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FDI-Based Business: The Case of Bangladesh

Rashid Ahmed Chowdhury*, Mohammad Nayeem Abdullah**
and Rahat Bari Tooheen***

The study examines the characteristics of the current policies for setting up business enterprises based on Foreign Direct Investment (FDI) in Bangladesh. Data was collected through a non-random convenience survey among companies engaged in the export import business. The data was analyzed in Microsoft Excel and then rechecked through SPSS. The results identified a number of positive factors of the current FDI policies such as time efficiency and cost reduction, while bureaucratic issues and a lack of upgrading capability were identified as the main hindrances of the policies.

Field of Research: Economics

1. Introduction

The economy of Bangladesh is stated to maintain a steady momentum of growth (Bangladesh Bank, 2015). The Government of Bangladesh is looking forward to establish the nation as a middle income country within 2021. This goal requires significant financial investments from home and abroad. Foreign Direct Investment (FDI) is considered as one of the crucial ingredients for fostering economic development of developing countries (Borensztein, De Gregorio and Lee, 1998; Hermes and Lensink, 2003; Sahoo, 2006; Iamsiraroj, 2016). FDI plays an important part in creating jobs but is also significant as a source of income. Foreign Direct Investment (FDI) is established when a company from one country establishes business operations in another nation (Moran, 2012). According to Bosworth, Collins and Reinhart (1999), there are large benefits for developing countries to draw upon an international finance pool.

Iamsiraroj (2016) found that overall impacts of FDI have a positive association with growth. Almfraji and Almsafir (2014) acknowledge that FDI is viewed as having a significant impact on economic growth. Economic growth is a multifaceted concept (Greenway and Kneller, 2007; Knox, Agnew and McCarthy, 2014). Waqas, Hashmi and Nazir (2015) posit that macroeconomic factors are important for the attraction of FDI into a nation. Davletshin, Kotenkova and Vladimir (2015) determine that developing nations have a higher dependency on foreign direct investments in comparison to their developed counterparts. Haskel, Pereira and Slaughter (2007) state there are spillovers of productivity from FDI to domestic firms. Javorcik (2004) also finds evidence to this effect. Foreign investment, with particular preference to foreign direct investment will be encouraged in all industrial activities in Bangladesh.

* Rashid Ahmed Chowdhury, Assistant Professor, School of Business, Chittagong Independent University, Bangladesh. Email: rashid@ciu.edu.bd
** Dr. Mohammad Nayeem Abdullah Assistant Professor, School of Business, Chittagong Independent University, Bangladesh. Email: nayeem@ciu.edu.bd
*** Rahat Bari Tooheen, Assistant Professor, School of Business, Chittagong Independent University, Bangladesh. Email: tooheen@ciu.edu.bd

Foreign direct investment (FDI) has the potential to generate employment, raise productivity, transfer skills and technology, enhance exports, and contribute to the long-term economic development of the world's developing countries. One Stop Service basically gives the service at a particular point which gives the potential investors an opportunity to save time. All the services related to an investment proposal, starting from Registration, Import Registration Certificate (IRC), visa recommendations, work permits, establishment of branch, and liaison and representative offices of foreign companies in Bangladesh, including foreign loans which encourage to foreign investment can be completed under the One Stop Service.

Major reforms were implemented in Bangladesh as a part of structural adjustment policies under the World Bank and the IMF in the 1980s and early 1990s. The efforts started with World Bank structural and sectoral adjustment loans (SALs and SECLs) in the 1980s. IMF introduced a three-year structural adjustment facility (SAF) in 1986 under which major reform initiatives were undertaken in areas such as agricultural policy, trade and industrial policy, along with privatization and public enterprise reforms, fiscal policy reform and financial sector reform. Moreover, the implementation of these reforms gained momentum during the 1990s (Kruger, 1975). The government has liberalized its industrial and investment policies in recent years through a number of major incentives including tax exemptions for power generation, import duty exemptions for export processing, an exemption of import duties for export oriented industries, and tax holidays for different industries. Double taxation can be avoided by foreign investors on the basis of bilateral agreements. Facilities for the full repatriation of invested capital, profit and dividend exist as well.

Markusen and Venables (1999) identify FDI as an important input for industrial development. Similarly, Globerman and Shapiro (2002) state that governance infrastructure is an important requirement for the inflow of foreign direct investment. Since the beginning of the 1990s, Bangladesh has adopted a number of policies to facilitate the expansion of the private sector and increase inflows of foreign investment. The private sector is recognized as the engine of economic growth. Although the transition process from an agrarian to an industrial economy has only started, there is consensus among the political parties on promoting a market-oriented economic policy. International investors usually consider investing in Bangladesh to access the growing market, low-cost production facilities and an abundance of natural resources. Low-cost is the factor most often cited by the private as well as the public sectors in Bangladesh to be a factor attracting investment inflows.

The paper is organized as follows: Section 1 deals with Introduction and Section 2 focuses on Literature Review. Section 3 contains the Methodology and Model. The Findings are provided in Section 4 and Conclusion is in Section 5.

2. Literature Review

2.1 Theoretical Overview

Rothgeb (1984) used his model to explore the impact of foreign investment on the growth of Bangladesh and found that FDI has a positive impact on growth. He also found a strong positive effect of the change in the level of domestic investment on growth. Bengoa and Sanchez-Robles (2003) showed the positive correlation between FDI and economic growth. In this connection, with a view to getting benefit from long term FDI inflows, human capital, stable economic condition and liberalized markets are required in host countries.

Borensztein, De Gregorio and Lee (1998) examined the data on FDI inflows of sixty nine developing countries by regression framework and found the importance of FDI as a means of transferring technology that contributes more to growth than domestic investment. Teanravisitsagool (1999) analyzed the long run relationship between FDI and domestic investment in case of Thailand. He found that FDI has a significant and positive long term effect on domestic investment in Thailand. Bosworth, Collins and Reinhart (1999) distinguished among three types of inflows: FDI, portfolio investment, and other financial flows (primarily bank loans) by their effect on domestic investment for 58 developing countries during 1978-95 covering nearly all of Latin America and Asia, as well as many countries in Africa. The authors found that an increase of a dollar in capital inflows is associated with an increase in domestic investment of about 50 cents.

Lee, Baimukhamedova, and Akhmetova (2010) analyzed the correlation between FDI inflows, exchange rate, and economic growth of Kazakhstan by a multivariate regression model with weighted least squares estimates. The results revealed the minimum significant impact of FDI on GDP growth of Kazakhstan. Quader (2009) applied extreme bounds analysis to the data of the various catalyst variables of FDI inflows in Bangladesh. They found FDI and domestic investment have a positive effect on economic growth. Misztal (2010) examined the influence of FDI on the economic growth in the Romania in period of 2000-2009 using the Vector Auto regression Model (VAR) and found linear relationship between FDI and economic growth. Azam (2010) examined the impacts of exports and FDI of South Asian countries namely Bangladesh, India, Pakistan and Sri Lanka with simple log linear regression model using secondary data ranging from 1980 to 2009 and found that due to promotion of exports, economic growth of each country would increase. He also found FDI as positively significant at 1% level of significance for Bangladesh and Pakistan, while for India it's insignificant and in case of Sri Lanka though it is significant but with unexpected negative sign. Billah (2012) examined the relationships between FDI and growth. FDI generally has a positive impact on economic growth in developing countries. He found that it enables a capital-poor country like Bangladesh to build up physical capital, create employment opportunities, develop productive capacity, enhance skills of local labor through transfer of technology and managerial know– how, and help integrate the domestic economy with the global economy.

Foreign direct investment is encouraged in industrial activities in Bangladesh excluding those on the list of reserved industries such as production of arms and ammunitions; forest plantation and mechanized extraction within the bounds of a reserved forest, production of nuclear energy and printing and minting fresh currency notes. Such investments may be undertaken either independently or through joint ventures, either with the local, private or public sectors. The capital market also remains open for portfolio investment. The policy framework for foreign investment in Bangladesh is based on the Foreign Private Investment (Promotion and Protection) Act, 1980, which provides measures for the non-discriminatory treatment and protection of foreign investments. A notable aspect of the FDI policy framework has been identified by Azman-Saini, Baharumshah and Law (2010) in a multi country study which finds that FDI by itself exerts no impact on growth; rather the impact is dependent on the level of economic freedom in the recipient country. Nunnenkamp and Spatz (2003) earlier highlighted another aspect of this argument by determining that industry and recipient country characteristics are important factors influencing the impact of FDI on growth.

The Literature Review section has shown that FDI has been examined in the context of a number of countries across the globe. However, the study authors have been unable to locate a study which analyses in details the prospects of FDI-based businesses in the Bangladesh context. As a result, the present study will add to the growing body of academic and research literature which examines the prospects of FDI-based business in the context of developing nations such as Bangladesh.

The research question for the study can be stated as follows: What are the Merits and Demerits of the One Stop Process for FDI-based businesses in Bangladesh?

The research question has been formulated keeping in mind the focus of the study, which is the One Stop Process for FDI-based businesses in Bangladesh. This particular aspect has been selected as the focus of the study since this model is poised to become the norm for FDI-based enterprises in the nation.

2.2 Bangladesh Context

FDI registration is completed through BOI. This registration facilitates not only the acquisition of a legal status but also entry to the support and incentives provided for the FDI. There are separate arrangements for investment made in specialized EPZs and the investment parks of Bangladesh Small and Cottage Industries Corporation (BSCIC). For the registration of projects, entrepreneurs are required to apply in the prescribed forms available at the one-stop service centre of BOI. As a matter of fact, unless an investor is setting up a unit in an EPZ or an industrial estate, BOI is the investor’s point of contact. However, preregistration clearance is required for investment in RMGs, banks, insurance companies and other financial institutions.

Registrations of industrial projects as well as royalty, technical knowhow and technical assistance agreements are done with BOI. Permission from BOI is required for payment beyond the prescribed limits of royalty, technical assistance fees and fees to foreign nationals as well as for foreign loans, suppliers’ credit, deferred payments, PAYE scheme, etc. If a local or foreign entrepreneur wishes to set up a joint venture with a public sector corporation, it must be registered with BOI, if the private sector’s share holding is more than 50 percent. In such a case, it is treated as a private sector project. The public sector entity in question needs to get the approval from the concerned ministry, in order to invest its own resources, and the ministry will then process the registration.

There have been several attempts to streamline the project registration process in Bangladesh, starting with the creation of BOI in 1980. BOI’s one-stop service provides free investment counselling, utility service connections, solution of problems in case of any difficulty arising in clearing imported machinery under concessional rate of import duty and obtaining bonded warehouse license. It also helps in getting environmental clearances for projects, although a certificate for anti-pollution and safety measures will still be required from the Department of Environment. Any manufacturing company employing ten or more workers, with or without the use of power, is required to be registered under the Factories Act, 1965 (Act IV of 1965), with the Office of the Chief Inspector of Factories and Establishment. This Act regulates the working conditions and to ensure safety measures in the factory.

The Foreign Private Investment (Promotion and Protection) Act of 1980 guarantees protection against expropriation of foreign investment. If a foreign investor is subject to a legal measure that has the effect of expropriation, adequate compensation will be paid which could be freely repatriated. The amount of compensation will be determined by appraising the market value of the investment project immediately before the measure comes into effect.

Risks of expropriation are almost nil, as the country avowedly follows the principle of free-market economy. Bangladesh is also a signatory to the Multilateral Investment Guarantee Agency, which insures investors against political risk. OPIC's (Overseas Private Investment Corporation, USA) insurance and finance programs are operable in Bangladesh. Bangladesh is also a member of the World Intellectual Property Organization (WIPO) and the World Association of Investment Promotion Agencies (WAIPA), which offer further safeguards to foreign investors. Bangladesh EPZ Authority (BEPZA) has also been set up to help investors in these areas. It facilitates access to land and utilities and also looks after the day-to-day problems of investors. In addition, BSCIC provides industrial estates for investors. Both BEPZA and BSCIC grant necessary approvals

Infrastructure Investment Facilitation Company (IIFC) has been set up with the backing of the World Bank to catalyze investment by the private sector for the development of ports, roads, energy, telecom and water supply. Established at a cost of US$15mn, the Company will work closely with the Infrastructure Development Company – another brainchild of the World Bank. The aim is to channel some US$225mn to the private sector companies as equity through the company, which is expected to attract private capital to the tune of US$1.5bn in a few years. National business chambers, such as Bangladesh Garments Manufacturers and Exporters Association (BGMEA) and Bangladesh Textiles Manufacturing Association (BTMA), often hold investment fairs of their own to attract the attention of foreign investors.

3. The Methodology and Model

3.1 Data Collection and Sampling

A non-random convenience survey to gather primary source data from companies currently engaged in the export-import business was conducted. The survey collects quantitative data on the range of services which is of the highest concern for the end users. The survey instrument consisted of a closed-ended questionnaire with 15 questions which the responses from the respondents were recorded in a scale of 1 to 5, 1 being labelled "Strongly Agree", 2 being labelled "Agree", 3 being labelled "Neither", 4 being labelled "Disagree", and 5 being labelled "Strongly Disagree". An additional random sample of companies was drawn from members of the One Stop Service Register. The focus of the paper justifies the non-random convenience sampling approach. The response rate for the close-ended questionnaire was approximately 75%.

The study is qualitative by nature, and the quantitative calculations were carried out to confirm the findings of the qualitative survey, as stated in the following sub-section 3.2 of the study. Since the focus of the paper is on FDI-based businesses which operate in the country, a non-random convenience survey is the applicable analysis tool which serves to yield the requisite data set.

3.2 Data Analysis

The spreadsheet package MS Excel (updated accessible version) is applied since it is compatible with any standard data set and this software can be used in conjunction with other applications when the data analysis requires. To ensure that the final calculations were free from statistical bias, the calculations were rechecked through SPSS. The quantitative analysis was conducted to confirm the qualitative portion of the paper. Hence, the quantitative calculations have been excluded from the results.

4. The Findings

The results of the survey and the following analysis have been presented below as follows since the focus of the paper is primarily qualitative in nature.

4.1 Merits of One Stop Process

Time efficient: In this process, the customer can complete all the requisite formalities from one point standing in a queue and hence does not need to spend a disproportionate amount of time for a particular task.

Meet customer expectations:The process reduces time consuming bureaucratic processes and ensures the speedy completion and delivery of services. Consequently this leads to an increase in the fulfillment of customer expectations.

Employment: The process can generate employment for a significant number of workers in the economic sector which in turn will lead to the generation of more income and service flows from and to other important sectors of the national economy.

Increasing GDP:The generation of increased income and service flows between vital sectors of the national economy will consequently lead to the increase in the GDP.

Reduction of costs: By providing services under one roof, leads to a significant reduction in costs which the company passes onto the consumer in the form of substantial discounts. It is also able to ensure smoother transactions.

4.2 Demerits of One Stop Process

Lack of upgrading capability: Once the one stop service has been constituted and established in a particular sector, upgrading the process presents a challenge since it has become habituated to a certain sequence of tasks for the completion of an assignment.

Bureaucratic problems: Despite being a functional democratic republic, the bureaucracy of the country is severely old fashioned, and hence the end users have a face significant hardships for the completion of a particular task.

5. Conclusions

Bangladesh has a number of positive attributes that can successfully attract the attention of foreign investors from developed and developing countries. The increasing availability of skilled and unskilled labor at relatively low wages and the success in maintaining reasonably stable macroeconomic environment is a few factors behind making the country an attractive destination for foreign investors. Foreign investors are generally aware that the wage rates in Bangladesh are among the lowest in Asian countries, the rate of inflation is usually contained within tolerable limits, the exchange rate is reasonably stable, custom regulations are investment friendly without discrimination between foreign and domestic investors, and attractive incentive packages are available for the foreign investors. Bangladesh needs to undertake effective promotion measures to convince the potential foreign investors that their involvement in business activities in the country is valued, they would be facing friendly regulations, and they can enjoy investment incentives that are competitive with those offered by other countries in the region and the developing world.

The scope for more advanced research is vast, given the fact that new developments will open new dimensions of study. The results have identified the basic merits and demerits of the One Stop Process for FDI-based businesses in Bangladesh, and the results, along with the positive attributes of the country mentioned in the preceding paragraph, will support more statistically rigorous quantitative studies in the future. How the results of the present study support or contradict the findings of previous studies can only be determined when statistically robust quantitative models are used to conduct more extensive studies in the coming years. The visible limitation of the present study is its qualitative focus, which is not statistically robust, and therefore, the scope for generalization with other contexts is limited. The results of the study has served to highlight an important aspect of FDI-based business operating in Bangladesh, and will serve as a platform to compare the performance of the country with other nations which have similar processes. The results can also facilitate the improvement of policies in relation to FDI-based businesses, which in turn will led to the creation of the scope for further research.

The results are important in the context of Bangladesh as they add to the existing literature on the operational aspects of FDI in the developing country context. The study is also the first in the Bangladesh scenario which explores the merits and demerits of the One Stop Service process. The authors were unable to locate any previous studies in the Bangladesh context in this regard, and the studies examined in the Literature Review do not specifically mention the One Stop Service process. The economy and therefore the markets of Bangladesh are expanding at a steady pace, and therefore the importance of integrating the One Stop Service process into the FDI procedures will enhance the global appeal of Bangladesh as a sustainable investment destination. The findings will serve to start a discussion on the importance of the One Stop Service process for FDI in Bangladesh, which will lead to the formation and implementation of appropriate policies by the policy makers.

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