size of GDP) as well as some of its characteristics (for example, average income levels and growth rates) Some studies found GDP growth rate to be a significant explanatory variable, while GDP was not; probably indicating that where the current size of national income is very small, increments may have less relevance to FDI decisions than growth performance (as an indicator of market potential). Three is little doubt that the size of China's market explains, in large part, the massive FDI flows it has attracted since the early 1980s. Within China, FDI has been concentrated (over 90%) in the coastal areas. Provincial GNP, reflecting economic development and potential demands, has also been indicated as the major determinant of this concentration (Broadman and Sun, 1997)

For sub-Saharan Africa as a whole, Bhattacharya *et al*. 1996 identifies GDP growth as a major factor. Only three SSA **(abbrev)** low-income countries are amongst the nine main recipients of FDI flows in recent years (see Table 1), and of these only Nigeria is close to being classified as a large market (according to UNCTAD's benchmark of \$5.5bn GNP). Angola and Ghana (with GNP of \$8.9bn and \$5.5bn in 1995 respectively), received larger proportional FDI flows in 1995 than Nigeria (see Table 2), indicating that small market size need not be a constraint in the case of resource-endowed, export-oriented economies. In fact, extractive industries in the low-income African countries continue to attract foreign investors as they have always done.

In contrast, India, Pakistan and, to a certain extent, Bangladesh, have large markets but received proportionately relatively small (below 1%) FDI flows in 1986 -1995. Some analysts interpret this as evidence of high potential for increased FDI flows in the future; others stress that constraints are still restraining the channeling of foreign investment to these countries.

For the majority of low-income countries, which fail to attract large FDI flows; their small domestic markets are often cited as the main deterrent. Given other economic and political shortcomings, most investors are doubtful about the value of installing a factory unless they can achieve a 'critical mass' for their products. Regional integration is often perceived as a positive means of compensating for small national markets. There is currently no clear evidence of the degree of this influence on FDI flows. Some investors expect positive spillover effects from South Africa and are generally optimistic about economically stronger states.

OPENNESS

Whilst access to specific markets - judged by their size and growth – is important, domestic market factors are predictably much less relevant in export-oriented foreign firms. A range of surveys suggests a widespread perception that 'open' economies encourage more foreign investment. One indicator of openness is

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DOI: https://doi.org/10.54784/1990-6587.1167

the relative size of the export sector. Singh and Jun's 1995 study indicates that exports, particularly manufacturing exports, are a significant determinant of FDI flows and that tests show that there is strong evidence that exports precede FDI flows. China, in particular, has attracted much foreign investment into the export sector. In Bangladesh, on the other hand, foreign investors have been attracted to the manufacturing sector by its lack of quota for textiles and clothing exports to the European Union and US markets. Garment exports, for example, rose from virtually nil in the 1970s to over one-half of its export earnings by the early 1990s. In contrast, most low-income SSA economies have remained more inward oriented.

LABOUR COSTS AND PRODUCTIVITY

Empirical research has also found relative labour costs to be statistically significant, particularly for foreign investment in labour-intensive industries and for export-oriented subsidiaries. The decision to invest in China, for example, has been heavily influenced by the prevailing low wage rate. The rapid growth in FDI to Vietnam has also been attributed primarily to the availability of low-cost labour. In India, in contrast, labour market rigidities and relatively high wages in the formal sector have been reported as deterring any significant inflows into the export sector in particular.

However, when the cost of labour is relatively insignificant (when wage rates vary little from country to country), the skills of the labour force are expected to have an impact on decisions about FDI location. Productivity levels in sub-Saharan Africa are generally lower than in low-income Asian countries, and attempts to redress the skill shortage by importing foreign workers have been frustrated by restrictions and delays in obtaining work permits. The lack of engineers and technical staff in these countries is reported as holding back potential foreign investment, especially in manufacturing, it lessens the attractiveness of investing in productive sectors.

POLITICAL RISK

The ranking of political risk among FDI determinants remains somewhat unclear. Where the host country possesses abundant natural resources, no further incentive may be required, as is seen in politically unstable countries such as Nigeria and Angola, where high returns in the extractive industries seem to compensate of political instability. In general, so long as the foreign company is confident of being able to operate profitably without undue risk to its capital and personnel, it will continue to invest. Large mining companies, for example, overcome some of the political risks by investing in their own infrastructure maintenance and their own security forces. Moreover, these companies are limited neither by small local

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DOI: https://doi.org/10.54784/1990-6587.1167

markets nor by exchange-rate risks since they tend to sell almost exclusively on the international market at hard currency prices.

Specific proxy variable (e.g. number of strikes and riots, work days lost, etc.) has proved significant in some studies; but these quantitative estimates can capture only some aspects of the qualitative nature of political risk. Surveys carried out in South Asia and sub-Saharan Africa appear to indicate that political instability, expressed in terms of crime level, riots, labour disputes and corruption, is an important factor restraining substantial foreign in investment.

INFRASTRUCTURE

Infrastructure covers many dimensions, ranging from roads, ports, railways and telecommunication systems to institutional development (e.g. accounting, legal services, etc.). Studies in China reveal the extent of transport facilities and the proximity to major ports as having a significant positive effect on the location of FDI within the country. Poor infrastructure can be seen, however, as both an obstacle and an opportunity for foreign investment. For the majority of low-income countries, it is often cited as one of the major constraints. But foreign investors also point to the potential for attracting significant FDI if host governments permit more substantial foreign participation in the infrastructure sector. Recent evidence seems to indicate that, although telecommunications and airlines have attracted FDI flows (e.g. to India and Pakistan), other more basic infrastructure such as road building remains unattractive, reflecting both the low returns and high political risks of such investments.

Surveys in sub-Saharan Africa indicate that poor accounting standards, inadequate disclosure and weak enforcement of legal obligations have damaged the credibility of financial institutions to the extent of deterring foreign investors. Bad roads, delays in shipments of goods at ports and unreliable means of communication have added to these disincentives.

INCENTIVES AND OPERATING CONDITIONS

Removing restrictions and providing good business operating conditions are generally believed to have a positive effect. In China, the ‘open-door’ policy and enhanced incentives for investing in the special economic zones contributed to the initial influx of FDI. Further incentives, such as the granting of equal treatment to foreign investors in relation to local counterparts and the opening up of new markets (e.g. air transport, retailing, banking), have been reported as important factors in encouraging FDI flows in recent years.

The Indian Government has recently relaxed most of the regulations regarding foreign investment. This is seen as contributing to the increased FDI flows in the last couple of years. However, the lack of transparency in investment approval procedures and an extensive bureaucratic system are still deterring foreign investors; hence the relatively low FDI/GNP ratios. In 1991, Bangladesh and Pakistan implemented reforms allowing foreign investors to operate with 100% foreign ownership but still failed to attract significant flows (as a proportion of GNP) because of political instability and an overextended bureaucracy. Nigeria, in contrast, continues to attract foreign investment as an oil-exporting country despite its erratic and relatively inhospitable policies. With regard to the remaining low-income countries with small FDI inflows, surveys indicate that the lack of a clear-cut policy with respect to foreign investment and excessive delays in approval procedures are amongst the most important deterrents. Although a number of African countries setup 'one-stop investment ships' during the 1980s in order to simplify approval procedures, the increased workload created bottlenecks.

PRIVATISATION

Though privatization has attracted some foreign investment flows in recent years (e.g. Nigeria in 1993 and Ghana in 1995), progress is still slow in the majority of low-income countries, partly because the divestment of state assets is a highly political issue. In India, for example, organised labour has fiercely resisted privatization or other moves, which threaten existing jobs and workers' rights. At a regional level, 1994 figures show 15% of FDI flows to Latin America as derived from privatization, but only 8.8% in sub-Saharan Africa and 1.1% in South Asia. A number of structural problems are constraining the process of privatization. Financial markets in most low-income countries are slow to become competitive; they are characterized by inefficiencies, lack of depth and transparency and the absence of regulatory procedure. They continue to be dominated by government activity and are often protected from competition. Existing stock markets are thin and illiquid and securitised debt is virtually non-existent. An under-developed financial sector of this type inhibits privatization and discourages foreign investors.

Over the last 25 years, FDI in low-income countries has been highly concentrated in three countries, China, Nigeria and India. Large market size, low labour costs and high returns in natural resources are amongst the major determinants in the decision to invest in these countries. New major destinations for FDI flows in the 1990s include Vietnam, Ghana and Bangladesh. Given the easier access to their markets, motives for investment in these economies are mainly determined by the low cost of labour and the availability of natural resources.

For the vast majority of low-income countries, however, FDI is minimal. The structural weaknesses of these economies, the inefficiencies of their small markets, their skill shortages and weak technological capabilities, are all characteristics that depress the prospective profitability of investment. These factors also make it less worthwhile for potential international investors to incur the costs of a serious examination of local investment opportunities, thus leading to informational inefficiencies. The financing requirements of economic growth in these countries are therefore unlikely to be fulfilled by private capital inflows. Until these constraints on possible investment are addressed, they are likely to continue to rely heavily on receipt of foreign aid.

DESTINATION INDIA

FDI flows to developing countries are in rising mood and India is the hot destination in today's FDI culture. The country offers to any MNC, a vast market, a strong legal system, well developed capital market, a class of private sector partners, high quality of human resources, dedicated and hard working peoples, and a vast majority of English speaking managers who can well manage and operate business.

India has a well-entrenched democratic set up and perhaps India is the only country that has come out of the 40 years old socialist trap successfully. Most of Asia has done it at the cost of or in the absence of democracy.

India is also blessed with two separate sets of variables that attract the attention of the global investors. The first group is made of what is called the institutional background of an attractive investment climate. The second group is more directly related to doing business with a country's supply of economic and human resources.

1. THE INSTITUTIONAL BACKGROUND

India has the following well defined, established and ever growing institutions that are attracting the foreign investors.

(a) Political and macroeconomic stability: This is the most important prerequisite for non –footloose foreign investors. Investors in general are deterred by risk; moreover they need to be able to evaluate their investment return on a medium to long-term period.

India in recent past has been able to show to the rest of the world that we are economically and politically stable. There have been no frequent changes in the political system at the center and the economic environment is also conducive for the investors. These two factors alone have resulted in more foreign investor's attraction.

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DOI: https://doi.org/10.54784/1990-6587.1167

(b) A transparent stable and non-discriminatory legal and regulatory environment. The country is showing a sign of improvement in legal system and the rules are made as per the international code of conduct.

(c) Finally, bureaucratic procedures and institutional rigidities are diminishing or rather strictly banned. The administrative procedures are made simple and easy in order to attract more and more foreign investors. Several anti corruption units are working round the corner to eliminate the bribery system, which used to be a major hurdle in the ways of multinationalisation and globalisation.

2. **THE ECONOMIC AND SOCIAL BACKGROUND** In recent past, India has been able to make economic and social system stable. According to D.Ricardo's inquiry findings, there are five main groups of economic and social factors that are necessary to make a country attractive.

(a) A big and growing market: India is very big and the most growing market with a huge population of over one billion. Along with India, there is regional market like SAFTA, which is recently signed (2005) between the Asian members, which is also attracting a huge amount of FDI because they have free access to a very big regional market being members of SAFTA. The rate of growth of market size is also growing which is good sign for the foreign investors.

(b) An efficient communication system is a key factor for MNCs to efficiently operate far-flung subsidiaries in the rest of the world as well as the home office. Subsidiaries need to be able, on a day-to-day basis, to send and receive faxes, email and make telephone calls. They also need proper transportation links both within the country and to the outside world.

There has been communication revolution in India and the connections are provided to even the remotest part of the country. A number of key players in the field of telephone have entered both from within the country and outside the country. The major cities of India are well connected with air routes, surface routes, rail routes and even sea routes. These all characteristics are attracting the foreign investors.

(c) **QUALIFIED AND SKILLED LABOURS** Another most vital factor that attracts the foreign investors is the availability of the qualified and skilled labour force. Cheap labour was playing a dominant role in the 1960's and 1970's when most MNCs were following a vertical outsourcing strategy. Today, all the firms stress that the availability of qualified manpower, particularly for middle ranking and senior technical position, is a major consideration. Most of the subsidiaries are using the same sophisticated technology as that employed in the home country units. The presence of sophisticated and specialized engineers, management graduates,

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DOI: https://doi.org/10.54784/1990-6587.1167

computer professionals, technicians and scientists are reasons for the attraction of FDI.

(d) The presence of efficient local firms is also a huge source of attraction for the foreign investors.

(e) India way back in 1956, adopted the principle to promote the private sectors along with the public sectors. Privatization programmes are also an investment opportunity for most of the firms investing in foreign countries. India is becoming the hub of the privatisation and as a result of this the foreign investors are getting lured to this country.

(f) Fiscal incentive: India has brought a radical change in its fiscal policies and all kinds of taxes are modified and readjusted as per the international standard and norms.

India's strength and weakness can be discussed as below:

Strength	Scale	Rank
Stock Market:		
Stock market is important for new financing	5.42	13
Science and Engineering		
Schools excel in basic and Maths	5.27	16
Country has a large pool of competent		
Scientists & Engineers	6.37	1
Engg. As a profession greatly attracts		
Young talent	6.26	1
Labour force:		
Country has first class business schools		
to train mangers	5.05	8
Country has an abundant labour	6.77	1
Rule of law:		
Judiciary is the independent of Govt.	5.40	9
Companies with court ruling is high	5.37	14
Firms have recourse to courts		
for challenging Govt. Actions	5.56	1

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Weaknesses:		
Financial markets:		
Citizens prohibited from investing in foreign stocks	1.60	53
Financial sectors sophistication is lower than international norms	2.74	43
Venture capital is scarce	2.63	50
Public administration		
Administrative regulations that constrain Business are pervasive	2.90	47
Govt. subsidies keep old industries alive	2.68	52
Civil service is subject to political pressure	2.65	43
Tax evasion is rampant	2.27	48
Infrastructures:		
Overall infrastructure is far worse than major trading partners	1.92	53
Port facilities are underdeveloped	2.18	53
Country suffers from severe power shortages	1.95	53
Labour Regulations:		
Average workers are unproductive	2.94	51
Extra payments connected with permits and licensee are common	2.79	48

Published by iRepository, February 2021

https://ir.iba.edu.pk/businessreview/vol4/iss1/5
DOI: https://doi.org/10.54784/1990-6587.1167

FDI INFLOW

A. Cumulative FDI Equity Inflow (equity capital components only):

1.	Cumulative amount of FDI inflow (from August 1991 to March 2007)	Rs. 2,32,041 Crore	US$54,628 Million
2.	Amount of FDI inflow During 2007-08 (from April to February2008)	Rs. 80,732 Crore	US$ 20136 Million
3.	Cumulative amount of FDI inflows (updated Up to February2008)	Rs. 3,12,773 Crore	US$ 74764 Million

Note:- FDI inflow include amount received on account of advances pending for issue of share for the year 1999 to 2004

B. FDI Equity Inflow during Financial Year 2007-2008

Financial Year 2007-2008 (April –March)	Amount of FDI inflow	
	(in Rs. Crore)	(in US$ million)
April 2007	6,538	1,551
May 2007	8,642	2,120
June 2007	5,048	1,238
July 2007	2,849	705
August 2007	3394	831
September 2007	2876	713
October 2007	8008	2027
November 2007	7353	1864
December 2007	6146	1558
2007-2008 (up to February 2008)	**80732**	**20136**
2006-2007 (upto February 2007)	53734	11888
%age growth over last year	**(+)50%**	**(+)69%**

C. FDI Equity Inflow during Calendar Year 2008

Calendar Year 2008	Amount of FDI inflow	
	(in Rs. Crore)	(in US$ million)
Year 2008 (up to February 2008)	29489	7437
Year 2007 (up to February 2007	11595	2619
%age growth over last year	**(+)154%**	**(+)185%**

Published by iRepository, February 2021

https://ir.iba.edu.pk/businessreview/vol4/iss1/5
DOI: https://doi.org/10.54784/1990-6587.1167

D. SHARE OF TOP INVESTING COUNTRIES FDI EQUITY INFLOW (Financial year- wise):

Rank	Country	2004-05 (April – March)	2005-06 (April – March)	2006-07 (April – March)	2007-08 (April –Dec.)	Cumulative Inflows (from Apr2000 to Dec07)	%age with total Inflows (in term of rupees)
1	Mauritius	5141 (1129)	11441 (2570)	28759 (6363)	22435 (5564)	88,325 (20104)	44.46
2.	USA	3005 (669)	2210 (502)	3861 (856)	2540 (627)	18121 (4070)	9.12
3.	U.K	458 (101)	1164 (266)	8389 (1878)	1103 (274)	15478 (3461)	7.79
4.	Netherlands	1217 (267)	340 (76)	2905 (644)	2101 (525)	11243 (2535)	5.76
5.	Japan	575 (126)	925 (208)	382 (85)	2630 (637)	8629 (1948)	4.34
6.	Singapore	822 (184)	1218 (275)	2662 (578)	5632 (1411)	11438 (2695)	5.76
7.	Germany	663 (145)	1345 (303)	540 (120)	1195 (293)	5859 (1323)	2.95
8.	France	537 (117)	82 (18)	528 (117)	358 (89)	3159 (705)	1.59
9.	Switzerland	353 (77)	426 (96)	257 (56)	861 (211)	2792 (634)	1.41
10.	South Korea	157 (35)	269 (60)	321 (71)	133 (33)	3366 (855)	1.57
Total FDI INFLOW		**17138 (3754)**	**24613 (5546)**	**70630 (15726)**	**51234 (12699)**	**222680 (50628)**	**--**

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E. SECTORS ATTRACTING HIGHEST FDI EQUITY INFLOWS

Rank	Sector	2004-05 (April – March)	2005-06 (April – March)	2006-07 (April – March)	2007-08 (April – Feb)	Cumulative Inflows (from April 2000 to Feb 2008)	%age with total Inflows (in term of rupees)
1	Service Sector (Financial & Non Financial)	1986 (444)	2399 (543)	21047 (4664)	6442 (1557)	40844 994430	22.42%
2.	Computer software & hardware	2441 (539)	6172 (1375)	11786 (2614)	5476 (1373)	32020 (7241)	14.03%
3.	Telecommunications	570 (125)	2776 (624)	2155 (478)	4846 (1198)	16491 (3778)	7.23%
4.	Construction Activities	696 (152)	667 (151)	4424 (985)	6119 (1527)	12515 (2947)	5.49%
5.	Housing & Real Estate	0 (0)	171 (38)	2121 (467)	7186 (1792)	9598 (2324)	4.21%
6.	Automobile Industry	559 (122)	630 (143)	1254 (276)	2204 (553)	9363 (2115)	4.10%
7.	Power	241 (53)	386 (87)	713 (157)	2003 (503)	7755 (1741)	3.40%
8.	Drugs & Pharmaceuticals	1343 (292)	760 (172)	970 (215)	1326 (334)	5607 (1276)	2.46%
9.	Metallurgical Industries	836 (182)	6540 (147)	7866 (173)	3856 (971)	6519 (1557)	2.86%
10.	Chemicals	909 (198)	1731 (390)	930 (205)	868 (216)	6091 (1373)	2.67%

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FDI INFLOW FINANCIAL YEAR WISE DATA

A. **AS PER INTERNATIONAL BEST PRACTICES**

S.No	Financial Year (April-March)	Equity		Reinvested earning +	Other Capital +	Total FDI Inflow	%age growth over previous year
		FIPB Route / RBI's Automatic Route	Equity capital of Unincorporated bodies #				
A) 1991-2000 (from August 1991 to March 2000)		15483	-----	-----	-----	**15483**	-----
1.	2000-01	2339	61	1350	279	**4029**	----
2.	2001-02	3904	191	1645	390	**6130**	**(+)52**
3.	2002-03	2574	190	1833	438	**5035**	**(-)18**
4.	2003-04	2197	32	1460	633	**4322**	**(-)14**
5.	2004-05	3250	528	1904	369	**6051**	**(+)40**
6.	2005-06 (P)	5540	280	1676	226	**7722**	**(+)28**
7.	2006-07(P)*	15585	480	2936	530	**19531**	**(+)153**
8.	2007-08 (April-Dec07)	12699	334	2054	254	**15341**	----
(B) Sub Total (1 to 8 above) (from April 2000 to July 2007)		**48088**	**2668**	**18097**	**3095**	**71948**	----
Cumulative Total (A)+(B) (from Aug 1991 to July07)		**63571**	**2668**	**18097**	**3095**	**87431**	-----

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DOI: https://doi.org/10.54784/1990-6587.1167

WHAT MAKES A COUNTRY ATTRACTIVE?

Interviews made by me during my research work provide a good picture of what makes a country attractive from the viewpoint of global investors
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To put a country on their short list, global investors consider two separate sets of variables and both sets are prerequisites. The first group is made of what may be called this institutional background of an attractive investment climate. The second group is more directly related to doing business with a country's supply of economic and human resources. If the latter fits with the MNC are looking for according to its strategy, and as long as the institutional background is fine, the country might be put on the short list. This step is a necessary condition for attracting FDI; however in most cases, it is not a sufficient one.

a) THE INSTITUTIONAL BACKGROUND

For a country to be attractive, a set of institutional prerequisites has to be fulfilled:

Political and macroeconomic stability: This is the most important prerequisite for non-footloose foreign investor. Investors in general are deterred by risk; moreover, they need to be able to evaluate their investment return on a medium to long-term period.

A transparent, stable, and non-discriminatory legal and regulatory environment. Specific foreign investment laws or codes, mostly adopted in the 1960's, including a whole set of TRIMs, have to be liberalized before starting any promotion. Moreover, laws, regulations and contracts must be followed. In cases of conflict, an efficient, non-corrupt judicial system is required. This point has very often been stressed by the managers interviewed by FIAS. At minimum, international arbitrage has to be permitted by the law.

Finally, bureaucratic procedures and institutional rigidities must be banned. A global strategy is no longer compatible with wasting time in bureaucratic procedures and negotiations, with a myriad of different and uncoordinated services. MNCs now want a free foreign exchange regime with repatriation and a flexible labor market. In the past, during the time when MNCs were following a "multi-domestic" strategy, the situation was quite different. Bureaucratic procedures and its usual informal "payments" (i.e., bribes) were considered as the price to pay for having access to the domestic market and for benefiting from a rentier position due to the existing level of tariff barriers (those which deterred the current foreign investor from exporting). Global investors need free trade, on the one hand, to

https://ir.iba.edu.pk/businessreview/vol4/iss1/5
DOI: https://doi.org/10.54784/1990-6587.1167

maximize economics of scale generated by manufacturing in different sites and in various countries and, on the other, by exporting to the world market. Transaction costs have to be as small as possible – an objective not compatible with red tape. In the case when administrative procedures are too long and too complex, global investors prefer to move to another place.

With globalization, competition for attracting FDI is now among host-countries; it is no longer among foreign firms trying to have access to domestic markets.

b) THE ECONOMIC AND SOCIAL BACKGROUND

The economic and social background is becoming primarily important when a global investor is deciding what business to do in country with a good institutional background. To be able to decide, he compares what he needs to start a profitable activity with what factors for FDI is defined. Note that in the globalization framework, the country location advantage has to be an absolute advantage—on this point; A. Smith is taking his vengeance on D. Ricardo.

According to the inquiries there are five main groups of economic and social factors that are necessary to make a country attractive:

A big and growing market: for all the companies in the FIAS sample, market size is a prerequisite. However, it does not mean a big domestic market. More and more, as was previously emphasized, global investors are mainly attracted by big and growing regional markets. Ireland or Portugal each has a small domestic market. Nevertheless, they are attracting a huge amount of FDI because they have free access to a very big regional market by being members of eh European Union. Similarly, the beginning of NAFTA increased Mexico's attractiveness as an FDI location. A high growth rate market is also very important for global investors whose home markets are saturated. This issue shall be discussed later.

An efficient communication system is a key factor for MNCs to efficiently operate far-flung subsidiaries in the rest of the world, as well as home office. Subsidiaries need to be able, day-to-day basis, to sent and receive faxes, e-mail, and make telephone calls. They also need proper transportation links both within the country and to the outside world. All this may seem obvious; however a dysfunctional telecommunications system in a country can cause an investor to regret his initial choice to locate there. This point is of special importance to governments in the case where they are planning to implement an export-processing zone or to rehabilitate an existing one.

Qualified labor is another major attractive advantage from a global investors' viewpoint. Cheap labor was playing a determinant role in 1960's, when most MNCs were following a vertical outsourcing strategy. Today, all the firms

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interviewed, whatever their home country or industrial sector, stressed that the availability of qualified manpower—particularly for middle-ranking and senior technical positions – is a major consideration. Most of the subsidiaries are using the same sophisticated technology as that employed in the home country units. Often, technology used abroad is even more sophisticated than in the home country because the plants are more recent and embody the latest technology. The present of specialized engineers and scientists in key sectors, many of whom once worked in the military-industrial complex, is the major locational advantage of CEE countries.

The presence of efficient local firms is at first sight an expansion of the qualified labor force argument, but in fact it is covering an increasingly important dimension of a countries' attractiveness value. Very efficient local support industries are defined by their capacity to meet the needs of subsidiaries in terms of technical specification, quality for product, and delivery time. With the growing externalization process followed by an increasing number of firms, the issue of efficient local support industries is drastically changing. It can no longer be limited to sub-contracting operations. Now it is in fact commanding the growth of a new type of MNC: the "network firms" or "hollow corporations" or "virtual firms".

Privatization programs are also an investment opportunity for most of the firms interviewed. It is particularly important in the case of the CEE countries. But, for global investors, the main interest in buying a public enterprise is in most cases to acquire a market share. Taking over the productive facilities is generally a secondary consideration and may even be seen as a drawback. Most of the enterprises in the former Comecon zone will require heavy injection of new investments to rehabilitate them. However, the main attraction played by the existence of privatization programs has to be looked at from another perspective i.e. that of the oligopolistic competition pressure among MNCs. As a matter of fact, a firm that fails in its bid under a particular privatization may find itself excluded from the market permanently or for a long time. This risk is especially severe in the case of sectors where economies of scale are important, such as chemicals, electricity generation, or luxury hotels, where there is room for only a very small number of players given the size of the market.

Fiscal incentives (tax holidays or subsidies) have been mentioned by only a minority of firms polled as a factor that can enhance a country's attractiveness. The incentive issue is very broad and cannot be dealt with in the framework of this note. Nevertheless it might be of interest to stress two major points which are formulated in a more implicit than explicit way in the answers made by most of the firms surveyed. First, incentives cannot be a substitute for a country's lack of attractiveness, except for investors who are putting financial profitability above economic profitability. Most of the time, investors who are making such a choice are footloose investors. Attracting them is of a very limited interest for a host country. Second, in the case of countries which are competing for the same investment project and which are in the same circle as defined before, incentives are

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DOI: https://doi.org/10.54784/1990-6587.1167

playing a different role: that of the icing on the cake. Unfortunately for public finance, the cost of getting an investment project is often too high compared to the benefit of having it. This is the rule in a non-cooperative game.

FDI EQUITY INFLOWS TFDI PROMOTION UNDER FREE TRADE

For developing countries, what kind of policies is required in a world with free and fastidious FDI? I recommend the following. This advice comes from my experience of talking to the Vietnamese officials and enterprise managers in the last ten years. It assumes a country which already receives a certain amount of FDI and hopes to receive more, above the critical mass, to industrialize and join the regional flying geese [For those countries with little or no FDI absorption in manufacturing, a different strategy must be taken.]

First, understand FDI dynamics from the viewpoint of foreign investors (as discussed above). Too many officials think in terms of domestically set goals and requirement, and scare away potential investors. National goals and social concerns are certainly important, but they must be realized in a way that is consistent with FDI inflows.

Second, do not change rules after foreigners have already invested. Policy changes are fine, sometimes. But for those who came earlier, the old rules should continue to apply so that will not suddenly face an unfavorable situation ("grandfather clause"). Policy uncertainty is the biggest problem in Vietnam. Third, do not try to have a vertically integrated industry, from raw materials to final assembly. In the age of globalization, no country can do that, not even developed ones Target where your dynamic (i.e., future) comparative advantage is, and concentrate your effort on it.

Fourth, do not try to use domestically available natural unless they are highest quality and lowest cost (or nearly so) in the world. From the viewpoint of competitiveness, it is better to import best raw material from the most efficient producers in the world.

Fifth, building supporting industries and technical transfer will take time. They must be done in proper speed and sequence. Hasty requirement of local contents not only violates WTO but also drives away foreign investors.

Six, accumulate assembly-type FDI. First, without selectivity, even though domestic value-added is low. Second, as assemblers naturally desire to procure inputs domestically, promote or invite domestic and foreign part suppliers. If successful, a virtuous circle between assembly and parts will emerge. Technology transfer will come after this, not before

https://ir.iba.edu.pk/businessreview/vol4/iss1/5
DOI: https://doi.org/10.54784/1990-6587.1167

Seven, work cooperatively with foreign investors. Listen to their needs carefully (you don't have to accept all of their complaints; sometimes they are selfish). Set agreed goals for technical transfer, domestic procurement, etc. and design consistent supporting policies. Work with foreign investors toward these goals, and also solve any problems with them.

Eight, simple external opening (free trade and investment) is not enough. You must use targeted policies to create superior locational advantage and lower the costs of doing business in your country. This requires, among other things, improving domestic skills (production management, marketing, engineering-not just primary education), infrastructure, supporting institutions, efficient government services, good management of industrial and export processing zones (if any), and so on.

Nine, export-oriented FDI should be welcomed most, while domestically oriented FDI is a different story and must be treated differently. Do not attract them with high import protection. If they are already here with high protection, show them a tariff reduction schedule and give them incentive to lower costs. The final outcome (survive or exit) should be determined by global competition and efforts of individual enterprises. This is the same for protected local enterprises as well.

CONCLUDING REMARKS

I would like to conclude by making two kinds of remarks, both being oriented towards the further and going beyond the finding of the FIAS **(abbrev)** inquiry. On the one hand, I would like to return to the trade-off issue which was originally at the beginning of the story, and which might be changed in a backwash effect. On the other hand, I would like to raise incidentally the question of the future or FDI promotion involved by the new firm's organization.

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We are what we repeatedly do.
Excellence, then, is not an act, but a habit. – Aristotle