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A Comprehensive Study of Foreign Direct Investment

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Abstract

With the process of industrialization, the world economy has undergone several changes through the agriculture-based economy to the industry-based one. The industrial scenario is quite enthusiastic now which reveals the people's faith more in industrial growth than agriculture. All the nations with the exception to none, have succumbed to the various types and forms of industries. The more the times are advancing, the better industrial scenario is emerging. Beginning with the cottage industries with the investment of the least capital, the industrialization has made the existence of small scale and large scale industries that not only satiate the investors' passion to establish industries but also ensure them a handsome safe return. The current global economic scenario is quite enthusiastic. There are the countries that have long retained their high, moderate or low economic status; there are the ones that have charismatically raised their economic status through their effective manufacturing, service or tourism sector; and there are the ones that are still lagging behind despite the organized working of their various sectors. The roots of foreign direct investment lie in industrialization, social change and industrialization. Foreign direct investment and economic growth are also related and complementary to each other. Both go side-by-side leading the countries to constant growth and development. The twenty-first century has several boons to the modern man. Globalization is one of them. The process of economic globalization has pulled down the walls between the nations, and has enabled the capitalists and investors of the world to stand at the one and same platform. The time is over when the people were confined to the inland investment. Now the economic scenario is all changed. Man is running after money. For the sake of better and safer earnings, he is ready to invest his capital even in such industries that he is unfamiliar with, or in the countries anywhere on the planet that can help him make more and more money.

The paper is a comprehensive study of all the major aspects of foreign direct investment which is now considered a panacea to the growth of the global economy, and which is attracting all the countries of the world towards it for the sake of the safe monetary returns. The findings reveal that the global economy can get a real strength only through more and more foreign direct investment.

Keywords: Comprehensive, Foreign, Investment, Inward Flows, Outward Flows, Economy.

Introduction

In the era of multi-national companies in the countries all over the world, the economy has got a new meaning. The economy of a nation is determined now not only by the native determinants, but also the investments made by the people of one nation into another one. It is the modern trend all over the world among the millionaires and multi-millionaires to invest their capital in several countries other than their own that can ensure them an incredibly big safe return in the form of interest or profit. In fact, when the investors find that their capital is safer in other countries through the businesses or just interest, they prefer investing in other countries to their own.

An investment from a party in one country into a business or corporation in another country with the purpose of earning and establishing a lasting interest, is called Foreign Direct Investment. One should be familiar with the fact that FDI is different from foreign portfolio investments which refer to the investors' passively holding securities from a foreign country. Generally, FDI is made either by obtaining a lasting interest on the money invested in another country or by expanding business into a foreign country. In fact, FDI is not a simple and frequent monetary transfer of ownership or controlling interest but also of organizational and management systems or technology.

The IMF defines Foreign Direct Investment as 'the category of international investment the main aim of which is to earn a lasting interest, in which there is a long term relationship between the investor and the firm, and which is noted for the distinct influence of the investor on the management of the firm.'

FDI can be made both by an individual and a firm of one country into another into business with a view to making money from money. It refers to an investment in a foreign business enterprise designed to acquire a controlling interest. Without the purchase of regular shares of a company's stock, it provides capital funding in exchange for an equity interest, and thus builds or purchases businesses and their associated infrastructure in the foreign countries. In other words, when an investor does foreign business operations or acquires foreign business assets in a foreign company, FDI takes place. It should be made clear that FDI and SME development are differently, and should be interpreted in different ways.

FDI is now a common term in International economy, and the investors in all the countries with the exception of probably none, are on the way to make investments, still there are the legal problems before the investors that need to be solved at the governmental level. The economists and industrialists are hopeful that in the next few decades these problems will be solved, and more and more FDI will be made in the world. Some of the countries are lagging in it, but as it is hoped, such countries will also join the race of FDI and thus will change their economic destiny.

Importance of Global FDI

1. It brings in investible resources to host countries
2. It introduces modern technologies
3. It provides access to export markets
4. FDI flows are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors.
5. The trans-national companies (TNCs/MNEs) have large internal (inter-firm) markets, whose access is only available to affiliates.

Implications of Foreign Direct Investment

Both the positive and the negative implications are there about FDI. Some of them are as follows-

1. The growth of FDI contributes to the rise of globalization, and thus, is helpful in making the process of globalization successful
2. FDI generates several benefits to the countries associated with it
3. Outward foreign direct investment increases overseas investment income, such as, overseas subsidiaries profits, dividends and interest payments, and thus, is helpful in bringing foreign currency
4. FDI is helpful in creating jobs, increasing productive capacity and borrowing latest technique, and thus, has a tremendously positive effect on the account of the countries.
5. FDI compensates the lack of domestic investment
6. FDI flows exhibit high levels of volatility
7. FDI contributes to a country's economic integration into the world economy
8. FDI has a vital and dominant role to play in driving economic growth and development in the world
9. FDI is an effective channel of progress and development which promises to bring financial resources and technology
10. FDI leads to economic growth and productivity increases in the economy as a whole

Aims of Foreign Direct Investment

The maxim 'nothing is done without a cause' is applicable to FDI which is made with the following specific purposes-

1. To gain an equity interest sufficient to provide control of a company through opening its own business operations in another country, and acquiring control of existing assets of a business already operating in the foreign country.
2. To gain a majority interest in a company with effective control of the company.
3. To make the opening of a subsidiary or associate company in a foreign country
4. To acquire a controlling interest in an existing foreign company, or by means of a merger or joint venture with a foreign company.
5. To establish a lasting interest and to obtain at least 10% of the voting power in a firm in the foreign country.

Working of FDI

The basic requirement for a legitimate FDI is the minimum 10% ownership stake in a foreign based company selected for FDI. No doubt, there are instances that reveal that even with less than 10% ownership the controlling interest can be gained, its legitimacy lies in minimum 10% ownership stake. FDI is found working effectively where there are the open economies offering a skilled workforce and above-average growth prospects for the investors. FDI is not effective where there are the tightly regulated economies. In addition to the capital investment of the investors of a nation into the business or company of another nation or nations, it includes provisions of management or technology as well. Establishment of either effective control of or at least substantial influence over the decision-making of a foreign business is the master-key feature. Foreign direct investment is frequently not a simple monetary transfer of ownership or controlling interest, rather it involves complementary factors, such as organizational and management systems or technology. It can be made by individuals but are more commonly made by companies wishing to establish a business presence in a foreign country. Indeed, the working of FDI is not as simple and easy as it seems. It requires certain conditions for effective working. As it is clear, FDI is made with certain specific aims and purposes, it is essential that those specific aims are fulfilled, and the investors are successful in earning a lasting interest on the investment made by them in certain business or industries in the foreign countries.

Types of Investment

Horizontal Foreign Direct Investment

In Horizontal Foreign Direct Investment, the investor of a country establishes the same type of business operation in a foreign country as is operated by him in his own country. In other words, in it, the investor generally expands his business through establishing it in one or more than one countries. For instance, if a Chinese Cell Phone businessman and investor opens cell phone stores in India or in any other country of the world, it is said to be horizontal foreign direct investment.

Vertical Foreign Direct Investment

Vertical foreign direct investment means the establishment or acquisition of different but related business activities to the main business in some foreign country which is found suitable for FDI. For example, if for the sake of a better manufacturing, a manufacturing company takes interest in a foreign company which is popular for the supply of parts or raw materials, and makes investment, it will be called the vertical direct investment.

Conglomerate Foreign Direct Investment

In Conglomerate Foreign Direct Investment, the investment is made in an absolutely unrelated business, and the investor, thus, enters an industry or business about which he has no previous knowledge and experience. It is often in the form of joint venture with a company which is already in existence in the foreign country.

Platform Foreign Direct Investment

The platform FDI occurs when a business is expanded into a foreign country with a view to exporting the output from the foreign operations to some third country. The special feature of such an investment is that it is made in low cost locations and free trade areas.

FDI Net Inflows and Net Outflows

The value of the inward direct investment made by foreigner residents in a reporting country is known as the FDI net inflows, while the value of outward direct investment made by the residents of the reporting country to the other countries is known as the FDI net outflows. In simple words, Inward Direct Investment is the direct investment in the reporting economy. In its compass lie all the liabilities and assets which are transferred between resident direct investment enterprises and their direct investors as well as between resident and nonresident fellow enterprises, provided the ultimate controlling parent is nonresident. Contrary to the inward direct investment, outward direct investment is the direct investment abroad, which encompasses the transfers of liabilities and the assets between resident direct investors and their direct investment enterprises as well as between resident and nonresident fellow enterprises, provided the ultimate controlling parent is resident.

Methods of Foreign Direct Investment

The multiple methods that enable an investor to acquire voting power in a foreign country include Acquiring voting stock in a foreign company, Mergers and acquisitions, Joint ventures with foreign corporations and Starting a subsidiary of a domestic firm in a foreign country.

Review of Literature

Ashfaque H. Khan and Yun-Hwan Kim (1999)[1] suggest that developing economies should attach short-term priority to attracting FDI to the foreign exchange earning sector, or, at least, both the foreign exchange earning sector and other sectors simultaneously. Multilateral development organizations, including the Asian Development Bank, should also take this into account in their private sector operations, particularly the build-own-transfer type, to develop economic infrastructures in developing economies.

Silvio Contessi **,** Hoda El-Ghazaly (2010)[2] assert that emerging Markets Multinationals (EM-MNCs) have become important in almost every industry. India's Infosys and TCS have become two of the world's leading information technology companies. China's Haier is the fourth-largest maker of home appliances in the world, and its ZTE is on its way to becoming one of the world's top five manufacturers of telecommunications equipment and systems.

Francis Cai, Huifang Cheng, LianZan Xu & C.K. Leung (2011)[3] report that the World Bank reported a spurt in China's economic growth in 2017 for the first time since 2010, mainly driven by a cyclical rebound in global trade. It projects a growth of 6.6% in 2018, which would sober down to around 5.5% by 2023. With a GDP (PPP) of $25.27 trillion, China is the largest economy. By 2023, its GDP (PPP) is expected to grow to $37.28 trillion. Since 1990, in China, the foreign investment dependence degree has increased dramatically. Although not going down like most of the developed countries, foreign trade dependence in China starts to show less dramatic positive role in the economic growth lately.

Uri Dadush and William Shaw (2011)[4] survey that two centuries of history show that there is nothing automatic about economic development and catch-up. In recent years, however, an extraordinary confluence of factors has allowed an unprecedented number of countries—and people— to achieve rapid income growth. These factors include access to technology, the opening up of markets, stabilized macroeconomic conditions, higher savings and investment rates, and effective government interventions to support private-sector development.

Tanzania Investor Survey (2014)[5] reports that domestic enterprises, independent of productivity measure used (i.e. valued added per employee or total factor productivity), are less productive than foreign firms, yet they are more inclined to invest in the future than foreign companies. Domestic enterprises tend also to be more labour intensive and report lower levels of capacity utilization when compared to their foreign counterparts.

Kavaljit Singh and Burghard Ilge (2016)[6] cite that the United Nations Conference on Trade and Development (UNCTAD) defines BITs as "agreements between two countries for the reciprocal encouragement, promotion and protection of investments in each other's territories by companies based in either country." The countries signing BITs commit themselves to following specific standards on the treatment of foreign investments within their jurisdiction.

Donny Susilo (2018)[7] observes that US has been the best country for their FDI level among all countries throughout the world; it been open to foreign investment longer than most countries and thus provides longer time-series data for examining the growth effects of FDI than are available from most other countries, and has been running huge and growing current account deficits that have been financed by equally large investment inflows.

Takeo HOSHI (2018)[8] surveys that while the inward FDI stock exceeds 20% in recent years for all the five countries other than Japan, Japan's inward FDI is still below 5% of GDP. Another way to see the exceptionally low level of inward FDI to Japan is to look at its share in the total inward FDI in the world.

Objectives of the Study

1. To reflect the short history of global economic conditions
2. To study and interpret the important studies on FDI
3. To discuss the various aspects of FDI
4. To draw findings from the studied material
5. To make suggestions about how FDI can work more effectively for the growth and development of global economy

Hypothesis

1. As in other fields, in the field of economy too, the process of globalization is active
2. The concept of FDI has its roots in the international trade
3. FDI is the latest trend of international trade
4. FDI is carried through inflows and outflows
5. Outflow of FDI is preferred to the inflow of FDI

Methodology

The paper is a review study made with the specific purpose to comprehend the various major and minor aspects of foreign direct investment which is the latest feature of the international trade, and which is being adopted by almost every country of the world with a view to earning a lasting interest on the invested money in the foreign countries. The study met completion as a result of following several steps. From the selection of the title to the findings there occurred several other errands like the review of literature which supplied the required subject matter on the theme, setting of objectives that allowed the researcher to go to certain extents, the hypothesis that provided a certain base to the study to be tested during the study, research design that enabled the researchers to present the contents in a manner that is befitting to the approved research design, and findings drawn from the studied stuff.

Findings

1. The current global economic scenario is quite enthusiastic with the countries that have long retained their high, moderate or low economic status, that have charismatically raised their economic status through their effective manufacturing, service or tourism sector, and the ones that are still lagging behind despite the organized working of their various sectors
2. Domestic enterprises are less productive than foreign firms
3. FDI is in the interest and well being of the global economy
4. Foreign direct investment and economic growth are also related and complementary to each other
5. FDI allows and enables even the undeveloped and underdeveloped countries to develop their resources, and brings profits which can be used to develop infrastructure, improve health care, education, productivity and to modernize industries with latest known technology.
6. FDI is different from foreign portfolio investments which refer to the investors' passively holding securities from a foreign country
7. FDI is not a simple and frequent monetary transfer of ownership or controlling interest but also of organizational and management systems or technology
8. FDI can be made both by an individual and a firm of one country into another into business with a view to making money from money
9. Outward investment can lead to increased overseas investment income for a country
10. Countries inviting inward investment gain in a number of ways through GDP, creation of jobs, increase in productive capacity, latest technique from abroad and positive effect on country's account.

Endnotes

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