Review of Literature

FDI has been one of the most fascinating and intriguing topics among researchers in international business. Numerous researchers, financial analysts and economists have done remarkable work in the field of FDI. Impact of FDI on host country, and investing country, trends of foreign financial flows and identifying determinants of FDI have been the major areas of past researches undertaken in the context of FDI. In this chapter an endeavour is made to present an overview of some of the more important research studies in the area of FDI. First we have presented a summary of the studies describing role of FDI, its impact on economic development of the host country and trend and progress of financial flows, particularly FDI. Then, review of the studies striving to identify determinants of FDI is made.

Impact of FDI on CSR Programs: Review of past studies

The development impact of foreign investment on host countries has always aroused great deal of controversy. But this controversy has reduced greatly in recent years (Lall, S., 1999). In his work about the growing importance of FDI throughout the world, argued that with certain transaction cost the firm’s internal procedures are better suited than the market to organise transaction. He has also concluded on the same line that foreign direct investment should ultimately flow into those countries that are importing goods from abroad. Because of market imperfection; such as tariffs and quotas, foreign firms will find it attractive to produce locally in order to satisfy domestic demand.

Chenery and Hollis, Ahluwalia Montek .S (2004) have also stated that external finances could enhance growth prospects of recipient countries by augmenting domestic availability of investable surpluses. In the above framework, external financial inflows are presumed to result in
a virtuous circle of growth, who observed that domestic savings in recipient countries could be negative, if capital inflows became large enough, implying thereby that external finance did not necessarily supplement, but might actually replace domestic savings.

**Dunning John, H (2003)** contends that foreign direct investment creates vertically integrated production units and therefore increases the amount of trade. Numerous factors have compelled many developing economies to change their earlier versions of trade, industrialisation and investment policies. For instance India has come out with new policies relating to trade, industrialisation and foreign direct investment. This has been because, FDI inflows do not have many of the costs previously associated with it and that many developing countries have managed to industrialize successfully with FDI. The most appropriate examples are of East Asian Economies or newly industrialized economies (NIEs). The benefits of FDI can be maximized only in a relatively free and market oriented environment where private economic decisions don’t diverge greatly from the social good **Soon L.Y (2004)**.

A number of studies show the central role played by technology diffusion in the process of economic growth **Grossman and Helpman, (2006)**; and **Barro R, Sala-I-Martin, (2008)**. Endogenous growth models look at FDI as an important vehicle for the transfer of technology and knowledge and show that FDI can have long run effects on growth by generating increasing returns in production via externalities and productivity spillovers.

**Bloom Strom M (2007)** show the spillover effect of FDI on exports with the example of Bangladesh, where the entry of a single Korean multinational in garment exports led to the establishment of a number of domestic export firms, creating the country’s largest export industry. Moreover, FDI can contribute more to growth than domestic investment when there is
sufficient absorptive capacity available in the host country. This is because FDI flows today are not confined to the primary sectors of developing countries but to modern manufacturing.

To make their operations more productive and efficient, transnationals take with them high levels of technology. In 1913 the primary sector (mainly mining and in processed agricultural raw materials) accounted for more than half of FDI flows to developing countries and the manufacturing sector only 10 per cent, in 1990 about 40 per cent of FDI went to manufacturing, 50 per cent to services and only 10 per cent to primary sector.

**Dutt, (2007)** Thus FDI can lead to higher growth by incorporating new inputs and techniques finds that technology spillovers from FDI in Indian manufacturing have significant benefits. uses urban data to show that FDI produces technological spillovers in China and explains growth differentials among Chinese urban areas. There are good theoretical reasons to show that the growth consequences of FDI depend on what kinds of sectors receive FDI and that the change in sectoral flows strengthen the positive effects and weaken the negative ones. FDI is also an important source of human capital augmentation and provides specific productivity increasing labour training and skill acquisition through knowledge transfers.

**De Mello and Sinclair (2005)** show that FDI can promote knowledge transfers even without significant capital accumulation as in the case of licensing and start-up arrangements, management contracts and joint ventures in general.

The idea of trade-related international knowledge spillovers developed by **Grossman and Helpman E (2001)** is extended by **Walz Uwe (2002)** to FDI to show that FDI is accompanied by interregional spillovers of knowledge from the more to less advanced countries. Policies leading to an inflow of FDI therefore speed up the growth process and anything from investment controls
for TNCs to specific taxes on their repatriation of profits hurts the international growth process and thereby the consumers in the developing country. Thus, theoretically speaking, the main avenues by which FDI can affect growth are productivity spillovers, human capital augmentation and technological change, though it becomes very difficult to incorporate these in empirical studies as these are not easy to measure. The dependency theorists believe that FDI can have a favourable short-term effect on growth. In the long-run, however, as FDI accumulates, it can have a negative effect on the rest of the economy due to the intervening mechanisms of dependency, in particular, “decapitalization” and “disarticulation”

Found positive abnormal returns as a result of foreign acquisition in countries in which the firms were not operating before. Goldberg and Klein (2008) identified a clear relation between real exchange rates and FDI from Japan and the United States into Southeast Asian Countries (Indonesia, Malaysia, the Philippines and Thailand).

Yasheng, Huang (2006) examined the effect of joint venture announcements on stock price with reference to investment in Japan and China respectively. Both studies showed positive abnormal returns about (1 per cent in the case of Japan and 52 per cent in the case of China) as a result of announcements. However, in an examination of 136 foreign investment announcements during the period (1971-86) around the world, He found significant excess negative returns for firms making such decisions.

The study by Liu, X and Wang (2007) in examined the wealth effect for shareholders by classifying foreign investments by geographical boundaries into Asian markets and rest of the world. The results of their study indicate insignificant positive abnormal returns for investments in Asian market, while indicating significant negative abnormal return for rest of the world.
Scope and need to study
Keeping in view the various issues analyzed at length in the present study, it can be concluded that the study is a wonderful addition to the existing body of knowledge on the subject under consideration. The findings of the study would be beneficial to the multiple groups of people. First, the study will be increasingly beneficial to economic policy makers related to institutions, economy and regulatory bodies. Second, the study may help the corporates willing to take advantage of international financial flows in corporate social responsibility activities. Last, it is hoped that the study would open new vistas of research for economists, academicians, researchers, social workers and students working in the area of international business in general and FDI impact on CSR in particular.