UNIT 12 FOREIGN INVESTMENT AND MNCs

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12.0 OBJECTIVES

After studying this unit, you should be able to :

- explain whal is foreign capital and classify its types
- explain the role of foreign capital and its shortcomings
- describe joint ventures and their merits and demerits
- examine the latest government policy
- analyse pros and cons of MNCs.

12.1 INTRODUCTION

For economic and industrial development, capital is the most important factor. Such capital may be from within the country or from outside the country. When capital available within the country is not sufficient, capital from abroad is made use of. For less developed countries, capital has been provided by international organisations like World Bank andnternational Monetary Fund (IMF) at government level. The recent technological developments and spread of information technology have opened up the economies the world over as never in the past. This in turn has increased the muftinational role and importance of capital. It has been realised by many countries that inflow of capital from abroad is vital not only in the early stages of economic development,.but also for the growth of a developing economy. Most of the

countries now have been making use of foreign capital and investment. In this unit, we shall first discuss about the meaning and role of foreign capital. Later we shall examine the joint ventures and multinational corporalions — their meaning, advantages and disadvantages. The government policy with regard to foreign investment shall also be discussed.

12.2 FOREIGN CAPITAL

The term 'foreign capital' is a comprehensive term and includes any inflow of capital in home country from abroad. It may be in the form of foreign aid or loans and grants from the host country or an institution at the government level as well as foreign investment and commercial borrowings at the enterprise level or both. Foreign capital may flow in any country with technological collaboration as well.

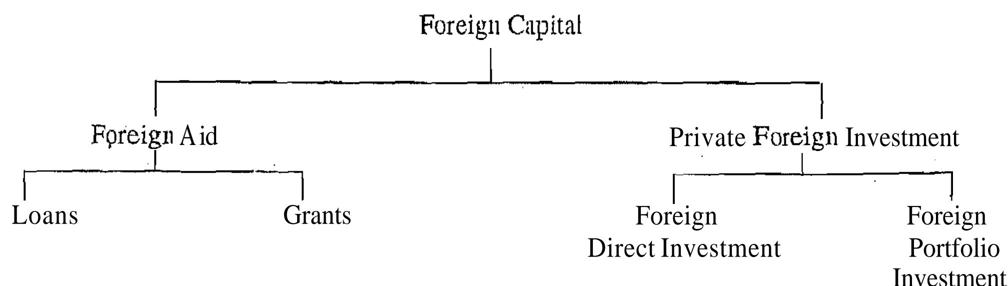
It is interesting to note that even in Russia and East European countries foreign capital has been allowed to flow in. In countries like China, Thailand, Malaysia and Singapore contribution of foreign capital has been extretnely encouraging. But in Latin America and African Countries foreign capilal flow has not been satisfactory. Foreign capital is useful for both developed and developing countries. Advanced countries try actively to invest capilal in developing countries. In India, foreign capital has been given a significant role, although it has been changing overtime. In the early phases of planning, foreign capital has been used as a means to supplement domestic investment. Later on there were technological collaborations between foreign and Indian entrepreneurs. But since July 1991, there has been a tremendous change in government's policy (commonly called liberalisation policy) about foreign investments.

12.3 TYPES OF FOREIGN CAPITAL

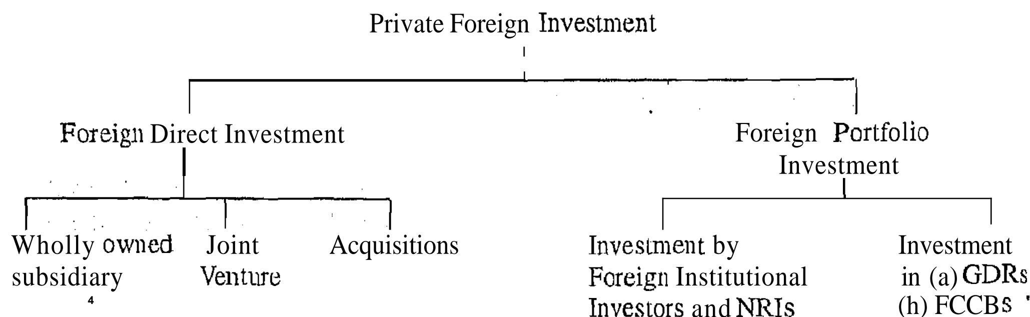
Foreign capital can be divided into two types:

1) Foreign Aid
2) Private Foreign Investment

Foreign aid may consist of loans and grants. Private foreign investment takes two forms: a) Foreign Direct Investment (FDI) h) Foreign Portfolio Investment (FPI). In India foreign direct investment may further lake the form of (i) wholly owned subsidiary (ii) joint venture and (iii) acquisitions, Foreign portfolio investment may bc (i) Investment by Foreign Institutional Investors (FIIs) including Non-Resident Indians (NRIs) (ii) Investmenl in a) Global Depository Receipts (GDRs) and b) Foreign Currency Convertible Bonds (FCCBs). The above classification is shown below:



Private foreign investment in India can be further classified as follows :



Let us discuss them ont: by one.

Foreign Aid: It consists of loans and grants. Loans may be taken from individual countries or from institutional agencies like World Bank, IMF and International Financial Corporation.. Usually loans are taken for medium and long term capital needs of a country. Loans impose a heavy burden on the borrower country because they are to he repaid, along with interest, called surviving of loans. Loans may be tied because of restrictions. Such restrictions may hc in the form of end use or in the form of source. Grants are given by public or private charitable organisations. They are given for relief purposes and immediate use. Grants may he time bound and can be used only for specific purpose. Loans involve repayment obligations, where as grants are not refunded. It is important to see that grants are properly utilised for the specified purpose.

Any foreign capital in the form of aid should be pledged on the basis of its purpose, mode of repayment, cost to the borrower and political considerations. For it is not only uncertain, usually not extended for public sector but for consumer goods industries and do not create means for its repayment. It is therefore better to create 'trade' rather than 'aid' from a foreign country.

Private Foreign Investment : It is of two types: 1) Foreign Direct Investment 2) Foreign Porlfolio Investment

You should note that foreign investment and collaboration with a foreign nation are closely interrelated, but they are different from each other. Capital investment is participation of a foreign country in capital of recipient country's enterprises. Collaboration, on the other hand, means providing technical and managerial know how, licensing franchise, trade marks and patents by a host country to home country. Lel us now discuss the two major components of private foreign investment

12.4 FOREIGN DIRECT INVESTMENT

It is also known as 'direct business investment'. Foreign direct investment (FDI), according to IMF manual on 'Balance of payments' is "all investment involving a long tam relationship and reflecting a lasting interest and control of a residual entity in one economy in an enterprise resident in an economy other than that of the direct investor. Such investment involves both initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates". Foreign affiliate means a suhsidiary company or an associate in which investor owns a total of at least 10%, but not more than half of shareholder's voting power or branches,

From the above definition we notice ttic following characteristics of FDI :

1) It is an investment made by a foreign company in a home country.
2) The foreign company may make an investment either by opening its branch or by having a suhsidiary or foreign controlled company in home country. It may have wholly owned suhsidiary or joint venture or may acquire a stake in the existing business.
3) Profit is the prime motive of such an investment. It may be in the form of a royally and dividend payments.
4) Inveslor retains control over investment and management of the firm concerned. In FDI investor may obtain efective voice in the management through other means such as subcontracting, management contracts, turnkey arrangements, franchising, licensing, trade marks and patents and product sharing.
5) On the winding up of the firm, the assets may he repatriated to the country of origin.

According to Seclion. 591 of the Indian Companies Act 1956, a foreign company means any company incorporated outside India which established a place nf business within India after or before 1.4.1956. The Reserve Bank of India has classified foreign companies into three types:

a) subsidiaries in which a single foreign company holds more than 50% of the equity share capital
b) minority companies in which foreign company holdings arc 50% or less,

c) purely technical collaboration companies which have no foreign equity participation They have only technical collaboration agreements.

Foreign companies are also governed by Indian Income Tax Act 1961, MRTP Act 1969, Industrial (Development and Regulation) Act 1951, and Foreign Exchange Regulation Act, 1973.

FDI are governed by long term considerations because these investments cannot be easily liquidated. In aiming at investment decision, a foreign investor would have to he convinced that existing comparative advantages are more than the comparative disadvantages in a country. Hc will compare the improved investment climate in one country with investment markets in another country. There are many other factors that Influence FDI decisions. They are: a) long-tern political stability b) government policy of a country c) industrial and economic prospects d) rules about repatriation of profits and disinvestment e) treatment by officials in government departments and f) taxation laws.

The recipient counuy should he cautious that FDI may be harmful if the economy is highly protected and foreign investment takes place behind high tariff walls.

12.5 PORTFOLIO INVESTMENT

Portfolio investment is an investment in a foreign country where the investing party does not seek control over the investment. It takes the form of the purchase of equity in a foreign stock market or credit or capital from private or official sources. If we analyse the ahove definition we find the following features of portfolio investment:

1) The investor purchases the equity in a foreign stock market i.e., he has a sort of property interest
2) The equity includes shares (stock) and creditors capital (debentures/bonds/other securities)
3) The equity purchased is of a joint stock company
4) The investor is a non-resident
5) If it is creditors capital, it may be from private or official sources and is invested in recipient country's Joint stock companies
6) The investor does not seek control over the investment if they do not have involvement with promotion and management of joint stock company

Two more characteristics may be added here:

a) Portfolio investment can be liquidated fairly easily.
b) Portfolio investments are influenced by short term gains and are more sensitive than FDI.

There are mainly two forms ofportfolio investment in India a) by foreign institutional investors (FIIs) like mutual funds b) investment in global depository receipts (GDRs) and foreign currency convertible bonds (FCCBs).

A) Foreign Institutional Investors (FIIs)

Indian Stock Market was openedup to FIIs in 1992-93. FIIs include pension funds, mutual funds, asset management companies, investment trusts, nominee companies and corporate or institutional managers. The regulations on FIIs, notified on November 14, 1995 by RBI, contains various provisions relating to definition of FIIs' eligibility criteria, investment restrictions, procedure of registration and general obligations and responsibilities of FIIs. They may invest only in:

a) securities in the primary and secondary markets including shares, debentures and warrants of companies listed on a recognised stock exchange in India; and
b) units of schemes floated by mutual funds including Unit Trust of India, whether listed or not.

In 1996-97 the Government of India liberalised investment policy hy FIIs. There is no reslriction on the volume of investment and no lock-in period. Disinvestment is allowed only through stock exchanges in India. The holding of a single FII in any company would be

subject to a ceiling of 10% of total equity capital. They have to pay tax on concessional rate on capital gains. They can invest in unlisted conlpanies, in corporate as well as government securities.

The greatest disadvantage of investment by FIIs is that it is not certain how long they will hold their investment, If they are allowed to acquire more of a company's equity (at 25%), they can pressurise courtly interests of most companies. They may engage in speculative investment, avoid tax laws due to double-taxation treaties and take undue advantage of exchange rates. This can be prevented by improving the functioning of the stock markets. The Government has to adopt apolicy by which FIIs may not benefit at the cost of Indians.

Investment **by NRIs**

Non-Resident Indians are the persons not residing in India. They are of two types: a) an Indian citizen who i) has made his permanent home outside India or ii) has proceeded abroad for employment or gainful occupation, b) an Indian citizen who made his permanent home outside India and acquired foreign citizenship or the descendent of an Indian who had earlier migrated from undivided India.

This definition has been extended and includes a foreign born husband of a citizen of India. Investment made by NRI of category (a) are allowed to invest liberally, Investment by NRI of category (h) are subject to policy guidelines framed by thc government of India, The RBI has given a general exemption to NRI for transfer of sharcs/debentures/bonds of Indian conlpanies through recongnised stock exchange. They can gifl the shares etc. to their close relatives. They can invest funds in government securities or units of UTI. NRIs and Overseas Corporate Bodies (OCBs) predominantly owned by NRIs can acquire listed securities of Indian Companies upto 24% of their paid up capital under porlfolio investment scheme. They can make direct investment upto 100% of the equity in industrics mentioned in Annexure III of the New Industrial Policy 1991. There is a single window facility available lo NRIs for obtaining all information about investments in India. There is automatic clearance for investment proposals of NRIs for the industries mentioned in Annexure III.

B) Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds **(FCCBs)**

GDRs and FCCBs are investments issued by Indian companies in Euro or US markets for mobilising foreign capital by facilitating portfolio investment.

A GDR can be defined as i) an instrument, ii) expressed in dollars, iii) traded on stock exchange in Europe or US and iv) represents a certain number of equity shares. These equity shares are, however, denominated in rupees.

The procedure of GDR is as follows: First the equity shares are issued by the company to an inlermediary, called 'Depository', The shares are registered in the name of depository, It is the depository that issues GDRs. The depository also has the agent and the actual possession of equity shares is with the agent. The agent is called 'custodian'. Then GDR does not figure in the books of the issuing company.

FCCBs, are also called 'Euro Convertible Bonds'. They are quasi debt securities i.e. they can be converted into a 'depository receipt' or local shares. The investor has the option to convert the bonds into equity shares at a fixed price after a minimum period. The exchange rate for the conversion price is fixed as is the conversion price.

There are two types of options — 'Put option' and 'Call option'. Put option is the right given to the investor and call option is the right given to the company. By put option the investor has a right to gel his money back before maturity, either at par or at 100% basis point over the US tresury rate at the time of issue. By call option the company has a right to convert bonds into shares, if the market price of the shares exceeds a particular percentage of the conversion price. Since 1993 these bonds have become popular.

12.6 ROLE OF FOREIGN CAPITAL

In the early stages of industrialisation in any country foreign capital plays an important role. Their role can he better understood under the following heads:

1) Increase **in** Resources: Foreign capital not only provide an addition to the domestic savings and resources, but also an addition to the productive assets of

the country. The country gets foreign exchange through FDI. It helps to increase the investment level and thereby income and employment in the recipient country.

2) **Risk Taking:** Foreign capital undertakes the initial risk of developing new lines of production. It has with it experience, initiative, resources to explore new lines.. If a concern fails, losses are borne by the foreign investor.

3) **Technical Know-how:** Foreign investor brings with him the technical and managerial know how. This helps the recipient country to organise its resources in most efficient ways i.e. the least costs of production methods are adopted. They provide training facilities to the local personnel they employ.

4) **High Standards:** Foreign capital brings with it the tradition of keeping high standards in respect of quality of goods, higher real wages to labour and business practices. Such things not only serve the interest of investors, but they act as an important factor in raising the quality of product of other native concerns.

5) **Marketing Facilities:** Foreign capital provides marketing outlcts. It helps exports and imports among the units located in different countries financed by the same firm,

6) **Reduces Trade Deficit:** Foreign capital by helping the host country to increase exports reduces trade deficit. The exports are increased by raising the quality and quantity of products and by lower prices.

7) **Increases Competition:** Foreign capital may help to increase competition and break domestic monopoly. Foreign capital is a good barometer of world's perception of a country's potential.

It is rightly said that a satisfied foreign investor is the best commercial ambassador a country can have. To sum up, foreign capital helps three important areas that are necessary for the economic development of a country. These three areas are savings, trade and foreign exchange and technology. Foreign capital performs three gaps filling function i.e, i) savings gap ii) trade gap iii) and technological gap in the recipient country's economy. It encourages development of technology, managerial expertise, integration with other economies of the world, export of goods and services and higher growth of country's economy.

Short comings of foreign capital

The following criticisms are levelled against foreign capital:

1) It may flow-to the high profit area rather than the priority sector.

2) The activities of foreign investors may be inimical to the national interest. It may interfere in the national politics or may engage in unfair trade practices or may impose restrictive conditions.

3) It increases dependence on foreign resources. First in the use of foreign technology and second the foreign technology used requires import of goods for replacement and maintenance that are costly. There may be intensity of foreign capital.

4) Often the profit earned in early stages are high involving big remittances. Foreign investor may recover his amount in a relatively short time. Yet the payment on account of such things as technical services, royalty payment etc; continues.

5) There may be adverse effects on income distribution in the country, transfer pricing and balance of payments.

Though there are arguments for and against foreign capital and statistics are available to support both points of view, yet the role of foreign capital can not be ignored. We will study more details about foreign capital in the next unit.

12.7 GOVERNMENT POLICY

The Industrial Policy Resolution 1948 was the first step that emphasised the need for regulating as well as inviting private foreign capital. On April 6, 1949 the Government issued a statement

on policy towards foreign capital. The main principles of the policy towards foreign capital was that foreign capital would be treated at par with Indian capital, profit will be allowed to be remitted and adequate compensation shall be paid on acquisition of any foreign enterprise. In 1970 the role of foreign capital was restricted to core, heavy and export oriented industries. In 1980, some liberalisation was introduced towards foreign collaboration.

A new policy statement was made on July 1, 1991, by which foreign technology agreements was to be encouraged, approval for FDI up to 51% equity in high priority industries was allowed and a special board was set up to negotiate with foreign firms.

In 1996-97, following changes have been effected in respect of foreign investments:

1) The list of industries eligible for automatic approval up to 51% foreign equity has been increased to 48 as against 35. In mining industries it is 50% foreign equity and in 9 categories of industries it is up to 74% foreign equity allowed for automatic approval.

2) Foreign Investment Promotion Council (FIPC) and Foreign Investment Promotion Board (FIPB) are to prepare project reports and make foreign investment rules more transparent respectively.

3) FIIs are allowed to make equity investment in unlisted companies.

4) Guidelines have been issued in 1097 for consideration of foreign investments for proposals not covered under automatic route areas where 100% foreign equity is allowed and priority areas for FDI. Some of the guidelines are as follows:-

   a) The priority areas are i) infrastructure, ii) large scale employment potential, specially for rural areas iii) export potential iv) items linked with farm sector v) social sector projects like hospitals, medicines and health care.

   b) The approvals will be subject to following limits :

      — Banking Sector— 20% (40% for NRIs)
      — Non banking financial companies —— 51% (100% with specified minimum levels of foreign investment)
      — Power, Ports, Roads, Tourism and venture capital funds ——100%
      — Tele communications —— 40%
      — Airlines/Air taxi —— 40% (100% for NRI)
      — Small Scale Industries —— 24%
      — Drugs and Pharmaceuticals —— 51%
      — Petroleum —— 100%
      — Mining —— 50% (Except for gold, silver and diamonds)

   c) Where the foreign company is not able to find a suitable Indian joint venture 100% foreign equity is allowed provided foreign company will divest at least 26% of its equity in favour of Indian party within 3 to 5 years.

   d) Proposal for 100% trading firms for exports, bulk imports, cash and carry wholesale trading and other import of goods and services is allowed if at least 75% is for sale among group firms.

   e) Foreign firms are allowed to set up 100% equity companies on the following basis:

      i) Where only holding operation is involved and all downstream investments to be carried out need prior approval

      ii) Where at least 50% of production is exported

      iiii) Consultancy proposals

      iv) Projects in power, ports, roads and industrial towns and estates

   v) Where sophisticated technology is to be brought in.

Recently the Government has opened 26% foreign equity participation and 14% for NRI in insurance sector.

The response of foreign investors to the policy has been encouraging. For example FDI in 1996-97 were $2696 million as against $ 129 million in 1991-92. The portfolio investment were $3312 million in 1996-97 as against $ 158 million in 1991-92. NRI deposits have grown from about $ 63 million in 1991-92 to US $ 639 million by 1996-97. 435 FIIs were registered with SEBI by October 1996. There were about 177 joint ventures in operation by the end of 1995, involving Indian equity of Rs 179 crores. It shows foreigners are showing greater confidence in India's investment climate. The new policy of the government is, of course, much better than the old policy. Ever since liberlisation most of the foreign investment has been in priority sectors. Table 12.1 gives the latest position of foreign investment.

Table 12.1: Foreign Investment Flows

(US $ Millions)

	91-92	92-93	93-94	94-95	95-96	96-97	97-98
A. Direct Investment	129	315	586	1314	2133	2696	3197
i) RBI automatic route	—	42	89	171	169	135	202
ii) SIA/FIBB route	66	222	280	701	1249	1922	2754
iii) NRI(40% and 100%)	63	51	217	442	715	639	241
B. Portfolio Investment	4	244	3567	3824	2748	3312	1601
i) FIIs .x.	—	1	1665	1503	2009	1926	752
ii) Euro equities (GDRs).x..x.	—	240	1520	2082	683	1366	645
iii) Offshore funds and other	4	3	382	239	56	20	204
Total	**133**	**559**	**4153**	**4153**	**5136**	**4881**	**4796**

.x. Figures represent fresh inflows of funds by FIIs

.x..x. Figures represent GDRs amounts raised abroad by Indian Companies.

Source: Economic Survey 1997-98

Check Your Progress A

1. What is foreign capital?

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2. What are the various forms of foreign capital?

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3. State whether the following statements are True or False?

   i) Foreign direct investment is an investment where the foreign party retains control over the investment.

   ii) Portfolio investment is an investment where the foreign party does not seek control over the investmenl.

   iii) GDRs is a convertible bond.

   iv) FCCBs can be converted into GDRs.

   v) Foreign capital may take place either in the form of foreign aid or private investment.

12.8 JOINT' VENTURES

There are three factors that determine global joint ventures (JVs) and foreign direct investment. **First** is the ownership advantage in the form of monopoly over a product or brand name, a patent on a production process or technology or a superior knowledge of the market and marketing techniques. **Second** is that the host country may have some locatibnal advantage in terms of serving its market or an export base, or low wage labour and low transportation cost etc. **Third** is the condition that makes the foreign market more profitable than internal market.

12.8.1 Meaning

Joint venture includes commercial and industrial enterprises in which two or more parties from two or more countries share responsibility for operation. They provide risk capital, goodwill, know how and management and natural resources. There is a controlling partner in joint venture who is a major decision maker. A joint venture in simple words, is an enterprise which is jointly owned and managed by a local entrepreneur and a foreign entrepreneur. Ajoint venture can be formed by starting a new firm or by buying an interest of a firm in a host country by a foreign firm and vice versa. Thus a joint venture is any form of association which implies collaboration for a long period between local and a foreign firm. The earliest joint ventures between developed and developing countries were in mining and plantation.

12.8.2 Types of Joint Ventures

Joint ventures may be investment oriented or non-investment oriented. Non investment oriented joint ventures involve like use of brand name or to develop a source of supply of raw material for parent firm's use. In case of investment oriented joint ventures a foreign firm participates in local firms equity, which may be minority or majority equity. Many combinations of joint ventures have emerged. Following are some examples:

a) A foreign private company and a local state government.

b) One foreign company joining with a local company.

c) A government controlled company with joint ventures abroad.

d) Two firms of one foreign country joining together in a foreign market.

e) Companies from two or more countries forming a joint venture in a third country.

f) More than two nations in one joint venture.

12.8.3 Advantages

Joint ventures have the following advantages:

1) They are an alternative where a country does not allow fully foreign owned firms.

2) They help a local firm to enter foreign markets.

3) They make possible the use of know how, patent etc.

4) They help to enhance foreign exchange earnings.

5) The local firm can easily approach the national government and the public.

6) They help diversification of business risk among two countries.

12.8.4 Disadvantages

From the point of view of host country joint ventures may bring some disadvantages also. Some of them are as follows:

1) The subsidiaries in host country may he allowed to use only limited or outdated technology or may dump unwanted technology or even banned products.

2) The local skilled technical personnel may he restricted from learning process or to take over key positions. This may lead to drawing away talented personnel.

3) Respect for local social customs and traditions may not be shown. They may be acting against objectives of national plans or may manipulate laws by bribing officials.

4) They map dominate some key industrial sectors. Due to monopolistic advantage they may be extracting high profits and fees. Producing unnecessary goods with scarce resources may lead to inflation.

5) They may divert local savings away from 'productive investment by nationals. The equipments or spare parts to be exported may be over invoiced. The financing may be mainly through local debt.

To overcome these disadvantages the government of host country may change their policy towards joint ventures from time to time. Some of the steps a government may take; are like limiting equity participation, keeping nationals on hoard of directors, placing ceiling rates on royalties and percentage of profits and raising debt outside local capital market.

12.8.5 Indian Joint Ventures

In the beginning of 199'5 there were 177 Indian joint ventures in operation involving total equity of 179 crores. In addition, 347 other ventures were under implementation involving Indian equity of about 1400 crores. Indian joint ventures are mostly in south-east Asia and in Africa. These countries are mostly middle income countries like Sri Lanka, Nigeria, Kenya, UAE, Thailand, Uzbekistan and Uganda. The Indian joint ventures are mostly in engineering, construction, textiles, chemicals, electrical, paper and glass and shipping. They have been undertaken by private entrepreneurs and public sector undertakings.

But there has been a high failure rate of these ventures: One because of delays in clearance by the Government and secondly because their objectives were not clearly defined. The government has recently liberalised its policy in regard to setting up joint ventures abroad. Now automatic clearance wili be given to Indian entrepreneurs for joint ventures proposals. It has issued fresh guidelines on 17-8-95. These guidelines are for firms engaged in industrial activity, trading or services such as hotel, tourism and financial services. Banking businesses are not covered by these guidelines. According to it, Indian direct investment abroad below $ 4 million will be cleared by RBI under the 'fast track' route scheme within 21 days. Investments above this amount will be processed by a special committee consisting of representatives of the Ministries of finance, commerce and external affairs. Under fast track scheme approval is given only if the investment does not exceed 25% of the annual average export earnings of Indian company during the preceding three years. Within five years from investment time full invested amount will be repatriated by way of dividend and royalty. Financial services must have a three years track record of minimum net worth of Rs. 15 crore and prudential norm of 8% capital adequacy. The project statement is to be verified by a chartered accountant.

Since 1995, a new trend to set up overseas investment companies by Indian firms has been started in tax heavens like e.g. in British Virgin Islands. Birlas are on top in respect of Indian investors abroad- followed by Thapars, Tatas, J&K group, Modies, HMT, Usha, Martin Black, Oberoi Hotels, Larsen and Touhro and Kirloskars.

12.9 MULTINATIONAL CORPORATIONS (MNCs)

In modern times large corporations have become major carriers of foreign capital and technical know-how. They are known by various names such as: i) Multinational Corporations, ii) Transnational Corporations, iii) International Corporations, and iv) Global Corporations. These terms are sometimes used as synonyms.

In early days USA was the centre of most of MNCs. But now Japaneese and European MNCs are also emerging. The first MNC came to India in 1921. Singer sewing machines of USA came to England in 1862-63.

12.9.1 Definition

There is no universally accepted definition of the term MNC. MNC can be defined as a company (a) which has a direct investment base in several countries, b) which generally derives from 20% to 50% or more of its net profits from foreign operations, and c) whose management makes a policy decision based on the alternatives available anywhere in the world. A firm becomes MNC on the basis of its size, performance, structure and behaviour. They are usually organised around a national headquarter from which international control is exercised.

The term MNC differ from international corporation. The later is a company with manufacturing investment (or service operation) in at least one country, while MNCs have direct investment in several countries and considerable share is in foreign countries. The transnational corporations (TNCs), are incorporated or unincorporated enterprises comprising parent enterprises and its affiliates. TNC is a multinational company in which both ownership and control are so dispersed internationally. There is no principal domicile and no one central source of power. The term 'global corporation' is also often used to mean more or less the same thing as TNC. However there is a view that global corporation is one which considers the entire world as single market in which globally standardised products are sold.

MNC as a company has following five criteria:

1) It operates in many countries at different levels of economic development.
2) Its local subsidiaries are managed by nationals.
3) It has a multinational stock ownership.
4) It has a multinational central management.
5) It maintains complete industrial organisations, including research and development and manufacturing facilities in several countries. .

The managing headquarters of MNCs are located in one country (home country), while enterprise carries out operations in a number of other countries (host country).

There are many reasons that motivate a company to go for international investments. Some of them are as follows:

1) to reduce'the impact of tariffs.
2) to reduce the cost of production. This is done by use of cheap labour or material cost or transport costs.
3) to gain a greater share in a foreign market or to combat competition.
4) to exploit natural resources of the host country.
5) to reduce the impact of strict trade and industry rules and regulations of home country, for example pollution laws.
6) to enjoy benefits of tax exemptions.

12.9.2 Characteristics of MNCs

a) **Giant Size:** The assets and sales of MNCs run into billions of dollars. In terms of total assets General Electric (US) and in terms of foreign assets Royal Dutch Shall (UK/Netherland) are the largest among 50, Mitsui (Japan) ranks top in terms of total sales. Some MNCs have their assets more than GNP of some countries.

b) **International Operations:** An MNC operates through a parent corporation in home country. It may have a branch or a subsidiary. It is called affiliate. The control may range between 20% to' 100%.

c) **Oligopolistic Structure:** Because of its giant size, it is able to acquire control through merger or takeover. Thus it becomes oligopolistic in character.

d) **Collective Transfer of Resources: An** MNC has the facilily of transfer of resources in the form of 'package'. It includes technical know how, equipment and machinery, managerial skill and raw materials etc.

e) **Growth:** An MNC can grow at a faster rate because of wage differences, and availability of opportunities in a host country. The economic dominance, investment in developed economies and increase in world trade are other features of MNCs.

12.9.3 Merits

1) They provide technological and managerial know-how to underdeveloped countries.
2) They increase the investment level by providing capital from developed countries and also help to provide increase in income and employment to people in host countries by opening their branches or subsidiaries.

3) They help to break the monopolies. They also help domestic suppliers.

43 They act as a 'linkage' to other industries in underdeveloped countries and such linkage is either backward or forward.

5) They provide management technology and thus build up a 'knowledge box' They help research and development (R&D).

6) They help in creating favourable balance of payments in host countries by helping to increase exports and decrease imports. They are 'global scanner'

12.9.4 Demerits

.Following are some of the objections raised against MNCs:

1) They relatively create few jobs and do not help in solving unemployment problem in a host country.

2) They bring such technology which underdeveloped countries cannot easily adopt. So these countries have to permanently depend upon them for such technology.

3) The expenditure on R &D by MNCs is negligible. The transfer of technology may sometimes be very costly.

4) The dividend, royalties, professional services and technical know how are paid in hard currency. This puts a drain on the foreign exchange of the host country. They may resort to devaluation of their currency.

5) MNCs sometimes become monopoly. They may direct their profits to their wholly owned subsidiaries.

6) They may participate in non-essential and consumer goods,

7) They may resort to undesirable and unfair trade practices through rigging of bids, price discrimination, price fixing etc. This is because they are oligopolistic in character.

However, above dangers from MNCs can be minimized by a host country's cautious policy of the government. There may be a threat of nationalisation. The Government may allow collaboration in selected industries or investment for a specific period and may impose high tax on their income. It may lay down export criteria as well. The Brandt Commission recommends a code of conduct relating to multinational enterprises.

MNCs are not criticized so much as was in the past. Developing countries are now encouraging MNCs. Countries are making bilateral practice to promote and protect FDI. Privatisation policies offer new opportunities for foreign investors.

However, Indian companies so far have not made significant foreign investment outside. Comparatively very little foreign investment has taken place in India. The Government of India's new pdlicy is expected to encourage foreign investments, Foreign Exchange Regulation Act 1973 is being replaced by Prevention of Money Laundering Act and Foreign Exchange Management Act.

Check Your Progress B

1. Define the terms Joint Venture and MNC.

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2, What are the various types of Joint ventures?

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3. Point out some characteristics of MNCs.

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12.10 LET US SUM UP

Foreign capital include any inflow of capital in home country from abroad. It may be in the form of foreign aid or loans and grants at government level as well as foreign investment and commercial borrowing at the enterprise level or both. Foreign capital is of two types: 1) foreign aid and 2) private foreign investment. Foreign private investment can he divided into a) foreign direct investment, b) foreign portfolio investment. FDI may be in the form of joint ventures. wholly owned subsidiary or acquisitions. FPI includes investment by foreign institutions, NRIs. and in GDRs/FCCBs. Foreign capital plays an important role in the development of a country. Its role is seen in a) increase in the resources, b) risk taking, c) technical know how, d) high standards, e) marketing facilities, f) reducing trade deficit and, g) increasing competition. Foreign capital is criticized on certain grounds like that it may be against national interest, may be invested in low priority areas, affecls balance of payments and income distribution. The Government policy of 1991, along with changes announced in 1996-97, have been encouraging foreign investments.

Joint ventures include commercial and industrial enterprises in which two or more parties from two or more countries share responsibililies for operation. They provide risk capital, goodwill, know how and management and natural resomces. It may lake many forms.

Large Corporations are known by many names such as MNCs, transnational corporations, global corporations and international corporations. MNC is defined as a company which has a direct investment base in several countries and which generally derives 20% to 50% or more of its net profits from foreign operations and whose management makes a policy decision based on alternatives available anywhere in the world. MNCs have the characteristics such as giant size, international operations, oligopolistic structure, collective transfer of resources and growth. MNCs have been favoured as well as criticised on many grounds. Of late, their role has been appreciated and developing countries are establishing more MNCs,

12.11 KEY WORDS

Foreign Direct Investment (**FDI**): FDI refers to investment in a foreign country where investor retains control over the investment.

Foreign Institutional Investors (**FIIs**): These are financial institutions who invest money in a foreign country.

Foreign **Currency** Convertible Bonds (**FCCBs**): They are quasi debt securities. The investor has option lo convert these bonds into depository receipt or equity shares at a fixed price after a certain period.

Global Depository Receipts (**GDRs**): It is an instrument whose value is denominated in dollars and is traded both in USA and Europe. The company issncs shares to a depository, who then issues GDR. Thus it represents the issuing companies shares.

Joint Venture: It includes commercial and industrial enterprise in which lwo or more parties from two or more countries share the operation responsibilities in an undertaking.

Multinational Corporation: It is that corporation which owns and controls business or commercial undertakings in more than one country.

Non-Resident **Indian:** They are Indians who are not residing in India.

Portfolio Investment: It means an investment in a foreign country where the investing party does not seek control over the investment.

12.12 ANSWERS TO CHECK YOUR PROGRESS

A 3. i) False ii) True iii) False iv) True v) True

12.13 TERMINAL QUESTIONS

1. In what forms the foreign capital flows in a country?
2. "Foreign capital is dangerous and should not he allowed." Do you agree with this statement? If not why?
3. What are the main considerations that make an enterprise to be called an MNC? Are there any benefits of MNCs?
4. Point out the special features of FDI.
5. Define a joint venture. Discuss their merits and demerits.

Note: These questions will help you to understand the Unit better. Try to write answers for them, but do not send your answers to the University. These are for your practice only.