CHAPTER I
INTRODUCTION

Multinational Corporations [also known as Multinational Companies (MNCs), Multinational Enterprises (MNEs), Foreign Controlled Companies, or Transnational Corporations etc.] have become the buzzword of globalization. Today these MNCs are playing a major role in global economy. Analysis of emerging trends of global corporate power reveals that in the last two decades, the economic influence of these multinational corporations has increased enormously. UNCTAD World Investment Report, 2012 enunciates that there are 80,000 parent firms and 8,00,000 foreign affiliates in the World. With an expanding international production base, foreign sales, employment and assets of these Multinational Corporations (MNCs) is increasing too. In the year 2010, production of MNCs generated a value-addition of approximately $16 trillion, which in turn accounts for a quarter of global GDP. This production led to sales of $33 trillion in turn. In addition, foreign affiliates of MNCs contributed more than 10 per cent to global GDP and also exported more than $6 trillion which accounts for one-third of total global exports (World Investment Report, 2011).

Multinational corporations (MNCs) play a crucial role in inter-connecting developed and developing economies, thereby transmitting capital, knowledge, technical know-how and creativity across the nations. This is because, it has been widely recognized that MNCs are among most technologically advanced nations of the World due to their capability to invest substantially in R&D than domestic firms in host nations (Borrensztein et al., 1998; Griffith, 1999 and Marcin, 2007). Furthermore, operations of MNCs lead to transfer of superior technology, better management practices and exploitation of economies of scale to domestic firms in the host country (Findlay, 1978; Turok, 1993; Young et al., 1994; De Mello and Sinclair, 1995; Caves, 1996; Rodriguez-Clare 1996; Blomstrom and Kokko, 1997; Moran, 1998; Blomstrom and Sjoholm, 1999; Markusen and Venables, 1999; Lim, 2001; Giarratana, 2004; Gorg and Strobl, 2005; Bergman, 2006; Branstetter, 2006; Lee, 2007; and Marcin, 2007). World Investment Report 2012 supplements this argument that since international production as well as consumption by
MNCs is shifting to developing and transition economies across the Globe, MNCs are increasingly investing in both efficiency and market-seeking projects in those countries to gain cost-effectiveness and edge over competitors in domestic as well as international market. This has led to absorption of more than half of global FDI inflows being absorbed by the developing or transition economies.

Whenever these MNCs operate through their affiliates in host countries, they affect the domestic companies of that country in a variety of ways. However, researchers fail to reach a unanimous conclusion as to effects (also called spillovers) are definitely positive or otherwise (Haddad and Harrison, 1993; Kokko and Tansini, 1996; Djankov and Hoekman, 1998; Aitken and Harrison, 1999; and Konings, 2001). Whereas, some researchers are of the viewpoint that these MNCs cause the domestic firms of the host nation to increase their efficiency, yet another line of scholars have concluded that the productivity of domestic companies may undergo a decrease due to competition generated by these MNCs (Aitken and Harrison, 1999; and Marchin, 2007). In addition, foreign firms may also entice away the most competent skilled labour force of the domestic corporations (Marchin, 2007).

Nevertheless, the indication on spillovers generated from MNCs is consistent with the hypothesis that these corporations transmit their knowledge on new technologies and information on external markets, policy makers in developing countries will be willing to diffuse such knowledge to their domestic industries in order to increase their nation’s competitiveness in international markets. Hence, a concrete understanding of the contribution of MNCs in positive or adverse form in budding economies is becoming imperative to shape the regulatory regime under which both MNCs and domestic companies operate. If MNCs offer benefits to domestic economy of host country, policy makers will be willing to offer incentives to lure more and more multinational corporations in their economies (Oman, 2000; Blomstrom and Kokko, 2003 and Meyer, 2004).

An imperative facet of globalization during the last few years has been the impressive surge of foreign direct investment (FDI) by multinational corporations, which has become the key source of external financing for countries all over the World. During the
past few years, the role of FDI has become increasingly important for developing countries and less developed countries which increased rapidly during the late 1980s and the 1990s. According to the UNCTAD database, FDI flows to less developed countries have soared by 7 times between the two decades from 1991 and 2000, while the stock of FDI has grown by 5 times (Wan, 2010).

Since the initiation of its economic reforms process known as “LPG (Liberalization, Privatization and Globalization) reforms” in mid 1991, the Indian economy has been ranked among the fastest growing economies in the world with the average growth rate over 7 per cent per annum (see Annexure-I). Attracting Foreign Direct Investment (FDI) has become a vital element of economic and industrial development strategies for many developing countries, and India is not an exception. During its transition to a market-based economy, speedier economic growth has taken place together with the expansion of FDI inflows and trade. India has managed to attract a large inflow of inward Foreign Direct Investment (FDI) during the last two decades. In response to this, the Indian policy makers have undertaken several measures to attract Foreign Direct Investment to the country from time to time.

As already pointed out in existing literature, when foreign investment takes place in any country, multinational corporations bring along capital, technology, managerial and marketing skills and its global network which contribute significantly to a host country’s economic growth. These are believed to contribute to the economic growth of the host countries, directly through capital inflow, increased local employment, usage of advanced equipment and technology or indirectly through a number of channels including technological innovation caused by increased domestic competition and technology spillover from subsidiaries of multinational corporations (MNCs) to domestic firms in the host countries.

India’s recent experience of FDI and in achieving rapid economic growth has generated an increasing body of research literature. Various studies have been carried out to measure the impact of the presence of multinationals in India in the pre as well as post liberalization period. Desai (1980), Lall (1983), Alam (1985), Kartak (1985, 1989) and Kumar (1987), Siddharthan (1988, 1992), Deolalikar and Evenson (1989), Basant (1997),
Kumar and Aggarwal (2000) confirmed complementary relationship between imported technology and local R&D. As far as contribution of exports by these MNCs is concerned, studies fail to reach a unanimous conclusion on the same. Whereas, scholars such as Lall and Mohammad (1983), Pant (1995) and Majumdar and Chhiber (1998) hold a view that higher foreign share in turn leads to higher exports, others researchers such as Kumar and Siddharthan (1994); Athyere and Kapur (1999); and Banga (2000) have a different viewpoint on this issue.

Similarly, divergent opinions have also emerged concerning the contribution of these MNCs to ongoing Research and Development in India. While some researches have shown positive R&D spillovers of MNCs on Indian industry (Basant and Fikkert, 1996; Athyere and Kapur, 1999; Banga, 2000 and so on) yet some other (Kumar, 1994 and Aggarwal, 2000) are of the view that in India MNCs have a low R&D intensity. Despite of these differences, the views regarding high profitability seem to be unanimous (Kumar, 1994 and Athyere and Kapur, 1999), lavish expenditure on advertisement than domestic Indian firms (Kumar, 1994 and Athyere and Kapur, 1999) and leaning of spillovers to high-tech and scientific sectors than low-tech sectors (Kathuria, 1998 and Feinberg and Majumdar, 2001).

Therefore, with the surge of FDI, it has become imperative to study and analyze the determinants as well as draw to a comparative performance of foreign multinational and Indian domestic companies in the contemporary context.

1.1 CONCEPTUAL FRAMEWORK FOR DEFINING MNCs

There is no unanimously accepted standardized definition of the term MNC and different scholars and agencies have attempted to define MNCs in their own manner most acceptable to them. A commonly accepted definition of the MNCs is that MNCs are those enterprises that engage in investing FDI and that own and control the value added activities in more than one country. Wikipedia also expresses the same viewpoint whereby it defines multinational corporation as multinational corporation (MNC) (Gilpin, 2001, Spero and Hart, 2003 ,and Balaam and Veseth, 2005 etc), or Transnational Corporation (TNC) (Susan Strange and UNCTAD), also called Multinational Enterprise.
(MNE) (Ngaire Woods, 2000) is a corporation or enterprise that manages production or delivers services in more than one country. It can also be referred to as an International Corporation.

Some of the definitions are presented hereunder to gain an understanding of the term “Multinational (MNC or MNE) or Foreign Controlled Company (FOC)”.

- **Vaupel and Curhan, (1969)** mentioned that the early Harvard studies, under the direction of Raymond Vernon confined their research to the firms listed among the 500 largest US corporations among which, “…… the US parent system held equity interests in manufacturing enterprises located in 6 or more foreign countries, such equity interest in each case amounting to 25 % or more of the total equity.”

- **Mira Wilkins (1970)** defined “American Multinational Enterprise” as, “the US headquartered company that does business in two or more foreign countries” and a “genuine” multinational manufacturing corporation is that, “ ……. had direct investments in more than just sales abroad, that adapted to and respected foreign traditions and acted under foreign rules and regulations in the nations abroad where they operated.”

- **Raymond Vernon (1971)** defined a Multinational Corporation as “A multinational business enterprise can be thought of as a cluster of corporations of different nationalities that are joined together by a parent company through bonds of common ownership, that respond to a common strategy, and that draw a common pool of financial & human resources.”

- **ILO Report (1973)** observed that the essential nature of the multinational enterprises lies in the fact that its managerial headquarters are located in one country (referred to for convenience as the ‘home country’) while the enterprise carries out operations in a number of other countries as well.

- **Inter Secretariat Working Group on National Accounts, USA (1993)** describes that foreign controlled enterprises include the subsidiaries in which
foreign parent owns more than 50 per cent. Further, it is up to the individual countries to include the associates in which parents have 10 – 50 per cent of the equity (Lipsey, 2001).

- According to Franklin Root (1994), an MNC is a parent company that
  - engages in foreign production through its affiliates located in several countries;
  - exercises direct control over the policies of its affiliates; and
  - implements business strategies in production, marketing, finance and staffing that transcend national boundaries.

- Kumar (1994) who has to his credit a lot of literature on multinationals classifies a firm as foreign controlled if “at least 25 per cent of its shares are held abroad.”

- World Bank (1996) defines foreign direct investment is an investment made to acquire a lasting management interest (normally 10% of voting stock) in a business enterprise operating in a country other than that of the investor defined according to residency.

- Fieldhouse (2000) defines MNC as “An MNC can be defined as a “firm that owns or controls income- generating assets in more than one country”

It is clear from the above cited definitions that there is no single and universally accepted definition of Multinational Corporation and every researcher carry out his research according to his self-innovated criteria. When the term FDI is used in connection with MNC’s, it implies buying or building subsidiaries and owning, wholly or partially, affiliates in foreign countries.

Overseas ownership may be achieved either by taking over local enterprises through mergers, acquisitions etc. or by investing directly in a new capacity creation. All MNC’s combine in various degrees, vertical integration (different stages of the same production activity taking place in different countries) and horizontal integration (performing the same operation in different countries) as a part of their operation process.

Thus, the MNC is a company that has established an international presence by engaging
in foreign direct investment (FDI). Unlike general trade, FDI represents the physical extension of operations and the investment of equity funds and stock in several countries. Every time a company builds a factory, marketing office, or exporting warehouse, acquires control of the distributing agency, or buys out the competitor’s share of the market, it is engaging in FDI (Rugman, 2005). However many counties in the world are slowly accepting the revised definition given by International Monetary Fund (IMF) in 1993 given hereunder:

“A direct investment enterprise is defined as an incorporated or unincorporated enterprise in which direct investor, who is resident in other economy, owns 10 per cent or more of the ordinary shares or the voting power (for an incorporated enterprise) and the equivalent (for unincorporated enterprise)”.

The definition given by IMF is also supported by another eminent body i.e. OECD, Paris. This is because, according to the benchmark definition of the OECD (1996),

“A direct investment enterprise is an incorporated or unincorporated enterprise in which a single foreign investor either owns 10 per cent or more of the ordinary shares or voting power of an enterprise or owns less than 10 per cent of the ordinary shares or the voting power of an enterprise, yet still maintains an effective voice in the management. The effective voice only implies that that direct investors are only able to influence the management of the enterprise and does not imply that they have an absolute control.”

1.2 INDIAN YARDSTICK FOR DEFINING MNCs

The definition of MNC has changed over a period of time in India. Prior to economic reforms, a foreign controlled company was used to be defined as a company wherein either 25 per cent of the equity was held by a single investor or if 40 per cent of the equity was held in any one of the foreign country. However, after the year 1992 in the post-reforms era, Reserve Bank of India has also adopted the same criterion as followed by IMF i.e. a firm is treated as foreign controlled firm if 10 per cent of its voting stock is held by a single investor.

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## 1.3 Arguments for and Against Multinational Corporations

MNCs are equally praised and vilified at the global level. The following table summarizes some of the views in favor of and against MNCs.

### Table 1.1
**Arguments for and Against Multinational Corporations**

<table>
<thead>
<tr>
<th>Basis of Argument</th>
<th>In Favour</th>
<th>Against</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI as a Source of Capital</td>
<td>MNCs have abundant capital as well as access to international capital markets.</td>
<td>Not much capital transfer is taking place through MNCs rather most of investments is being financed locally.</td>
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<tr>
<td></td>
<td>MNCs may assist in mobilizing local savings.</td>
<td>FDI is an expensive source of funds.</td>
</tr>
<tr>
<td></td>
<td>MNCs may stimulate foreign aid flows.</td>
<td>A major share of profits are repatriated back to parent nation.</td>
</tr>
<tr>
<td>FDI as a Source of Technology</td>
<td>MNCs own a rich Technological know-how.</td>
<td>MNC technology may be too expensive.</td>
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<td></td>
<td>Only a few countries can afford comprehensive R&amp;D programs on their own therefore MNCs may be a source of help.</td>
<td>Technology brought in by MNCs may not be appropriate for host nations.</td>
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<td></td>
<td>Benefits possible even if MNCs keep ownership of technology spillovers.</td>
<td></td>
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<tr>
<td>Balance of Payment Effects</td>
<td>Shortage of forex for imports of investment goods a common development problem.</td>
<td>MNCs import a lot. Import-substituting MNCs, in particular, may create import dependence.</td>
</tr>
<tr>
<td></td>
<td>Both export-oriented and import-substituting FDI should improve BoP.</td>
<td>MNCs repatriate profits.</td>
</tr>
<tr>
<td>Competitive and Anti-Competitive effects</td>
<td>MNC entry may stimulate competition, efficiency, and development</td>
<td>MNCs may outcompete local firms. Risk for foreign oligopolies and monopolies</td>
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<td></td>
<td>MNCs often enter industries where entry barriers for local firms are high</td>
<td></td>
</tr>
<tr>
<td>Sovereignty and Autonomy Effects</td>
<td>Foreign ownership always carries a cost as foreign MNCs may insist for the policies serving their own interest than of the host country.</td>
<td>The sovereignty is put at stake for the sake of employment and tax revenue by host countries.</td>
</tr>
</tbody>
</table>
1.4 RISING IMPORTANCE OF MNCs AND FDI

More than ever, countries at any level of development are undertaking efforts to find novel ways to channelize FDI in their countries for purposes of overall sectoral development. The UN Conference on Trade and Development (UNCTAD) claims that FDI is becoming the largest and most popular source of external finance for developing countries. Due to this, around 63 developing countries had already liberalized their trade policies at the commencement of the Uruguay Round talks by the end of year 1992 (UNCTAD, 1992). Not only this, many countries have also been progressively removing or slackening restrictions on capital flows. During the year 1995 alone, as many as 64 countries made 112 changes to the rulings governing foreign direct investment (FDI) (UNCTAD 1996).

The dominance of these multinational companies in world economy was recognized in the 1960s when economist J.K. Galbraith suggested for the first time that MNCs were becoming a "strategic economic unit of great significance" (Haggett, 2001). As the time passed, the strength of these corporations has not diminished rather their growth is continuing in the 21st century even.

The multinational corporation (MNC) is the key institutional agent of international production and FDI is the most usual and preferred means to undertake and organize international production in spite of existence of other significant modes such as subcontracting, franchising, licensing and contract manufacturing.

Foreign direct investment is said to have the potential to generate skilled as well as unskilled employment, elevate productivity, transmitting skills and technology to domestic industry, augment exports and also contribute to the long-term economic development of the World’s developing countries (UNCTAD, 2004).

When viewed from a macro-economic perspective, multinational corporations play an important role in economic growth of a nation by augmenting the pool of available capital for investment on a universal basis. In the year 2000 alone, when the absorption of
According to Spero & Hart (2003), various empirical studies have found that a positive relationship exists between rise in foreign direct investment (FDI) flows and economic growth rates in host countries.

1.5 MOTIVES OF MNCs ENTRANCE IN THE HOST COUNTRY

The economics studying the motives governing a MNC to invest into a host country is not much older. Since the year 1960, many economists have attempted to explain this phenomenon with their own logics. Hymer (1960, published 1976) was a pioneer to explain the internationalization of the firms. Hymer argues that the existence of imperfect market condition becomes the major motivator for investing abroad. Since Hymer contribution, the theory has evolved with the contributions of Vernon’s Product Life Cycle Theory (1966), Kindleberger (1969), Caves (1971, 1974a, 1982), Buckley and Casson (1976), Dunning (1979, 1981), Rugman (1981), Teece (1981,1983), Wlliamson (1981), and Hennart (1982) among others (Kumar, 1996). The imperfect market theories have identified three advantages that force multinational corporations to invest in a host country i.e. ownership specific advantages, location specific advantages and internalization specific advantages. Instead of considering these three advantages in isolation, Dunning (1979; 1988; 1993; and 2000) stressed on combining these advantages to complete the picture. Therefore, he developed a paradigm called “O-L-I (Ownership, Location, Internalization) paradigm” in his popular theory called “Eclectic theory”. Dunning’s paradigm has gained recognition all over the world among the contemporary researchers.

1 Product life cycle theory states that the foreign investment decisions of the multinational firms are mainly affected by the life cycle of its products. At the introductory stage of the product, both production facilities and sales are based in the domestic country. In the second stage i.e. the maturing stage, With the eventual saturation of market, the profit levels of the innovative firm are maintained thorough exports and later on to shifting the production facilities abroad. In the last stage i.e. the standardized stage, production facility is shifted to the developing countries keeping in view the low cost of production. The product life cycle theory is supported by the empirical analysis of the post war period up to the early 1970s, whereby the United States firms invested in Western European countries before subsequently investing in developing countries (Chen, 1983).
As quoted by Dunning, multinational firms must have three inherent advantages to make their operations in the foreign countries profitable. These are:

- Ownership Advantages;
- Locational Advantages; and
- Internalization Advantages

These are explained as under:

❖ **Ownership Advantages**

“O-advantages” originate from the ownership of intangible proprietary assets possessed by the multinational firms, the status of which can be enjoyed productively in other countries of the world as well. These assets include brand goodwill; organizational, technology, managerial and marketing skills, strategies, capital and liquid assets endowment, access to cheaper sources of raw material and many more.

❖ **Locational Advantages**

L-advantages refer to the attractive opportunities offered by the host countries to these MNCs. These include high quality and low price factors of production existing in the host countries. These factors account for inter-country differences in input/factor process and productivity, cheap and skilled labor in the developing economies, market access as well as infrastructural (primarily communication and transportation), societal or political conditions favoring the foreign investors. Locational advantages are also a result of tariffs and quantitative restrictions imposed on imports by the host country governments.

❖ **Internalization Advantages**

Ownership and locational advantages must be complemented by internalization incentives to reap full benefits. As multinational firms are rich in technological, managerial and other type of intellectual property and knowledge, they always
operate under a fear of leakage of such unique knowledge to the domestic firms. This leakage occurs through some modes of entry like joint venture or licensing etc. So in order to avoid knowledge leakages that will result into enhanced competition, these firms must internalize its technology and knowledge. Therefore, these firms instead of licensing prefer to invest in a local subsidiary that takes care of production and sales activities (internalization advantage).

Further, according to another famous researcher Adams (1985), a firm will choose foreign rather than domestic production when three conditions are met:

- First, a firm must have some distinctive advantage which makes it worthwhile to compete in a distant and unknown environment with firms familiar with their own market. Therefore, the resources giving them the advantages and including aspects such as technology, marketing skills, size, or preferred access to inputs, and must be owned by the MNC.

- Second, the MNC also prefers to utilize these advantages itself, rather than to sell or license them off to foreigners. By licensing off the marketing skills or technology that they have developed at private costs would in fact spoil the competitive advantage that they have built up. In addition, setting a market price for technology or marketing skills is difficult. The only way in which a firm can achieve a satisfactory return on its research and development (R&D) outlay is by retaining control over the production of the final goods or services itself.

- Finally, producing abroad must also be more profitable than exporting. Determinants in deciding whether to transfer abroad will include among others access to resources, transportation costs, and/or tariff barriers.

Furthermore, as per (Streeten, 1974), MNCs as part of foreign direct investment (FDI) and as a “package” of financial, managerial and technological resources, constitute one of the most effective means available to fill the four gaps namely the resource gap; foreign exchange gap; skills and technology gap; and the budgetary gap” experienced by Least Developing Countries (LDCs). In line with the above, neoliberal writers reason that, in
Order to promote domestic economic growth and development, LDC governments should encourage investment by MNCs through the adoption of “appropriate” economic policies.

According to Mills (1999), “Part of these policies is a package of measures including deregulation, privatization, currency exchangeability and fiscal conservatism”. However, these matters are by no means clear-cut because there is a lot of debate as to the kinds of effects MNCs have on LDCs.

Many political scientists among others, Van deWalle (1999), Balaam and Veseth (2001) and Spero and Hart (2003), show that developed countries and LDCs often experience the impact of globalization, FDI and trade liberalization differently. The unequal strengths between the developed and less developed nations manifest themselves not only in the dominant power of the rich nations to control the pattern of international trade, but often also in their ability to dictate the terms whereby technology, foreign aid and private capital are transferred to LDCs.

Leaver & Cavanaugh (1996) argue that governments of developing countries often find that they are not strong enough to regulate the easy flow of capital across national borders and are thus unable to wield enough influence over their nations’ development as they bid for MNC investment, often at great social cost to the country. Van de Walle (1999) reiterates this, arguing that “integrating the less developed nations into the world economy often takes away their governments’ discretionary decision-making powers. The logic of globalisation forces individual governments to accommodate market forces in the name of "national competitiveness", even if it means erosion of wages and labour standards”.

Therefore, it is very clear that the foreign firms are motivated by multiple reasons that hover around Dunning’s paradigm, seeking for availability of resources (Dunning, 1998; and Rugmen and Verbeke, 2001), large unexplored markets as well as low factor cost of production (Vernon, 1966).
1.6 SPILLOVER EFFECTS OF MULTINATIONAL CORPORATIONS ON HOST COUNTRIES

Multinational corporations have both direct as well indirect effects on the economy of the host nations. In a direct manner, MNCs influence resort to the modes such as technology transfer, licensing and exporting. In this process, these MNCs create employment, transfer R & D, bring technology and skills infused in manpower to the host economy. Besides these direct effects, MNCs also exert certain indirect effects on host countries that are referred to as the spillover effects. In fact, the term “spillover” has not been defined very clearly anywhere in the literature when comes with reference to FDI or MNCs with the exception of a few authors such as Globerman (1979), Blomstrom and Kokko (1993) and Meyer (2003). In their view, spillovers are said to take place when the firm-specific assets of the advantages of the company can not be fully internalized, thus making the uncompensated benefits to leak from these MNCs to domestic companies, customers as well as suppliers in the host nation. In other words, the spillovers exist when

“The MNCs cannot reap all the productivity or efficiency benefits that take place in the host country's domestic firms as a result of the entry or presence of MNC affiliates.”

As far as types of spillovers are concerned, Harris and Robinson (2004) divided these as follows:

- **Intra Industry Effects** These effects include demonstration effect (Girma and Wakelin, 2001; Meyer, 2004) resulting from imitation of foreign products and processes, competition effects that result in reduction in costs (Aitken and Harrison, 1999) and labor market effects (Driffield and Taylor, 2001) resulting in improved human capital in the host nation;

- **Inter-industry Effects** These include forward linkages (Lall, 1978; Markusen and Venables, 1999; Kugler, 2001; Smarzynska, 2002 and Meyer, 2004) resulting in upgradation of quality and lowering of cost thus weeding out the crowding out of less efficient domestic firms as well as backward linkages (Markusen and Venables, 1999 and Kugler, 2000) through purchase of improved quality intermediate products;
• **Agglomeration Effects** include labor market effects such as foreign firms trained workers to domestic firms or upward pressure of wage costs (Driffield, 1999) and infrastructure effects resulting in access to R & D of foreign firms or negative spillovers in the form of increased cost of resource access etc. (Audretsch and Feldman, 1996. Taylor and Wren, 1997).

For example, where a domestic firm improves its productivity by copying some technology used by MNC affiliates operating in the local market without paying any price. Another kind of spillover occurs if the entry of an affiliate leads to more severe competition in the host economy, so that local firms are forced to use existing technology and resources more efficiently; a third type of spillover effect takes place if the competition forces local firms to search for new, more efficient technologies. These effects may take place either in the foreign affiliate's own industry or in other industries, among the affiliate's suppliers or customers.

The views regarding the effects of MNCs on host countries are divided as some of the scholars opine that MNCs have positive effect on host countries while others argue that they affect the host country’s economy adversely. Based on the various study, the following possible effects of MNCs on host countries can be enunciated

(Source: Klaus, 2003)
As far as literature is concerned, MacDougall (1960) was first to include spillovers while trying to measure the welfare effects of FDI (Blomstrom and Kokko, 1998). Since then, numerous studies at aggregate level, industry level and even at company level have been carried out at the global level. However, the results of these studies don’t turn out to be unanimous. On the one hand, some of the studies find positive effects or spillovers of these multinationals on the host countries, while other studies fail to find out the presence of such effects and enunciate rather negative outcome of the presence of these multinationals.

The analysis of existing literature brings out various effects of multinational companies on host nations. Firstly, a good number of studies have appeared linking the export spillovers of firms with firm size and multinational affiliation. Some of these studies find a very strong positive relationship between the presence of multinational and export spillovers in the host country (Lall and Mohammad, 1983; Willmore, 1992; Kumar, 1996; Kokko et al., 1997; Majumdar and Chhiker, 1998; Aitken and Harrison, 1999; Aggarwal, 2001; Greenway et al., 2001; Mahambare, 2001; Ngoc and Ramstetter, 2004; Rasiah and Gachino, 2004; Alvarez, 2007; Nguyen, 2008). But, the studies predicting low or negligible export contribution of MNCs to domestic firms can also be traced in the literature without much effort (Kumar and Siddharthan, 1994; Pant, 1995; Athukorala et al., 1995; Athyere and Kapur, 1999; Barrios et al., 2003 and Bernard and Jensen, 2004). Further, when considered in Asian perspective, various studies have considered FDI as a vital contributor to the rapid growth of manufactured exports of newly industrializing Asian countries viz., Taiwan, Singapore, Hong Kong, Malaysia and other (Nayyar, 1983; Lall & Mohammed, 1983; Willmore, 1992 and Haddad et al 1996). For India, though FDI has not led to the growth of export oriented sector, but has shown the way for export diversification (Banga, 2003a and Veeramani, 2004).

Another group of studies found positive relationship between presence of foreign ownership and R & D spillovers. These studies include Desai (1980); Lall (1983); Kartak (1985,1989); Alam (1985); Willmore (1986); Siddarthan (1988, 1992); Kokko (1994); Basant and Fikkert (1996); Athyere and Kapur (1999); Aitken and Harrison (1999); Banga (2000); Patibandla (2000); Mahambare (2001) and Rasiah and Gachino (2004).
However, some other empirical research studies found either a low or negative or neutral relationship e.g. studies of Kumar (1987); Kumar (1994); Kumar and Aggarwal (2000); Feinberg and Majumdar (2001); Giarratana et al. (2004). Besides this, there are some evidences that also came out with both positive and negative relationship between the two (Tong and Hu, 2003).

Further, as far as impact of presence of multinationals on the labor productivity of the host countries is concerned most of the studies are in favor of a positive impact on the labor productivity of these countries [Caves, 1974; Blomstrom and Wolff, 1989; Aitken and Harrison, 1999; Rasiah and Gachino, 2004; Ngoc and Ramstetter, 2004; Giarratana et al., 2004 and Waldkrich and Andra, 2008]. Along with rise in the productivity of the labor, there are also many evidences in the literature, which suggest that MNCs induce competition in the host country [Hirschman, 1958; Kokko, 1994; Rodriguez-Clare, 1996; Athyere and Kapur, 1999; Markusen and Venables, 1999 and Gorg and Strobl, 2005 etc.].

Further more, literature also suggests that these MNCs have a high expenditure intensity and they spend lavishly on advertisement, royalties and technology imports, salaries and training of their employees [Katz, 1969, Caves et al., 1980; Gupta, 1983; Chen, 1983; Willmore, 1986; Gerschenberg, 1987; Willmore, 1992; Athyere and Kapur, 1999; Greenway et al., 2001; Ngoc and Ramstetter, 2004; and Hale and Long, 2006].

Therefore, the review of literature reveals that the researchers differ in regard to the contribution of multinational companies in the host countries. Several studies find positive impacts of multinational companies on the host countries while others find either negative or neutral effects. At the same time, the results of these studies can't be interpreted in the same manner for developing and developed nations. There is a need to organize specific studies to measure the impact of MNCs operations on the host countries, particularly the developing countries.

**1.7 SIGNIFICANCE OF THE STUDY**

Foreign multinational companies have a long history in India. Though British and Japanese companies dominated in the pre independence era, however, the structure and
composition of MNCs has undergone a major change in the post independence era. Moreover, there is a need to study the drastic changes in regard to policies on foreign investment which have led to favorable policy changes in India. After initiation of reforms process, the policy regarding FDI has occupied ever rising importance. Therefore, it becomes imperative to evaluate the role of foreign multinational companies operating in India in different sectors of the economy. The present study is an attempt in the same direction and studies the dynamics of Multinational Corporations in India during the pre as well as post independence era. The study will also focus on appraising the role of foreign direct investment in India.

This study will be relevant for the policy makers, researchers as a debate is going on the ‘extent’ to which these multinational corporations should occupy the role in a developing country like India.

Till date, not many studies have focused on performance of multinational corporations in India; therefore, the motive of this study is to shift the debate towards this issue. It will be quite fruitful to carry out the study because it presents a detailed descriptive overview of the results of comparative performance of foreign multinational corporations as compared to domestic corporations in India for a comprehensive period of 19 years starting from the reforms since 1992 till 2009 (the period till when latest data was available for these companies). The present study has also attempted to suggest some policy measures that can be taken in the coming time by evaluating the policy changes undertaken since independence.

1.8 LOGIC OF COMPARATIVE ANALYSIS

It is often argued that foreign firms operating in less developed countries have greater efficiency than their local counterparts (Lim, 1976). However, not much of the empirical evidence exists to authenticate this claim.

While making empirical comparisons of multinational corporations with that of domestic firms, perhaps the more pertinent point is the general empirical agreement that multinational corporations tend to possess a distinguishing set of firm-specific advantages
(e.g. production technology; marketing networks and management know-how). However, this fact is ignored that simply by virtue of possessing firm-specific assets in comparatively larger quantities, multinational firms can be expected to differ systematically from domestic firms. Therefore, two differences are particularly considered to be important when investigating the trade' propensities of multinationals and domestic firms.

First, by virtue of their “superior production technology and management know-how”, these multinational corporations may be capable of producing efficiently than non-multinationals. Therefore, these firms tend to be able to produce internationally marketable products at a lower cost. As a result of this argument, it can be assumed that export propensities of multinational corporations will be higher than non-multinational firms.

Second, multinational corporations also have a tendency to possess “relatively sophisticated marketing networks in general, and international marketing networks in particular”. As a result, the transaction costs linked with international trade also tend to be relatively low for these corporations. This again advocates that multinational corporations should be characterized by relatively high export as well as import propensities compared to non-multinational firms.

In view of these arguments and hypotheses, the present study attempts to deliberate on these aspects related to foreign multinational corporations operating in India. The major thrust of this study is on undertaking a comparative analysis of three parameters of performance i.e. operating performance, R&D performance and export performance of both multinational corporations operating in India as well as domestic Indian corporations.

1.8.1 Operating Performance

The debate pertaining to relation between ownership and performance has been a matter of a concern in the literature relating to corporate finance from decades back when Berle and Means, (1932) attempted to explore this aspect. Thereafter, various researches have
been conducted in different countries, industries, time as well as plant level. However, there is no unanimity among the researchers on the basis of empirical evidence existing on the subject till date. Whereas, in some studies, MNCs have been proved to be performing better than domestic companies, vice versa has also been proved in the others. The competitive performance of an industry in a market economy is measured in several ways, but most frequently by relative profitability (Weiss, 1971). The measurement of firm performance varies substantially from one study to another. Scholars have firmly acknowledged that the choice of performance measures is difficult and discretionary (Venkatraman and Ramanujam, 1986 and Capon et al. 1990). The relevant literature has shown that there has been a predominant use of accounting-based (e.g. return on assets, return on sales and return on equity) and market based (e.g. Tobin’s q, risk-adjusted return) financial indicators in the earlier studies, though some scholars have also used operational performance indicators such as sales growth.

After the introduction of reforms during the post liberalization era 1991 onwards, the liberal entry norms of FDI and MNCs required the examination of performance of these foreign controlled corporations on the basis of a sufficiently long period of two decades. However, as far as Indian viewpoint is concerned, the number of studies are still not sufficient to draw a clear picture till date.

1.8.2 Export Performance

The importance of export as an economic activity and a driver of growth has long been established in various research endeavors. It is argued that one of the key prospective determinants of any firm’s export behavior in any developing countries is existence of multinationals corporations (MNCs). In order to give boost to the exports by the domestic companies, one of the globalization strategy is to encourage inflow of foreign capital (Lall, 1995). The logic behind this argument as given by theorists is that foreign multinational firms have a better access to international trading networks, which can in turn enhance export intensity of domestic firms in host countries. In principle, there are two primary channels through which MNCs can affect trade performance. First, spillovers effects which cause domestic firms to learn about exporting from these
Another channel through which MNCs can induce enhanced export behavior in domestic firms is by way of increasing competition in the host country’s market. This is because, the boosted competitive pressure acts as a catalyst to engage in more efficient production techniques, which in turn facilitates entry of domestic firms in foreign markets. The reforms of 1991 in Indian industry, which liberalized the entry of FDI, provide a natural experiment to test this hypothesis only. Further, these foreign multinational corporations could be exporting either to their home nations or to any third countries as well. Empirical studies on the determinants of international trade have mainly been carried out across countries and industries. Out of these, many studies have focused on an analysis of export performance of enterprises in industrialized and developing countries (Bonaccorsi (1992); Willmore (1992); Kumar and Siddharthan (1994); Athukorala et al. (1995); Patibandla (1995); Buck et al. (2000); Katsikeas et al. (2000); and Wagner (2001); Aggarwal, (2002)). The neo-factor endowment and neo-technology theories of international trade have generally provided the theoretical framework for most of these studies. As the predictions emanating from these theories are about industry characteristics, most of the studies have been made in an inter-industry context. A great variation in export performance across firms within an industry suggests, however, that firm characteristics also play an important role in explaining it. One of the characteristics is considered to be the nature of the firm whether multinational or domestic.

1.8.3 Research & Development

Evolutionary growth theory and neo-technology trade theory stress knowledge that is valuable, inimitable, rare and non-substitutable as one of the firm’s critical resources that explains its growth and performance [Nelson, 1995]. While some of the firm’s knowledge resources can be obtained locally (e.g., skilled labour), other knowledge resources need to be obtained from foreign sources.

Since 1980s, FDI has been a principal form of transfer of technology from developed countries to developing countries. It is based on the conception that multinational enterprises and their affiliate are an important source of global capital and technology
that bring along technical know-how, equipment, management marketing and other skills (Lall, 1997). The effects of transfer of technology by MNCs are also particularly significant in lesser developed countries (LDCs). The foremost reason of this is that most of the World’s advanced technology is controlled by MNCs having a base in a few advanced countries (Blomstro¨m and Kokko, 1997).

However, for efficiency seeking FDI they prefer locations, which have well-developed R&D base. In the absence of such assets, developing countries may fail to attract such FDI. It is therefore crucial for the countries to upgrade the competitiveness of their own resources and capabilities. Governments may also need to revise their policies with respect to FDI regulations India appears to have failed in attracting efficiency-seeking FDI on a significant scale, particularly in high-tech industries.

The role of R&D by foreign multinational corporations in host countries is often debated as it is generally feared that relaxation in the restrictions on technology transfers would enhance firms’ dependence on foreign technologies reducing the role of domestic R&D [Subramanyam, 1991]. However, as per the evolutionary school of thought, which maintains that building up technological capabilities through own R&D efforts are crucial in creating competitiveness. Firms in LDCs are unlikely to be innovators of new technologies because they are unlikely to have the organizational resources or R&D networks with firms abroad that are needed to follow the developmental trajectories (Ostry & Gestrin, 1993). Therefore, firms in LDCs are expected to obtain innovative technology via agreements with foreign firms. Although many firms in LDCs do conduct R&D in-house, this R&D is adaptive rather than innovative (Lall; 1983, Katrak; 1985, 1997, and Siddharthan; 1992). In-house R&D aims to adapt production processes of foreign origin to different domestic input availabilities, and to adapt foreign products to different needs of domestic markets. This technology effort is usually insufficient to become competitive in export markets. In Franko's (1989) opinion, if technology is the driving force for growth in advanced economies, it should also drive the growth of individual firms. This position motivates to make an effort to enunciate the relationship between the expenditures on R&D vis-à-vis measures of performance.
Blomstrom and Kokko (1997) suggest that, when affiliates are established by foreign multinational corporations, they should be distinguished from local firms in the host country. This is because MNCs transfer proprietary technology to their affiliates, giving those affiliates a competitive advantage relative to local firms. Thus, the entry of the MNC affiliates disturbs the existing equilibrium in the market and forces local firms to modify their behavior in order to protect market shares and profits.

1.9 POLICY MEASURES AND INCLINATION OF FDI

The analysis of literature suggests that the industrial distribution of foreign direct investment (FDI) is linked with the economic environment of the host country (Dunning; 1981, 1988, 1993). This economic environment, in turn, is influenced by the development strategies and macro-organizational policies of the host-country government (Dunning, 1993), Dunning further observed that transnational corporations (TNCs) engaged in the type of FDI most suited to the market conditions they faced in a host country, and the government, by its ability to influence the market conditions through its development strategies and macro-organizational policies, could affect their willingness and capacity to internalize. Some of the studies on developing countries (Lall and Mohammad; 1983, for India and more recently Aswicahyono and Hill; 1996, for Indonesia) have explicitly taken note of the impact of industrial and trade policy regulations on the inter-industry patterns of foreign ownership -- a proxy for the industrial distribution of FDI.

1.10 STATEMENT OF THE PROBLEM AND PURPOSE OF THE STUDY

“The main aim of this study is to understand the dynamics of performance of Foreign Multinational Corporations operating in India in the Post Liberalization Period along with making a comparative analysis with that of domestic corporations. The study also aims to get an insight into policy changes related to foreign direct investment and multinational corporations in historical perspective since independence.”
1.11 OBJECTIVES OF THE STUDY

The present study has been designed to study the dynamics of MNCs operating in three sectors within Indian manufacturing i.e. chemical, food and machinery in general and following in particular:

1. To study the historical background of MNCs in India;
2. To analyze the government policy changes in regard to MNCs since post independence era;
3. To study the comparative performance of selected manufacturing companies with regard to ownership pattern in financial, exports and research and development arena;
4. To study the determinants of foreign ownership in Indian manufacturing; and
5. To suggest suitable recommendations for necessary policy changes.

1.12 PLAN OF THE STUDY

The study has been divided into Seven Chapters. The First Chapter, the present one, is introductory in nature. It deals with the conceptual framework of defining MNCs, rising importance of FDI nad MNCs in global economies, motives of entrance of MNCs in host countries, and spillover effects created by them, it also touches arguments in favor of allowing MNC entry as well as against the phenomenon.

The Second Chapter, reviews the work carried out in the past in the field of multinational companies in general and performance related aspects of multinational companies in particular. It includes contributions to research in this area whether related directly or indirectly to the topic. Many models and theories on multinational corporations were reviewed in chronological order in order to build a solid empirical base for the present study.

The Third Chapter explains the research methodology employed in the present study. It describes the universe of the study, sampling design, data preparation, data collection tools, data analysis methods and limitations of the study.
The Fourth Chapter discusses the historical background of the multinational corporations in India. It also reviews the policy framework during pre as well as post independence era in India. In addition, it also throws a light on the latest guidelines for the entry of MNCs and FDI in various sectors in India.

Chapter Five is empirical in nature and devotes itself to data analysis and its interpretation. It attempts to make a comparative performance of three main sectors of Indian manufacturing viz. chemical, food and machinery on three parameters i.e. Financial performance, Export intensity and R&D intensity for two group of companies i.e. Foreign Multinational corporations operating in India and Domestic Indian Companies.

Chapter Six is also empirical in nature and endeavors to bring out the determinants of foreign ownership in three sectors viz. “chemicals”, “machinery” and “food” of Indian manufacturing.

The Final Chapter presents a summary of findings and conclusions. It winds up with suggestions and recommendations for future policy framework concerning MNCs and FDI entry in India. It also highlights the limitations of the present study and further scope of research in this area.