FOREIGN DIRECT INVESTMENT– OVER PIONEERING THE ECONOMY

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ABSTRACT

In this 21st century, Foreign Direct Investment may bring the employment, standard of living, good economy, global atmosphere, urbanization, liberalization, professional exchanges, interaction between the country, exchanging the culture, importing and exporting of technical knowhow, etc. All areas of foreign direct investment interaction in this partnership between the countries should be more worthy and result oriented. The data for the study was collected from published sources such as books, magazines, websites, journals, news papers, manuals, pamphlets and observations etc. In this paper, it mentioned about globalization, history of foreign investment, form of international capital flows, foreign direct investment, components of foreign direct investment, foreign direct investment as external sources of finance, foreign direct investment vs. foreign Portfolio Investment, foreign direct Investment and multinational companies, types of business objectives of foreign direct investment, types of foreign direct investment, diversified views on foreign direct investment, foreign direct investment by sovereign wealth Funds (SWFs) and Growing Concerns about sovereign wealth funds.

KEYWORDS: Economic development, foreign direct Investment, foreign investment, globalization, Investment.

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GLOBALIZATION

In this millennium years, Foreign Direct Investment may bring the employment, standard of living, good economy, global atmosphere, urbanization, liberalization, professional exchanges, interaction between the country, exchanging the culture, importing and exporting of technical knowhow, etc. All areas of foreign direct investment interaction in this partnership between the countries should be more worthy and result oriented. The process which is marked by phenomenal increase in the private capital flow across the world, aided by information and communication technology by transnational corporations is known as globalization. In a globalised world, national economies are interlocked, commercial banking and business ownership are controlled by global corporation which transcend economic borders, international trade is integrated and financial markets are connected through instant computer link up. Globalization, according to the European Commission, "is the process by which markets and production in different countries are becoming increasingly interdependent due to dynamics of trade in goods and services and flow of capital and technology". Globalization is a dynamic process of liberalization, openness, and international integration across a wide range of markets, from labor to goods and from services to capital and technology. Globalization is based upon the freedom to trade with the rest of the world and to capitalize on each country's comparative advantage, the freedom to invest where returns on capital are greatest. Globalization signifies a process of intensification of economic, political, and cultural interconnectedness among the various actors in the global system. In the economic arena it represents a process of integration of national economies with the global economy.

The growing worldwide trend towards globalization of economic activity has increased the importance of multinational enterprises in the development process of a country. Growth in foreign direct investment is perhaps one of the clearest sign of globalization. Foreign Direct Investment is an important source of external finance and accounts for more than half of all capital inflows to developing countries (UNCTAD 2003). FDI is obviously not the only source of capital and technology. Countries may rely on their own savings or borrow money in the international markets to add to the capital stock. And countries may rely on domestic research and development in order to upgrade technological sophistication. However, developing countries may face constraints on international credit markets, and may not have the resources necessary to undertake domestic research and development. Moreover, FDI implies an element

of risk sharing between the capital owners and the capital importing countries that may make this type of capital flow more desirable than loans.

The gap between the world's rich and poor countries largely comes down to the financial and physical assets that create wealth. Developed economies possess more of this capital than developing ones, and what they have usually incorporates more advanced technologies. The implication is clear: A key aspect of economic advancement lies in poorer nations' capacity to acquire more capital and scale the technological ladder. Emerging economies undertake some capital formation on their own, but in this era of globalization, they increasingly rely on foreign capital. Indeed, total capital flows to developing economies have skyrocketed from $104 billion in 1980 to $472 billion in 2005. The foreign capital has the potential to deliver enormous benefits to developing nations like India and Ethiopia. Besides helping bridge the gap between savings and investment in capital-scarce economies, capital often brings with it modern technology and encourages development of more mature financial sectors. Capital flows have proven effective in promoting growth and productivity in countries that have enough skilled workers and infrastructure. As we know that there are three types of economy. They are socialism, capitalism and mixed economy. Through globalization it can be developed the economy through the foreign direct investment which well help for the growth in several ways among the countries. In there world there are around 220 countries are there. In terms of income category they can be classified into high income, middle income and low income counties. People have to sustain in their own economy by multiplying their currencies. In this aspect the foreign direct investment is very important part to develop the economy in every low, middle and high income countries. High income countries even they can go for strengthen their technology in various fields and increase the important patterns of the required product for the people welfare. Country like Ethiopia need all of this and welcoming the investors to develop the economy. Looking at the per capital income of the country comparatively it should be better in the future of the country's welfare.

HISTORY OF FOREIGN INVESTMENT

The idea to produce in a foreign country goes back a long way. As a matter of fact, several activities similar to FDI in this day and age took place in the ancient times. During the third millennium before Christ, Sumerian merchants, established in the southern part of Mesopotamia (current Iraq), realized the necessity of having representatives based abroad to receive, to stock and to sell their commodities (Lipsey, R E, 2001). During the fourteenth century, the Hanseatic League which was a guild of German cities' merchants set up trading posts in Bergen (Norway), Bruges (Belgium), London (UK), and Novgorod (Russia). During the same period there were about one hundred Italian banks involved in multinational operations.

The seventeenth and eighteenth centuries witnessed the emergence of colonial companies such as the Dutch and British East India, Muscovy Company, Royal Africa, Hudson's Bay, and Virginia Company. The Virginia Company was chartered in 1606 by King James I to establish the first permanent English settlement in Jamestown (State of Virginia in the current USA) (Hirst, P and Thompson G, 1999).

By the end of the nineteenth century to the first two decades of the twentieth century, quite a few European companies were enjoying extracting minerals, running farms, manufacturing goods in overseas territories in Africa, America, Asia, and Australia (Dunning J.H, 1970). Some American and European companies operating affiliates abroad before the First World War I were: Lever, Singer General Electric, Courtaulds, Nestlé, Michelin, Hoechst, Orenstein & Koppel, and Edison (Foreman-Peck, J, 1995). It is worthwhile to stress here that before World War I, direct investment abroad was an activity less important than FPI. In 1914, this latter accounted for 90 percent of all international capital movements (FBL, FDI, FPI, government loans, grants…). The major providers of the £9,500m invested abroad in 1914 were Great Britain (43 percent), France (20 percent), and Germany (13 percent) (Kenwood, A G and Lougheed, A L (2000). The main recipients of these funds were other developed countries in North America and Europe. It was during such time that the interest rate differential was regarded as the main determinant of international capital movement. Investments (especially portfolio investments) were made in countries offering high interest rates. US investors, contrary to other capital exporters, leaned towards direct investments (Lipsey, R E, 2000). The Depression of 1929 and World War II caused downturns in international business activities. During the post Second World War period, global FDI was being dominated by the United States. The US accounted for around three quarters of new FDI between 1945 to 1960 and then after FDI spread globally while constituting

28 percent of global GDP in today's global economy. After the Second World War, official gifts and loans, followed by direct investments made up the most prominent international capital flows (Sodersten, B and Reed, G, 1994). Recently Ethiopia has also invited the foreign direct investment to trying to globalize the economy. In our country there are numerous investors from various high, medium and low income countries around the world and making part of developing the economy. Ethiopian also going to other countries to globalizes their business. This history one day it will become a great achievement of the country economy.

FORM OF INTERNATIONAL CAPITAL FLOWS

Capital flows from one country to another come in three primary forms:

- Portfolio equity investment, which involves buying company shares, usually through stock markets, without gaining effective control
- Portfolio debt investment, which typically covers bonds and short term and long-term borrowing from banks and multilateral institutions, such as the World Bank
- Foreign direct investment (FDI), which involves interminable long-term relationships with enterprises in foreign countries

FOREIGN DIRECT INVESTMENT

Foreign Direct Investment (FDI) eludes definition owing to the presence of many authorities: Organization for Economic Co-operation and Development (OECD), International Monetary Fund (IMF), United Nations Conference on Trade and Development (UNCTAD) etc. All these bodies attempt to illustrate the nature of FDI with certain measuring methodologies.

Generally speaking FDI refers to capital inflows from abroad that invest in the production capacity of the economy and are:

> "Usually preferred over other forms of external finance because they are non-debt creating, non volatile and their returns depend on the performance of the projects financed by the investors. FDI also facilitates international trade and transfer of knowledge, skills and technology." (Planning Commission of India *Report* 2002)

It is furthermore described as a source of economic development, modernization, and employment generation, whereby the overall benefits (dependant on the policies of the host government)

> …triggers technology spillovers, assists human capital formation, contributes to international trade integration and particularly exports, helps create a more competitive business environment, enhances enterprise development, increases total factor productivity and, more generally, improves the efficiency of resource use (OECD, 2002).

Foreign direct investment (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate).

FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates, both incorporated and unincorporated.

FDI may be undertaken by individuals as well as business entities. Flows of FDI comprise capital provided by a foreign direct investor to an FDI enterprise (either directly or through other related enterprises), or capital received from an FDI enterprise by a foreign direct investor.

According to International Monetary Fund (IMF), "Foreign Direct Investment reflects the aim of obtaining a lasting interest by a resident entity of an economy in an enterprise that is resident in another economy".

The above definition implies that an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor. The essence of FDI is the transmission to the host country of a package of capital, managerial skills and technical knowledge. FDI is direct investment in to an organisation, equipment, plants and facilities at a level that is considered significant to exercise managerial control.

RBI embraced the FDI company concept and explains FDI as:

A direct investment enterprise is defined as an incorporated or unincorporated enterprise in which a direct investor, who is resident in another economy, owns 10% or more of the ordinary

shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated). As such, a company in which 10% or more equity capital is held by a *single non-resident investor* is defined as a Foreign Direct Investment Company (*RBI Monthly Bulletin*, March 1999).

According to the benchmark definition of OECD, the most referred to and relied upon definition of FDI: Foreign direct investment reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship.

Foreign direct investment is the investment that is made to serve the business interests of the investor in a company, which is in a different nation from the investor's country of origin. It can be described as a company from one country making physical investment into building an empire in another country (Bannock, G et al, 1998). Foreign investment is called direct if it provides actual control to the investor while the investment is called indirect or portfolio ownership rights are not in actual control. The control is not merely restricted to the invested capital; it covers power of management and decision-making in terms of finance, production, technology, marketing, staffing etc. FDI is an investment made abroad either by establishing a new production facility or by acquiring a minimum share of an already existing company (Lawler, K and Seddighi, H, 2001).

It inevitably portrays an investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor. The essence of Foreign Direct Investment is the transmission to the host country of a package of capital, managerial skills and technical knowledge. The risk-sharing properties of FDI are undisputed. This suggests that FDI, indeed, is the appropriate form of external financing for developing countries, which has lesser capacity than highly developed economies to absorb external shocks. Likewise, the evidence supports the predominant view that FDI is more stable than other types of capital inflows.

As we all know there is a developed countries and developed economy. The developed countries is based on the different parameters like patterns, copy right, standard of living, per capital, GDP, etc. If there is a good development in the economy there is a great chance of falling into developed countries categories like G7. Ethiopia is also very keeping in the development of each and every areas of marketing their own product or mixed of the technology, and investors for the business. Though it is a challenge it is great pleasure to meet the challenges and do the requirement for the country development.

COMPONENTS OF FDI

Since there are different opinions of calculating FDI, OECD has formulated three components that should be included when calculating the flows. These are retained earnings, equity capital, intra-company loans and intra-company borrowing.

1. *Equity capital is* the foreign direct investor's purchase of shares of an enterprise in a country other than its own.
2. *Reinvested earnings* comprise the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates, or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested.
3. *Intra-company loans or intra-company debt transactions* refer to short term or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises.

As shown above, FDI can be made in several ways. First, and most likely, it may involve parent enterprises injecting equity capital by purchasing shares in foreign affiliates. Second, it may take the form of reinvesting the affiliate's earnings. Third, it may entail short term or long-term lending between parents and affiliates. To be categorized as a multinational enterprise for inclusion in FDI data, the parent must hold a minimum equity stake of 10 percent in the affiliate.

Each of the three components of FDI flows (equity investment, reinvested earnings and intra-company loans) has reasons for fluctuation. Intra-company debt generally comes with more flexible terms and conditions than commercial loans, being related more to the decisions of the parent company in order to help its foreign affiliates to expand or cover the running costs during

start-up, restructurings, or upswings. Reinvested earnings fluctuate quite significantly, depending on profitability and the level of repatriation from abroad in the form of dividend payments. Although equity investment continues to be the most stable component of FDI, global production chains have changed considerably and it has become much easier for equity to relocate. FDI would therefore appear to be much less volatile than these other private flows (namely private portfolio and private other capital). All private foreign capital flows – portfolio investment, bank loans and FDI – contribute to development.

FDI AS EXTERNAL SOURCES OF FINANCE

Domestic investment still accounts for the majority of the total investment in developing and transition economies. Foreign investment can only complement this. However, each form of foreign investment plays a distinct and important role in promoting growth and sustainable development, boosting countries' competitiveness, generating employment, and reducing social and income disparities. Non-FDI flows may work either in association with FDI, or separately from it. As no single type of flow alone can meet investment needs, it is vital to leverage their combinations to maximize their development impact. Foreign investors may finance their activities using a range of instruments in addition to FDI. These have different motivations, behave differently, and consequently have different impacts on development. This makes it necessary to review each instrument and the synergies between them. Differing motivations, characteristics and responses also drive different groups of investors in an enterprise.

FDI is traditionally broken down into three components: equity capital, intra-company loans, and reinvested earnings of foreign affiliates. These component parts can be considered as sources of funds for investment, additional to funds raised on local and international capital markets. However, the decision by a TNC to finance an investment in productive assets in a host country through an increase in equity capital, a loan, or by using income earned in the host country is driven by a wide range of factors, most of which are beyond the reach of host-country policymakers to influence. From a policymaker's perspective (WIR 2011, p.12), it may be more relevant to see how FDI flows are used (use of funds). TNCs can employ FDI (1) for the creation, expansion or improvement of productive assets, generating additional productive capacity, (2) to finance changes in ownership of assets (M&As), or (3) to add to the financial

reserves of foreign affiliates. The latter may be motivated by decisions on the level of financial leverage of the firm, by the need to retain cash for planned future investments, by fiscal considerations (e.g. to defer tax liabilities upon repatriation of profits), or by other factors, including opportunistic behavior on the part of TNCs to profit from changes in exchange rates or local asset-price rises. The traditional method of analyzing FDI by sources of funds tends to overlook the significance of such "parked funds" held in foreign affiliates of TNCs. "Reinvested earnings" consist of income earned by foreign affiliates that is not repatriated to the home country of the parent firm; firms do not necessarily reinvest this income in additional productive capacity. The difference between FDI flows and actual capital expenditures by foreign affiliates represents FDI not immediately employed for the creation of additional productive capacity and, as such, it is a good proxy for the increase in cash reserves in foreign affiliates.

FDI Vs FPI/FII

Foreign Direct Investment is one commonly used measure of internationalization. A concomitant form of capital flows to FDI is Foreign Portfolio Investment (FPI). Foreign portfolios investments enter into the stock market through the mechanism of foreign institutional investors. Both FDI and FPI are related to investment in a foreign country. Foreign direct investment flows into a company's coffers and therefore generates production, employment, taxes and growth; whereas foreign institutional investment flows into the secondary market i.e. stock exchanges. It helps in increasing capital availability in general rather than enhancing the capital of a specific enterprise. The Foreign Institutional Investor is also known as hot money as the investors have the liberty to sell it and take it back. Foreign Direct Investment only targets a specific enterprise. It aims to increase the enterprises capacity or productivity or change its management control. In an FDI, the capital inflow is translated into additional production. While both are important, FDI has special importance for a developing country like India. Maruti's enduring collaboration with Suzuki is a testimony to the potential of FDI. The entry of FII has added depth and substance to the share market. Thus, FDI is preferred over FPI as it is conspicuously stable and, being a bundle of assets in addition to capital, it could enable the host economy to gain competitiveness.

The distinction between FDI and FII is presented below:

FDI	FII
Investment made by controlling parent enterprise in the asset of an affiliate enterprise	Investment by an investor from other country in the capital/debt stock of a company/government securities
Investment by corporation that proposes to carry out business in the country other than its own	Investments by hedge funds, insurance companies, pension funds and mutual funds
Long term investment in plant and machinery aimed to carry out/expand business in the affiliates' country	Short term investments, generally, made under portfolio management to earn profits from value appreciation
Regulated by RBI and FIPB of the Dept. of Commerce under ministry of Finance	SEBI registration is required to operate as an FII in India
Sector specific limits are prescribed for FDI under automatic/approval route	Aggregate investment ceiling for FII investment is 10% of the paid up capital of a company
Increases the national stock of the host country	Increases the liquidity level of the stock/debt market
Larger spillover effects in the host country in term of technology diffusion, employment generation etc.,	Highly volatile speculative capital does not offer additional benefits

FDI and MNCs

In the early 1960s, the term MNC was introduced in the economic literature to refer to those firms operating in more than one country. Multinational Corporations are the chief vehicle of FDI. MNCs are incorporated or unincorporated enterprise comprising parent enterprise and foreign affiliate. A parent enterprise is defined as an enterprise that controls the assets of other entities in countries other than its home country. A foreign affiliate is an enterprise in which an

investor who is a resident in another economy owns a stake that permits a lasting interest in the management of that enterprise. Unlike Foreign Bank Lending (FBL) and Foreign Portfolio Investment (FPI), FDI is characterized by "the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the enterprise" (IMF, 1993). A direct investor may be an individual, a firm, a multinational company (MNC), a financial institution, or a government. FDI and MNC are inseparable in nature as multinational corporations are the major source of FDI, which account for about ninety five percent of global FDI flows. An enterprise is called MNC if at least twenty five percent of its world output is made outside its country of origin. The terms MNC, Multinational Enterprise (MNE), and Transnational Corporation (TNC) are used interchangeably.

FOUR TYPES OF BUSINESS OBJECTIVES OF FDI

The four major types of business objectives of FDI, which outweigh the risks of FDI for the corporations, are listed below (Daniels, J.D., Radebaugh, L.H., & Sullivan, D.P 2001):

1. SALES EXPANSION

In order to increase competitiveness in foreign markets, manufacturing and service providers are preferred to have a physical presence in those markets. Physical presence in different forms is a great way to circumvent trade barriers, official and hidden, to the new market. These barriers can be imposed by the government (in the form of foreign government pressure for local production) or media, or appear as psychological obstacles for the potential customers' purchasing decision-making, based on prejudice to the country-of-origin of the manufactured product. Among additional advantages one can note potential ability to decrease transportation costs from the country of manufacturing to the market, save on the human resources employment compensation in all areas of the company operations (manufacturing, marketing, sales, and technical support).

2. RESOURCES ACQUISITION

Reviewing the resources acquisition group of objectives, one can emphasize company's potential savings through vertical FDI, where a firm establishes its manufacturing facilities, deliberately allocating different stages of production in different countries. These types of investment are developed based on the differences across countries in input costs and availability of the appropriate trained employees. An MNC involved in an extractive industry, where the endowment of natural resources is concentrated in certain countries, is an obvious example. Another example is the case in which a firm locates a certain labor-intensive stage of its production chain in a country with low labor costs; while at the same time locating production stages requiring substantial amounts of "human capital" in a nation where highly skilled workers are available. Among additional advantages, general capability to increase total production capacity, increasing the operations portfolio, and gaining government incentives are the objectives for establishing business presence in other countries.

3. RISK MINIMIZATION

A company can minimize risk of the business and financial instability and benefit from the FDI approach due to diversification. Diversification might appear in different forms. The most obvious form is product diversification, when one company is purchasing another company doing somewhat different activities than the purchaser, to seize new opportunities. Spreading its area of expertise for the wider application base, organization has better abilities to be flexible and survive unstable market demands for the particular products. Another form of diversification is a diversification of customer base, allowing leveraging the profits and risks throughout different customer clusters, saving company from severe hits that might be caused by recession and market saturation in one stand-alone country. And finally, supplier base diversification helps to stabilize supply chain and secure components acquisition from vendors on safe and favorable conditions from multiple sources.

4. POLITICAL OBJECTIVES

Some of the serious reasons in favor of FDI are tightly related to host government political and economic regulations. Additional advantages might be gained, if the consumers on the host

market are having certain, not very positive, sentiments towards the particular foreign product manufacturers, or the manufacturing nations. In these cases, local market penetration through locally produced and localized products will allow to improve the company's product recognition and acceptance. There is a complicated interactive relationship between consumers and manufacturer. It is not manufacturer only, who make adjustments to the product in order to follow the consumer demand and capture the customer needs, but by introducing its goods in the daily life of the people, it changes their perception towards the manufacturing firm to some degree.

TYPES OF FOREIGN DIRECT INVESTMENT

FDI can take many forms and can be directed at diverse sectors of the economy. FDI necessarily differentiate a multinational enterprise from a local firm. FDI is classified on number of ways which are listed below:

1. **ON THE BASIS OF TYPE OF PRODUCT PRODUCED OR SERVICES OFFERED BY MNC IN THE HOST COUNTRY**

FDI is classified as horizontal and vertical.

a) **HORIZONTAL FDI**

When an investment is made by MNC to produce the same products produced at home, in multiples and service the local markets through affiliate production rather than through exports from the home country of MNC. The purpose of horizontal FDI is to produce goods and services locally for sale in the recipient country. The determinants of such an investment are the local market size, the host country trade policy, etc. The main purpose of Horizontal FDI is to obtain better market access to local markets within the host country. Most of the global FDI is horizontal which is sometime referred to as market seeking FDI. MNCs opt for Horizontal FDI

due to factors such as reduced transportation costs , smaller cultural barriers, avoidance of tariff, low labor cost, skill levels of human resources , availability of natural resources etc,.

b) VERTICAL FDI

Vertical FDI involves a geographical decentralization of the firm's production chain. Here, MNC produces intermediate goods that are shipped back to high wage countries, often to the parent company itself. The purpose of an export-oriented FDI is either to extract raw materials or to manufacture component parts or finished goods at a lower cost for export to the investor's home country or elsewhere. This is a vertical extension backwards of the activities of the firm. The investor in making such an investment seeks to maintain or increase its market share through sale of cheap goods. When a firm establishes sales subsidiaries abroad, there is a vertical integration forward of its activities. Vertical FDI is made primarily to access lower production costs and to produce inputs or final goods for export to destination outside the host country. It is also referred to as Efficiency Seeking FDI because the main motive for the investment is to improve the cost effectiveness of the firm's production.

2. ON THE BASIS OF ADDITION MADE TO THE NATIONAL STOCK OF THE HOST COUNTRY

FDI is classified in to Greenfield and Brownfield FDI.

a) GREENFIELD FDI

FDI is referred to as Greenfield investment, when the setting-up of a new site abroad is financed out of capital raised in the direct investor's country. The use of the term Greenfield FDI has been extended to cover any investment made abroad by establishing new productive assets. It does not matter whether there has been a transfer of capital from the investor's country (home or source country) to the host country or not. A Greenfield investment involves the establishment of a new production unit and implies that the MNC construct new facilities of production, distribution and enhance the research in the host country. The result of Greenfield FDI is an increase in the host

country stock of physical capital that can be substantial, especially for developing economies that tend to be capital scarce. From the host country standpoint establishment of foreign firms in this form has many benefits to offer, firstly it directly increases labor demand .Secondly, its link up with local economy increases demand for intermediate goods and services from local suppliers. This indirect effect also adds to labor demand and should lead to reduced unemployment in the host country. Greenfield FDI is more preferred over other types because it results in a larger inflow of physical capital.

b) BROWNFIELD FDI

In Brownfield FDI, MNC acquires already existing facilities in the host country. An acquisition is the purchase of shares in an already existing company in the host country. Most of the FDI taking place in recent years has been in the form of acquisition or merger. Brownfield FDI should therefore only result in a limited increase in the stock of physical capital since there is a change of ownership rather than an inflow of new capital. However, it is also argued that acquisition in the form of merger or joint venture could maximize the potential for technology spillovers. In order to improve the product quality the MNC can provide technical know-how resulting in a voluntary spill over of technology that increase the supplier's productivity in the host country.

3. ON THE BASIS OF INVESTOR'S MOTIVE TO INVEST IN THE HOST COUNTRY

FDI can be classified in to Resource Seeking and Efficiency Seeking.

a) RESOURCE SEEKING FDI

Resource seeking FDI is motivated by the availability of natural resources, like minerals, raw material etc, in the host countries. Resource-seeking FDI aims at securing access to raw materials required for production and have positive consequences for the domestic labor market. This type of FDI was historically important and remains a relevant source of FDI for various developing countries. For example, South Africa- the largest economy and the largest recipient of FDI in

Sub-Saharan Africa is mainly due to its vast mineral resources. It is also known as market seeking FDI. Market-seeking FDI aims at securing and developing existing foreign markets and at gaining access to new markets and has a positive impact on the home economy.

b) **EFFICIENCY SEEKING FDI**

Efficiency-seeking FDI primarily aims at reducing the cost of producing goods and services and has a negative impact on domestic employment. Foreign investor is motivated by the creation of competitive environment for firms in the host country .The intention of the Efficiency seeking firm is to take advantage of different cultures ,institutional arrangements, economic systems and policies. The competition for FDI would be based increasingly on cost differences between locations, the quality of infrastructure, business related services, the ease in doing business and the availability of skills. It is also known as Technology seeking FDI. For example, FDI from industrialized countries to Bangalore in India, the Silicon Valley of Asia, is presumably motivated both by cost efficiency and access to an advanced I.T milieu.

4. ON THE BASIS OF DIRECTION OF FLOW OF CAPITAL

FDI is classified as inward and outward FDI. According to IMF, investment abroad should be recorded by the home country as an outward FDI and by the recipient country as an inward flow of FDI provided the foreign investor owns at least 10 percent of the ordinary shares /voting power of the direct investment enterprise.

a) INWARD FDI

The value of all productive assets held by the non-resident of a country makes up FDI inward stock. There is an inflow of foreign capital in to the host country.

b) **OUTWARD FDI**

FDI outward stock is the net value of all the productive assets held abroad by the resident of a country. India's outward FDI refers to Indian investment abroad in joint ventures and wholly

owned subsidiaries by Indian public and private limited companies and registered partnership firms.

DIVERSIFIED VIEWS ON FDI

There is an ongoing debate about the impact of inflow of foreign direct investment on economic growth in a closed country. This is mainly due to two diversified views pertaining to the relationship between foreign direct investment and economic growth. The main arguments in favour of Foreign Direct Investment promote economic growth are

i) The superiority of Multinational Corporations (MNC's) over local firms in its operations. Output per worker in MNC's taken as a group, is often any time greater than in local owned operation. Similarly wages paid by foreign affiliates are also higher than local owned operations in both developed and developing host countries, within the same industries and same locations.

ii) A shift towards greater use of non-equity and co-operative relationships with other enterprises such as alliances, partnership, management contracts or sub contracting arrangements serve varieties of corporate objectives. They can provide better access to technologies or other assets allowing firms to share the cost and risk of innovatory activities. They can reduce the production cost of labour-incentive products.

iii) Emerging of a network type of organisation expands the scope of interactions between MNC's and enterprises from host countries which will create international economic integration.

iv) MNC's through foreign direct investment creates an integrated international product system. This will broaden the range of resources sought by MNC's in host countries, making firms more selective in their choices. Besides, it can also encourage foreign direct investment in countries that cannot provide a wide range of resources, but have some specific access advantage (eg. accounting, technology, short products etc.).

v) By and large, there is a direct relationship between inward foreign direct investment in relation to their size and economic development of a country. One of the strongest statements in that connection was made by Paul Romer who suggested that for a

developing country that wishes to gain on the developed countries, or at least keep up with their growth "one of the most important and easily implemented policies is to give foreign firms an incentive to close the idea gap, to let them make a profit from doing so. The government of a poor country can therefore help its residents by creating an economic environment that offers an adequate reward to multinational corporations when they bring ideas from the rest of the world and put them to use with domestic resources".

Another view pertaining to the negative relation between foreign direct investment and economic growth are mainly due to

(i) Foreign direct investment comes to those sectors in which the domestic firms are themselves contemplating investment and it will act against the investment opportunities of domestic enterprises. Further, if MNC's raised funds through their expansion programmes from the host country, it might harm the domestic firms in the financial markets due to their weak competitive power.

(ii) The decision of MNC's for acquisition of domestic firms might lead to large inflow of foreign exchange which will create an atmosphere for appreciation of the currency of the host country. This might in turn make the host country's export less competitive and discourage domestic investment for export markets.

(iii) On economic grounds, fears were also expressed that foreign direct investment would stripe indigenous enterprises, simply replacing host country enterprises and financing without adding to capital formation of economic growth. This will create a situation of "Branch-plant economy" or plebeian aspect of MNC's operation. These arguments make the proposition of foreign direct investment leads to economic growth as weak.

Economic growth may also leads to foreign direct investment due to the fact that higher levels of economic growth will be attained through efficient use of resources, which reduces cost per unit of output, and it also creates market for the output produced. This will attract higher levels of foreign direct investment. The above arguments create the phenomenon of economic growth and foreign direct investment as complex in nature.

In recent years, however, the heat of the debate has subsidized considerably. By the closing years of 1980s, there was a general warming of attitudes to FDI not just in the development literature but also on the part of the national governments traditionally strongly hostile to TNCs. Host developing countries improved their capabilities to deal with TNCs which also changed their patterns of behavior, reducing the threat of a handful of giant enterprises. Moreover, globalization also affects the TNCs. Their ownership advantages change in line with technical progress and shrinking economic space.

FDI BY SOVEREIGN WEALTH FUNDS (SWFs)

A growing number of individual and institutional investors invest in collective investment institutions (e.g. hedge funds, private equity funds), which have become direct investors by acquiring 10% or more of equity, with voting power, in enterprises abroad. These institutions are incorporated investment companies or unincorporated undertakings, and in most cases private. However, sovereign wealth funds (SWFs) have also begun to expand abroad as a result of a rapid accumulation of reserves in recent years.

SWFs are government investment vehicles that are funded by the accumulation of foreign exchange assets and managed separately from the official reserves of the monetary authorities. They usually have a higher risk tolerance and higher expected returns than traditional official reserves managed by the monetary authorities. They aim at systematic professional portfolio management to generate a sustainable future income stream. Their portfolio investment includes bonds, equities and alternative asset classes.

SWFs are not a new phenomenon. They have existed since the 1950s, especially in countries that were rich in natural resources (particularly oil), but had largely gone unnoticed until the middle of the present decade. Two of the largest of these funds, Kuwait Investment Authority and Temasek Holdings of Singapore, were founded in 1953 and 1974 respectively. In recent years, the assets of SWFs have grown considerably, reflecting the rapidly growing current account surpluses of many developing countries and the accompanying accumulation of foreign exchange reserves.

Some examples of SWFs are the Abu Dhabi Investment Authority, China Investment Corporation, Kuwait Investment Authority, GPFG Norway and GIC fund from Singapore. Recently, the Libyan Arab Jamahiriya launched a fund as well. Equivalent to 2% of the total global value of traded securities, SWFs are becoming aggressive investment vehicles. Some of them take on management stakes, such as Singapore's Temasek, Qatar's Investment Authority, Abu Dhabi Mudabala, Dubai International Capital and Istithmar – the latter two of which are the investment vehicles of the Dubai Government. However, the distinction among different funds is not clear. Certain funds are prohibited by law from acquiring a large equity share such as FDI (e.g. Norwegian funds whose investments in equity stakes are limited to a maximum of 5%). Some governments also have stabilization funds, the only purpose of which is to stabilize revenues from commodity exports, and they do not usually engage in the purchase of shares. Since SWFs hold more financial resources than private equity or hedge funds, they could have a significant influence on financial markets worldwide. Source: UNCTAD.

In portfolio investment, in which SWFs are more active, there are a number of significant investments. In the manufacturing sector, for example, the Kuwait Investment Authority (KIA) is the largest single investor in Germany's Daimler Benz, though its share is quite small. In 2007, however, the most active investments took place in the financial services of developed countries, due to the financial market crisis and the associated liquidity needs of numerous banks in the United States and the EU. In the latter half of 2007, three of the largest financial services companies in the United States, Citigroup, Merril Lynch and Morgan Stanley, actively sought new investors and fresh capital.

Sharply falling stock prices made these investments relatively cheap for SWFs (WIR, 2007):

1. China Investment Company (CIC) invested $5 billion in Morgan Stanley;
2. Abu Dhabi Investment Authority acquired a $7.5 billion stake in Citigroup;
3. KIC (Republic of Korea), together with Kuwait Investment Authority, invested $5.4 billion for an equity capital stake in Merrill Lynch; and
4. The Government of Singapore Investment Corporation (GIC) acquired a $9.8 billion stake in the Swiss bank UBS.

Apart from these spectacular investments in the financial sector, SWFs acquired significant stakes in private equity funds and hedge funds in 2007. This is a new strategy of SWFs, which still shy away from larger or complete takeovers of TNCs in other production activities, as they lack the expertise to manage such TNCs. For example, CIC acquired a 9.9% stake in Blackstone (United States), one of the biggest private equity companies. Mubadala Fund of Abu Dhabi invested in Carlyle (United States), the Abu Dhabi Investment Authority acquired a 9% stake in Apollo (United States) and Dubai International Capital bought a 10% stake in Och-Ziff, a hedge fund in the United States. The growing investments of SWFs in private equity and hedge funds could signal an increasing number of joint deals in the future. SWFs are additional and emerging sources of funds for private equity firms as bank loans decline because of the financial crisis.

GROWING CONCERNS ABOUT SWFs

Concerns by developed as well as developing countries that SWFs could gain control of infrastructure and other strategic industries (e.g. energy, national defense, oil, gas and electricity supply, and other sensitive activities such as sea ports and airports) have led some governments to tighten regulations (or propose such changes) relating to investments by SWFs. it has been argued that since SWFs could pose a threat to national security, governments should erect barriers against these investors. But most States already reserve the right to refuse M&A s for national security reasons, even if, overall, they are very open to foreign investors (see *WIR06*: 225f.)

Also criticized is the lack of transparency of SWFs which do not disclose their asset portfolios and investment decisions (Truman, 2007; IMF, 2008a). Despite their potentially strong impact on the market, SWFs have little accountability to regulators, shareholders or voters, and there are limited data on their investment strategies, portfolio composition and the average annual returns on assets (WIR, 2010).

CONCLUSION

In this 21st century, Foreign Direct Investment may bring the employment, standard of living, good economy, global atmosphere, organization, liberalization, professional exchanges, interaction between the countries, exchanging the culture, technical know how, etc. All areas of foreign direct investment interaction in this partnership must be more worthy and result oriented. The professionals and investors from either side have to make up their minds not to keep their partnership merely as a formality because it is a desire of a improvement of economy in the society. The professional and investors from between the countries must join their hands to generate, the future technocrats who are skilled, able, and efficient enough to suit the industry requirements. FDI Interaction can be successful in making good things and more relevant to society needs and in making industry more competitive through the provision of a more highly skilled workforce and production of various products. Ethiopia is one among the Eastern African Countries which will pioneer the economy through the foreign direct investment collaborations.

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