

# Does Foreign Ownership Improve Firm's Productivity? An Analytical View

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*Foreign Direct Investment (FDI) is one of the vehicles which bring inflow of capital, technology upgradation, improvements in human productivity and efficiency in firms of the host country and also change in the ownership structure of the firms. This paper explores the relationship between foreign ownership of the firms and its impact on the productivity by reviewing the literature available over the period of 1976 to 2017. In majority of the cases over the years, scholars concluded that foreign ownership acquired through FDI promotes total productivity factor as well as labor productivity except in two cases, namely: family-owned firms and firms that employ unskilled labors.*

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## Introduction

Expert thinkers encourage inward FDI, considered as a key source of driver of economic growth especially in the emerging economies where capital and technology are scarce compounded with lack of skilled, productive manpower and efficient processes. The economic growth of a country depends on its ability to harness the natural advantages through efficient utilization of productive resources, technology, capital and labor. Foreign capital in the form of FDI could lead to change in the firm's ownership either to minority or the majority in the host country.

The trend of inward FDI across countries is increased in recent years due to trade globalization and economic reforms in the emerging economies. The prime motivation for the host countries to attract FDI was based upon the basic premise that its presence would benefit them by the exposure to upgraded technology, availability of funds and better processes to improve productivity. Interestingly World Bank stated in 1993 that "FDI brings considerable benefits: technology transfer, management know-how,

and export marketing accesses". While in late 1960s and early 1970s, inward foreign direct investment (FDI) was frequently alleged to be disadvantageous for host countries the opinion in recent years has changed drastically (Sahu & Solarin, 2013). In many cases host countries have expressed concern that FDI entry through the takeover of domestic firms is less beneficial though not completely harmful for economic development. The rationale of these concerns was that overseas acquisitions did not promote the productive capacity but rather transfer ownership and shift the control from domestic to foreign hands. The primary reasons to make these changes in the struc-

ture of firm were usually an important factor to achieve benefits. However they were frequently opposed by the host country labor unions. On the other end, the FDI route where foreign firms invested in the firms of the host countries was well researched and good amount of evidences were available to form opinions. In recent days a new topic which was drawing the attention of the scholars was to study the FDI impact on the family vs. non-family firms.

This paper reviews the literature associated with foreign ownership through FDI and its impact on productivity in the light of these views.

**Table 1 Findings of Key Papers**

S. No.	Year	Author (s)	Paper Title	Relationship between Foreign Ownership and productivity	Major findings
1	2017	Liang et.al	Does foreign direct investment improve the productivity of domestic firms? Technology spillovers, industry linkages, and firm capabilities	Accepted	Diffusion of technology through FDI depends on industrial linkage, firm capability, and location.
2	2017	Domanoviæ, Jovanovic	Effects of foreign direct investments on Serbian exporters' profitability	Rejected	Could not establish any conclusion that FDI contributed to the return on assets.
3	2017	Sunde et.al	Foreign direct investment, exports and economic growth: ADRL and causality analysis for South Africa	Accepted	The ARDL model observed the co-integration for the long run relationship between economic growths, FDI and exports.
4	2017	Singh	Does FDI Promote Productivity? A Deep Dive.	Accepted	FDI promoted total factor productivity as well as labor productivity in the host country except in two instances 1) family-

5	2016 a	Singh	Do Technology Spillovers Accelerate Performance of Firms? Unravelling a Puzzle from Indian Manufacturing Industry.	Accepted	owned enterprises and 2) firms that employ unskilled labor. FDI promotes technology import that leads to productivity
6	2016 b	Singh	R&D spillovers & productivity growth: evidence from Indian manufacturing	Accepted	Foreign firms promote skill building specially in ICT (information and communication technology)
7	2014	Anwar et.al	Heterogeneity and curvi-linearity of FDI-related productivity spillovers in China's manufacturing sector	Accepted	The size of the productivity spillovers depended on firm age, capital intensity and ownership structure.
8	2013	Sahu and Solarin	Foreign Shareholding and Productivity Spillover:: A Firm-Level Analysis of Indian Manufacturing	Accepted	FDI had positive impact on output growth, the increase in foreign equity at firm level and at sector level directly affected the productivity growth
9	2012	Chopra et.al	Analysis of FDI Inflows and Outflows in India	Accepted	FDI and ownership was positively connected with the productivity improvement of the firm
10	2012	Sciascia et.al	The role of family ownership in international entrepreneurship: exploring nonlinear effects	Rejected	Family structure influenced productivity and FDI was not having strong spillover in the productivity improvement
11	2009	Nilekani	Imagining India: The idea of a renewed nation	Accepted	Foreign investments had direct bearing on the improvement on the firms productivity
12	2009	Barbosa et.al	Linking corporate productivity to foreign direct investment: An empirical assessment	Rejected	Failed to establish a significant correlation and influence of the FDI or the MNE ownership to productivity and firms specific characteristics
13	2007	Chakraborty	Economic Reforms, FDI, and Economic Growth in India: A Sector Level Analysis	Accepted	FDI in the services sector had cross industry productivity improvement spillover

14	2007	Haskel, et.al	Does Inward Foreign Direct Investment Boost the Productivity of Domestic Firms?	Accepted	A 10% increase in foreign presence in industry raised the total factor productivity of that industry's domestic plants by about 0.5%.
15	2006	Villalonga et.al	How do family ownership, control and management affect firm value?	Rejected	Family firm structure did influence the productivity of the firm
16	2005	Zahra	Ownership and the Internationalization of Small Firms	Rejected	Family considerations could limit strategic aggressiveness of the family owned firms with limited scope of FDI
17	2004	Deva S	The Sangam of foreign investment, multinational corporations and human rights: An Indian perspective of developing Asia	Accepted	Foreign investment and ownership enhanced the productivity of the firm
18	2003	Anderson et.al	Founding-Family Ownership and Firm Performance: Evidence from the S&P 500	Rejected	Family run firms performed better than nonfamily firms. The relation between family holdings and firm performance is nonlinear
19	2003	De Backer et.al	Foreign ownership and productivity dynamics	Accepted	Foreign firms contributed disproportionately to aggregate productivity growth of the host country firm.
20	2003	Morcket.al	Agency problems in the large family business groups	Rejected	Family-owned firms may suppress capital-improving & innovation to protect their wealth
21	2001	D Kapur, Ramamurti	India's emerging competitive advantage in services	Accepted	FDI influenced the productivity of the firms in the Services sector
22	2000	Djankovet.al	Foreign Investment and Productivity Growth in Czech Enterprises	Accepted	Foreign investment had the predicted positive impact on total factor productivity growth of recipient firms.
23	1999	Aitken et.al	Do domestic firms benefit from direct foreign investment? Evidence from Venezuela	Rejected	FDI had negative impact on the host country firms productivity

24	1999	Helpman	R&D spillovers and global growth	Accepted	R&D spillovers, trade, foreign ownership played important roles in boosting growth, technology spill over and productivity
25	1995	Cantwell	The globalization of technology: what remains of the product cycle model?	Rejected	Technology leaders were ahead despite of dispersion of the technology due to globalization
26	1995	McGuckin et.al	On Productivity and Plant Ownership Change: New Evidence from the Longitudinal Research Database	Accepted	Change in the ownership was positively correlated with the productivity improvement
27	1995	Kholdy	Causality between foreign investment and spillover efficiency	Accepted	Observed positive effect of the foreign ownership on the host country.
28	1993	Haddad and Harrison	Are there positive spillovers from direct foreign investment?: Evidence from panel data for Morocco	Rejected	FDI infused firms were subsidized to leverage technology spilloverbut the study didn't support the accelerated productivity growth
29	1990	Agrawal et.al	Corporate capital structure, agency costs, and ownership control: The case of all equity firms	Accepted	All-equity firms exhibited greater levels of managerial autonomy than the family owned firm's top management.
30	1989	Blomström and Wolff	Multinational Corporations and Productivity Convergence in Mexico	Accepted	Productivity growth of industries and its rates of convergence were higher in industries with a greater presence of foreign owners.
31	1987	Ward	The special role of strategic planning for family businesses	Rejected	Strategic planning for family-owned businesses differs from planning for other types of firms
32	1984	Hughes	Economic policies and direct foreign investment with particular reference to the developing countries of East Asia	Accepted	Technology gap between foreign and host countries led to FDI that improved productivity.
33	1983	Lall and Mohammad	Multinationals in Indian big business: Industrial characteristic of foreign investment in a heavily regulated economy	Accepted	Overseas investment was concentrated in complex technologies, large-scale production and intensive management

34	1983	Demsetz	The Structure of Ownership and the Theory of the Firm	Accepted	Technology gap between foreign and host countries led to FDI.
35	1980	Gulati et.al	Export Obligation, Technology Transfer and Foreign Collaboration in Electronics	Rejected	Policy framework, export obligations and technology transfer, link between productivity and the firm's ownership was not established
36	1979	Globerman	Foreign Direct Investment and 'Spillover' Efficiency Benefits in Canadian Manufacturing Industries	Accepted	Labor productivity differences across FDI infused plants were found to be positively related to amount of foreign ownership in the plant
37	1979	Pillai, P. Mohanan	Technology transfer, adaptation and assimilation	Accepted	FDI helped in technology transfer and adaptation for the improvement in productivity
38	1976	Long and Frank	Foreign direct investment in an underdeveloped European economy — the Republic of Ireland	Rejected	The socio economic data and its relationship due to FDI did not establish a very positive relationship.
39	1974	Caves	Multinational firms, competition, and productivity in host-country markets	Accepted	The time series data established the positive link between FDI and productivity
40	1932	Berle et.al	The Modern Corporation and Private Property	Accepted	Structure and ownership of the modern corporations did influence the total productivity of the firms

### **Yes: Foreign Ownership Accelerates Productivity in Host Country**

Multinational firms always look for opportunity to leverage their capital and technical capability to strengthen their market share in the host countries. This led to flow of capital and technology from the matured multinational firms to target firms in the host countries and the subsequent changes in the firm's ownership in host countries. Inward FDI had always fascinated firms as it opens up the gates

to access advanced foreign technology and capital resources.

Caves (1974) was one of the early scholars who demonstrated the positive correlation between inward FDI and productivity. Globerman (1979) also supported the findings and argued that if foreign firms brought new products or innovation in the host country then host country firms benefit through the accelerated dissemination of technology. In one of the early papers, Demsetz (1983) found that technology gap between foreign and host

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countries led to FDI, and also established positive correlation between structure of the ownership and firm's productivity. Lall and Mohammad (1983) were able to establish positive link between FDI and productivity in the host country firms. Blomström and Wolff (1989) observed that the inflow of FDI can reduce the technological gap among foreign and domestic firms of developing country and could establish that this led to quicker convergence between Mexican and American industries. Agrawal et.al (1990) found during their study of the corporate capital structure and agency cost, that all-equity firms exhibit greater levels of managerial controls and stockholdings. They could establish that foreign ownership in the capital structure could lead to higher productivity in the host firm.

Theories prompting technological spillovers observed that host country firms may get benefited from the presence of FDI in the same industry, leading to horizontal spillovers or intra-industry, through labor movement and positive competition. Kholdy (1995) was able to establish the causality between foreign investment and spillover efficiency caused due to FDI in the host country. McGuckin et.al (1995) established that change in the ownership of the plants was positively correlated with the productivity improvement of the

plants. In the study of the globalization of technology-product cycle model, Cantwell (1995) was able to establish that despite technology dispersion, leaders have been ahead. FDI however helped to improve the productivity and technical edge in the host country but it did not harm the technology leading country as well. Helpman (1999) was able to link that foreign ownership in the firms improved the level of productivity and reduced the cost of innovation which helped to improve total factor productivity. Djankov et.al (2000) predicted positive impact on total factor productivity growth of recipient firms in Czech Republic. In one of the studies in the context of Belgian industries, De Backer et.al (2003) found that foreign firms contributed disproportionately to the productivity growth of the host country firm. Deva (2004) stated that despite facing empirical difficulties to measure the technology spillovers, improvements in productivity among the FDI infused firms were visible. In the context of UK industries, Haskel et.al (2007) estimated that with the increase of 10% foreign ownership through FDI, total factor of productivity increases by 0.5% in the host country firms. This study was showing significant light on the positive co-relationship between foreign ownership and firm's total factor productivity. Nilekani (2009) in the context of India also observed a similar trend with a separate view on the firm's ownership. In the context of Asian developing countries where FDI was considered one of the core vehicles for development, Liang et.al (2017) found positive productivity spillovers between foreign suppliers and their

domestic customers. They also observed that local firms learn from both joint ventures and wholly-owned foreign subsidiaries.

**FDI promoted firm's productivity except in two cases specifically first: family owned business and second: where unskilled labors were employed.**

In recent years, where FDI flow in India was growing, Chopra et.al (2012) observed that introduction of FDI and change in the ownership structure could help the country in job creation, infrastructure development, and the country's GDP growth. Sahu and Solarin (2013) demonstrated the spillover action by incorporating FDI in measuring productivity of the manufacturing sector. The result indicated that the increase in foreign equity at firm and sector levels directly affected the productivity growth of the firm. Anwar et.al (2014) observed that the size of the spillovers depended on firm age, capital intensity and ownership structure. While studying the impact of the foreign direct investment in the host countries, Singh (2017) carried out an excellent study to evaluate the relationship between FDI and productivity. He narrated that in most of the cases the FDI promoted firm's productivity except in two cases specifically first: family owned business and second: where unskilled labors were employed. Interestingly, Singh (2016a) illustrated that foreign firms help to boost the technology transfer and that can also lead to productivity. In another related study, Singh (2016b) pointed out

that FDI can lead to promote better infrastructure such as ICT (information and communication technology) and this could lead to higher productivity. Until this point, the R&D expenses was the only determinant that was taken into account for firm's research endeavor, however Singh (2016b) was the first one to take royalty and technology transfer to prove the point how FDI can turn the things around from foreign firms to local enterprises. Put together, the work carried out by Singh (2017, 2016a 2016b) was pioneer to unveil the complex web of FDI and productivity. Sunde et.al (2017) was able to establish the causality relationship between foreign direct investment, exports and economic growth. Liang et.al (2017) observed that Chinese domestic firms benefited from foreign-owned suppliers but not from foreign customers.

In the course of studies, two categories of literature emerged significantly: one which demonstrated the impact of FDI and foreign ownership on the host economy and local firms in terms of efficiency and productivity, the second one investigated the impact of ownership changes on target and bidder firm's performance. A separate approach was adopted by Hughes (1984) particularly in the context of developing countries and analyzed the benefits of the FDI, using stock markets approach and measured technical efficiency and productivity.

In the last few years, many authors compared the foreign owned and host country owned firms. McGuckin et.al (2001) accepted that foreign owned firms (FDI infused) are relatively more produc-

tive than domestic firms. One of the most interesting finding came with Haskel et al. (2007) who observed that firms that are acquired by foreign firms showcased the increase of labor productivity approximately by 13% in seven years.

While FDI was not very popular, Berle et.al (1932) brought a unique dimension very early days of the modern industrial age and debated the impact of ownership structure on firm's productivity. It was only later that Demsetz (1983) and Morck et al. (1988) argued this phenomenon by demonstrating the impact of ownership on productivity and established that change in ownership through foreign direct investment did promote productivity.

A few scholars undertook detailed studies of the impact on productivity based on ownership structure like family vs. non-family owned firms, especially those with FDI. A brief analysis was done by Anderson et.al (2003) and Lee (2006). They established a structure based approach where family firms were defined, controlled and owned by family based outfit. Following this analogy Villalonga (2006) and Sciascia (2008) argued that family structure did impact the total productivity factor of the firm. This is where the debate of productivity by family vs. non-family owned firms started to become serious.

#### **No: Inward FDI Does Not Boost Productivity in the Host Country**

Though most of the studies since 1976 supported the FDI led foreign own-

ership to promote productivity in the host countries a few studies did not see this argument in the favor. Long and Frank (1976) used the socioeconomic data and its relationship due to direct foreign investment in the context of Ireland. They could not establish a very positive relationship. Gulati et.al (1980) did the similar study in the context of FDI in India. They failed to establish strong relationship in FDI and productivity improvement in India. Haddad et.al (1993) also could not find any link between FDI and productivity. They noticed that the dispersion of productivity is smaller in sectors with more foreign firms. They rejected the hypothesis that foreign presence accelerated productivity growth in domestic firms. Cantwell (1995) observed that in the globalization of technology-product cycle model technology leaders have been ahead despite of dispersion of the technology due to globalization. At the same time Aitken et.al (1991) observed rather a negative impact of FDI on firm's productivity in the case of Venezuela manufacturing firms. Following that, Djankov (2000) could not find any evidence to support the link between inward FDI and performance of the firms. Morck et.al (2003) in his study of agency problems in the large family business groups, observed that family-owned firms might actively suppress innovation to protect their already established wealth. They also found that family-owned firms might have lacked strategic aggressive-

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ness even in the case of FDI. Anderson et.al (2003) in his study of Founding-Family Ownership and Firm Performance for the S&P 500 firms found that family firms perform better than non-family firms.

Additional analysis revealed that the relation between family holdings and firm performance is nonlinear. It was Ward (1987) who first explained that family preferences and considerations limited the strategic aggressiveness of family firms and may thus reduce the productivity even in the presence of FDI. Suppression of capital-enhancing steps may in turn reduce the productivity contribution of the family-firm. Morck et.al (2003) considered situations in which family firms may actively suppress capital-improving innovation to protect their already established wealth. This may in turn reduce output. They further demonstrated that these family firms may not be able to enjoy the benefits of FDI in certain case if family effect is large and very risk averse. Agrawal et.al (1990); Zahra (2005); Villalonga (2006) and Barbosa (2009) argued that family owned firms are so engrossed that they forgo many risk taking capital investment activities that can reap benefits to improve the firms total productivity and efficiency. Sciascia et.al (2012) used the structure based approach and observed that family structure influenced productivity.

It was Singh (2017) who noticed two major exceptions where FDI failed to promote productivity. Singh (2017) by studying more than 50 papers in this area pointed out that FDI may not promote productivity, first: in the case of family

owned business and secondly in the case of unskilled workers. He stated that family owned business may not have required risk-taking ability and hence that may hamper productivity. In case of unskilled labor, he stated that they may not be able to draw differentiation and hence significant impact to productivity may not be noticed.

Singh (2016a) made a significant revelation about technology transfer between foreign owned firms and the local firms. He noted that local firms need to have required knowledge and human capital in order to absorb the high-end technology transfer and import. This can be built by investing in research and development. In another study, Singh (2016b) further stated that while ICT (information and communication technology) transfer can help promote productivity in local firms, however the investments need to be made judiciously. The overspent may lead to low productivity in certain cases.

### **Indian Context**

In the last few years, services sector has attracted the maximum amount of foreign direct investment in India, which had been a matter of much academic attention. In a recent study by Chakraborty (2007) it was observed that FDI in the services sector appeared to have promoted growth and total factor productivity improvement in the manufacturing sector through cross-sector spillovers. Study by Kapur (2001), Singh (2017), Ramamurti (2001), acknowledged the importance of inward FDI in

the overall economic development and productivity of firms. The R&D promoted FDI was seen to encourage the structural changes in the host country through resource and technology sharing and leverage knowledge spillovers to promote productivity. Chopra (2003) established that competitive advantages, intent to increase productivity and efficiency, access to technology and resources were the driving force to seek FDI. He demonstrated that FDI can create an impact that promotes the local firms to improve their productivity by leveraging the new technology and resources available to their foreign counterparts. This enhances their competencies not only to compete locally but to spread their wings to foreign markets (Deva, 2004; Singh, 2016 a; Nilekani, 2009; Singh, 2016 b).

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While the above results were in favor of FDI promoting productivity, few of them showed the opposite. Agrawal et.al (1990), Singh (2017), Zahra (2005) discussed the issues with family-owned firms where they explained that family's wealth is so closely tied to the firm's future, it might become difficult for inside family owners to support such risk taking activities. Gulati et.al (1980) argued that inward FDI may not improve productivity of the family run businesses mainly due to slow decision making, risk-

averse approach and slow dissipation of knowledge. In the context of India, Pillai (1979) debated that inward FDI is infused by those firms which are already productive and producing better than their peers. Apparently the FDI helped them to create a longer-term partnership to boost the productivity of the domestic firms. While Singh (2017) accepted the benefit of FDI to boost productivity he also mentioned that besides family owned business, unskilled labor is the major hurdle to promote productivity through FDI.

### **Concluding Remarks**

The prime motivation of a host country in attracting FDI rests upon the belief that the presence of FDI would benefit them. Many authors showed that FDI brings considerable benefits: technology transfer, process and management know-how and export market access. At the same time, a few scholars could not see strong relationship between FDI and productivity of the firm especially when the firm's ownership structure was family driven.

Following observations are made based upon this study:

1. Most authors agreed that FDI promotes productivity (total factor productivity as well as labor productivity) for the host country firms. This consistently holds good for non-family owned firms.
2. The inflow of FDI could reduce the technological gap between foreign and domestic firms of the host country.

3. Few exceptions were also observed when domestic firms were already productive and second, where industry was already saturated with multiple foreign players. In these two situations the improvement in productivity may not be significant.
4. Another key exceptions was observed where FDI did not promote productivity in the case of family-owned firms and companies that employ unskilled labor
5. In the context of India, authors established that inward FDI raises the productivity and efficiency of the firms. The increased productivity can then be utilized to expand the firms or diversify its business horizontally.

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