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ETHICAL PERSPECTIVES ON THE FOREIGN DIRECT INVESTMENT DECISION

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Abstract

The Foreign Direct Investment has played an important role in the process of globalization during the last two decades. The rapid expansion in FDI by multinational enterprises may be attributed to significant changes in technologies, greater liberalisation of trade & investment regimes and deregulation & privatization of markets in many countries including developing countries like India. Transfer of capital globally takes place broadly through Foreign Direct Investment (FDI) and International loans and grants. FDl has been the largest source of finance for developing countries and according to the World Bank Report on Global Development Finance (1999), is likely to remain the largest source of finance in future. Additionally, FDI mitigates some constraints to growth, thereby ensures development. Presently, almost every developing country is in a race to attract more and more FDI. It is therefore necessary to follow business ethics while taking foreign investment decision. Business ethics are moral principles and doctrines that determine behavior in the business world. Although the purpose of every business is to earn profits, it also ought to pay a major role in society by ensuring fair practices. Instead of fairness and equality, greed has taken over the present business scenario leading to unethical business practices. This paper examines the foreign direct investment decision from an ethical perspective, and considers the moral agency involved in such decisions, with emphasis upon the corporate decision-maker. Historical capital allocation models once regarded as both financially and ethically normative are shown to be deficient in today's environment. Work of modern western philosophical and theological ethicists is included in analyses of the applicability of selected ethical approaches to multinational foreign direct investment decisions and the corporate manager's role and responsibility as corporate decision-maker and moral agent. The ethical perspectives reviewed can serve as an aid to the individual manager's determination of what constitutes a responsible exercise of decision-making power.

Keywords: Foreign Direct Investment (FDI), Ethical approaches, Ethical perspective, normative ethic, corporate responsibility.

INTRODUCTION

FDI not only brings non-debt creating capital flows but also transfer the technology, generates employment opportunities in host economy, and has spin off effects through backward and forward linkages within the host economy by Greenfield investment (Javorcik 2004)There is a belief among policymaker that FDI enhances productivity of host countries by promoting competition in to the market. In addition, FDI also bring in best management practices to the host country, and spillover effects make the economy more competitive. A number of studies (Caves, 1974, Kathuria, 1998; & Pradhan, 2006) find significant evidence of such knowledge spillovers from foreign enterprises. FDI is becoming a key

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component of the world's growth engine; hence countries try to create favorable condition to attract more FDI inflows into their economies.

With the basic understanding of the Indian legal system, international companies or investors seeking to set up operations or make investments in India need to appraise and structure their activities on three pillars:

Strategy

- Observing the economic and political environment in India from the perspective of the investment;
- Understanding the ability of the investor to carry out operations in India, the location of its customers, the quality and location of its workforce.

Law

- Exchange Control Laws: Primarily the Foreign Exchange Management Act, 1999 ("FEMA") and circulars, notifications and press notes issued under the same;
- Corporate Laws: Primarily the Companies Act, 1956 and Companies Act, 2013 (collectively the "Companies Act") and the regulations laid down by the Securities and Exchanges Board of India ("SEBI") for listed companies in India;
- Sector Specific Laws: In addition to the abovementioned general legislations, specific Laws relating to Financial Services (banking, non-banking financial services), Infrastructure (highways, airports) and other sectors are also applicable.

Tax

- **Domestic Taxation Laws:** The Income Tax Act, 1961 ("ITA"); indirect tax laws including laws relating to value added tax, service tax, customs, excise etc.;
- **International Tax Treaties:** Treaties with favorable jurisdictions such as Mauritius, Singapore, the Netherlands etc.

Setting up India operations or investing in India by non-residents requires conformity with India's foreign exchange regulations, specifically, the regulations governing FDI. Most aspects of foreign currency transactions with India are governed by FEMA and the delegated legislations there under. Investments in, and acquisitions (complete and partial) of, Indian companies by foreign entities, are governed by the terms of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 (the "FDI Regulations") and the provisions of the Industrial Policy and Procedures issued by the Secretariat for Industrial Assistance ("SIA") in the Ministry of Commerce and Industry, Government of India. FDI limits with respect to the shareholding of an Indian company can be divided into the following categories: A. Prohibited Sectors: - The following is the list of sectors where FDI is prohibited: Activities/ sectors not open to private sector investment like (i) Atomic Energy (ii) Railway operations; Gambling and betting including casinos/ Lottery business including government/lottery, online lotteries etc. (*FDI_Circular_2015)*

Earlier, companies which did not carry on any operations were required to obtain government approval prior to receiving foreign investment. Now, Indian company which does not have any operations and also does not have any downstream investments, will be permitted to have infusion of foreign investment under automatic route for undertaking activities which are under automatic route and without FDI linked performance conditions. (DIPP)

Yet, empirical evidence on the corruption-FDI nexus appears to be mixed. One possible explanation is that FDI is in fact comprised of different compositions, and the effect of corruption on each of those FDI sub-types could therefore be inherently dissimilar. For example, concerning the two major modes of FDI entry: Greenfield investment and cross-border mergers and acquisitions (M&As), one may claim that they are related but still distinct in their nature. While Greenfield investment refers to the establishment of an entirely new entity, M&A merely involves the transfer of ownership from a domestic enterprise to a foreign investor (UNCTAD, 2009).

As a result, since the institutions of host country could affect MNEs' transaction costs, expected returns, perceived risk and operational stability, they could significantly influence entry mode decisions (Meyer and Nguyen, 2005) Studies on the factors affecting FDI entry modes might hold important implications for regulators and policy makers due to the fact that different types of FDI might exert very different effects on various aspects of socio-economic life. Whilst greenfield FDI is generally believed to yield positive effects on the host country's economic performance as it can directly increase the stock of capital, generate employment opportunities, and subsequently expedite growth (UNCTAD, 2009; Wang and Wong, 2009), M&As on the other hand, is often criticized as a speculative strategy seeking only the arbitrage profits (Kim, 2008), and might not lead to any capital formation and/or productivity enhancement of the host nation (Luu, 2016).

Surprisingly, there has been little to no empirical evidence distinguishing the effects of corruption on Greenfield investment and on cross-border M&A decision. This paper therefore aims to fill this gap in the literature by explicitly answering the question of whether corruption impedes or 'greases' the wheels of FDI activities, both in terms of the aggregated inflow level and the certain type of FDI.

Table No 1: FDI Confidence Index 2017, Top 20

2015 Ranking	2016 Ranking	2017 Ranking	Country	Index Value (0 to 3 Scale)
1	1	1	United States	2.03
5	4	2	Germany	1.86
2	2	3	China	1.83
3	5	4	United Kingdom	1.80
4	3	5	Canada	1.78
7	6	6	Japan	1.72
8	8	7	France	1.71
11	9	8	India	1.68
10	7	9	Australia	1.67
15	10	10	Singapore	1.61
17	13	11	Spain	1.60
14	11	12	Switzerland	1.58
12	16	13	Italy	1.56
13	14	14	Netherlands	1.55
18	22	15	Sweden	1.53
6	12	16	Brazil	1.52
9	18	17	Mexico	1.51
16	17	18	South Korea	1.50
-	21	19	Thailand	1.48
-	23	20	Ireland	1.46

Source: 2017 A.T. Kearney Foreign Direct Investment Confidence Index

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Foreign Direct Investment Confidence Index including the ranking of countries which have potential investment opportunities. FDI Confidence Index tracks the impact of the likely political, economic and regulatory changes on the foreign direct investment intentions and preferences of the leaders of the world's leading companies. India ranked eighth the Foreign Direct Investment Confidence Index in 2017. It is observed that sustained and gained more investor interest in the Indian economy is likely the result of three factors. First, investors have an overwhelmingly positive outlook for the Indian economy this year. Second, the enduring attractiveness of the Indian market in terms of both its size and its transparent and relatively efficient legal and regulatory environment continue to make it a highly attractive investment location. And third, it is possible that the "100 percent auto route in FDI" and "make in India" policy commitments from the new Modi's administration are motivating investors to gain a toehold in the Indian market with the aim of being perceived as a local as well as a foreign player.

Most investors plan to increase FDI, primarily driven by the availability of high-quality targets. The availability of quality investment targets is the most often cited reason to increase investments, followed by the macroeconomic environment. These two factors could be related, as slow economic growth in recent years may have made some high-quality targets vulnerable to takeovers because of weaker performance, while lower FDI levels since the 2008 global financial crisis may have created a backlog of potential investments. Investors also point to an availability of funds motivating their decision to increase FDI, which could signal a forth- coming rebound in business more generally. It is also notable that risk tolerance is a primary factor driving FDI in the coming years, as this relates to the incipient shift back to emerging markets as investment destinations as well as an overall diversification in the markets where companies plan to invest.

Table No 2: Important Factors for increasing FDI

Factors	percentages
Availability of quality targets	34
Macroeconomic environment	29
Availability of funds	27
Risk tolerance	27
Foreign exchange dynamics	25

Regulatory environment	22
Prices of targets	20
Reserve requirements	13

Source: 2017 A.T. Kearney Foreign Direct Investment Confidence Index

Consistent with previous years, investors are still most interested in developed and emerging markets, with 78 and 75 percent of investors respectively planning to maintain or seek new investments Frontier markets remain somewhat less popular, with only 69 percent of investors planning to maintain or seek new investments there. While almost one in five investors are seeking to divest from frontier markets, the same proportion are seeking new opportunities in these markets. This suggests there will likely continue to be considerable churn as some companies land on winning strategies while others struggle to succeed in these more challenging consumer and regulatory environments. Among investors that are already in or are seeking investments in each type of market, selling into the market is the most popular form of investment across asset classes. However, investors prefer producing in emerging markets (48 percent) and—somewhat surprisingly—sourcing from developed markets (45 percent).

CONCLUSION

India has the world's second largest population with nearly a fifth of the fifth of the world's population, and 50 percent of its people are below the age of 25 years old or younger (Basu, 2007), ensuring a large and relatively low-cost labour force for many years. This is a timely advantage given that rising labour costs in India are pushing some foreign investors to seek alternative, lower-cost manufacturing centers. Relatedly, many investors also point to the skill level of the Indian labour force as a positive characteristic driving FDI. The second-most attractive characteristic foreign investors see in India is its vast domestic market, which is hardly surprising given that India is the world's third-largest economy (at purchasing power parity). This makes for an extensive market for consumer goods as well as business-to-business sales. Finally, some investors point to India's economic performance as a selling point. It is forecast to be the fastest-growing major economy in the world in the coming years, which should provide a variety of investment opportunities.

On the other hand, India's opaque regulatory environment and prevalence of corruption is the primary deterrent to foreign investment. Relatedly, some investors also point to inefficiencies in India's legal and regulatory processes as a

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negative aspect of its investment environment. The government has been pursuing an anticorruption drive in recent years, so these governance factors may improve over time. The security environment is another factor that may give some investors pause, given continual tensions with Pakistan and several ongoing domestic insurgencies. Finally, investors also highlight the quality of India's transportation and electricity infrastructure as among the worst aspects of its investment environment. Notably, all of these negative factors are within the government's direct power to improve. This bodes well for the future of India's investment environment should the government continue to try to tackle these issues through its reform agenda.

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