

Facets of Managerial Evaluation of Foreign Direct Investment in a Developing Country

An Investigation of Australian Firms Investing in India

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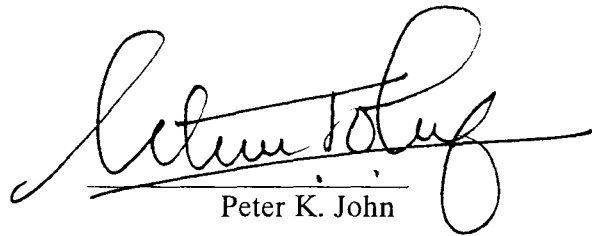
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Peter K. John

ABSTRACT

This dissertation investigates managerial evaluation of FDI and IJV formation in a developing country. The assessment is likely to be influenced by a country's factor endowments, created assets and policy framework. The efficiencies of the processes relating to decision-making, IJV formation and FDI implementation in a particular country can also impact a firm's evaluation of the country. Further, all the above variables are assessed by a firm in the context of its motives and organisational characteristics.

After an initial growth period, driven by the country's economic reforms, FDI in India seems to have stagnated at relatively low levels. In addition, the conversion of FDI proposals (approved by Indian authorities) into direct investment in the country remains low. Empirical research on FDI outflows has typically focussed on large economies. A limited industrial base and market size differentiates Australia from these countries.

This thesis contributes to the understanding of managerial assessment of a potential FDI destination in the context of Australian firms investing in India — a recent phenomenon that has not been previously explored. This research also differentiates itself from other studies in its investigation of FDI-related processes that are virtually overlooked in earlier empirical literature. Earlier empirical studies have explored some of the dimensions affecting a firm's assessment of an FDI location in isolation. Investigating these issues on the same set of sample firms renders the findings of this research more holistic. Through exploring the impact of a firm's organisational

context on its assessment of a potential FDI location, this study also addresses the inadequate attention given to a firm's 'operational and strategically-based variables' and to 'managerial' rather than 'market' processes in existing empirical literature on FDI (Dunning, 1988, p. 8; Buckley, 1996, p. 18). At a practical level, this research provides guidance to decision makers in India to improve its FDI appeal. It also identifies the key issues potential investors should consider in making FDI in the country.

The theoretical base of this research is inter-disciplinary, incorporating explanations for FDI and IJV formation based on economics, behavioural science, organisational learning and strategic perspectives. Multiple perspectives are used in this exploratory study, primarily to extend our knowledge of FDI and IJV-related processes and decisions. The findings are also compared with the expectations of the alternative theoretical frameworks.

The data for this research was collected from 25 Australian firms that have invested in India already or have FDI proposals approved by Indian authorities during 1993-1998. A questionnaire was completed in personal meetings with CEOs or other senior executives of the firms in the sample. This data collection was supplemented by interviews with these officers from a sub-sample of 16 firms.

This research finds that Australian firms are primarily driven by the aggressive motive of market growth in the liberalising economy. The overall FDI attractiveness of India's location-specific factors is perceived by firms to be in the significantly attractive class, albeit close to its lower bound. It is inhibited by unfavourable

perceptions of the country relating to eleven location-specific factors which are important to a firm's FDI location decision. These factors are categorised into economic/financial (six), political/legal (three) and IJV-related (two). Firms, which have already invested in India, tend to rate the overall attractiveness of these country factors lower than other firms.

The study finds that, despite recent reforms, India's FDI-related policy framework is still perceived as not sufficiently friendly by Australian investors. Unfavourable assessments of the country, relating to eight policy variables, inhibits its overall policy friendliness for FDI. Regulatory controls on FDI are perceived as the most unfriendly feature of India's FDI regime. The study also shows that the scope to improve the friendliness of its policy regime, through building better awareness of the policies among investors, is limited. Thus improvements in policies are needed before the country undertakes extensive promotional efforts of its policies.

A firm's FDI decision-making process is materially hampered by delays resulting from cumbersome approval requirements and obtaining responses from the country's authorities. Discussions with potential IJV partners are the only source of information that firms find useful relating to FDI in the country. This suggests that improvements may be needed in India's communication strategies. This research also shows that the host country needs to focus separately on improving some of the country's location-specific factors, policies and FDI processes to improve its appeal to investors.

The FDI implementation process in the country is significantly hindered by bureaucratic delays within its various agencies. Firms that have already invested in the country emphasise the severity of this hindrance more than other firms.

Ownership interest of Australian firms in FDI ventures tends to be lower than the host country's regulatory hurdles. The perception that a local partner can add value to the FDI operation is a major reason for forming IJVs. However, large, non-Australian owned, capital-intensive or well-internationalised firms tend to show more confidence in assuming higher ownership in FDI ventures.

The study also identifies some important effects of the three dimensions of a firm's organisational context — its attributes, internationalisation behaviour and host country experience — on its assessment of FDI and IJV formation in a country.

More emphasis on aggressive FDI motives, less concerns relating to cultural dissimilarity with the host country, greater expectation of contributions from IJV partners and an inclination to accept lower ownership interest in IJVs tend to differentiate the FDI behaviour of Australian firms from others dealt with in some earlier studies. Having identified a suitable partner, Australian firms have a positive perception of the IJV formation process in India, with no issues presenting any significant hindrance to FDI.

The target audience of this study includes potential Australian and other investors in India, policy planners in India and other developing countries and academics involved in FDI and IJV research.

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LIST OF ABBREVIATIONS

ASEAN: Association of South East Asian Nations

CAPM: Capital Asset Pricing Model

CEO: Chief Executive Officer

FIPB: Foreign Investment Promotion Board (India)

EPZ: Export Processing Zone

FDI: Foreign Direct Investment

FIAS: Foreign Investment Advisory Service (World Bank Group)

G7 Countries: Group of Seven Countries

GATT: General Agreement on Trade and Tariffs

IFC: International Finance Corporation

IIZ: Investment Incentive Zone

IJV: International Joint Venture

MIGA: Multilateral Investment Guarantee Agency

MNE: Multinational Enterprise

OECD: Organisation for Economic Co-Operation and Development

OFFA Index: Overall Factor FDI Attractiveness Index

OPEC: Organisation of Petroleum Exporting Countries

OPA Index: Overall Policy Awareness Index

OPF Index: Overall Policy Friendliness Index

OPIC: Overseas Private Insurance Corporation

RBI: Reserve Bank of India

SME: Small and Medium-sized Enterprise

TRIMS: Trade-Related Investment Measures

UNCTAD: United Nations Conference on Trade and Investment

UNCTC: United Nations Centre for Transnational Corporations

WTO: World Trade Organisation.