“EFFECTS OF CORPORATE GOVERNANCE ON FOREIGN DIRECT INVESTMENT”
Prof. Rupesh Kumar Gupta

ABSTRACT
Corporate Governance is the new mantra of developing countries, as it will change the direction of governance in the new world order. A country and its economy depend to a great extent on the corporate houses as standards of corporate governance influence the behavior of foreign investors. India is passing through a great economic and social change, the society and its ambitions are getting new directions, aspiration and means of survival. Mergers & Acquisitions are taking place at phenomenal paces; big corporate houses that can undermine government policies and corporate battles are fact of day. So we have to look in the reality of corporate tycoons and their empires, which decide the business decisions and investment in other economies. The whole world has become a market; the business events of one country are influencing other market. The manufacturing factories of world i.e. China, India and other developing countries are ready to influence the established economies at large scale. The era of globalization has seen many odds, even it is being said that companies from developing countries are trading against the tide, making foray into new markets, more reliable and quality products. The world is witnessing many business odds like Mergers & Acquisitions of big corporate houses by smaller ones. The need for better corporate governance to attract foreign investment is not confined to a particular region. Its felt all over the world, better corporate governance certainly attracts more investments along with less hustles to FDI. It is corporate governance that decides the growth of industries & economies. The adopted models of corporate world are benchmarks for quality life and policies in general public. Its quality management and visionary decisions decide the life span of a corporate house and the growth. Corporate governance is window to the prevailing investment scenario in a country. Foreign investors are very sensitive in destination country, if the things are not stable & clear, they are always uncertain about the investment. The paper will throw light on FDI and the influence of corporate governance on it.

KEY WORDS - Corporate Governance, Investments, Policy, Capital, Stakeholders

Introduction
The world has become a global village, the governments are different so is the case with society, people, customs and human race. But the one thing, which has seen unprecedented event, is the business community of the whole globe. They have come much closer, event of one country, the policy matter of a particular country are strong enough to influence the matters in other countries whether it is the tax cut in USA or the telecom cases in India. Governance provides a structure that, at least in theory, works for the benefit of everyone concerned by ensuring that the enterprise adheres to accepted ethical standards and best practices as well as to formal laws. To that end, organizations have been formed at the regional, national, and global levels. In recent years, corporate governance has received increased attention because of high-profile scandals involving abuse of corporate power and, in some cases, alleged criminal activity by corporate officers. An integral part of an effective corporate governance regime includes provisions for civil or criminal prosecution of individuals who conduct unethical or illegal acts in the name of the enterprise.

CORPORATE GOVERNANCE
It is a term that refers broadly to the rules, processes, or laws by which businesses are operated, regulated, and controlled. The term can refer to internal factors defined by the officers, stockholders or constitution of a corporation, as well as to external forces such as consumer groups, clients, and government regulations. Corporate governance refers to the set of systems, principles and processes by which a company is governed. They provide the guidelines as to how the company can be directed or controlled such that it can fulfill its goals and objectives in a manner that adds to the value of the company and is also beneficial for all stakeholders in the long term. Stakeholders in this case would include everyone ranging from the board of directors, management, and shareholders to customers, employees and society. The management of the company hence assumes the role of a trustee for all the others. Corporate governance is based on principles such as conducting the business with all integrity and fairness, being transparent with regard to all transactions, making all the necessary disclosures and decisions, complying with all the laws of the land, accountability and responsibility towards the stakeholders and commitment to conducting business in an ethical manner. Another point which is highlighted in the SEBI (Securities and Exchange Board of India) report on corporate governance is the need for those in control to be able to distinguish between what are personal and corporate funds while managing a company.

FOREIGN DIRECT INVESTMENT
Foreign Direct Investment (FDI) can be defined as “a company
“EFFECTS OF CORPORATE GOVERNANCE ON FOREIGN DIRECT INVESTMENT”

from one country making a physical investment into building a factory in another country. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment, which is considered an indirect investment.” In recent years, given rapid growth and change in global investment patterns, the definition has been broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investing firm’s home country. As such, it may take many forms, such as a direct acquisition of a foreign firm, construction of a facility, or investment in a joint venture or strategic alliance with a local firm with attendant input of technology, licensing of intellectual property. FDI has gone to great changes in the past decade and is responsible for the internationalization of the businesses. India is a country that has been able to restore investor confidence in its markets, even during the toughest of times. Increase in capital inflows, Foreign Direct Investments and overseas entities' participation reflect the fact that Indian markets have fared well in recent times. Moreover, foreign companies are viewing the South-Asian nation as a strategic hub for their operations and investments owing to investor-friendly policy environment, positive eco-system and huge potential for growth. The data of FDI in India over the year has been shown in the table.

FOREIGN DIRECT INVESTMENT (FDI) IN INDIA

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>Year</th>
<th>Total FDI Flows (US $ million)</th>
<th>% age growth over the year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2000 - 01</td>
<td>4,028</td>
<td>-</td>
</tr>
<tr>
<td>2</td>
<td>2001 - 02</td>
<td>6,130</td>
<td>(+) 52%</td>
</tr>
<tr>
<td>3</td>
<td>2002 - 03</td>
<td>5,035</td>
<td>(-) 18%</td>
</tr>
<tr>
<td>4</td>
<td>2003 - 04</td>
<td>4,322</td>
<td>(-) 14%</td>
</tr>
<tr>
<td>5</td>
<td>2004 - 05</td>
<td>6,051</td>
<td>(+) 40%</td>
</tr>
<tr>
<td>6</td>
<td>2005 - 06</td>
<td>8,961</td>
<td>(+) 48%</td>
</tr>
<tr>
<td>7</td>
<td>2006 - 07</td>
<td>22,826</td>
<td>(+) 146%</td>
</tr>
<tr>
<td>8</td>
<td>2007 - 08</td>
<td>34,835</td>
<td>(+) 53%</td>
</tr>
<tr>
<td>9</td>
<td>2008 - 09</td>
<td>37,838</td>
<td>(+) 09%</td>
</tr>
<tr>
<td>10</td>
<td>2009 - 10</td>
<td>37,763</td>
<td>(-) 0.2%</td>
</tr>
<tr>
<td>11</td>
<td>2010 - 11</td>
<td>27,024</td>
<td>(-) 28%</td>
</tr>
</tbody>
</table>

TABLE: 1 Data Source - www.dipp.nic.in
India Inc’s increasing presence over the global canvas and Indian government’s consistent support to the FDI space has facilitated remarkable developments and investments from overseas partners.

**THE IMPORTANCE OF CORPORATE GOVERNANCE**

Fundamentally, there is a level of confidence that is associated with a company that is known to have good corporate governance. The presence of an active group of independent directors on the board contributes a great deal towards ensuring confidence in the market. Corporate governance is known to be one of the criteria that foreign institutional investors are increasingly depending on when deciding on which companies to invest in. It is also known to have a positive influence on the share price of the company. Having a clean image on the corporate governance front could also make it easier for companies to source capital at more reasonable costs.

Unfortunately, corporate governance often becomes the centre of discussion only after the exposure of a large scam. A large industry is resource sensitive, whether it is the raw material or the required capital. The capital is a liquid thing and sensitive to certain market conditions dominating the current policy matters of the land. In current scenario, whether it is developed world or the developing countries, all major industries needs capital at large scale to flourish in new dimensions and horizons. The global village phenomenon has made the inroad in every business of the nation, helping and promoting the trade and commerce. Foreign direct Investment (FDI) is required for the cash stripped industries and businesses, as it is the life and blood of the industry. The FDI in one nation is sensitive to the prevailing conditions in that nation provided the economic and political conditions allow as such.

The developing nations and third world country are highly susceptible to the political stability, so the investors are always very sensitive to the events in these countries as a small mistake can wipe off their whole wealth. A number of cases have happened in African countries where private investments were converted into government entities. There is an environment of uncertainty, which don’t allow the foreign businessman to make solid and stable decisions about their investments. The Indian conditions are a classic example of corporate governance influencing the government decisions that influences the FDI further. FDIs do not only provide a foreign capital and funds, but also provides domestic countries with an exchange of skill sets, information and expertise, job opportunities and improved productivity levels.

The "Asian Tiger" economies such as China, South Korea, Singapore and the Philippines benefitted tremendously and experienced high levels of economic growth at the onset of foreign direct investment into their economies. Given the high growth rates and changes to global investment patterns, the definition to FDI has evolved to include foreign mergers and acquisitions, investments in joint ventures or strategic alliances with local enterprises. For example, India in 1997 allowed foreign direct investment (FDI) in cash and carry wholesale. Then, it required government approval. The approval requirement was relaxed, and automatic permission was granted in 2006. Between 2000-2010, Indian retail attracted about $1.8 billion in foreign direct investment, representing a very small 1.5% of total investment flow into India.

**THE RELATION OF CORPORATE GOVERNANCE & FDI**

The FDI inflows are very sensitive and responsive to the
corporate governance being practiced in a particular nation. Corporate governance has started surfacing in India after the fraud of Satyam by its founder and chairman Ramalinga Raju. However, in what has been seen as one of the largest corporate frauds in India, Raju confessed that the profits in the Satyam books had been inflated and that the cash reserve with the company was minimal. Ironically, Satyam had received the Golden Peacock Global Award for Excellence in Corporate Governance in September 2008 but was stripped of it soon after Raju’s confession. The FDI inflows answer to these kinds of events very sharply. Therefore it can be said, any decision on investing is thus a combination of a number of key factors including:

- Assessment of Internal Resources
- Competitiveness
- Market Analysis
- Market Expectations

The recent Telecom licenses fiasco by Union Government and involvement of corporate house, under table practices show the level of corruption and malpractices in corridors of the business. The above-mentioned table has shown the inflow of FDI in India, 2006-07 saw a quantum jump in inflow, but since then after stabilization, the negative mood is prevailing in the industry. The best business practices depend on moral and ethic codes of the industry. Corporate governance sets the standard of the industry, it influence the best practices.

Some of the Corporate Governance practices that influence the FDI are:

**Fraud Risk Management**
It is one of the most important aspects of a business environment, the frauds can thank the whole economy, and it can affect the market over the years. It has serious repercussions to FDI as the market loses its credibility of fair game. The practices done by Bank of America are before the world.

**Corporate Social Responsibility**
Big corporations not only aim for profits and fatty balance sheets, instead tries to give back to the society as much as it can give to the society for welfare and progress of it. CSR practices gain momentum in case of industries having polluting history or which affects the human race at large, the cases of Tobacco companies and corporations involved in Oil Industry.

**Risk Management Practices**
The risk management practices and mitigation policies plays a crucial role for the stable and long lasting investment environment. An investor remains sensitive, as nobody wants to wipe off his investments and money. The risk management practices of a corporation and industry will depend on the vision of the management having, so the faith of the investor remains on the remedy measures being followed there.

**Investors & Lenders Relationships**
A lender lends his money only when he is expecting some return out of it. The foreign investor doing investments through the FDI channels are nothing but big lender who is relying on various market factors. Their decisions depend on a healthy relationship between them and the targeted market.

**Performance Management System**
The big corporations and quality institutions always attract FDI, why the IT sector in India, manufacturing sector in Thailand and Indonesia attract so much FDI, the answer lies in the performance system of these sector and industry practices being followed. They have developed the way to cop up with ups and downs of market remaining performance and quality system. If an organization is mapping the performance of its employees, it will be ranking high in performance itself.

**Joint Venture Partners**
The global village phenomena has come up with joint ventures so that cost cutting can happen on R&D projects, new and best products could be launched to meet the expectations of the customers. The JV of oil companies, defense and space sector are well known efforts all over the world. The FDI inflows in this
sector are sensitive to the reliability and hope of good results. The JV culture will be a win-win situation if it hassle free, legally sound and long-term policy, it attracts FDI and attracts big. The fatty investments happen.

There has been a considerable debate to determine, why firms undertake Foreign Direct Investment (FDI), but very little on whether firms with different governance characteristics are more or less likely to venture overseas. Does the presence of institutional shareholders suggest a greater propensity to invest abroad? Does the composition of the Board of Directors have an impact? Most extant studies on corporate governance focus on the impact of governance factors on firm performance. However, these performance outcomes are a function of the strategic decisions made by the firms, which suggests it might be useful to consider the relationship between corporate governance factors and particular strategic decisions. Both internalization theory and the resource-based view see FDI primarily as a means by which firms can appropriate rents in overseas markets from the exploitation of their idiosyncratic resources and capabilities. The above-mentioned points have told about the factors, which influence the relationship between FDI and good governance.

Foreign Direct Investment, a component of a country's national financial accounts. It plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, and access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic. Foreign Direct Investment (FDI) in its classic form is defined as a company from one country making a physical investment into building a factory in another country. It is the establishment of an enterprise by a foreigner. More specifically, Foreign Direct Investment is a cross-border corporate governance mechanism through which a company obtains productive assets in another country. Its definition can be extended to include investments made to acquire lasting interest in enterprises operating outside of the economy of the investor. The FDI relationship consists of a parent enterprise and a foreign affiliate that together form an international business or a Multi-National Corporation (MNC). In order to qualify, as FDI the investment must afford the parent enterprise control over its foreign affiliate. The IMF (International Monetary Fund) defines control in this case as owning 10% or more of the ordinary shares or voting power of an incorporated firm or its equivalent for an unincorporated firm; lower ownership shares are known as portfolio investment. An investment abroad, usually where the company being invested in is controlled by the foreign corporation. For e.g. FDI is an INDIAN company taking a majority stake in a company in USA, as Tata’s have done in case of Land Rover and Jaguar of UK.

**CONCLUSION**

Depending on the industry sector and type of business, a Foreign Direct Investment may be an attractive and viable option. With rapid globalization of many industries and vertical integration rapidly taking place on a global level, at a minimum a firm needs to keep abreast of global trends in their industry. From a competitive standpoint, it is important to be aware of whether a company's competitors are expanding into a foreign market and how they are doing that. At the same time, it also becomes important to monitor how globalization is affecting domestic clients. Often, it becomes imperative to follow the expansion of key clients overseas if an active business relationship is to be maintained. New market access is also another major reason to invest in a foreign country. At some stage, export of product or service reaches a critical mass of amount and cost where foreign production or location begins to be more cost effective. The other major point turn out to be from an internal resources standpoint, does the firm have senior management support for the investment and the internal management and system capabilities to support the set up time as well as ongoing management of a foreign subsidiary? Has the company conducted extensive market research involving the industry, product and local regulations governing foreign investment that will set the broad market parameters for any investment decision? Is there a realistic assessment in place of what resource utilization the investment will entail? Has information on local industry and foreign investment regulations, incentives, profit retention, financing, distribution, and other factors been completely analyzed to determine the most viable vehicle for entering the market (Greenfield, acquisition, merger, joint venture, etc.)? These are the major plan issues, which have been drawn up with reasonable expectations for expansion into the market through the vehicle of FDI. If the foreign economy, industry or foreign investment climate is characterized by government regulation, have the relevant government agencies been contacted and concurred remains a major investment issue. Political risk is also important for the FDI inflow as the corporate governance practices tends to comply or play the level field as the political practices being followed in the land of investment.
“EFFECTS OF CORPORATE GOVERNANCE ON FOREIGN DIRECT INVESTMENT”

BIBLIOGRAPHY
Books referred

Websites
www.dipp.nic.in
www.indiastat.com
www.thehindu.com
www.un.org
www.ficci.com