Both home country and host country in fdi

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The unprecedented growth of multinationals is due to the concept of globalisation which has no boundaries or limits. Usually within country's economy there are flows of goods, capital and technology. This leads to high competition in the industry and naturally companies tend to expand their business in order to survive in the global arena. The countries use Foreign Direct Investment as a key to internationalise their business. In order to understand the full meaning of FDI, let us see the definition. FDI is defined as " the acquisition abroad of physical assets, such as plant and equipment, with operational control ultimately residing with the parent company in the home country" (Buckley, p. 35, 1996). In the past 25 years, FDI is growing at a much faster rate than trade and both of these have grown faster than world output (Kozul-Wright and Rowthorn, 1998). There are many factors contributing to the development of FDI. Some of them are Internet, technological advancement, flexible rules and regulations of the country and lesser communication costs. FDI stimulates competition, capital, technological and managerial skills which has a positive effect on both host and home country's economic growth. The importance given to FDI by other country is astounding. One such example is US which has a separate department called ' Bureau of Economic Analysis'. The department monitors FDI inflows and outflows and introduce FDI attraction schemes for successful results. (Graham & Spaulding, 2005). This essay analyses various costs and benefits to home country and host country with suitable evidences.

Costs and Benefits

Let us discuss the costs and benefits of FDI to both home countries and host countries.

Benefits of FDI to the host country

Hill (2005) suggested that there are three main benefits to the host country derived out of FDI. They are resource transfer effects, employment effects and balance of payment effects. Whenever a company invests in a foreign firm, the resources are capital, technology and managerial skills. In terms of capital, the host country will have a higher financial status than the home country. The change in technology and managerial skills will have a drastic effect on the operations carried out by the company. In the host country due to FDI, it creates many employment opportunities through which the citizens of that particular country would be benefited. The balance of payments keeps tracks of FDI inflow and outflows through two types of accounts, current account and capital account. " The current account is a record of a country's export and import of goods" (Hill, 2005) and the capital account maintain purchase or sale details of assets by the country. By using FDI, the country can achieve a current account surplus (where exports are greater than imports) and reduce current account deficit (where imports are greater than exports). (Hill, 2005)

Costs of FDI to the host country

The negative effects are termed as ' costs'. There are also significant effects which affects the host country. When a foreign firm establishes with the superior technological skills which can produce quality items at cheaper rates, it adversely affects the domestic producers. Balance of payments are also affected by inward FDI by two sources. When there is a initial capital inflow there must be subsequent capital outflow and this will be recorded as debits on capital account. The second source is due to import of goods from

other countries which will be recorded as debits in current account. The foreign firm can alter the economic stability of a country as they will be focussing only on the profit. Eventually all the inhabitants of the country will have an emotional outbreak to apparent loss of national sovereignty. (Hill, 2005)

Benefits of FDI to the home country

The benefit to the home country also includes the factors similar to that of host country. In terms of balance of payments, what is debit to host country is credit to home country. The outward FDI also leads to creation of new job market with great expertise and necessary skills. Reverse resource transfer effect takes place whenever resources like managerial skills are transferred back to the home country. The profit of the foreign firm goes back to the home country unlike domestic producers which contributes to their country. The home country is exposed to create new market share and it is liable to create many in the future. (Hill, 2005)

Costs of FDI to the home country

Due to FDI, the home country is mainly affected by capital and employment. Suppose a country ' A' decides to invest in country ' B', using its capital and technology there will be an addition of financial position to the host country than home country. Even in future, if the country ' A' wants to make any advancement, much focus will be given to the company in country ' B' and implement changes. As a result the production in home country decreases and it sometimes result in shutting down all its operations and completely concentrate on the host country. This badly affects the home country's economy and employment. (Hill, 2005)

Summary of costs and benefits

To conclude the discussion of the benefits and costs of FDI, points are tabulated in Table 1

Table 1 Benefits and costs of FDI

Benefits

Costs

Host country

Financial resources of MNEs Access to new technology

Training of local managers

Job creation

Capital inflows

BOP credits from exports

BOP credits from local production of parts

Competition of local producers

BOP debits on repatriated earnings

BOP debits on MNE imports on components

Perception of loss of national identity

Home country

BOP credits from earnings

Creation of jobs in higher skill categories

Exposure to new markets, managerial expertise and technology

Protects market share in competition with other MNEs

Initial investment a capital outflow

BOP debits from input of low-cost goods

Loss of exports for which FDI is a substitute

Job losses in low skill areas

Source: Hill (2005)

The benefit of home country is the cost of host country and vice-versa. After researching for many years, economists have come to a conclusion that host country has more benefits than home country. This is because of three main reasons. The first one is that they own assets like technology and brand name. Second it is very easier to produce in a country where it is going to be marketed than producing in the home country and exporting as it save costs on transportation. It also rules out the problem of licensing and handling unnecessary pressures on production from the government. (World Trade Organization, 1996)

The following sections are illustration of FDI costs and benefits.

Renault-Nissan Alliance

The Renault-Nissan alliance in 1999 is the first business-related and industrial partnership between France and Japan (www. renault. com). The

alliance received a great attention as they created a very big impact on the Japanese car industry. Before the association, Nissan was about to bankrupt and incurred a dramatic loss of ¥700 billion. When it was taken over by Renault with a new management team headed by Carlos Ghosn, a complete restructuring was done. The global work force was reduced by 10 percent, five factories were closed and Nissan's shareholdings were sold. These were very high according to Japanese standards (Paprzycki, 2006). The outcomes were astonishing as they recorded consecutive profit in the following years with high operating margins and it was due to " combined expertise and technology sharing" (www. renault. com). The stealing of market share from its rivals Honda, Mazda and Mitsubishi was a clear indication of its accelerated development (Paprzycki, 2006). From this, it is very clear that transfer of managerial skills will have a huge impact in the success of the industry.

Mexican Maquiladores

Maquiladores refers to an American company on the Mexican side of US-Mexico border. They are owned by US, Japanese and European countries. The reason for these companies to go to Mexico is due to inexpensive labour and low tax (www. about. com). Many US companies including GE, RCA, IBM, Coca-cola and Ford were the first to initiate production in Mexico. Japanese and Korean firms also became major investors in 1982. As a result, it had a positive reflection on employment. It rose from 100, 000 in 1982 to 500, 000 in 1992. The NAFTA implementation further boosted up to 1. 3 million and the region reported for 40 percent of total Mexican exports. The amount of goods exported to US increased from $42 billion in 1993 to $166 billion in

2000. Ford’s plant in Mexico became the third largest foreign owned manufacturing operation in Latin America. (Jones, 2005)

US -Malaysia FDI relationship

The economy of Malaysia was badly affected by several recessions like worldwide oil crisis and Asian economic crisis. Its economy again rebounded in 1999. FDI became a key factor in country’s development. Anderson (1993) suggested few factors that attract FDI in Malaysia were undervalued currency, low cost of labour and fairly low inflation rate. Though there are many foreign investors, U. S. companies ranks first in FDI in Malaysia. The companies like Boeing, General Electric, R. J. Reynolds and Bechtel were major American investors. The government provided perfect climatic conditions for American firms to operate in Malaysia. The following factors attracted U. S. firms to invest in Malaysia. The government set up an Anti corruption Agency to prevent corruption in any form. It has the same legal structure so the investors had great convenience in handling their business following the rules and regulations enacted by the government. Moreover there was not any language issue as Malaysia is an English speaking country. The investors got attracted towards the incentives provided through tax treatment and “ generous equity ownership”. There were also some issues faced by foreign investors. Any foreign investor who wants to start industry must get proper approval from Malaysian Investment Development Authority (MIDA). The approval depends on various conditions which will be frustrating for investors. The other problem faced by investors was that they have to get work permit for foreign workers, which was a time consuming process. The government has several restrictions on total number of foreign workers on

their land as it will have a direct effect on country's employment opportunities (Prempeh & Abenna, 2003).

FDI has also negative impacts on home country. In case of Malaysia, the American investors violated both Human rights and Workers right. Malaysia faced a severe violation of human rights as pay was very much less than the minimum wage. The working conditions were also not employee friendly because of which workers faced several types of health problems. The company was against in forming labour union and when protested by the government, they complained that forming unions was a violation according to U. S. Generalized System of Preferences (GSP) requirement (Prempeh & Abenna, 2003).

McDonalds-a world's largest chain of quick service restaurants

McDonalds was started in a suburb of Chicago in 1955. It became the largest fast food restaurant and held one third of US market in 1990. McDonalds opened its branch in Canada in 1967 and later began to open in Europe by making joint ventures. McDonalds influenced the needs of locals and all other local fast food outlets in Germany and Netherlands faced a very tough competition. The local restaurants had to change their style to McDonalds in order to meet customer demands. After that, every step ahead was a success to the company. They had joint ventured with Japanese and very soon became country's largest restaurant chain. (Jones, 2005)

McDonald's operation in Russia, China and India was a clear indication of International expansion. They had 30, 000 outlets in 120 countries and

employed 250, 000 people outside the United States. They established in all major cities and helped students to manage their living by providing part time jobs. Their international operations reported one half of McDonalds's revenues. As time changes, customer needs also changes. Now customers prefer to have a nutritious meal, so McDonalds used their marketing nuances to satisfy their customers. For example, in France items like salads, fresh fruits and Evian mineral water are included in the menu. (Jones, 2005)

Conclusion

In this essay, we have seen several factors that affect both home country and host country. Every company in the market sees to maximise the benefits and minimise the costs. The goal of achieving maximum profit influences every other decision while investing in a country. So far, we have seen the costs and benefits of home countries and host countries and real time examples are also cited. The primary factors that affect both home country and host country are employment, competition, economic development, technology and management. A success of an industry can be determined by how well these factors are managed by the country practising all rules and regulations adopted by the country in which operations are carried out. The governments also play an active role in framing rules and regulations to derive maximum benefit out of both FDI inflow and outflow. The negotiations are done on every agreement. Only if it is beneficial the operations are performed otherwise they are rejected at the initial phase itself.

FDI is also used for improving the infrastructure of economically backward countries. The funding is done by world level organisations like World Health

Organisation, World Bank and International Monetary Fund. The infrastructure is provided even in terms of upgrading medical facilities. For example, in Africa money and medicines are provided to eradicate diseases and in India several awareness programmes are being conducted about HIV prevention. The money invested in the country can also be used for constructing roads to remote areas which will help in transportation of medicines and in situations like floods and other natural disasters. It can also be effectively used for training unskilled labour by conducting educational programmes that would benefit them to get into any industry (www. economywatch. com). The extent to which a country can be benefited out of FDI is solely decided by the government and foreign firms. Many foreign firms involve actively in promoting social and environmental factors. The government can give tax exemptions and other incentives for the companies that benefit their country.