Foreign Direct Investment: A Business Proposition to Exploit Opportunities to Maximize Profit

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Abstract

The study is designed to explore the possible impact of direct foreign investment on economic growth of developing countries. It is presumed that foreign investors are likely to exploit opportunities in developing countries to make abnormal profits and they are unconcerned with the economic growth process of the host country and welfare of its people. Looking at the successful experience of developing countries such as China and Singapore, the low performing developing countries are keen to attract foreign investors on terms difficult to justify as an economic proposition. The study found sufficient evidence to prove that foreign investors when investing abroad are solely guided by their profit making motives. In fact, the foreign investors fully exploit the possible privileges to take advantage for maximizing their profit. The author has made an attempt to bring in possible options for the developing countries to reduce their dependence on FDI as priority source for boosting economic growth in the country. Relying more on the foreign earning of their own nationals in the form of foreign remittances, developing countries can protect themselves from exploitation of foreign investors.

Key words: economic growth, foreign investors, dependence, nationals, and remittances.

1. *Introduction*

The very essence of globalization is to do business anywhere in any form to strengthen competitive capability of the business firm so that cost efficiency can be realized to serve the largest number of consumers in the world. It is the free mobility of factors of production that is to be ensured, so that only highly cost efficient business firms can survive. Many of the multinationals have established their processing units in China and India and even China and India are making investments in United States and Europe. This brings sufficient evidence to support the fact that FDI is a business proposition and its location is decided on the basis of comparative return offered in the international market setup.

With the coming of World Trade Organization (WTO), the developing countries have become very hopeful in strengthening their competitive ability to sell their products and services in the global markets. These countries are keen to attract foreign investment to uplift their economies in collaboration with well-established business firms. The host countries are setting up investment zones, where businesses are provided with all the necessary inputs at highly competitive costs and privileges for the foreign investors to bring in beside capital, management skills, technical know-how and international contacts for boosting the economic activity in the host country.

The developing countries need facilitators and supporters to help them to grow fast enough to achieve a standard of economic well being enjoyed by the more advanced countries of the world. Among various options available to get external assistance, such as foreign aid, donations and loan, many of the developing countries in the world are eager to attract direct foreign investment (DFI) as the sure way to boost their economies. We hear more and more countries are now insisting to have access to the donors markets instead of having donations. Looking at China, India, Singapore, Malaysia and many fast developing countries, the impact of direct foreign investment (FDI) is considered as a strong catalyst to upgrade economic activity in the less developed countries.

This study primarily addresses the subject of FDI to see how far such investments are beneficial to the host countries. On account of rapid mobility of capital and labor between countries, it is assumed that FDI is a business proposition, where businesses (largely multinationals) look for short run gains.

To attract FDI inflow in their country, the developing countries offer special privileges and compensations to win their preferences. The study also examines the side effects of such privileges, offered to the foreign investors in improving the performance of the economic activity in the host countries.

The study is to highlight the experience of developing countries in accommodating direct foreign investment to serve as illustration for drawing necessary conclusions. In the light of these experiences, the study is to analyze the future course of action for the developing countries for achieving a much desired growth pattern for their society. The main concern of the study is to examine the capability and competence of the less developed countries to monitor and channelize the activities of the foreign investors in the host country, so that nothing happens which is contrary to the host country's national interest.

2. *Literature Review*

The role-played by the foreign direct investment (FDI) in boosting the economic performance of some of the developing countries, such as China, Singapore, and Malaysia is universally recognized as outstanding. Looking at the successful experience of high performing developing countries, more and more low performing developing countries in the world are eager to attract direct foreign investment to increase the momentum of economic growth and to achieve takeoff position at the earliest. However, the ideological change came about during 1990s, when FDI inflows had become the most important component of total capital flows to developing countries, notably in East and South East Asia. A brief account of the amount of effort put in by the role model developing countries is given below to highlight the key features, which enabled these countries to achieve best possible results.

2.1 China: Highly Preferred FDI Destination

China is currently recognized as the second highest recipient of direct foreign investment in the world. It has shown tremendous awareness and competence to build economic strength of its people. China was one time among relatively poor countries of the world, but after 1979, China redefined its economic growth strategy. A country with the highest population in the world (around 1.3 billion people), China took the initiative to create human power as its primary strength to compete in the global market. By educating its people and providing them with marketable skills, China built its labor cost advantage far better than its competitors in the global market.

The competitive strength, enabled China to become the world supplier of consumer goods, at costs, no other country in the world could sell. Looking at processing cost advantages available in China, many of the multinational business firms shifted their production and processing units and even some of them shifted their headquarters to China. This very much helped China to strengthen its exports. Currently (year 2012) China's export reached a level of US$ 190 billion and is ranked second highest export earner in the world. In fact, almost 80 percent of its export earnings are accrued on account of foreign investors.

According to UNCTAD China received US$ 124 billion in FDI in the year 2011. In the first half of 2012, China secured highest position in absorbing FDI in the world. The FDI inflow of the top performers in this respect includes the following (see Table-1).

Table-1: FDI Inflows in Top Performing Countries (First Six Months of 2012)

Country	FDI Inflows
China	US$ 59.1 billion
USA	US$ 57.4 billion
Hong Kong	US$ 40.8 billion

Source: Reuters: "China Overtook the U.S. as the World's Top Destination for Foreign Direct Investment". UNCTAD, Beijing, Wednesday October 24, 2012

The WTO accession in November 2001 provided another impetus to FDI and China on account of its highly skilled manpower and highly cost efficient technology outclassed several of its competitors. Recently China is seeking to attract FDI that will help in restructuring its economy to bring change away from the labor-intensive (low-cost manufacturing) into higher value-added enterprises. This diversion has pushed FDIs seeking labor-intensive (low-cost labor) to look for other destinations in the developing world.

2.2 Singapore: Highly Preferred FDI Destination

Singapore, a country with meager physical resources emerged as one of the fastest growing economies in the Asian Region. Singapore has the highest trade-to-GDP ratio in the world. Singapore largely focused to increase its global competitiveness by promoting stable macroeconomic policies, its cost efficient and modern infrastructure, and an educated manpower, fully appreciated the importance of close connection between FDI and internationalization. In Singapore, the transnational organizations (TNCs) were considered as powerful agents for the transfer of modern technologies to developing countries. These organizations (TNCs) were relied as forefront of innovations and promoter of latest technical progress. The TNCs having internationally established brand names, global marketing presence and superior knowledge of market channels, and access to international flows of information, seem to have played highly effective impact on Singapore's export trade.

Singapore took deliberate course of economic growth by adopting export-oriented industrialization in the mid-60s. For this several policy decisions were taken largely to neutralize the power of organized labor, wages were reduced, working conditions weakened, and working hours increased. All this was designed to meet the pre-conditions for attracting foreign investors.

The main objective of adopting export-oriented industrialization was to develop Singapore as an international business center for the multinational business companies to establish their regional operational headquarters. On account of its strategic location in the region, Singapore offered highly skilled manpower and several operational advantages for the foreign business firms. The Singaporean economy depends heavily on exports and refining imported goods, which include electronics, petroleum refining, chemicals, and mechanical engineering and biomedical sciences sectors. Currently (year 2011) Singapore is recorded as the 14th largest exporter and the 15th largest importer in the world. FDI in many ways transformed Singapore with relatively low per capita income in 1960s into a nation with one of the highest per capita income earner in the world.

2.3 India: Next Highly Preferred FDI Destination

In India FDI inflows are attracted to avail advantages of a large domestic market, cheap labor, and human capital. In addition India offers to foreign investors a well-balanced package of fiscal incentives for exports and industrial investments. UNCTAD survey of 2012 projected India as the second most important FDI destination (after China) for transnational corporations (TNCs) during 2010-2012. The sectors that attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. The Indian economy starting from a very small base of less than US$ 1.00 billion in the year 1990 managed to attract FDI of the amount close to US$ 50 billion in 2011. Apparently the increase in FDI inflows into India was on account of several measures taken to facilitate foreign investment, which included the following:

- i) Relaxed Foreign exchange controls.
- ii) Foreign investors can remit earnings from Indian operations.
- iii) Foreign trade is largely free from regulations, and tariff levels have come down sharply in the last two years.
- iv) While most Foreign Investments in India (up to 51 %) are allowed in most industries, foreign equity up to 100 % is encouraged in export-oriented units, depending on the merit of the proposal. In certain specified industries reserved for the small scale sector, foreign equity up to 24 % is being permitted now.
- v) Complete tax exemptions.

The top ten investing countries in India largely included Mauritius (around 40%), Singapore and UK (around 10 per cent each), Japan, USA, and Netherlands (around 7 to 8 % each), Cyprus, Germany, and UAE (less than 5 % each).

2.4 Pakistan's Potential to Attract FDI

Pakistan is the 6th highest populous country in the world. It has many physical and geographical features similar to India and China. Pakistan is ideally located to function as the most cost effective distribution center to countries in Central Asia, Middle East and to South East Asia. Due to mismanagement and large-scale corruption in the governance of the country, Pakistan is unable to attract sufficient amount of FDI to boost its economy.

The FDI inflow during the last twelve years in Pakistan have shown irregular increase overtime and since 2007-08, the FDI inflow is consistently dropping down to a miserably low level (see Table-2):

Table-2: FDI Inflow into Pakistan (US$ Million)

Period	FDI Inflow
2005-06	3,521.0
2006-07	5,139.6
2007-08	5,409.8
2008-09	3,719.9
2009-10	2,150.8
2010-11	1,634.8
2011-12	812.6

Source: Board of Investment, Prime Minister's Secretariat (Public) Government of Pakistan. File:///volumes/Lexar/Foreign%20investment%20Pakistan.webrchive

The FDI inflow trend revealed in the data given in the above Table- 2 suggests that all the essential features required to attract foreign investors seems to have been disappearing in Pakistan. Pakistan, due to its participation in war on terror, became unsafe for carrying out peaceful activities. The security risk, severe shortage of electricity, gas and water plus several other interconnected operational constraints frustrated the foreign investors to come in to the extent that even the domestic entrepreneurs decided to transfer their business processing and production units to the neighboring countries (Bangladesh, Malaysia, UAE and the like) for earning normal profits. Business Environment and Enterprise Performance Survey 2005 carried out jointly by the European Bank for Reconstruction and Development and the World Bank came out with the scores: Pakistan 51 points out of 100, UK 88, Singapore 73, Namibia 72, New Zealand 71, and Mauritius 68. Precisely the business environment in Pakistan seizes to be conducive for long-term heavy investment and many of the FDI is in the form of contracts getting the job done through local entrepreneurs.

2.5 Sum-up of FDI Experiences

The FDI experiences revealed by some of the developing countries, such as China and Singapore, provide sufficient evidence to suggest that FDI inflows very effective and beneficial in countries where the basic infrastructure to do business is highly cost efficient and protected. The FDI inflow to low performing countries where the necessary pre-requisites to do business are not available, will be very costly. The FDI in such circumstances may come in for a short period, demanding special concessions and privileges to do business in the low performing country, but its effectiveness and benefits will be highly questionable. In fact, it will be an attempt by FDI to exploit the opportunities to make abnormal profits due to weaknesses of the governing system of the poor performing country and to move out when better opportunities to make higher profit appear elsewhere.

3. *Methodology*

Looking at the reluctance of multinational business firms to make long- term investment in relatively weak and capital deficient developing countries of the world, the author is convinced that foreign direct investment inflow is primarily meant for making abnormal profit. To follow this theme the study presents an analytical framework to discuss viability of seeking foreign direct investment on terms and conditions, which may not be in the national interest of the host countries. Knowing the implications of this issue, the study highlights the experience of developing countries in accommodating FDI and its related impact on the growth process of the host countries. The study focuses on high performing developing countries as well as on low performing developing countries to determine the role of FDIs in accelerating economic growth process in these two different business environments.

The sequence adopted to analyze the important aspects of the research paper includes identification of the precise subject of enquiry, determining its scope, in-depth study of the issues confronted by various representative countries in the world, drawing necessary guidelines for suggesting future course of action for accelerating economic growth process, presenting more feasible option for adoption by the developing countries. In order to make specific recommendations for adoption by the low performing developing countries, an alternative approach is discussed to reduce their dependence on foreign investors.

4. Discussions and Analysis

Since the establishment of the International Bank for Reconstruction and Development (IBRD) in the year 1944, developing countries are made to realize that they can grow and they can form part of more developed nations of the world.

Under the influence of the IBRD, a number of less developed countries decided to formulate economic development plans and policies to enhance economic wellbeing of their country. The primary aim in all these efforts was to increase the momentum of economic growth so that the average man can be made better off through trickledown effect. In this effort many of the less developed countries have accepted external help in various forms, such as donations, aids, loan and foreign direct investment. However, the donations and aids to developing countries miserably failed in providing any long-term improvement in the economic welfare of the countries in which these seem to have been distributed. The people living in developing countries are becoming increasingly aware of the ineffectiveness of donations in promoting economic welfare. The developing countries are now asking for more trade rather than more aid or donations. The loan and borrowing has been very costly and, many poor countries cannot afford to pay back the principle amount, instead they borrow more to pay for the servicing of the loan taken.

Globalization has directly affected the economic growth prospects of developing countries without lowering down the economic wellbeing of the developed world. The emerging picture seems to be similar to the one described by the Pareto Optimality syndrome. Globalization provides opportunity to seek mobility of capital, labor, and promotes rapid technological advancement and dissemination of knowledge for universal application and transfer. Due to several of these interactions, the differential between developed and developing countries are disappearing to some extent. The total (world) Foreign Direct Investment flows reached US$ 1.3 trillion in the year 2012. In the same period developing countries surpassed developed countries in FDI flows and absorbed nearly US$680 billion. Since 1980s the volume of world trade has increased far more than the world income, while share of developing countries in the total volume of world trade has increased much faster. It was 19% in the year 1971 and by the year 2010 it reached 46%. This trend is sufficient to suggest that developing countries as a whole have become the main driving force behind rapid global change.

The high performing countries such as China, Singapore and India are relatively matured economies where the basic economic infrastructure is very conducive for attracting DFI. These countries are highly preferred destinations for the FDI in recent years. Looking at their successful experiences, majority of the developing countries are eager to attract foreign investors and are willing to give them best possible concessions to do business even at costs, which may not be in the national interest of a host country. The FDI Inflows are largely attracted on account of security, cost advantage and unrestrictive policies to do business. Any attempt to bring FDI into poor performing countries, by giving them special concessions and privileges over the domestic entrepreneurial activity, is bound to be costly for the host country.

4.1 FDI-A Critical Analysis

FDI is not simply a transfer of business interest from domestic to foreign residents. Experience has shown that it provides leverage for interfering in the policies of the host country. In many ways the FDI creates an opportunity to exercise management and control over host country firms and often such controls are not in the national interest of the host country.

International Financial agencies, such as IMF and the World Bank want developing countries to consider all options to promote economic growth in the present global setup. In fact, they have raised a very pertinent question "How Beneficial Is Foreign Direct Investment for Developing Countries?" suggesting that the growing eagerness of many developing countries to attract foreign direct investment may not prove beneficial in all circumstances. Although there is a substantial evidence to support the positive impact of FDI inflows in promoting economic growth of host countries such as Singapore and China, other countries enjoying high economic growth like South Korea, and Taiwan took quite a different route to accelerate their economic growth process. These countries relied heavily upon external borrowings, including aid to finance their development programs. As a result South Korea and other countries not fully depending on FDIs, have retained control of investments and acquired the skills and infrastructure to innovate. This kind of capability is missing in case of Singapore, because it took deliberate course of economic growth by adopting export-oriented industrialization while heavily depending on FDIs, where non-Singaporean TCNs have complete domination.

So far the evidence shows that bulk of foreign investment comes from the developed and economically powerful countries into developing and relatively less efficient countries. A position, which helps FDI to negotiate with the developing countries favorable terms and conditions to bring in necessary investment.

Basically the level of incentives required to attract FDI inflows largely depend on the eagerness of the host country and the amount of risk associated in doing business in that country. But all such concessions and incentives to FDIs are bound to create an edge over local business firms. Caves (1982) in his study relating to "Oligopolistic Competition" came to the conclusion that MNCs are creatures of market imperfection that lead a business firm to possess specific advantages over local business firms in the host country. This awareness is being created in some of the developing countries to avoid exploitation by the foreign investors.

India fears that "allowing the entry of retail giants such as US-based Wal-Mart Stores Inc. will force India's millions of small shopkeepers out of business. They want to avoid such situations, which prevailed when the East India Company was allowed entry into India and was disbanded after the bloody revolution of 1857. In Pakistan with the coming of KFC and MacDonald, multinationals have taken over a large number of indigenous suppliers of similar food items with the result that millions of people who were engaged in preparing similar food items on traditional style (small shops, low overhead, with little capital) at very low price were replaced by such outlets, which are very costly largely serving the elite class of the society.

Gary Dean (2000) while comparing economic growth strategies of Singapore, Hong Kong, South Korea and Taiwan came to the conclusion that "The cost in human terms of Singapore's success has been high: Singapore today is an authoritarian corporatist state that intervenes in virtually every aspect of citizen's lives. Singapore has become a nation of functionaries who serve the interests of the TNCs and the Singaporean state elite." China's manufacturing sector is highly dependent on FDI and almost 80 percent of its export earnings are accrued on account of foreign investors located in China. Thus making China's export trade highly vulnerable and dependent on the business decisions of the foreign investors. FDI is a business proposition and a businessman to be successful is to make decisions to realize highest profits.

In a global setting, FDI flow has dramatically changed. There was a global decline of US$300 billion in FDI flows, from US$1.6 trillion in 2011 to an estimated US$1.3 trillion in 2012, almost 90% was accounted for by developed countries. In the same period developing countries surpassed developed countries in FDI flows and absorbed nearly US$680 billion. Given the profitability syndrome this trend can be reversed with all its consequent setbacks to developing countries. The foreign direct investors, like any commercial investors are to make a decision in their own interest and not in the national interest of the host country. A well-known proverb "lets make hay while the sun shines" broadly explains the attitude of a foreign investor.

Except a few high performing countries (China, Hong Kong and the like) majority of developing countries are not performing well. Some of these countries have ample human and material resources (Pakistan, Nigeria and the like), but due to corrupt practices, injustices and strong hold of powerful elite class in the distribution of national resources the business environment in these countries is highly insecure for FDI. Even in some of the developing countries the local investors are withdrawing and transferring their business interest to other more secure and better performing countries such as Malaysia and Bangladesh.

4.2Best Possible Solution

Population itself is a great potential for accelerating economic growth. An educated and skilled manpower can earn far more than any material resource available in a country. China, the country with the highest population in the world, is a proven case to support this claim. On account of its highly skilled and productive manpower, China is recognized as the most favorable destination for the FDI. Its export earnings are second highest in the world. The first being Unites States of America. For many highly populous countries of the world, including Pakistan, Nigeria, Bangladesh, and the like where work force is not educated and skilled, FDI is reluctant to come in. In view of the prevalence of incompetent governments, corruption, non-availability of desired human skills, low productivity and insecurity in doing business in most of the poor performing countries, the FDI is not likely to be a feasible option.The possible exploitation by the foreign investors in dictating terms when negotiating with the less efficient developing countries, is likely to be very high. There is enough evidence to show that FDI look for quick and high returns in high-risk countries and they are unconcerned with the national interest of the host country.

So far the available data reveal that foreign remittances are becoming a major source of earning foreign exchange for the developing countries. According to the World Bank Report (2011) total foreign remittances added up to US$414 billion in the year 2009, out of which, US$316 billion were received by the developing countries (76%).

The foreign remittance flows to developing countries proved to be less resistant to change during recent global crises. The World Bank Report (2011) further reveals that foreign remittances fell only 5.5 percent in the year 2009 while the FDI declined by 40 percent and private debt and portfolio equity flows dropped by 46 percent.

The countries like India and China (the top two highly populous countries of the world) are making best use of the foreign remittance flows in accelerating their economic growth process. At the initial stage, China depended heavily on the earning of its workers working abroad. In fact, the foreign remittance inflow proved to be a more reliable source of foreign exchange earnings in the balance of payment of many developing countries. India seem to have followed the same track and is now recognized as a country receiving the highest foreign remittances in the world (Year 2012).

Keeping in view the disadvantages of attracting FDIs, the foreign remittances as an alternate source for accelerating investment in developing countries is relatively more dependable and sympathetic towards country's national interest. In fact, the workforce working abroad are receiving skills and developing entrepreneurship capability, and they are more eager to return to their home country if given due incentives. Their return to the home country will become a national asset, adding to the competitive strength of its economy. The inflow of foreign remittances over the past years has shown consistent increase (see table-3). The rate at which foreign remittances have grown so far is very promising source of foreign finance for accelerating economic growth in highly populous developing countries.

Table-3: Foreign Remittances Inflow Trend (US$ in Millions)

Year	India	China	Mexico	Nigeria	Pakistan
2000	12,883	4,822	7,525	1,392	1,075
2005	22,128	23,478	22,742	14,640	4,280
2006	28,334	27,401	26,543	16,932	5,121
2007	37,217	38,186	26,880	18,011	5,998
2008	49,977	47,492	26,041	19,206	7,039
2009	49,468	47,930	22,076	18,368	8,717
2010	54,035	52,269	22,080	19,818	9,6901
2011	63,011	61,365	23,588	20,619	12,269

Source: The World Bank: Migration and Remittances Factbook 2011.

5. *Conclusions and Recommendations*

The role of foreign direct investment (FDI) in accelerating economic growth of countries such as China, Singapore, Hong Kong and Taiwan is undeniable very impressive. In many ways FDI transformed, this one time, underdeveloped countries into fast growing economies in the world. Very much impressed by the performance of these countries, a large number of poor performing countries are very keen to bring FDI flows to achieve take off position at the earliest. In fact, these countries are very ambitious in expecting highly positive impact of FDI in boosting economic activity in their country. The foreign investors, like any other business venture, are to maximize their profit without losing their initial capital. The higher the risk, then higher the rate of return they expect. The proverb "Let us make hay while the sun shines" very well explains the attitude of the FDIs.

The foreign investors are clearly more competent and resourceful in handling their own private interest and to exploit the in-competencies and deficiencies of the host countries. To make best use of FDI the recipient countries have to be very watchful to safeguard their national interest and the long run impact of FDI on the indigenous competitive setup of their countries. This kind of capability and competency is presently not readily available in many of the developing countries seeking FDI inflows. Thus in such circumstances it will be unjustified to bring FDI with special privileges and concessions. With the coming of World Trade Organization (1995) the pattern of production and processing of goods and services all over the world is undergoing widespread structural changes. The WTO calls for free mobility of resources within and between countries in support of free trade. In this particular context the WTO is seen as the most beneficial move for the promotion of universal mobility of labor and capital in favor of developing countries. Looking at the promises of WTO, many of the developing countries joined WTO as members with the hope that it will provide opportunities for the developing countries to compete freely in the global market.Under WTO regime the developing countries are given a chance to mobilize their potentials to build their competitive strength in the global market.

So far, many of the developing countries have performed extremely well in using their workforce to receive substantial amount of foreign remittances on a regular basis. In some of the underdeveloped countries (Pakistan and Nigeria) the foreign remittances inflow has exceeded the amount of their export earnings. In all circumstances, foreign remittances inflow is a valuable national asset, dependable to serve the country's national interest. Thus the use of foreign remittances as a source of foreign capital in place of foreign direct investment is far more beneficial for the developing countries. The highly populous countries, like India, Nigeria, Pakistan and Bangladesh where inflow of foreign remittances is recognized as a major source of earning foreign exchange are to redesign their priorities to further strengthen the capability of their workforce to compete in the global job market. FDI hunting for developing countries is more costly and its impact on their domestic business environment is not always favorable.

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