Chapter Two: Review of Related Literature and Studies

2.1. Foreign Direct Investment

Significant features of the global economy are international transfers, foreign direct investment. FDI is regarded to be key component of capital structuring for developed and developing countries. A significant number of researches have shed light on its strategies and policies that improve the flow of FDI in a country's foreign reserves. With evident results, most developing countries are striving to increase FDI as it brings long-term economic growth and foreign resources. Not only restricting to macro-economic advancements, FDI also caters to enhanced technological expertise, advances in research and development and improved know-how of host nation. FDI also help host nations to access foreign markets and unlock newer market as through exports where its impact is amplified (Iamsiraroj, 2016).

FDI has enabled numerous Asian countries to economically upgrade themselves, it supports as it provides financial aiding to weaker sector of economy. A study initiated by Ali and Malik (2017) reflects on the value and advancement FDI has provided in a span of 1976-2015. Blessed with extraordinary landscape and geographical features, Pakistan gained much of attraction and admiration from developed economies of west. After 9/11 Pakistan's image as unsafe country immensely has influenced the flow of its foreign direct investment in a negative sense.

Reflecting on advances and prosperity that FDI brings to the developing countries, Nakamura, and Zhang (2018) argues on the legal complication it brings to a foreign investor as to what legal structure of foreign subsidiary holds fully owned subsidiary or joint venture if it is joint venture then what portion of ownership does the parent company owns. Such disputes can be of utmost significance for technology-based firms as it can distort the product quality and at many times results an IP violation.

Agreeing to the fact the developing nations do receive FDI at a greater scale but its flow can be negatively impacted by corruption. The study of Belgibayeva and Plekhanov (2019) has proposed that there exists a negative relationship between the flow of foreign direct investment and quality of institution that refers to effort made in making viable conditions for investment in host country. As corruption in a country poses threats to cost and revenues generated, the study suggests that improvements made by counter corruption result in increased and higher crossborder investments, however, surprisingly, parent companies that are situated in corrupt countries find corruption as a favourable opportunity. Whereas, FDI can create a positive impact on domestic firm's investment as they are encouraged by sound governance system. By improving corruption, host country might not only experience increased FDI but institutions belonging from regarded and developed countries would foster good management practices, domestic businesses abiding by laws and encouraging local investors.

An effective system and procedure of FDI are comprehended to be a need and an additional benefit for any country because through this, the countries can do the business and produce the capital for the country and eventually that country would be transforming from the emerging to a developed country. This is due to the fact that at some extent FDI is directly related to the economic conditions of the country. Moreover, urbanisation, the openness of the business, local and international investments, external wages and debts, labour force, current account and other related operation of the business impacts FDI in the countries. The main impact of aforementioned elements is in the lower middle countries while openness of the business, international and domestic debt, labour force, GDP per capita along with the urbanisation impacts the countries having middle income. In light of a study conducted by Uddin et al. (2019), it has been depicted about the FDI and its institutional factors related to the inward FDI. In the context of Pakistan FDI impacted by the numerous factors. Mainly, Pakistan faces the problem in the foreign trade is related to the political stability which is one the factors of this study.

2.2. Significance of Foreign Direct Investment

Immense financial backing is one of the key aspects of FDI from which majority of developing countries have benefits. Alfaro and Chauvi (2016) through their study have shed light on significance that goes beyond capital sourcing. The study has found that deploying FDI creates a positive impact of local, it increases their productivity due inclusion of foreign management. It adds in values that updates local skills and specialization level. Exploring the macro-level advances FDI provides, enables host nation to taste world-class technical expertise and provides in a range of exports by diversification. Its micro sides include knowledge sharing between two nations, moreover, it caters to transfer of technology and training at a larger scale and platform. It also improves and enhances local managers' and leaders' working style and employability skills. As FDI brings in reputed foreign ventures, it advances also includes setting higher standards for locals to be followed. Looking at the broader perspective, inflows of capital help as it increases host country's GDP, allowing local to be benefited by the viable conditions created by FDI inclusion.

However, it has been argued that significance of FDI goes beyond capital advancements (Liu et al., 2018). The study explores the significant change in environmental pollution in China, the findings suggest that the inclusion of FDI caused reduction in water soot and air pollution. However, it is important that government formulates policies that encourage such initiatives because not having proper wastage and sanitation systems might result in impact on society. Jasper (2019) has shed light on how Vietnam benefited from FDI, as it brought new innovative products. Here key aspects of investment were technical expertise where R&D activities got enhanced and improved. Artificial Intelligence (AI) and Virtual Reality (VR) were technologies that Vietnam did not witness previously. In a nutshell FDI is not restricted to capital, but it also brings knowledge, expertise, and most of all it stabilises the economic conditions.

2.3. Factors Affecting Foreign Direct Investment

2.3.1 Foreign Exchange (FOREX)

In simple terms forex refers to foreign exchange market or currency market in a global market currency are trade through over the counter (OTC). A relationship denoted by Lee and Wang (2018) indicates that increase in FDI, causes shift in demand for currency which eventually increases the interest rate. In broader terms increase in currency causes enhancement in trade and balance of payment (BOP). In conversely Cambazoglu and Günes (2016) argues that foreign direct investment is a controversial topic. FDI cannot only be admired due to its short-term benefit's macroeconomic improvements and environmental factors. Study findings suggest that their insignificant relations in short-term between FDI inflows and exchange rate, however results denoted a positive correlation between FDI inflows and exchange rate in long-term. As increase in real exchange rate level represents appreciation of domestic currency. More precisely research suggest that relationship also carries a reverse impact if domestic currency depreciates the domestic price of internally owed enterprises also fall.

2.3.2 Interest rate

Interest rate are simple defined as reward in shape of percentage paid by borrower to lender for utilizing certain capital. As accurately defined by Iamsiraroj (2016) interest rate refers to return on investment, as describe investor have tendency of yielding higher return on invest thus rise interest rate can result in increased foreign direct investment. Whereas research initiated by Hadi, Zafar, Iqbal, Zafar, and Hussain (2018) supports the notion that in countries like Malaysia and Singapore low interest does not attract FDI. However, the study suggests that due to increased FDI inflows inflation and interest rates might result in political stability.

Khan and Zahra (2016) conducted research and elaborated through it that a higher rate of interest upsurges the real cost of capital that consequently declines the level of private investment. Hence, investment reacts positively and certainly to greater (real) interest proportions in financial markets which are not well developed and they typically exist in less developing countries. The countries all around the world are constantly making efforts for rapid economic development and growth and as a consequence, the countries are attracting numerous foreign investors to capitalise in their countries by giving a higher interest rate.

2.3.3 Corruption

Corruption is literally defined as abuse of power, manipulation, and exploitation of public resources. Study initiated by Yi, Mange, Macaulay, and Peng (2019) examines effects of corruption on inward foreign direct investment (FDI) in different investment phases in host countries. Findings suggest that in light of theory corruption can be both sand and grease, which refers to support and contradiction. However, its intensity can vary depending on propensity for bribery, however direct didn’t denoted a direct impact rather it was intervened by investment freedom and press/media freedom. Since FDI in channeled through state institutions and officials, corruption can negative impact while formulating economic and investment related policies. Additionally, Canare (2017) suggest that corruption decreases FDI inflows, as analyzing 46 Asia and the Pacific countries, less-corrupted nations tend to receive higher FDI inflows. More surprisingly reforms initiated towards encountering corruption can cause increase in FDI inflows.

2.3.4. GDP

Ali and Malik (2017) suggest that there is a positive relationship between GDP and FDI, where not many studies support this notion. This study held the view that international firms investing in to the local and domestic market ultimately increases the GDP. Every dollar earned in or comes to country ads in the GDP. In broader terms, it improves the export and reduces the country's dependence on imports which results in increase balance of payment. With an increasing trend of globalisation. MNC and JV reliance help the developing countries to gain out of opportunities such as landscape and geographical location.

The inflows of FDI is an essential determining factor of GDP growth. The positive influence of FDI on the economy relies on its relations with the stability of the macroeconomic environment, filling the technological gaps, providing a better level of education and factor of open trade policy. The countries should perform well by focussing on emerging national companies, human capital, making a stable framework of the macroeconomic environment and making productive investments to initiate the economic development of a country. Though, many economists examined the adverse effects of FDI on the growth of country's economy. The foreign direct investment may possibly affect economic development negatively by switching the national savings. The inflow of FDI also influences by international companies in a way that they replace the national companies by introducing new technologies for production. Multinational companies also transfers the profit from the host country which causes a balance of payment crisis (Agrawal and Khan, 2011).

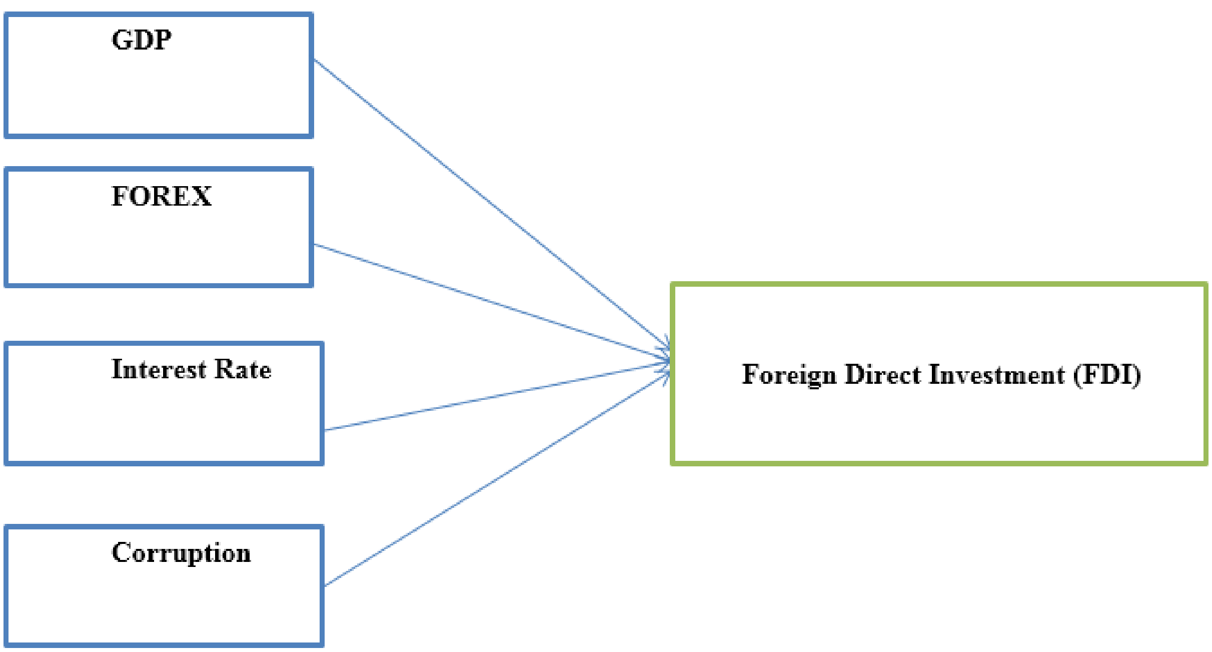
2.4. Economic Impact of Foreign Direct Investment

For the economic development of a country, FDI is considered one of the most important factors. When it comes to growth-enhancing factors, FDI is considered the most important factor in this regard. It has great impact on the economy and it has great significance in developing countries. In the world, foreign direct investment is considered an impressive sort of investment (Ali & Malik 2017).

Technology and capital are transferred to the developing country with the help of FDI. The economy of a country can attains prosperity and growth with the help FDI in the country. Besides, the finance and current account deficit can be provided a great amount of assistance by the inflow of capital. The rate of wages can be increased due to investment from abroad. Furthermore, FDI helps to improve the working conditions in developing economies (Su & Liu, 2016). Furthermore, with the help of FDI in a country the funds are transferred through which the physical capital can be purchased and acquired. Physical capital includes factories, machines, etc. These physical capitals play an imperative role in boosting the economy of a country.

The FDI's role is very important on a micro-economic level. The significant economic growth can be released by the domestic markets that expand into foreign markets. Besides, in the country where there is higher level of foreign direct investment, it has new opportunities that create more employment opportunities and generates more revenue for the country. Therefore, FDI is considered the most important determinant of economic performance and growth of a country (Jones & Wren, 2016). In this sophisticated and globalised world, the FDI is considered as an engine of economic growth, and it has garnered great significance in international business studies. The literature shows that enhancement in the FDI directs to that there is a certain difference in the growth ratio of countries with better financial conditions and the countries with deprived financial situations. Hence, the reason for this particular difference is the economic conditions of the country.

2.5. Conceptual Framework



The above framework is representing the overall picture of the research. The framework is showing the independent variables and dependent variable relationship. Here the independent variables are the GDP, FOREX, interest rate, and corruption while the dependent variable is foreign direct investment.

2.6. Theoretical Framework

FDI is putting much simpler term is the process where investment from developed countries is transferred to developing countries. Smith's theory initiated in 1937 revolves around the concept that if trade happens between nations, one country would be the producer and the other one would be the exporter. Internationalisation theory holds the view that combination of ideas can lead a business to address large markets. The study is relevant as it focuses on factors that play a role to magnify the process using FDI.

Smith and internationalization theory deal with development through foreign investment, considering the four variables it is necessary that FDI create a positive impact as all these variables are very important for a country to thrive and excel.

Nayak and Choudhury (2014) discussed the FDI theory based on perfect competition. They mentioned that in 1958 MacDougall established the model regarding FDI which is constructed on the assumptions and conventions of a perfectly competitive market. The theory assumed that prices of capital and two-country model are considered to be equivalent to its marginal productivity. It also stated that the marginal output of capital inclined to be levelled among the two countries when there was permitted movement of capital from a capitalising country to the host country. The output of the country that invested the capital cut down devoid of any decline in the national income of the country. However, the investing country will get a greater amount of income in the long from its investment in other countries.

The other method proceeds from the theory regarding an industrial organization. This method was founded in 1960 by Hymer and was established by Dunning, Vernon, Caves, and Kindleberger including many others. The initial idea in this theory is related to the query that why companies make investments in other countries to produce or manufacture the same offering as they offering in their own country. The response to this question was being articulated as trails that for making a direct investment to prosper there should be a certain imperfection in markets for offerings or goods. This also included the factors latter technology, particular intervention in the competition by companies within an industry or government, which splits markets. Therefore, to if countries want to make an investment in foreign markets in the field of production then they need to have a specific asset in the form of knowledge concerning to the public-good character (Blomstrom, 2014).

2.7. Hypotheses

H1: GDP has positive significant Impact on foreign direct investment.

H2: Interest rate has negative Impact on foreign direct investment.

H3: FOREX has positive Impact on foreign direct investment.

H4: Corruption has negative Impact on foreign direct investment.