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Legal Framework and Issues Impacting the Business Environment Faced by Foreign Companies Investing in India.

Challenges and Opportunities

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THESIS SUMMARY

The process of globalization has allowed for the progressive fading of economic, commercial and technological boundaries. This has resulted in Multinational firms or enterprises (MNEs) to become increasingly referred to as key players in the world market over the course of the past fifty years. In particular, inward Foreign Direct Investment (FDI) flows have increased significantly not only worldwide but in specific towards developing countries. These countries have been focused on trying to attract foreign investments due to the lack of domestic savings and thus as a stable means of foreign capital inflow. This is not the only positive trait of Foreign Direct Investments. They have been linked to multiple positive effects on macroeconomic variables such as productivity, production capacity, level of employment, factor prices, technological know-how and overall economic growth.

Investors, on the other hand, internationalize towards developing countries in an effort to seek and reap the multiple benefits found in these destination countries. Such benefits include the reduced production costs, given by lower relative wages and country endowment of resources, as well as market expansion possibilities. The scope of their needs is determined by the type of strategy adopted which can distinguish between market seeking, resource seeking, efficiency seeking and strategic investments. Though it is true that there are multiple benefits for foreign investors looking to expand their company in developing countries, they also susceptible to a series of risks. Such risks include the existence of trade barriers, an increase in resource costs, a low development of infrastructure, political instability (institutional risk) and exchange rate risk.

The aim of this thesis has been to demonstrate that MNEs investing in developing countries may incur a further form of risk determined by the legal environment of the country which can pose a non-negligible threat to foreign investment. It has done so by taking India as a case study and enforcing the proposed theory with supporting literature and findings from my personal experience working in an advisory firm in Pune, India specialized in supporting the internationalization of MNEs. With the support of extensive research and personal interviews with various CEOs and CFOs of MNEs located in India, my hypothesis is that although the current government is undergoing many changes to the legal environment in order to attract more foreign investments, there are still many loopholes greatly hindering the business climate as perceived by foreign investors.

The study first assessed that a weak legal environment characterized by frail laws and an inefficient, complex legal system altogether has a strong negative effect on the investment decision of a foreign investor and their feeling of protection once the investment has been made. This is because an inefficient legal structure is conducive to a feeling of insecurity and uncertainty increasing the risks posed to the foreign investor. The study then followed by analyzing specific cases of legal issues present in developing countries which may hinder a foreign investment. FDI policy may trouble investors due to the restrictions which might be placed on the permissible equity amounts of the investments or the sectors in which the investments are allowed. In addition, a policy which is FDI prone and thus consisting of incentives is also crucial in raising the attractiveness of the foreign investor and reduce the fears of entering a new market. The second analyzed element was the ease of starting a business. Problems here arise due to the possible presence of inefficient and or redundant procedures as well as the costs and length of the process'. A country hosting an easy, streamlined structure to start a business is far more attractive for foreign investors and reduces insecurity, at least in the initial phase. The third analyzed area of issue regarded tax legislation. In this case, issues may arise due to the poor quality, the clarity and the amount of the taxes. High taxes, as well as a poorly structured, confusing and unclear taxation system, pose a threat to a foreign investor as uncertainty, especially in form of amounts to be paid and mistakes in compliances arise. The non compliance leading to further costs and sanctions. The fourth possible problem area touched upon was that relating to property rights. A poor enforcement of the of property rights is an enormous deterrent to foreign direct investments. Investors are unwilling to invest in a country where their assets are not properly protected. Such situation would create uncertainty in the investment which is too high for an investor to stand. This also connects to the issue of the functioning of the legal infrastructure. Inefficient courts characterized by corruption, inefficiencies and lengthy procedures make foreign investors averse to an investment in a given country. Corruption and inefficient procedures may also create complications in any instance in which an investor must interact with authorities. This may occur when applying for licenses, filing documents and fulfilling compliances. Procedures are often lengthy due to the unclear, overlapping or frequently changing regulation as well as inadequate and uneducated personnel in public offices in developing countries. Procedures which are not streamlined and are surrounded by uncertainty make way for corruption. Another point of the issue within the legal system which was touched upon included labor laws by which pro-employee laws with a restriction on layoffs are seen in a negative light by foreign investors. A final area which could possibly lower the incentive of a foreign investor to invest in a particular country is that of dispute resolutions and insolvency. In the first case, slow and lengthy court cases, with a weak enforcement of the laws lead investors away from investing in a county. In the second case, major issues arise when there are no procedures for applying to have insolvent debtors wound up, to recover debts that are owed or when insolvency laws do not allow for an investment to be voluntarily dissolved. An attractive and predictable regulatory framework is an extremely important prerequisite for the host country in order for the investor to gain the benefits which foreign direct investments are carrying.

When applied to the Indian case, the initial biggest risk for foreign companies when entering the country is the lack of preparation. If time is taken to fully understand the characteristics of the country and it's business culture one can extract the huge rewards. The Indian market offers relatively low-cost labor, an enormous pool of possible consumers and many other benefits. If on the other hand investors take quick decisions and do not fully review all aspects which might create risks, the investment may result in serious and substantial failures with large losses of capital.

As in many developing countries, Indian laws and regulations are constantly evolving. In the Indian case, these laws are a reflection of the political compromise needed to balance the complex and conflicting demands of multiple constituencies (Nelivigi, Olier, Ray, Shabharwal, 2014). The government must satisfy a series goals and maintain a balance among safeguarding the home market, businesses, and consumers, while protecting legitimate business' and property rights, creating jobs and recognizing the demands of labor unions. Concurrently the government should also focus its actions to attract foreign investments, facilitate the transfer of foreign technology and know-how and promote industrial growth.

The result of these compromises is a high turnover of laws and regulations which among other things are passed through a trial error basis. This entails that ineffective and inefficient laws may be passed and then substituted once they are tested as not working, having unintended consequences and being impracticable. Often laws may also overlap and contradict each other. Such scheme reflects the fact that these laws are typically loosely drafted policies, press notes, circulars, clarifications, pronouncements on digital bulletin boards, amendments and occasional policy reversals which are often passed and become law without previously going through a standard legislative process and approval. The challenge for foreign companies is thus given by their difficulties in navigating the government's evolving rules and FDI policy. It should, however, be emphasized that in terms of FDI policy the government is taking the right steps in order to incentivize foreign investors to invest in India. Problems, however, are quite evident in the clarity of the laws. Many times, due to the constant change and their poor formulation, these laws, and regulations leave room for interpretation which in turn allows for the possibility of corruptions especially when interacting with government officials. In addition to this, the resolution of disputes characterized by extremely lengthy court cases creates a perfect recipe for an inefficient legal system. The discussion on lengthy disputes also ties to that on the protection of property rights. Given the poor enforcement of laws in India, foreign investors do not feel as if their interests are protected enough and thus increase the sense of uncertainty. Adding to this the government has also retrieved more than fifty BITs and substituted them with new ones which favor the country rather than the foreign investor. This action was taken as a "remedy" to the number of claims made by foreign investors against India.

The quality of regulations and procedures also effects the ease of starting a business. In this regard, the government has made sensational improvements to streamline the process. Although it has, the procedure often takes more time than estimated and the costs needed to pay for professionals aiding the process may be substantial. Extensive time spent to incorporate a company is equivalent to lost profit for the inability to initiate carrying out business. The main problem lays in the procedural difficulties of the process. Theoretically, the process is very much streamlined but, every step is risk-prone to advancement being blocked by the government authorities and their own inefficiency. Such inefficiency is given not only by the poor education level of state employees but also by their unawareness of the rapidly and constantly changing regulations at times difficult to interpret correctly.

The Indian tax system is also on the right track to offer an inviting business environment with a series of incentives. The tax system itself is very clean and clear especially after the introduction of GST. GST has unified the market giving investors enormous advantages in the form of fewer taxes and compliances to be followed. The problem remains in the application of the new system and the various related procedures which have done nothing but create headaches for foreign and national investors. An example includes the fact that a company must register and file taxes in all states it operates in. This creates issues in the form of heavy fees to be paid to professionals for filing.

Labor laws in India have also been identified as an area where investors might run into some complications. The power of labor laws and unions has decreased throughout the last twenty to thirty years. There are still strong pro-worker labor laws which foreign investors might not favor. Restrictive labor policy such as in the case of layoffs needing to be approved by competent authorities if the company has over 100 employees is an example of the restrictive measures that still exist. While the second major issue relates to the complexities in the compliances of human resource regulations.

In conclusion, it is possible to assess that the Indian government has made tremendous advancements in combating the inefficiencies of its legal environment. It has done so by making numerous amendments to its laws, such as in the case of the Companies act of 2013 and the application of GST substituting nine separate indirect taxes and unifying the country from a taxation standpoint. It has also streamlined electronic use for a series of processes and procedures. These include the amelioration of the incorporation process as well as the electronic use of the court system procedures. However, the last has seen an only slight improvement. The government has, in addition, maintained a very attractive FDI policy with the increase of automatic route sectors and increases in the cap amount of foreign investment. It comes to no surprise that the World Bank Doing Business report has seen India jump more than thirty places in the last years now finding itself in 100th place.

The main areas of concern for foreign investors, however, can be summarized as follows. A large issue is the presence of corruption which greatly hinders the perception of the legal system by the investor. This is because corruption can trace back to an inefficient legal system overall. The often unclear, repetitive, and turnover prone laws and regulations which create the need for interpretation and in turn high uncertainty. This together with the inefficient judiciary, due not to its quality, but to the extensive time in court cases leads the investor to have a low protection of property rights. This is also increased by the occasionally low enforcement of contracts and the law. Concern also arises from the lower quality and time-consuming procedures in the various application and filing processes. In many times, however, the government has made efforts to improve all the above mentioned but the major issue remains the actual application of the law once they are passed. Sometimes good law changes as GST are very positive, but their troublesome application with the problem it causes to investors turns the laws into another problem to be solved. Nelivigi, Olier, Ray, Shabharwal (2014) suggest that "the Companies which understand the motivations driving policies are more likely to understand how the rules will be interpreted in the future – and they will be better able to position themselves for success". Although this is true, it is clear that the Indian government must place more effort in order to make significant improvements especially to further streamline process and procedures, better apply laws, fight corruption and increase the protection of foreign investment right in order to create a more attractive business environment.

TABLE OF CONTENTS

ABBREVIATIONS:

AGM – Annual General Meeting

AOA – Articles of Association

AS – Accounting Standards

BIT – Bilateral Investment Treaty

BRIC – Brazil, Russia, India, China

CBDT – Central Board of Direct Taxes

CFO – Chief Financial Officer

CGST – Central Goods & Services Tax

CSR – Corporate Social responsibility

DGFT – Directorate General of Foreign Trade

DIPP – Department of Industrial Policy & Promotion

DSC – Digital Signature Certificate

ECT – Energy Charter Treaty

EU – European Union

FDI – Foreign Direct Investment

FERA – Foreign exchange regulation act

FIAS – Facility for Investment Climate Advisory Services

FIPB - Foreign Investment Promotion Board

GAAR – General Anti-Avoidance Rules

GATT – General Agreement on Tariffs and Trade

GDP – Gross Domestic Product

GST – Goods and Service Tax

ICAI – The Institute of Chartered Accountants of India

ICC – International Chamber of Commerce

ICSI – International Centre for Settlement of Investment Disputes

IGST – Integrated Goods & Services Tax (IGST)

ILO – International Labor Organization

IPR – Intellectual Property Rights

ISDS – Investment State Dispute Settlement

ITD – Income Tax Department

JV – Joint Venture

LLP – Limited Liability Partnership

M&A – Merger and Acquisition

MCA – Ministry of Corporate Affairs

MD – Managing Director

MNC – Multi-national Corporation

MOA – Memorandum of Association

MRTP – Monopolistic and restrictive trade practices

NAFTA – North American Free Trade Agreement

NRI – Non-Resident Indian

OECD - Organization for Economic Co-operation and Development

PPP –Purchasing Power Parity

PSA – Production-Sharing Agreements

RBI – Reserve Bank of India

ROC – Registrar of Companies

SAAR – Specific Anti-Avoidance Rules

SEBI – Securities and Exchange Board of India

SGST – State Goods & Services Tax

SME – Small Medium Enterprises

SOP – Standard Operating Procedure

SPE – Special Purpose Entities

SPICe- Simplified Proforma for Incorporating Company Electronically

TDR – Transferable Development Rights

UK – United Kingdom

UNCTAD – United Nations Conference on Trade and Development

VAT – Value Added Tax

WTO – World Trade Organization

INTRODUCTION

"Multinational firms or enterprises (MNEs) have in the past fifty years become increasingly referred to as key players in a world market which is becoming ever more globalized. In particular, inward Foreign Direct Investments (FDI) flows have increased significantly not only worldwide but in specific towards developing countries as it has become the most stable and prevalent component of foreign capital inflows for these countries" (Adams, 2009) (Pettoello Mantovani, 2015). Since the end of the twentieth century, FDI flows have displayed a rapid increase in growth. This has occurred regardless of unprecedented turmoil in the global economy. FDI flows have surpassed the pre-crisis average registered in 2011, reaching 1.5 trillion USD. However, these flows remained about 23% below their peak, when the value of FDI had reached 1,971 billion USD back in 2007 (UNCTAD, 2012). Ucal et all. (2010) revealed, "that the financial crisis had a significant influence on FDI". The level of FDI decreased in the year's followings the financial crisis after they had recorded an upturn in those preceding it. Moreover, many scholars have wondered if the last financial crisis has had a greater or lesser impact on FDI than that of past crisis' faced by the global economy. According to the study carried out by Dornean, Isan & Cristian Oanea (2012), their results show "that the financial crisis directly affected the level of FDI". To this regard, Poulsen and Hufbauer (2011) compared the current FDI recession with the responsiveness of FDI to past crisis and found "that the financial crisis of 2008 had indeed had a larger effect with respect to previous ones". This greater change in FDI was intuitively mostly due to the global level of this crisis. Higher expectations in economic growth across major regions together upturns in trade growth and corporate profits could help in securing increases in FDI flows. Although still below the peak reached in 2007, Global flows are forecast to increase to almost 1.85 trillion USD in 2018 after they had decreased by 2 percent to 1.75 trillion USD in 2016 (UNCTAD, 2017) mostly due to weak economic growth and significant policy risks perceived by multinational corporations. Developing countries were particularly affected by this downturn, as FDI inflows registered a decline of 14 percent to 646 billion USD. This issue presents itself as quite relevant because FDI is to date the highest contributing and most relentless external source of finance for developing countries. Not only, FDI can be viewed as a source of growth for host countries by playing an important role in microeconomic responses to the financial crisis. As a matter of fact, Alfaro and Chen (2012), emphasized “the importance of FDI in bolstering economic growth”. They also revealed its important status in “minimizing volatility as well as increasing economic interdependence across countries in order to reduce the negative features of the financial crisis”.

The commitment of countries, especially developing ones, to open themselves up to foreign capital has been evident in the past 30 years. “MNEs have emerged as important contributors in creating positive externalities in economic growth through the provision of financial resources, creating jobs, transferring technological know-how as well as managerial and organizational skills, and enhancing overall competitiveness (Adams, 2009). Navaretti and Venables (2006, P.1) describe Multinational firms as having a “Dr. Jekyll and Mr. Hyde perception among governments and policymakers”. The policymakers of Developing countries have understood that FDI is able and thus needed to boost the economic growth of their country” (Pettoello Mantovani, 2015). As a result, countries have entered into a deep competition aimed at attracting FDI. While MNEs are capable of having beneficial effects in the recipient country they may also bring negative ones including running national firms out of the market. Although this could be the case, the gains from FDI clearly outweigh the costs. This helps explain, although partially, why FDI flows have been recording increasing trends soon after the end of the 2008 crisis (Pettoello Mantovani, 2015). The continuous decrease in international trade barriers together with the economic and cost advantages perceived by firms when they invest abroad as well the rise of welcoming environments offered by countries around the world to attract investments are also crucial in determining the increase in FDI flows (Pettoello Mantovani, 2015). Indeed, considering countries have recognized the benefits tied to the entry of foreign capital, it is evident that they commit themselves to reforms enabling a suitable investment environment as a means to welcome new capital from overseas.

When a foreign investor undergoes the decision on whether and in which country to invest other than his/her own, the decision will be influenced by many legal and economic factors linked to the country in question. The complexity, as well as the multitude of relevant national laws, will highly impact the decision on whether to follow through on an investment in a particular country or not. A business environment plagued by continuous changes in laws and regulations can make a market quite an undesirable location for allocating foreign investments. Foreign investors demand a certain threshold of legal certainty, in terms of consistency and substance, from the host country in order to shift their production and do business abroad. In developing countries, such constant changes can be explained by their commitment to reform the legal framework in the effort to create ever more attractive and suitable environments for foreign investment and reduce the gap existing with traditional developed countries. The question to be asked is twofold. The first being, what common issues foreign investors face in a specific developing country. The second, whether the governments of these nations are indeed taking the right steps to solve these issues and thus create a suitable business environment. While an extended amount of scholarly work and research has been concluded on the legal frameworks and issues faced by foreign investors in developing countries as well as analyzing whether governments are taking the correct steps to diminish the source of these issues, only a few have tackled such study relevant to the case of India. In his research, Tony Khindria (Khindra, 1997), aimed to "identify the main Indian legislations relevant to the inward foreign direct investments in India" but did not fully tackle the issue of its current shortfalls which could potentially create problems for foreign investors. The Indian government, regulators, and policymakers have also been intent and focused on changing the regulatory scene of the country to introduce new policies inducing to the attainment and attraction of greater levels of foreign investment. The main purpose of this research paper is thus to evaluate the existing legal framework in India and to identify the main obstacles for foreign investors and the issues faced by them. In doing so it is meant to understand whether the government is undertaking the right changes, regulatory wise, to create a sound and investment-friendly market to attract evermore amounts of foreign investment.

A substantial amount of reasons have elicited the will to take India as a main case for undertaking this study which is based on the analysis of the legal framework and its major issues faced by foreign investors. India is increasingly being recognized as a significant market by companies, across all business sectors, all over the world. Although the prospects of global growth have slowed down and become quite uncertain, India together with other Asian economies is expected to strongly influence and lead the global growth prospectus. As the following chapters will better demonstrate, India has become and to this day remains one of the fastest growing economies of the world already surpassing China for a brief period (International Monetary Fund: International Economic Outlook, 2016). Its continuous growth has allowed it to become "the sixth largest economy in the world and induced expectations of becoming the largest global economy by 2050" (Sudeshna Sen, 2011). Known as the world's largest democracy, it has an active judiciary and is a very dynamic member at various international conferences, emerging as a leader in various negotiations. Its continuously strong economic positioning together with its active government have led India to carry an influential position politically, in turn, increasing its economic stature (DBS Group Research, 2015). India's latest government has been working endlessly to bring changes to every sphere of its economic activity. This has included improving the promotion of exports and attracting ever more amounts of investments from strategic countries to encourage a better allocation of resources and quicker decision making by government departments as well as improving all sectors of the economy. In addition, its stock market and currency have been performing better as compared to other emerging economies (DBS Group Research, 2015). Overall this has led the country to have a proven investment track record and expose its vibrant market full of possibilities. As a result, foreign investments have been flowing in large amounts. In terms of FDI inflows in 2015, India ranked 4th in Asia having registered a 28% year on year growth (UNCTAD, 2016). FDI inflows further grew by 1% to 44,5 billion USD in 2016 allowing India to climb to 9th place as one of the highest recipients of foreign direct investment (FDI) in the world (UNCTAD, 2017).

As can be seen, although there are many country determinants (and many others further displayed in the following chapters of this paper i.e. cheaper labor costs, large population, etc.) in support of foreign investments towards India, one is confronted by the question and subject of this paper of what role qualitative factors rather than quantitative factors have in influencing FDI. Understanding how the legal framework plays as a determinant in the attractiveness of foreign investments and whether the continuous changes and the modifications carried out are effective or are instead a deterrent for foreign investors and their will to continue business in India. Although the efforts made by the Indian government and the plethora of positive factor endowments that India offers, it is in fact still a common perception from literature, news and first-hand interviews with foreign CEOs, that the legal system and environment is one element critical in reducing the attractiveness of doing business in the country. This thesis will go about analyzing such claim by firstly covering an overview of FDI theory specifically looking at developing countries. This chapter will be followed by one dedicated to understanding the basic concepts and notions regarding how legal aspects are connected, influence and shape the foreign investment decisions. The third chapter will then expand on the argument by analyzing specific legal issues related to foreign investors which are highly influential on the overall perception of how good a specific country can be in terms of its business environment.

In particular, specific areas such as the present tax and labor laws, ease of starting a business, enforcement of the law, contracts and property rights will be highlighted in order to understand the possible challenges encountered by foreign investors when investing in another country and the possible remedies they may use to reduce legal risk. Once this analysis is complete the fourth chapter will proceed to give an overview of the economic situation in India as an introduction to the case study of this thesis. It will do so by reviewing the current economic conditions, changes and evolution of the market during the last decade, as well as an economic description of FDI flows into the country. The fifth chapter will then be dedicated to the analysis of the Indian legal system and framework as a promoter and/or “enemy” of foreign investments. To conclude the analysis, the sixth chapter will review the overall legal framework and particular fields of law tightly tied to the investment environment in terms of the possible issues that are being faced by foreign investors. With the support of extensive research and personal interviews with various CEOs and CFOs of MNEs located in India, my hypothesis is that although the current government is undergoing many changes to the legal environment in order to attract more foreign investments, there are still many loopholes greatly hindering the business climate as perceived by foreign investors.

1. OVERVIEW OF FDIs

The "internationalization of the world market has encouraged companies to devise a diverse amount of approaches to confronting an ever more globalized business world. This has resulted in the creation of extensive activities such as Foreign Direct Investment" (Pettoello Mantovani, 2015). According to the Consolidated Policy on Foreign Direct Investment (2012), "a foreign direct investment is made when a resident entity in one country acquires a "lasting interest" in an enterprise in another country in order to reap certain benefits and increase competitiveness". At the same time recipient countries tend to attract the highest levels of FDI. As Jeffrey Frieden, an economic and political scholar, noted, "the international economy has enabled countries to develop, alleviate poverty, improve social conditions, lengthen life spans, and carry out social and political reform" (Sweeney. 2010). As will be analyzed further, one crucial factor in attracting FDI is the legal environment of a given nation. As previously mentioned, the aim of this thesis is to analyze the importance of the legal framework of a country in terms of either enhancing attractiveness or creating unwanted issues for foreign investors specifically in the case of India. It is thus fundamental at this stage to briefly understand a few fundamentals tied to the concepts of FDI. This chapter will define what investments qualify as FDIs, the "players" mostly involved, the main determinants affecting FDIs, and the consequential effects. The review of previous theoretical and empirical literature on Foreign Direct Investments will be used as a means to layout and understand the notions that revolve around FDIs. This will be carried out to better contextualize these concepts within the analysis of the Indian legal environment and its possible issues with respect to foreign investors.

1.1 *FDIs and its main players*

Being one of the key features of the modern market economy, "a Foreign Direct Investment is an investment which has a cross-border element. Including such an element leads one to conclude that FDI should be defined on an international level" (Sauvant et. all, 2010). The IMF and the OECD give a more complex definition by stating that "FDI is an investment in a foreign company where the Foreign investor owns at least 10% of the ordinary shares, undertaken with the objective of establishing a “lasting interest” in the country, a long-term relationship and significant influence on the management of the firm. FDI flows include equity capital, reinvested earnings and other direct investment capital” (IMF 1993; OECD 1996). FDI’s, thus also include the retained earnings of the subsidiaries, the financing of new investments, inter-firm loans and cross-border mergers and acquisitions (Pettoello Mantovani, 2015).

There are a variety of means by which foreign investments occur. A first type is represented by the establishment of a new company in a given foreign country. These can be subdivided into two groups. The first, greenfield investments, take place when a new plant is constructed abroad. The second, brownfield investments, on the other hand, take place when a purchases or leases existing production facilities in a foreign country. Of course, both increase the capital stock in the country receiving the investment. The second type of method is mergers and acquisitions (M&A). These occur when a company acquires more than 10 percent of voting stock in a foreign company located in another country. Differently from brown or greenfield investments this form does not expand the capital stock of the recipient country. A final means of investment abroad is the reinvestment of earnings or capital raised by a company already located in a foreign territory to expand its business. This FDI also increases the capital stock in a country.

The above described are the means by which FDIs occur. Companies make use of different investment structures when they formulate entry strategies to enter a foreign market. These include either: the creation of a wholly owned subsidiary (WOS), the formulation of a joint-venture (JV) with a local partner (usually used to take advantage of the partners knowledge of the local market and distribution network), the setting up of a representation office, the setting up of a project office or the acquisition and merger (M&A) of a domestic company in the foreign country. Methods other than FDI used by MNCs to enter a new market include licensing and franchise models.

Multinational Enterprises or firms (MNE) are the main actors undertaking Foreign Direct Investments. Generally, examples include Nike, Intel, General Motors, IBM, and Danone. Navaretti, Venables (2006, P.2), define an MNE “as a firm that owns a significant equity share (usually 50% or more) of another company (henceforth subsidiary or affiliate) operating in a foreign country”. Jones (1996, Page 4) on the other hand defines an MNE “as being a firm which controls either the operation or income generating assets in more than one country and that Foreign Direct Investments are conventionally used as a proxy to measure the extent and the direction of MNE activities". It should be noted that how large corporations are is not to be considered as a determining factor for a company to have extensive multinational operations.

1.2 *Determinants of FDI*

When making the decision on whether to invest abroad a manager of a given company must evaluate a series of elements which are important in possibly determining the outcome of the investment itself. A starting point to understand how managers make decisions is the OLI model proposed by Professor Dunning (Dunning 2001). This model provides a useful organizational framework but needs to be expanded. Through his model, Dunning argued that "firms make decisions to invest abroad based on Ownership, Location, and Internationalization". The first relates to market power derived from the Ownership of a product or production process. This can be in the form of firm-specific assets both tangible (i.e. products or technologies) and intangible, (i.e. patents or brands)". The ownership advantage enables the firm to counterbalance and exceed the incremental transaction costs linked to multinational operations. The second relates to the existence of an advantage given by Location. Situating a plant in a foreign country can lead to advantages given by reduced factor prices, access to customers and are influenced by government regulations with respect to trade, exchange rates, capital flows, and institutional and political stability. Finally, the third element relates to the presence of advantages given from the Internalization of foreign activities in a fully owned subsidiary (Dunning 1977, 1981).

As mentioned above the business entities believing that the most effective way to penetrate a foreign market is by establishing a presence in the market have to carefully evaluate these factors. These elements can be divided among those particular to the firm itself and the industry it competes in and those which make a certain country attractive to the investor.

Firm and Industry specific determinants

"Theory suggests firm-level economies of scale to promote FDI. In the same respect, it is expected that plant-level economies of scale will hinder the quantity of FDIs. With regards to Plant level economies of scale, it can be said that they are detrimental to the quantity of FDI as they seem to favor the concentration of plants in order to reap the advantages of the economies of scale. At the same time, the effect of plant-level economies of scale on FDIs also depends on the nature of the investment. For example, in a vertical FDI an MNE may decide to invest in a country abroad and concentrate a certain stage of production in that country and then serve the rest of the production process from there (Navaretti, Venables, 2006. P. 32,131). In this case the costs saved from the lower wages and from reaping the advantages of plant-level economies of scale through the concentration of production in a single foreign country should outweigh the costs of trade which are incurred as the unfinished product is traded either back to the home country or elsewhere for the next stages of the assembly or production process" (Pettoello Mantovani, 2015).

Country Specific determinants

"Given that the main objectives of MNEs, like all businesses, is to maximize profits and reduce costs it can be stated that great consideration is given to the choice of regions which are most likely to bring the highest returns on investments (ROI) and are characterized by an enabling environment for business to succeed. Sethi et al. (2003) believe that multinational investments will be higher in regions that provide the best mix of traditional FDI determinants. This is, therefore, a qualified reason for why there are more FDI in some countries or regions of the world with respect to others" (Pettoello Mantovani, 2015). The legal and economic factors characterizing a particular country influence the motivations pushing a company to invest in a given country rather than another.

The first element is *barriers to trade* which have an inverse relationship on the number of incoming investments. "Brainard (1997) finds that "affiliate production rises as a share of total foreign sales the greater are transport costs and foreign trade barriers and the lower are foreign investment barriers and scale economies at the plant level relative to the corporate level". In general, results have highlighted that as the level of transport costs or trade barriers increases so does the amount of affiliate production relative to exports. Navaretti, Venables (2006, P. 136) based on the work by Brainard (1997) also indicates that "foreign affiliates are more likely to be set up if their presence in the market through exports has already been established, and once the decision has been made (to Invest abroad (FDI) the costlier it is to supply the local foreign market through exports, the greater the relative importance of affiliate sales'"' (Pettoello Mantovani, 2015).

Production costs (wages) and Factor endowment are other elements taken into consideration. Of course, firms are incentivized by the availability of natural resources. Tied to the previous discussion on ROI, the goal of an MNE is to improve its competitiveness. Cheap labor causes companies to move their production to countries where it is lower in order to save on production costs. Reaping the benefits of cheap labor and educated labor force is an attractive affair for MNCs. India, for example, is characterized by relatively cheap and at the same time educated labor force as compared to other South Asia nations. "The effect of relative skill abundance among countries on affiliate activity varies across industries. Brainard (1993) on one hand concluded that similarities rather than the differences of countries involved in bilateral activity help explain the total volumes of multinational activity or affiliate sales. While Ekholm (1997) and Yeaple (2003) concluded that MNE investments in skill abundant countries are in skill-intensive industries while vice versa occurs when countries have an abundance of low skill level workers. The difference in their conclusions was given by the industry of reference" (Pettoello Mantovani, 2015).

Another factor playing an important role is the *size and location of the market.* larger markets, with bigger numbers of consumers leads to a higher incentive for foreign companies to invest in the market in order to take advantage of its size. "Carr, Markusen, and Maskus (2001) find that market size plays a critical role in determining the cross-country distribution of FDI suggesting that the obtainment of market access is a crucial motivation for U.S. MNE. Research also indicated that the larger the size of a market the greater the amount of affiliate production. This is because as the market is larger the greater the opportunity for MNE to recuperate the fixed costs from setting up the foreign affiliated plant" (Pettoello Mantovani, 2015). India, for example, has a market of 1.3 billion population with an ever-increasing middle class having higher consumption capabilities. This large consumer base incentivizes foreign companies to invest in India and take advantage of its market size.

The availability and quality level of the *infrastructure* found in a country is indispensable for a foreign company's all-around operations. Higher levels of infrastructure quality cause a substantial reduction of overhead costs thus having a positive effect on the location decision (Shah and Ahmed 2003). “Infrastructure relates to the total length of metalled roads, rail networks, uninterrupted power and water supply, number of seaports, international airports and telecommunication density” (Asiedu 2004). Infrastructure is the basis for economic activity in developing countries as multinationals tend to prefer countries in which it is well-established and developed(Khan and Kim 1999). Keeping all other things constant high level of infrastructure quality would allow MNEs to optimally utilize their imported machinery and paraphernalia in a proper fashion.

A final element and the most important to the aim of this thesis is the *legal environment* of the recipient country. The decision to invest abroad and the attractiveness of the business environment of a country can be greatly impacted by the number of the national laws. It can also be influenced by their complexity. An unclear legal system offering low reliability and protection to investors is detrimental to foreign investors as their prospectus of a high ROI is made uncertain due to a variety of issues. These may include expropriation, poor enforcement of contracts and property rights (including intellectual), high and unclear tax systems, bureaucratic legal processes and unfavorable laws including FDI related regulations. The analysis of this factor will be covered and expanded upon in the following chapter in order to shed more light on its importance.

Other determinants also include the overall *political stability* of a country and the present *exchange rates*. A weak exchange rate is more attractive as it would result cheaper for multinational to purchase assets.

The overall decision to invest abroad is determined by a mix of the above-mentioned factors. These factors shape different reasons for company’s investment in a foreign country. One may, in fact, distinguish between market seeking, resource seeking, efficiency seeking and strategic investments. Should the reason to invest abroad be motivated by strategy, an MNC could be looking, for example, to improve the quality of existing products, introducing new products altogether, or benefit from favorable regulatory frameworks and/or agglomeration effects. Efficiency-seeking investments, on the other hand, are motivated by the reduction of costs and improvement of profitability and overall competitiveness. This is of course determined by the real operational costs present in the foreign country as compared to the home country including for example wages, taxes and energy costs. Other costs, as in the case of exchange rate levels also influence the decision. Market-seeking investments are characterized by the establishment of an affiliate firm in a foreign country or supplying of that country from an adjacent one (export platform) in order to improve access to the market or reduce transportation costs. This type of decision will be determined by a plethora of actors which affect the attractiveness of a particular market including the general attractiveness of the market: its size, growth rate, competitiveness of the company within the market itself, the trade costs, the present infrastructure to name a few. Finally, resource seeking investments are intended to source critical inputs of production which would increase the competitiveness of a company. These include natural resources, skilled and unskilled labor and as well as technological and managerial capabilities. The real costs, scarcity and relative productivity of these inputs will determine the location decision made by a given company (Copenhagen Economics, 2016)

1.3 Benefits and Costs of Investment to Home and Host Country

The act of a foreign investor to invest in a country other than his/her own has many positive and negative effects on both the home and the recipient country.

In terms of home country effects, the most common benefit is the reduction of prices to consumers as a result of MNEs being able to reap the advantages of cheaper labor and resources in other countries. Drawbacks, on the other hand, include the increase of unemployment due to the shift of production facilities to cheaper, better-endowed countries in other to better perform and compete in the home market (Lipsey, 2002).

Research has demonstrated and proved that host countries may greatly gain from FDI. These advantages come in the form of increased employment, reduced poverty, transfer of knowledge and increased competition. The productivity of labor force is also enhanced as employees in these countries come in to contact with higher working standards, procedures and training increasing both skill and productivity levels. Introducing new technology and expertise as well as rebooting underutilized domestic sectors may increase productivity as a whole. Another benefit for workers in the recipient country as a result of investments by MNEs is the increase in their wages. This is due to a series of reasons including the need for more skill intensive workers, as means to reduce labor turnover in order to protect knowledge and as a result of government regulation (Navaretti, Venables 2006 P. 163-165). Spero and Hart (2003) suggest that “FDI also generates positive externalities, including increases in global trade, new goods and services, improved quality of labor, and increased social welfare such as health, housing, and education”. FDI provides financial capital and its role in doing so is becoming more important as FDI flows to underdeveloped countries is continuously on the rise (Alvarez, 2003). Overall and most importantly, FDI is linked to economic growth justifying why many developing countries undergo deep policy and structural changes as a means to attract them. As put by the World Bank Report of 2005: “The creation of opportunities and incentives for firms to invest productively in a country, creates jobs becoming a top priority for governments to induce growth and reduce poverty” (World Bank Doing Business Report, 2005). Country-specific characteristics define the ability to capture the spillover effects given by FDI inflow depends (Zhang, 2001). According to Zhang (2001), this is when “the host countries favor investment by adopting policies to liberalize trade, improve education, encourage export-oriented FDI, and maintain macroeconomic stability”.

Potential drawbacks of FDIs may also be identified. These include, as outlined by a report issued by the OECD (OECD Report, 2002), the possible negative impact on the environment of the host country, the disruption of competition in the host market which can drive out local firms and the possibility of social disorders.

2. THE LEGAL/REGULATORY ENVIRONMENT AND FOREIGN INVESTMENTS

At this stage it is clear as to why foreign investors are very much keen to invest abroad and the reasons countries worldwide, especially developing ones, are determined to create a better business environment in order to attract greater levels of FDI inflow. It is therefore clear that resource endowment, cost of labor and physical infrastructure or in other words natural and produced capital, are some determining elements in determining where to locate an investment for the foreign investor. At the same time, these factors are fundamental in determining the attractiveness of a country, leading to higher FDI inflows and subsequently greater economic growth. As it is evident that these are not the only elements involved in the decision-making process, what is crucial in this phase to understand what role a legal system, its laws, the interconnected institutions and the way they are run play in the selection process of a foreign investor when making a location decision. In other words, what effect do the three above mentioned elements have on inducing or reducing a certain countries attractiveness as opposed to another in the eyes of a foreign manager and or investor. The focus is thus placed on the key areas of interaction between the legal environment and entrepreneurs and how the laws, regulations and governing bodies may ultimately affect their investment decisions.

2.1 From "Institutions" to Rule of Law

According to Douglas North law, trust, effective governance and individual rights are pieces of what he describes as being the societies institutions. As described by North in his *Institutions, Institutional Change and Economic Performance*: "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction. In consequence, they structure incentives in human exchange, whether political, social, or economic" (North, 1990, p. 3). These are thus to be differentiated and not confused with physical institutions. Institutions, as visualized by North, influence the decisions of individuals within a given society in two ways. They can do so either if they are formally constraining, thus through the concept of rule of law and individual rights, or if they are informally constraining, through common norms of behavior. Human interaction takes place within a framework of the previously mentioned constraints. They can be prohibited actions and/or the conditions under which individuals are permitted to undertake certain actions. According to North (1990, p.4) “They consist of formal written rules as well as typically unwritten codes of conduct that underlie and supplement formal rules” and if these “rules and informal codes are sometimes violated, punishment is enacted”. Therefore, the cost of asserting violations and the severity of the inflicted punishment are essential factors in the functioning of the institutions (North, 1990, p. 4). The correct functioning of institutions is thus also dependant on the enforcement and the punishment of violations falling under a predetermined code. If individuals repeatedly observe violations without punishment, then they would be induced to believe that they can, in fact, violate the norms without incurring any cost. The incentive for individuals to follow rules therefore disappears should little or no enforcement of these standardized limitations be held within a society. As time passes the reasons for setting institutional constraints as a means to create certainty falls as they are eliminated by arbitrary enforcement of formal institutions (North, 1990, p. 6). Should reliable enforcement measure be missing, it would reduce positive aspects in cooperative behavior of individuals, and the economy.

In the work *Where is the wealth of nations*, by Kirk, North and other authors of the World Bank, were led to conclude that there was more than just location and resources as determinants of wealth accumulation. (Hamilton et. all, 2006, p.4). What they discovered from their research was that rule of law, a variable capturing both institutional and social capital impacts, was a large contributor to the residual wealth of a country. Their regression highlighted how a 1 percent increase in rule of law paid a large role boosting intangible capital by 0.83 percent (Hamilton et. al, 2006 p. 13). As per their research, natural and produced capital are thus alone insufficient as a means to attribute the location of the world's wealth (Hamilton et. all, 2006 p.13).

As can be slightly perceived from the above statement, the presence of efficient and effective institutions plays a large role in the accumulation of wealth in a country. In developing countries, the accumulation of wealth can be induced by the higher inflows of FDI bringing in capital, knowledge, technology and so forth. Should a countries Institutions not be properly functioning, foreign investors would be put off by investing in that specific country as its ineffective institution would create a sense insecurity. The most renown measurement to understand how well a given country has established institutions, as well as the effectiveness in enforcing them, is defined by what is known as the rule of law. Based on pre-existent literature and as expressed by the scholar Kenneth W. Dam, the basic principles of a rule of law are: “(a) Legal rules should be written down and available to all residents of the realm: leaving no room for secret law; (b) Rules should apply, and be enforced, equally and dispassionately for all, regardless of position or station. Further, the state and the ruler should also be subject to the law: Nobody is therefore above the law; (c) Individuals have a right to have rules that favor them enforced for their benefit. In other words, they are entitled to access to justice on a nondiscriminatory basis no matter who they are and who the defendant may be” (Danner, 2008) (Dam, 2006, p. 16). Put in other words as described by a research executed by Hogan Lovells (2005) rule of law is: “Certain, accessible and prospective laws; equally enforced; with access to justice (i.e., the right to challenge decisions in courts or other equivalent bodies); where rights may be asserted (human rights and rights such as property, contracts, etc.); through fair trials before an independent judiciary”.

From the above-mentioned guiding principle, it is clear that rule of law may emboss a multitude of applications but for the sake of the objective of this thesis, only a few strongly interconnected applications to a country’s business environments will be further analyzed in the following chapter. It is also again clear that the institutions and rule of law may have a strong role in influencing the location decision process of a foreign investor. In fact, according to (Danner, 2008) “rule of law, or the expectation of legal fairness, affects the decisions of firms investing abroad”. This link between rule of law and FDI allocation means that countries looking to increase foreign investments should focus on working to increase and enforce lawfulness. What is interesting in this study is that rule of law may be even more influential for firms who are looking to increase or decrease their foreign investment within a given country rather than for firms undergoing the decision of which country to invest in. It is, therefore, possible to conclude that if considering only the rule of law, a stronger rule of law will encourage FDI by creating a transparent, stable and predictable environment. The environment must also consist of a host government committed to the enforcement of laws, of contracts as well as the protection of rights.

2.2 Laws, Regulation, Governing institutions, and FDI

Foreign investors, as any other investors, are interested in profits and are thus appealed by investing in places where their net profitability and/or return on investment (ROI) are highest and involved costs are the lowest. Governments of possible host countries, on the other hand, are determined to attract FDI to nurture economic development. They must, therefore, create the right pre-conditions for these investments. To do so a sound policy and regulatory framework as well as efficient supporting institutions to enforce the relevant laws and regulations must be created by the possible receiving state's government. The investor's ultimate decision on where he/she will go and how much the investment will contribute to the host economy lays upon a series of factors which determine how conducive the investment climate may be. These include the amount of administrative and regulatory obstacles an investor must overcome to enter and operate as well as the proper functioning of the relevant institutions such as the judiciary system and relevant state departments. Investment and attractiveness are therefore shaped by the policies and practices aimed at reducing investor costs and the perceived risks associated with the investment.

In the last thirty years, developing countries have liberalized their economic policies as a means to induce more foreign investment inflows. Market liberalization can be seen in terms of both the policies for opening the domestic market to foreign capital flows and the improvement of internal domestic laws and regulations (The Economist, Sept. 27, 2008). As per openness of the domestic market, this has resulted in a series of advantages to investors and/or multinational companies in the form of lower tariffs, fewer quantitative restrictions, currency convertibility, fewer sectoral restrictions to foreign investors or percentage of foreign ownership allowed and an overall more favorable outlook towards FDI.

A country's policy choice towards FDI is then supported by the internal regulatory framework. This consists of a set of laws (including commercial, tax, labor, etc.) and regulations as well as the institutions established for their enforcement. It serves to provide an overall framework to govern the transactions within the market as well as the process to settle any possible disputes. An effective framework seeks to guarantee private investors that their business transactions are permitted and that once entered into, the transactions will be protected, and that all supporting agreements are enforced (World Bank Doing Business Report, 2018).

Laws are the products of written statutes which are generally passed by state legislatures. In specific, the legislatures create bills that, when passed by a vote, become statutory law.

Regulations are the standards and rules adopted by administrative agencies that govern how laws will be enforced. They are rules based on and meant to carry out a specific piece of legislation. In this case, regulations related to those procedures that are put in place by the government in order to screen for or control certain activities and investors who are planning to establish a business in a given territory as well as the activities carried out once a company has been established. To serve their purpose regulations must be designed and implemented in such fashion that they are objective, consistent, transparent and non-arbitrary in such a way that they are not used as a rent-seeking mechanism for the industry incumbents, bureaucrats, and politicians (Sun, 2002).

Overall, the framework must, therefore, provide a degree of confidence required by foreign investors to enter into business transactions in a specific country. It can do so only if it has the objectives and policies for attracting, facilitating, and safeguarding foreign investment.

A well-working framework for investment includes a body of clear laws and regulations and efficient administrative bodies. Most of these laws are introduced ex-ante and are intended to design rules by which the companies in an economy must abide to carry on their business as well as prevent market failures (i.e. prevent low-quality products and services and/or externalities such as pollution).

Thus, an effective regulatory framework must be characterized by clear and coherent rules. These rules include rules that set out and clarify property rights and facilitate the resolution of disputes, rules that enhance the predictability of economic interactions and provide contractual partners with essential protections against arbitrariness and abuse. The higher quality of rules in terms of clearness and coherence benefit economic activity. When the rules are reasonably efficient in their design as well as transparent and accessible to those for whom they are intended and are implemented at a reasonable cost, they become much more effective in shaping the incentives of economic agents. In doing so, they are then also able to promote growth and development by playing a crucial role in determining how societies distribute the benefits and finance the costs of development strategies and policies. In terms of foreign investments, good rules provide an environment in which investors have the proper incentive to invest, drive their business and expand. This would also be beneficial to the recipient country as expansion of newly entering foreign firms could lead to positive effects as knowledge transfer and the creation of more job opportunities (World Bank Doing Business Report, 2018)

Should a country have an inappropriate regulatory system, it would significantly reduce a firm's interest in investing within its borders as it would distort investment decisions or deter investment entirely as well as possibly reduce a foreign firm's competitiveness with respect to incumbent or local firms. Poorly conceived and enforced regulation can prevent entrepreneurs from entering the formal economy, negatively impacting both the public and private sectors. This happens when laws and regulations are designed and implemented in a manner that is inefficient, antagonistic, and arbitrary. In such way, they might uphold the rights and obligations of the investors, deter the smooth functioning of the market, protect industry incumbents and or local firms by increasing the costs of entry and thus reducing competition. Regulation which is poorly conceived might also be difficult and too complex for foreign investors to understand and navigate through creating insecurity, higher risks and may simply become Burdensome and costly (Sun, 2002) (World Bank Doing Business Report, 2018).

A poor framework creates further problems for foreign and local investors as it can be easily hijacked by politicians and bureaucrats for rent creation and extraction. This will not only create additional costs for the investors but also lead to corruption and other inferior social outcomes (Sun, 2002) (World Bank Doing Business Report, 2018).

Investors are therefore in the search for a positive environment include: an effective, impartial and transparent legal system that protects property and individual rights; laws and regulations as well as the related compliance procedures which are clear, coherent and properly enforced, public institutions that are stable, credible and honest; and government policies that favor free and open markets. These conditions encourage FDI, as well as private domestic investment, by protecting privately held assets from the risks tied to the legal environment of a country (Shapiro and Globerman, 2002). Of course, there might be instances where regulation may be burdensome but for a just cause. This may include for example registration requirements. Through registration new companies acquire a type of official approval, which making them reputable enough to engage in transactions with the general public and other businesses thus although administrative and regulatory procedures may seem time-consuming and expensive, the investors understand that they are necessary and beneficial for the overall business environment (World Bank Doing Business Report, 2018).

The example above also denotes the necessity to provide a formalization of procedure which allows entrepreneurs and employees to easily access the legal and financial services available to registered companies (such as obtaining loans and social security benefits). The importance lays in the streamlining of such regulatory procedures which can encourage business entry, business growth, job creation and rising national incomes (World Bank Doing Business Report 2018). This is not the only improvement that must be made in efforts to attract more investment. Administrative burdens must be reduced, regulation simplified, competition strengthened, and red tape diminished. Scholarly work has demonstrated evidence on the positive correlation between reforms in areas of doing business and a higher number of reforms. Such reforms should be carried out in procedures for starting a business, paying taxes and trading across borders. For example, regulatory reforms to ensure easier procedures in starting a formal business are associated with an increase in the number of registered firms and with a higher level of employment and productivity. Research has also shown that eliminating fiscal barriers by improving the composition and quality of taxation can have a significant impact on productivity and economic growth (Tong, 2009). The problems related to reform are twofold. First, they typically slow to advance especially legal reforms. This is mainly because they require long-term political commitments, substantial resources and close collaboration between multiple regulatory agencies and rulemaking institutions. Second continuous changes in the procedures and regulations may create an unstable environment for investors as they must coop and adapt to the constant changes leading to higher cost in terms of time consumption, assistance and possible faults in compliance. Nonetheless, it is important for countries to create the best possible environment to continuously accommodate investment from abroad as well as induce investment from within.

One can therefore conclude that the economic and political benefits of improved business regulation are beneficial for multiple parties namely the investors, society and the economy of a country as a whole. Governments worldwide have grasped this concept and in fact according to the World Bank Doing Business Report 2018, 119 of the 190 economies considered, enacted at least one business regulation reform in 2016/17 (World Bank Doing Business Report, 2018). The host country's measures over foreign investment are embodied for the most part in investment statutes and necessary compliances to start a business, tax laws including the assurances for the repatriation of earnings or capital, labor laws, controls over foreign trade, foreign exchange regulations, the protection of property rights including guarantee of no expropriation and nondiscrimination and the overall efficient functioning of the entire framework, legal system and its institutions. Foreign investment will not be forthcoming when the allowable profits are not 'sufficiently attractive. This will happen in cases where for example, the will be limits on ownership, control and management of a company, burdensome labor and tax laws, onerous and unclear compliances no guarantees regarding property rights, a bad enforcement of the law and contracts as well as an overall inefficient functioning of the legal framework possibly leading to problems of corruption (Gerald M. Meier, 1966). The investor must effectively be and feel protected by any possible risk tied to legal issues which might deter his/her profits and or returns.

2.3 Local Legal Systems, International Treaties and Bilateral Investment Treaties

It has been demonstrated that a county's legal system plays a vital role in determining attractiveness in the eyes of a foreign investor (LaPorta et. al., 1998a, 1998b; Globerman and Shapiro, 2003; Chan-Lee and Ahn, 2001). Enforcement of laws and rules, by courts or market regulators, to protect the private investors is highly important to the eyes of a foreign investor. La Porta et al (1998) argue that enforcement of legal rules is important and can sometimes substitute for weak rules. Proper enforcement and legal rules lead to a reduction of information asymmetries for the foreign investor.

An interesting note to all the above mentioned is that legal systems can generally be classified based on origin in one of two ways. Either pure common law based on the English system or pure civil law based on the Roman system. Legal environments that protect investors can be significant in the decision-making process of an investor (LaPorta, et. al, 1999). For instance, countries whose commercial legal systems are rooted in English Common Law have fewer market regulations and are better at protecting shareholders and creditors as well as preserving property rights (LaPorta, et al., 1998a, 1999, 2001; Djankov et al., 2002). Cost of contracting is also lower because the legal system interprets the spirit rather than the letter of the contract (Lang and So, 2002). In common law countries managers also have fewer exigencies in exercising discretion over reported earnings. This results in a stronger relation between reported earnings in financial statements and the economic value of the company leading to a more persuasive environment for, as an example, a joint-venture investor who will feel more secure about their investments. Common Law also facilitates the development of capital markets and investment opportunities and as a result attracts more foreign investment (Globerman and Shapiro, 2003) (Reese and Weisbach, 2002). The positive perception of Common law countries is supported by the work of Globerman and Shapiro who analyzed the relationship between U.S. foreign direct investment and legal systems clearly indicating that countries whose legal systems are rooted in English Common Law were more likely to be recipients of U.S. FDI flows (Globerman and Shapiro, 2003). Civil or Code law, on the other hand, is expected to attract less investment from abroad because they are likely to be associated with higher durations of judicial proceedings, more corruption, less honesty and fairness and inferior access to justice. In terms of accounting example proposed above, in code law countries the law allows more latitude in accounting practices to smooth earning. More latitude implies that the financial figures in Code Law countries are to be perceived as less of a representation of economic reality (Guenther & Young, 2000) (Prasad, 2009) (Sweeney, 2010).

In addition to a strong domestic law and its enforcement, foreign investor's protection and therefore their attractiveness to invest in a specific country can be shaped by their possibility to avail from international investment laws, agreements and/or treaties particularly aimed at protecting their interests against discretionary policies such as in cases of taxation (i.e. double taxation) and property rights (i.e. expropriation). In the case of taxation though one must distinguish international taxation treaties from international investment treaties as they are specific to the protection of foreign investors in terms of issues related to taxation alone. These will be covered in a further chapter dealing with the possible issues related to taxation. International investment treaties derived from continuous questions about the appropriate standard of treatment owed by domestic sovereigns to foreign nationals within their territory (Hogan Lovells, 2015). These could be multilateral treaties such the North American Free Trade Association (NAFTA) or the Energy Charter Treaty (ECT) as well as the General Agreement on Trade and Tariffs (GATT) which ultimately resulted in the creation of the World Trade Organization (WTO). Multilateral investment agreements help avoid competitive distortions that might have a negative influence on the foreign investor's decision regarding where to invest. Should there be an absence of multilateral investment agreements many developed countries demand that developing countries sign bilateral investment treaties (BITs) (Noudari and Offermanns, 2017) (Guerin; 2011) (Kobeissi, 2005). This demand is driven by concerns about the adequacy of the Rule of Law and the treatment of foreign investors in host states in the developing world.

International investment treaties offer foreign investors a series of economic rights, including the right to arbitrate claims. In general, investment treaties are agreements which are made between two or more sovereign states for the purpose of offering legal protection by safeguarding investments concluded in the signatory countries. The protections commonly present in BITs are: right to fair and equitable treatment, right to “national treatment”, right to most favored-nation-treatment right to compensation for civil disturbance etc., protection against expropriation and nationalization, right to repatriate profits and property, protection against breach of contractual obligations, “umbrella clauses”, and dispute resolution/enforcing rights/arbitration. Once BITs are established they work to ensure that foreign investors are treated fairly and equitably giving them equal legal rights, as a domestic investor or any other foreign investor in the case of an investor-investor or investor-country dispute in the post-establishment period. This justifies why BITs and domestic legal systems are inextricably connected (Guerin, 2011).

BITs are used as a means to both protect and therefore satisfy foreign investors by de facto enhancing the legal framework under which the foreign investment operates.

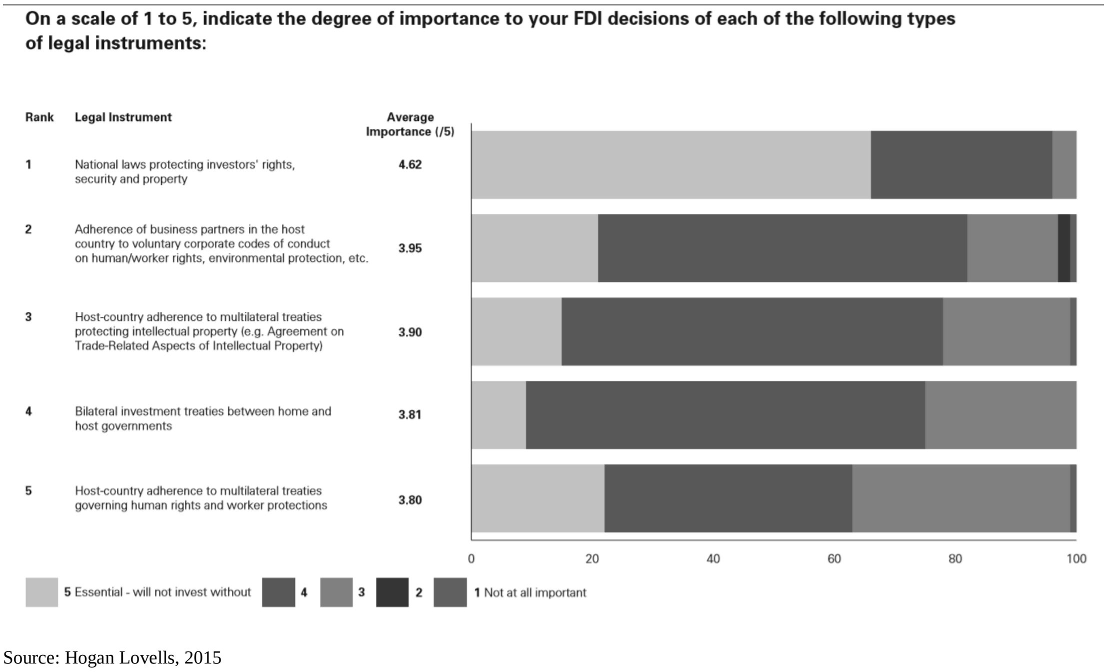
This satisfaction can also be achieved when the foreign investor is making the investment decision as a presence of such treaties would enhance a nation's credibility as a reputable international actor and thus be perceived as a decent location in which to invest. Irrespective of the motives behind signing international investment treaties, their propagation marks a paradigm shift in investors' substantive and procedural rights (Franck, 2007).

In terms of substantive rights, "treaty provisions guarantee 'fair and equitable' treatment of investors and their investments, prohibit discrimination in favor of national investors, guarantee the 'full protection and security' of investments, as well as the free transfer of investment capital, and prohibit expropriations except upon the payment of 'prompt, adequate, and effective' compensation" (Hogan Lovells, 2015). As the above-mentioned conditions are contained in the treaties each signatory state is obliged to abide by them. Thus, meaning and content are ultimately determined by international law and independent of each state's domestic laws and rules. In terms of procedural rights, on the other hand, foreign investors are empowered to raise claims of violations of their own rights before international arbitral tribunals. These tribunals are empowered to issue binding awards, potentially requiring respondent states to cease and desist in prohibited conduct and/or to pay compensation to the investor, irrespective of whether they are established ad hoc or are pursuant to international arrangements, such as the ICSID (International Centre for Settlement of Investment Disputes) Convention[1] (Hogan Lovells, 2015) or the core legal body of the United Nations system in the field of international trade law - the United Nations Commission on International Trade Law (UNCITRAL) (Noudari and Offermanns, 2017). By availing to the facilities of ICSID, investors are ensured with a framework for the resolution of investment disputes detached from the potential interference of national legal system (Shihata, 1991). Traditionally, an investor's remedies were limited when a government violated international law causing adverse effects on their investments. These remedies were often ineffective and unsatisfactory in terms of compensation. They included: (a) negotiating with the sovereign; (b) using the sovereign in the

[1] "ICSID is an institution that administers and provides facilities for the conciliation and arbitration of international commercial disputes between states and nationals of other member states. It was created pursuant to the 1965 Washington Convention on Settlement of Investment Disputes between states and nationals of other states (ICSID Convention)". The advantages of ICSID arbitration include: arbitration proceedings are administered by the World Bank, it is a neutral and self-contained system; it is transparent, and it has clear and reasonable legal cost schedules (Patrick, 2010).

sovereign's own courts where defenses of sovereign immunity may be readily available; (c) asking their home government to negotiate diplomatically on their behalf; or (d) lobbying their home government to espouse a claim on their behalf before the International Court of Justice (Franck, 2007). Past literature has concluded that investment treaties might have a negligible impact in terms of attracting investments. The United Nations Commission on Trade and Development (UNCTAD) and the World Bank, for example, have conducted studies concluding that investment treaties have a minimal impact on foreign investments (Frank, 2007). Neumayer and Spess (2005) and Swenson (2005) on the other hand agree by concluding that international treaties, in particular, BITs, are stimulators of higher investment by foreign investors. They are nevertheless, a piece in a larger picture of forces fostering FDI. In a study conducted by Hogan Lovell in 2014 in which they interviewed a series of international investors, they concluded that National laws were, in fact, more important when deciding on where to invest. As displayed in **figure 1** below, respondents were asked to rank five types of possible legal instruments in order of importance to their foreign investment decision on a scale from 1 to 5 with 5 indicating the most relevant factor. Although the existence of investment treaty protection with the host country is a factor generally taken into account in FDI decisions, the data clearly shows that other applicable legal regimes are frequently regarded as a more important factor.

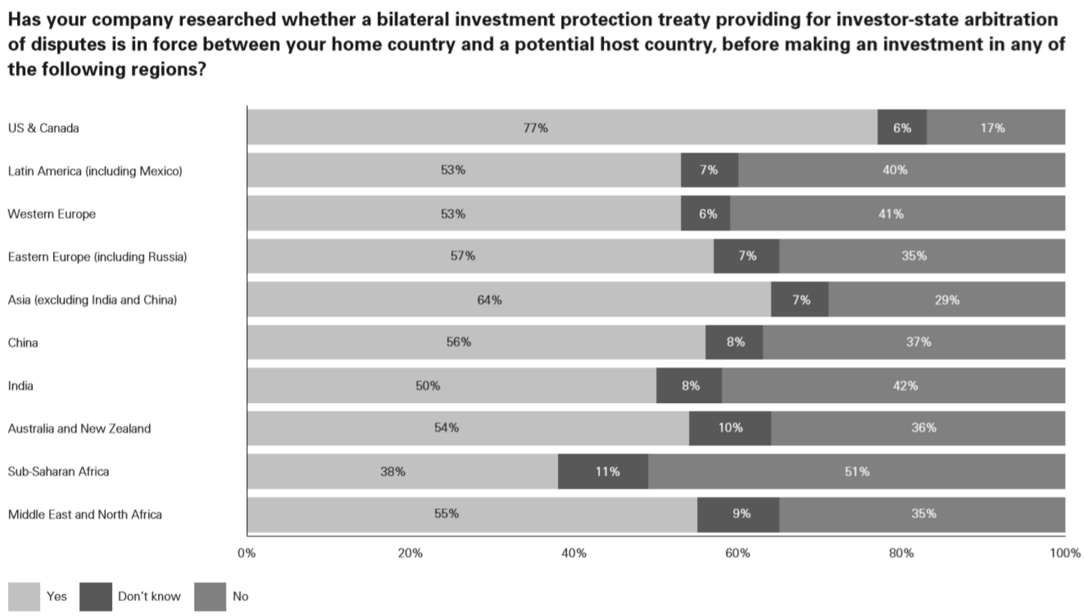
Figure 1. Degree of importance of legal systems to FDI decision



Source: Hogan Lovells, 2015

In addition, it is also interesting to note in **figure 2** below, that many companies did not even research whether a bilateral investment protection treaty providing for investor-state arbitration of a dispute was in force with a given country before making an investment there. Although yes answers were on average above 50 percent (except for Sub-Saharan Africa where yes response was only 38 percent) the figure highlights the general non-familiarity with the international treaties and their existence, denoting again their relatively lower importance. In most cases in fact (i.e. Western Europe, India, Middle East and North Africa, and Latin America) No or don't know responses were excessively high for being companies involved in making a decision on where and whether to invest in a specific country.

Figure 2. Research on presence of BITs between Home and Host country



Source: Hogan Lovells, 2015

2.4 Remarks

Overall most countries around the world are undergoing changes in their legal environment as a means to improve the ability and ease of doing business within their borders. According to the most recent issue of the World Bank Doing Business Report "Good regulatory practices are present in almost all of the world's regions. Aside from

28 OECD high-income economies, the 50 highest ranked economies include 13 from Europe and Central Asia, five from East Asia and the Pacific, two from Sub-Saharan Africa and one each from the regions of Latin America and the Caribbean and the Middle East and North Africa" (World Bank Doing Business Report, 2018). In the graph on the following page **(figure 3),** the various countries are ranked based on their distance to the frontier score. Frontier countries are those having the best performance observed on each of the indicators (starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, enforcing contracts, trading across borders, resolving insolvency and labor market regulation) across all economies. The table also demonstrates the change in distance since last year. It is possible to see that India although occupying the 100th position, is one of the countries with the highest improvement in 2017 registering a score of +4.71. In **figure 4** at the end of this chapter, one can extrapolate more information from the data in figure 3. It is, in fact, possible to see the gap between the highest and the lowest recorded scores by region. The OECD high-income group has the smallest gap with only 18.53 percentage points. Sub-Saharan Africa, on the other hand, has the widest gap with 57.56 percentage points and a regional average score of only 50.43. This is the lowest across all regions across all regions (World Bank Doing Business Report, 2018). India is located in the South Asian region which has a reasonable distance between the frontier country and those having the lowest score. In fact, the overall distance is almost just below Europe and Central Asia which is the second-best region. The substantial difference is that the average score of the region is the second lowest and the frontier country was the worst out of all frontiers.

In contrast to the above mentioned, **figure 5** displays the number of reforms making it easier to do business which has been made in each region. It also shows the number of reforms which have reduced the ease of doing business and the average change in distance to the frontier. Of course, this is again measured based on the indicators chosen by the World Bank for the study and indicated above. By analyzing the change in distance to frontier scores, it is evident that the OECD high-income countries have the lowest increase as they are already very close to global best practices. The Sub-Saharan Africa region, on the other hand, recorded the highest average increase in the distance to the frontier as they are the furthest from global good practices. The South

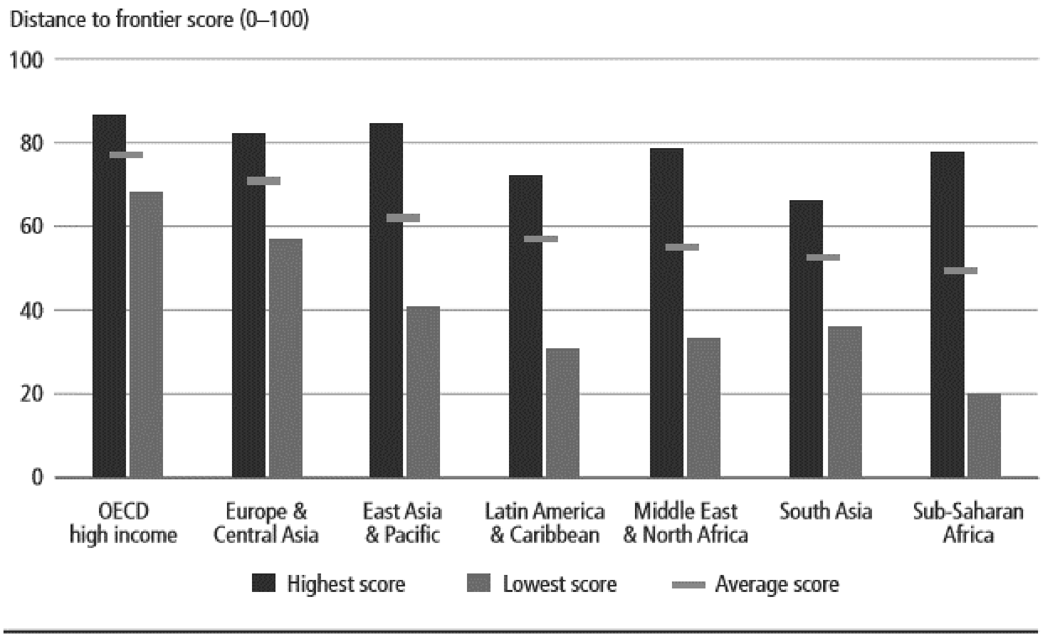
Asian region recorded the third lowest increase in the distance to frontier even though its countries are mostly developing presumably suggesting a great need for reform. Incredibly enough it is also second behind Latin America and the Caribbean in the average amount of reforms made making it harder to do business. In contrast to this, it was the region with the most average amount of reforms making it easier to do business. To conclude, figure 5 also highlights the most relevant reforms per region in terms of amount. In this respect, most business regulation reforms across regions in 2016/17 were made in paying taxes and trading across borders. The reform agendas of OECD high-income and East Asia and the Pacific economies were dominated by regulatory changes captured by the paying taxes indicator set while Latin America and the Caribbean and the Sub-Saharan Africa regions were dominated by regulatory changes captured by the trading across borders indicator set. In South Asia on the other hand, the majority of reforms were captured by the protecting minority interest indicator set.

Figure 3. Ease of Doing Business (a)

DB 2018 Rank	Economy	DTF score	DTF change	DB 2018 Rank	Economy	DTF score	DTF change	DB 2018 Rank	Economy	DTF score	DTF change
1	New Zealand	86.55	-0.18	65	Albania	68.70	+ 0.96	129	St. Vincent and the Grenadines	55.72	+0.01
2	Singapore	84.57	+0.04	66	Bahrain	68.13	+0.01	130	Palau	55.58	+0.46
3	Denmark	84.06	-0.01	67	Greece	68.02	+0.01	131	Nicaragua	55.39	+0.09
4	Korea, Rep.	83.92	0.00	68	Vietnam	67.93	+2.85	132	Barbados	55.20	-0.09
5	Hong Kong SAR, China	83.44	+0.29	69	Morocco	67.91	-0.03	133	Lebanon	54.67	-0.10
6	United States	82.54	-0.01	70	Jamaica	67.27	+0.57	134	St. Kitts and Nevis	54.52	+0.18
7	United Kingdom	82.22	-0.12	71	Oman	67.20	+0.08	135	Cambodia	54.47	+0.23
8	Norway	82.16	-0.25	72	Indonesia	66.47	+2.25	136	Maldives	54.42	+0.64
9	Georgia	82.04	+2.12	73	El Salvador	66.42	+3.54	137	Tanzania	54.04	+0.11
10	Sweden	81.27	+0.03	74	Uzbekistan	66.33	+4.46	138	Mozambique	54.00	+0.97
11	Macedonia, FYR	81.18	-0.21	75	Bhutan	66.27	+1.06	139	Côte d'Ivoire	53.71	+2.04
12	Estonia	80.80	+0.05	76	Ukraine	65.75	+1.90	140	Senegal	53.06	+3.75
13	Finland	80.37	-0.11	77	Kyrgyz Republic	65.70	+0.54	141	Lao PDR	53.01	+0.43
14	Australia	80.14	0.00	78	China	65.29	+0.40	142	Grenada	52.94	-0.11
15	Taiwan, China	80.07	+0.41	79	Panama	65.27	+1.25	143	Mali	52.92	+0.30
16	Lithuania	79.87	+1.05	80	Kenya	65.15	+2.59	144	Niger	52.34	+2.26
17	Ireland	79.51	-0.19	81	Botswana	64.94	+0.07	145	Nigeria	52.03	+3.85
18	Canada	79.29	-0.09	82	South Africa	64.89	-0.08	146	Gambia, The	51.92	-0.01
19	Latvia	79.26	-0.79	83	Qatar	64.86	+0.61	147	Pakistan	51.65	+0.71
20	Germany	79.00	-0.19	84	Malta	64.72	+0.43	148	Burkina Faso	51.54	+0.20
21	United Arab Emirates	78.73	+1.87	85	Zambia	64.50	+3.92	149	Marshall Islands	51.45	+0.03
22	Austria	78.54	-0.15	86	Bosnia and Herzegovina	64.20	+0.42	150	Mauritania	50.88	+1.56
23	Iceland	78.50	+0.01	87	Samoa	63.89	+2.06	151	Benin	50.47	+1.85
24	Malaysia	78.43	+0.96	88	Tunisia	63.58	-0.20	152	Bolivia	50.18	+0.32
25	Mauritius	77.54	+2.09	89	Tonga	63.43	+0.50	153	Guinea	49.80	+0.32
26	Thailand	77.44	+5.68	90	Vanuatu	63.08	+0.02	154	Djibouti	49.58	+3.99
27	Poland	77.30	+0.18	91	St. Lucia	62.88	+0.01	155	Micronesia, Fed. Sts.	48.99	+0.01
28	Spain	77.02	0.00	92	Saudi Arabia	62.50	+2.92	156	Togo	48.88	+0.64
29	Portugal	76.84	-0.14	93	San Marino	62.47	-0.03	157	Kiribati	48.74	-0.31
30	Czech Republic	76.27	+0.03	94	Uruguay	61.99	+0.35	158	Comoros	48.52	+0.47
31	France	76.13	-0.06	95	Seychelles	61.41	+1.01	159	Zimbabwe	48.47	+0.80
32	Netherlands	76.03	+0.51	96	Kuwait	61.23	+1.52	160	Sierra Leone	48.18	-0.06
33	Switzerland	75.92	+0.19	97	Guatemala	61.18	-0.43	161	Ethiopia	47.77	+2.08
34	Japan	75.68	+0.07	98	Dominica	60.96	+0.34	162	Madagascar	47.67	+3.05
35	Russian Federation	75.50	+0.81	99	Dominican Republic	60.93	+2.52	163	Cameroon	47.23	+2.18
36	Kazakhstan	75.44	+1.06	100	India	60.76	+4.71	164	Burundi	46.92	+0.06
37	Slovenia	75.42	+0.99	101	Fiji	60.74	+0.04	165	Suriname	46.87	+0.11
38	Belarus	75.06	+0.55	102	Trinidad and Tobago	60.68	-0.19	166	Algeria	46.71	-0.01
39	Slovak Republic	74.90	-0.25	103	Jordan	60.58	+2.38	167	Gabon	46.19	+1.33
40	Kosovo	73.49	+4.98	104	Lesotho	60.42	+0.54	168	Iraq	44.87	+0.48
41	Rwanda	73.40	+3.21	105	Nepal	59.95	+2.35	169	São Tomé and Príncipe	44.84	+0.39
42	Montenegro	73.18	+1.64	106	Namibia	59.94	+0.54	170	Sudan	44.46	+0.17
43	Serbia	73.13	+0.26	107	Antigua and Barbuda	59.63	+0.98	171	Myanmar	44.21	+0.30
44	Moldova	73.00	+0.20	108	Paraguay	59.18	+0.06	172	Liberia	43.55	+3.10
45	Romania	72.87	+0.17	109	Papua New Guinea	59.04	+0.17	173	Equatorial Guinea	41.66	+1.77
46	Italy	72.70	+1.15	110	Malawi	58.94	+6.33	174	Syrian Arab Republic	41.55	+0.08
47	Armenia	72.51	+0.59	111	Sri Lanka	58.86	+0.13	175	Angola	41.49	+1.38
48	Hungary	72.39	+0.26	112	Swaziland	58.82	+0.25	176	Guinea-Bissau	41.45	+0.23
49	Mexico	72.27	+0.18	113	Philippines	58.74	+0.42	177	Bangladesh	40.99	+0.15
50	Bulgaria	71.91	+0.10	114	West Bank and Gaza	58.68	+3.80	178	Timor-Leste	40.62	-0.07
51	Croatia	71.70	+0.05	115	Honduras	58.46	-0.07	179	Congo, Rep.	39.57	-0.52
52	Belgium	71.69	-0.23	116	Solomon Islands	58.13	-0.01	180	Chad	38.30	-0.28
53	Cyprus	71.63	-0.49	117	Argentina	58.11	+0.07	181	Haiti	38.24	+0.01
54	Israel	71.42	+0.05	118	Ecuador	57.83	-0.01	182	Congo, Dem. Rep.	37.65	+0.22
55	Chile	71.22	+0.37	119	Bahamas, The	57.47	+0.82	183	Afghanistan	36.19	-1.80
56	Brunei Darussalam	70.60	+5.83	120	Ghana	57.24	+0.34	184	Central African Republic	34.86	+0.78
57	Azerbaijan	70.19	+3.12	121	Belize	57.11	+0.03	185	Libya	33.21	+0.03
58	Peru	69.45	+0.01	122	Uganda	56.94	+0.42	186	Yemen, Rep.	33.00	+0.06
59	Colombia	69.41	-0.11	123	Tajikistan	56.86	+0.93	187	South Sudan	32.86	-0.33
60	Turkey	69.14	+1.16	124	Iran, Islamic Rep.	56.48	+0.26	188	Venezuela, RB	30.87	-0.79
61	Costa Rica	69.13	+1.23	125	Brazil	56.45	+0.38	189	Eritrea	22.87	+0.42
62	Mongolia	69.03	+1.27	126	Guyana	56.28	+0.39	190	Somalia	19.98	-0.31
63	Luxembourg	69.01	+0.35	127	Cabo Verde	56.24	+0.42				
64	Puerto Rico (U.S.)	68.85	+0.05	128	Egypt, Arab Rep.	56.22	+0.10				

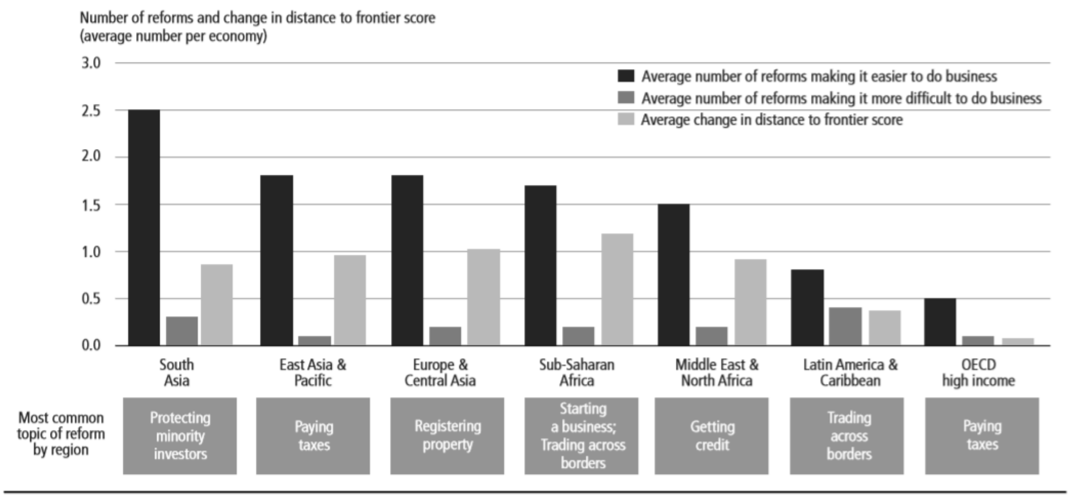
Source: World Bank Doing Business Report, 2018

Figure 4. Ease of Doing Business (b)



Source: World Bank Doing Business Report, 2018

Figure 5. Number of Reforms Made by Type and Average change in Frontier Score



Source: World Bank Doing Business Report, 2018

Note: The average change in the distance to frontier score shows the change between Doing Business 2018 and Doing Business 2017.

3. FOREIGN INVESTMENTS AND RELATED LEGAL ISSUES

On the basis of what has been described in the preceding chapter, it is within the objective of this thesis to better highlight aspects of the legal environment as a whole in which foreign investors might incur possible issues. The starting point of the analysis will be to overview the stages of a foreign investment. In doing so it will be possible to highlight which legal issues or obstacles might be incurred in each phase. After doing so, the chapter will serve to better analyze the inefficiencies which might be encountered in specific areas of the legal framework be it in terms of the procedures, the functioning, the governing institutions and the laws and regulations themselves.

3.1 Stages in foreign investments

When investors are undergoing the decision-making process to invest in a foreign country they may face many obstacles specifically related to the foreign countries legal environment. These obstacles can be classified as occurring in either or both the pre and post-establishment period. They can relate to problems faced in order to establish a business within a specific country or due to the labor or tax laws and regulations of the country. Problems may also arise in relation to intellectual property protection and property protection in general or in direct relation to the enforcement of the law itself and therefore the functioning of the governing institutions. Finally, issues may occur because the complexity of the laws and or procedures delineated by the governing institutions. It should be noted that this is not the exhaustive list of the obstacles, but that considered in this thesis to be highly influential in the decision-making process of foreign investors when deciding where and if to invest.

FDI project can broadly be divided into four phases: a pre-establishment phase; an establishment phase, an operational phase and possibly a termination phase. In addition, a dispute resolution phase may occur should the case arise. Within the **pre-establishment phase,** problems may occur in terms of restrictions to investment, restrictions on the business structure options which can be used and difficulties in carrying out a risk analysis due to information asymmetries caused by unclear laws and regulation and undocumented data. During the **establishment Phase,** an investor might encounter problems in terms of tax planning due to unclear or tedious tax systems and/or unfairness. He/she might also run into licensing and capital requirement issues. These depend on the clearness of procedures and laws, on the tediousness of the procedures and on possible restrictions tied to the amount of capital and the need for an excessive number of licenses. Possible problems may also arise in terms of property right and intellectual property right enforcement and protection. Once the foreign company has been established the investment follows into the **operational phase**. Within this phase problems arise in terms of labor law issues, repatriation of profits, issues related to the general ensured the competitiveness of the market by authorities as well as issues of corruption which could deter the timing of procedures and increase costs to the foreign investor. In a possible **termination phase,** the foreign investor may run into problems of unprotected rights due to termination by local authorities i.e. appropriation. Other problems incurred procedures for termination of an FDI project as well as issues related to laws and measures in the case of insolvency. An important factor here is the presence of problems tied to the recovery of intellectual property. In the event of a dispute, foreign companies may also find themselves confronted by the issues arising from the **resolution of disputes**. In particular, these problems relate to the transparency, time length and efficiency of the procedures, the enforcement of rights as well as foreign arbitral awards, the immunity of the local government to the law and the possibility to appeal administrative decisions (Massmann, 2016).

In the following sections this work will analyze a specific set of issues tied to the inefficiencies of a legal environment of a country irrespective of whether they are related directly to the law themselves, they are procedural, or they arise due to inept enforcement the enforcing bodies.

3.2 FDI Policy: Incentives and Restrictions

Governments of developing countries must make up for the operational difficulties which a foreign company may run into when investing in them. They may attempt to do so by utilizing tools to incentivize investment in order to make up for additional risk and/or costs associated with operating in their country. These risks and costs are linked to a certain location's accessibility, the level of development, or the present state of security. In normal circumstances, the presence of such conditions would surely exclude any territory from being a viable location for investment.

Foreign investors are interested in those exemptions offered by the hosting country's government, which will ensure and encourage the possibility to increase profit expectations and thus gain from the returns on their investment. This is especially true in the case of developing countries. Investors in these countries more than others are highly interested in the incentives which ensure profits rather than those exemptions which might be granted once profits are made. Governments may assist the growth in profit expectations of a foreign and/or local investor by applying provisions which reduce the nonbusiness risks of a project, lower the costs and increase the expected returns. It can do so through public expenditures, by providing public utilities, developing industrial sites, expanding labor training facilities, and furnishing statistical and information services. In terms of the legal environment, one may find both financial and non-financial incentives. An important legislative effort aimed at increasing investment in terms of financial incentives is the application of tax concessions. These come in three different forms: (a) Tax holidays or reduced rates on taxable income effective only when the investment yields substantial taxable profits. Tax holidays may also come in the form of relief from income and other taxes to new and necessary industries; (b) liberal depreciation allowances in the calculation of company taxes and finally (c) partial or complete exemption from duties on the importation of essential equipment and materials (Meier, 1966) (Sun, 2002).

Non-financial incentives, on the other hand, are also important in increasing the investment attractiveness of a country from the perspective of a foreign investor. Non-financial incentives are intended to increase the speed and flexibility of procedures, two elements which are highly prioritized in the business arena. This is because investors tend to position their investments in a business environment characterized by the freedom to operate as they see fit and that will quickly evolve along with their needs. Governments can create such environment by reducing the cost of complex and entangled operating environments thus by ensuring that the rules remain clear, simple, and flexible. To do so they may either pull efforts to disentangle the environment or develop means to compensate the investors. In the eyes of the investor, attractiveness will depend on the reduction of the costs or operational difficulties which would make the total cost picture more competitive. Non-financial incentives include those customized benefits offered to companies that help ensure speed, simplicity, and flexibility in doing business. Clear and simple processes will assist the company by ensuring that it can focus on its business rather than finding their way through the bureaucratic mess. Non- financial incentives come in the form of permit and approval processes, specialized customs clearance procedures, and fast-track permits as well as all-around simplified and clear procedures to start a business. Non-financial incentives are equally attractive because speed and flexibility are critical for most businesses. Companies want to locate where government efforts to develop non-financial incentives are high. In order to attract investment, a country's governing bodies must either disentangle its challenges or compensate the investor for dealing with them. Incentives can offset the higher costs caused by these challenges. Clear and simple processes are necessary to enable a company to focus on doing business rather than wading through quagmires. A few examples of non-financial incentives include infrastructure improvements, streamlined permit and approval processes, specialized customs clearance procedures, and fast-track construction permitting (Telford and Ures, 2001). Non-financial incentives will also benefit local investors.

Attractiveness to foreign investments also depends on the presence of discriminatory laws and regulations. A positive framework for foreign investors is that which is based on the principles of non-discrimination. In this particular case, discrimination takes the form of any positive legislative element which would favor the interest of local investors and nationals with respect to foreign ones. Of course, discrimination may also occur in the opposite direction, when the host government favors foreign investors too much vis-a-vis local ones. Discrimination towards foreign investor comes in the form of restrictions.

Restrictions can be sectoral prohibitions or caps. In the first case, a foreign investor may be off-limits to some sector considered sensitive by the host government. Prohibited Sectors are those considered by the host governments to be of strategic importance to the country. A sector restriction may also come in the form of sector-specific limitations which put a cap or limit on the amount of foreign investment in a specific sector. For a foreign investor, investments having the automatic approval of one-hundred percent and thus no government permission needed would be the best option. Such investments would still require being registered at the competent courts. Other forms of restriction include those in which an investor is forced to hold minority positions or can only invest under special conditions **(**Sun, 2002).

In general, from the standpoint of the legal environment, foreign investors encounter fewer issues and are thus more prone to invest in a foreign country characterized by a fair amount of incentives both financial and non-financial as well as the presence of a minor amount of restrictions if any.

3.3 Starting a business and relevant procedures

When investors invest in a foreign country they seek quick and efficient ways and procedures to start a business in that country. Usually, most of the foreign investment comes from developed countries, therefore these investors are used to and expect to work with the same quality of procedures. This, unfortunately, is not true when investments are made in developing countries. Procedures in these countries are typically slow, complex and articulated often creating an obstacle for the foreign investor.

According to various studies, administrative procedures linked to starting a business including incorporation, various registrations and adherence to local compliances both general and specific to foreign investors as well as the opening of a bank account, are extremely cumbersome, time-consuming, and expensive in most developing countries in the world. In fact, in more than three quarters of the countries analyzed an investor must go through, on average, more than seven steps to complete the startup-incorporation procedures, wait for more than one month to obtain all the required papers, and pay exorbitant fees both to the government and specialized local agencies needed to help them do so. In another recent study by the Facility for Investment Climate Advisory Services (FIAS), the administrative procedures of 32 developing countries were collected. On average investors needed to comply with 53 different procedures, resulting in delays with respect to business establishment and operation of 443 days, translating into imputed financial costs of close to 6,000 USD. Costs for the procedure can be both direct and indirect. Direct costs include formal and informal payments, facilitation costs and expenditures on external advisors. Indirect costs include the inefficient allocation of resources due to distortions caused by the government. An additional cost also arises in the form of time lost in dealing with regulatory requirements and interacting with government officials.

The list of procedures intended to screen, approve and monitor private and foreign investments vary from country to country but it is possible to categorize them into three broad categories. The first, entry procedures, include incorporation procedures, company registration, sectoral licenses, tax registration, statistical registration, social security, incentive approvals, Visas, work and residence permits for foreign investors and foreign exchange registration for foreign investment. After these have been accomplished investors are confronted with location procedures which include purchase/lease agreements, land titling, and cadaster, land use permission/re-zoning, environmental clearance/impact assessments, construction permit, site inspections, occupation permits and utility connections. The final set of procedures must be fulfilled in the initial phase of the investment but may also protract throughout the lifetime of the investment. These are operational procedures which include: tax compliance as well as reporting and inspections, fire, health, and safety inspections, Import-Export licenses procedures and clearances, technical standard approvals/certification and labor regulations (Sun, 2002).

It is clear that the clearer, the faster and the less burdensome the procedures to start a business the lower the costs to the investor in the form of money, time and lost possible profit resulting in the higher perceived attractiveness of a country. Unclear, unpredictable and cumbersome incorporation and registration guidelines and procedures lead to informality. Informality, in turn, perpetuates noncompliance with the law and thus possibly weakens the rule of law (De Giorgi et al., 2013) (UNCITRAL, 2013). It leads for example to an increase in the risk of non-payment of taxes, increase in corruption and creates a negative environment for foreign investment altogether. The high costs imposed by inefficient company registries together with bureaucratic obstacles dissuade entrepreneurs and investors to convert their ideas, operation, and strategies into actual use (The World Bank, 2017). The establishment of fast-track procedure for starting a business would, for example, further incentives foreign investors.

3.4 Tax Regulations

One of the greatest regulatory obstacles for foreign investors and a deterring element of their incentive to invest in a given country is represented by tax regulations. These include tax rates and tax administration, as well as customs regulations. A well-functioning society is characterized by a proper, efficient and well-developed taxation system. This would ensure a proportionate, certain and convenient model for investors and of course taxpayers in general as well as simplifications in the collection of taxes.

Regulatory problems with tax and customs administration are a big deterrent for foreign investors. Complexity in tax systems may result in overpay of taxes by foreign investors. Problems may also arise in terms of double taxations issues, repatriation of funds and capital, transfer pricing and in the case of taxation on earnings from the sale of shares (Noudari and Offermanns, 2017). Overall issues may arise due to corporate statutory taxes which are relatively too high. These issues directly convert into uncertainties for the foreign investor reducing his/her interest in investing in a specific country or maintaining operations there altogether. Aside from the importance of the investor's need to well understand the taxation environment prior to investment, possibly with the help of a local expert advisor, many countries have taken countermeasures to reduce these issues and difficulties. These have been taken as a means to increase investor security.

In the actual payment of taxes, electronic filing and payment systems have gradually been implemented or enhanced over the past year. Investment incentive schemes have also been put in place to attract foreign investment simplifies tax and customs treatments for the foreign investor. Governments influence the effective tax rates and the location decision of multinational companies by directly lowering the statutory corporate income tax rate. A lower rate allows for loss carryforward. This lets investors carry a fixed ratio of their losses forward, or back, for a specified time. Investors may also be incentivized by instruments such as tax holidays, investment tax allowances and tax heaven or Export Processing Zones. Tax holidays and tax heavens are the most popular forms of incentives around the world, especially the emerging countries. Tax holiday allows for exemption from corporate income tax or other taxes for a specified period, usually between 2 to 20 years. By eliminating the tax on net revenue and depending on the circumstances, tax holidays can improve the return on investment for foreign investors. Often though, tax deductibility of depreciation costs and other business expenses is often denied during the holiday period and carry-forward of business expenses incurred in the holiday period may not be allowed reducing the return on investment. Tax allowances, on the other hand, are generally applicable in addition to the normal allowances for depreciation that may result in total deductions that exceed initial investment costs. They provide for deductions of a specified percentage of certain capital investment costs from taxable income in the initial years of operation. In the alternative they may provide for 100% depreciation at once resulting in the freeing up of cash and reduction of the effective cost of the asset.

Investment tax allowances have the advantages of encouraging companies to take a long-term view when planning investments and represents a non-discretionary regime which does not depend on case-by-case evaluations. In contrast to tax havens and tax, holidays increase the attractiveness of short-term investments. Yet another form of incentive is tax-sparing or matching-credit clauses. Through this mechanism, the resident state of the investor grants a full credit in respect of a fictitious withholding tax that would have otherwise been levied by the source state. Benefits would come in the form of a significant reduction of its corporate tax liability (UNCTAD, 2000). Tax-sparing credits are usually provided for withholding taxes on dividends, interest, and royalties. In conclusion, one may also find incentives in the form of VAT relief or reduced customs duties and tariffs on imported raw materials and capital (Sun, 2002) (Noudari and Offermanns, 2017).

To reduce administrative complexity, eliminate double taxation, reduce any uncertainty and correct issues related to transfer pricing, countries have entered into many bilateral tax treaties. These deal specifically with the allocation of exclusive taxing rights over income or capital to one of the contracting states. In the case taxation is permitted in both states under a certain tax treaty, it requires the residence state to provide relief for the tax imposed by the source state. The provisions take are generally based on the provision contained in the OECD Model[2] and UN Model[3] although

[2] "The OECD Model Tax Convention, a model for countries concluding bilateral tax conventions, plays a crucial role in removing tax related barriers to cross border trade and investment. It is the basis for negotiation and application of bilateral tax treaties between countries, designed to assist business while helping to prevent tax evasion and avoidance. The OECD Model also provides a means for settling on a uniform basis the most common problems that arise in the field of international double taxation" (OECD, 2014).

[3] "The United Nations Model Double Taxation Convention between Developed and Developing Countries (the United Nations Model Convention) forms part of the continuing international efforts aimed at eliminating double taxation. generally, favors retention of greater so called "source country" taxing rights under a tax treaty—the taxation rights of the host country of investment—as compared to those of the "residence country" of the investor. This has long been regarded as an issue of special significance to developing countries, although it is a position that some developed countries also seek in their bilateral treaties" (UN, 2011).

deviations may exist as decided by the two signatory states. A first measure taken by these treaties relates to the withholding tax rates. The UN model specifies no maximum rate while the OECD model specifies 5% for direct holdings by a company of 25% or more and 15% in other cases for dividends and 10% for interest (Lennard, 2012). In developing countries, the withholding tax rates are typically high due to the easiness in their collection. Withholding Tax rates on outbound royalty payments are also generally high. Withholding tax rate in respect of qualifying outbound dividends are instead generally moderate. A second measure is taken with respect to double taxation. In this case, income generated in the source state is granted exemption from taxation or investors is granted a credit in respect of taxes paid in the source state against its own tax levied on such income. In the first case, the investor' s residence state exempts certain items of income (generally active income) from foreign sources from taxation. In the second case, the residence states allow for income taxes paid to the source state to be set off against its own income taxes, subject to certain exceptions. Thus, if the levied tax in the source state exceeds the tax levied in the residence state providing the credit, this can give rise to excess foreign tax credits. This typically applies to passive income, such as dividends, interest, and royalties (Noudari and Offermanns, 2017).

By offering a more uniform interpretation of the various laws on taxation, multilateral tax treaties, on the other hand, are intended to improve legal certainty for foreign investors. Examples include the Caribbean Community (CARICOM) Income Tax Treaty (1994), the Andean Community Income and Capital Tax Treaty (2004) and the Nordic Convention (1996) although other are also in existence.

Two common elements in tax treaties are non-discrimination provisions and Most Favored nation provisions. The first is based on the OECD model and prohibits open and direct discrimination as well as prevent tax claims being raised by a contracting state that is incompatible with the purpose and objective of a tax treaty. The second provides that contracting states grant similar tax benefits to residents of the other contracting state to the extent that it grants such benefits, to residents of third countries and that these benefits are more favorable than those in the tax treaty between the two contracting states.

Tax treaties are also a means to solve issues related to repatriation of funds and earning from the sale of shares. In general tax, treaties do provide for a beneficial tax treatment in regard to income derived in the form of capital gains. According to the OECD model, the exclusive taxing right is attributed to the residence state of the investor while for the UN model shared taxation of gains can be realized subject to substantial participation[4]. Should capital gains arise from the indirect sale of shares the first step is to determine whether there is a direct link with the source state thus when the shares sold are physically held in the residence state of the seller. Should the link not exist, one could strongly object taxation on the source state. The OECD Model and the UN Model typically do not permit this form of taxation. Although this is true, should a foreign investor hold shares in a foreign country through another foreign entity, the sale of these shares are taxable by application of domestic specific anti-avoidance rules (SAARs) or general anti-avoidance rules (GAARs). In the repatriation of funds in the presence of interest, the OECD Model and the UN Model provide for shared taxation. This means a source state may levy either a tax at a rate not exceeding 10% (OECD Model), or at a rate as agreed by the parties (UN Model), while the residence state taxes the income with the provision of a credit for the withholding tax levied in the source state (Khadija Baggerman-Noudari and René Offermanns, 2017). In the presence of Dividends both Un model and OECD model provide for shared taxation.

In the case of repatriation issues, foreign investors may also avail to indirect repatriation using transfer pricing strategies. The parent company, in this case, must comply with the arm' s length principle[5] and should satisfy the transfer pricing regulations that apply in both states (Noudari and Offermanns, 2017).

In conclusion to safeguard themselves foreign investors should closely examine how to organize a corporate structure in a tax efficient manner. These structures

[4] "Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 12-month period preceding such alienation, held directly or indirectly at least ___ per cent (the percentage is to be established through bilateral negotiations) of the capital of that company" (Noudari and Offermanns, 2017).

[5] "This valuation principle is commonly applied to commercial and financial transactions between related companies. It says that transactions should be valued as if they had been carried out between unrelated parties, each acting in his own best interest" (OECD, 2006).

usually vary from a domestic subsidiary in the form of a limited liability company (either in the form of a wholly owned subsidiaries and/or Joint Venture), a branch office, a representative office, and regional headquarters. Other structures are foreign-invested partnerships, common investment vehicles, holding companies and other special purpose entities (SPEs), production-sharing agreements (PSAs), licensing arrangements and concessions or service contracts or the investor could acquire shares in an existing domestic company through a merger and acquisition (M&A). In particular, the investor should essentially identify all tax-related risks, opportunities and look for possible advantages in existing tax treaties between source and residence country, He/she must analyze the availability of tax incentives and the efficiency of the taxation system of the country as a whole.

3.5 Property rights

The existence of valid property rights is an essential feature in supporting an investment, productivity and overall economic growth. They allow the owner of such rights maximum freedom to produce and develop their own property as they wish. This is true as long as the rights of one person do not impede the rights of another. The presence of such freedom induces an increase in the owners will spend more money on investments in their property. An act which could potentially cause beneficial spillover effects for the economy as a whole (World Bank Doing Business Report, 2018) (Danner, 2008). According to the World Bank, owners possessing registered titles are more induced to invest. They also have other benefits such as better chances of accessing credit when using the given property as collateral. What is interesting to note from a study conducted by La Porta et al (1996) is that “stronger protection of property rights is given to investors in common law countries while they are much lower in civil law ones such as France”.

Issues arise when owners, in our case foreign investors, feel insecure and unsure regarding how well their property is protected. In fact, economic freedom would be meaningless if individuals did not have secure rights to their property (Kobeissi, 2005). This would deter investment and undermine the operation of a market-exchange system (Gwartney, et.al., 2003). Should an investor feel that their property rights are not protected, they will not be able to accurately predict a secure rate of return, will, therefore, feel less inclined to invest in the development of their property and could ultimately risk the loss of a substantial amount of assets (Danner, 2008). Without the protection incentive, there is little motivation by investors to take risks and invest (Drabek and Payne, 2001).

Overall, the risks tied to a low level of protection of property right are multiple. One issue by La Porta et al (1996) suggests that, “in countries with weak property rights, investors must be “large” in order to stand up to local management and be able to extract payments from them”.

The most important issues related to the loss of assets, Clague, et al. (1997) argues that “the risk of such loss is greater the more one specializes and the more one depends on complex exchanges”. The environment must be characterized by the right amount of legal incentives otherwise businesses will not be motivated to expand and realize scale economies (Clague, 1997). In this case, uncertain may either come from the risk of government seizure of goods or revenues and a fear of physical destruction at the hands of other individuals. The probability of such occurrences must be weighed against the expected rate of return when making the investment decision. These two scenarios are known as expropriation. Although expropriation is defined as: “the action of the state in taking or modifying the property rights of an individual in the exercise of its sovereignty” (Merriam Webster, 2018) as mentioned above, two forms of expropriation exist. Expropriation by management and sovereign expropriation risk by the host state. Another form of expropriation can arise when there is the classic agency problem. In this case, the agent (affiliate firm) uses the profits to benefit themselves rather than return them to the principle (parent company). Usually, this may arise in the post-establishment period due to information asymmetries (Guerin, 2011**)** The rights of the investors either cases should be defined and protected by the legal system, the quality of which is thus closely related to sovereign expropriation risk.

Again, in absence of the right level of protection, a foreign investor will not be inclined to invest. Should the host country not be able to credibly protect foreign investments, the investor demands (Usually to home country on the investor’s behalf) that the host state signs a bilateral investment treaty. Such treaties include BITs which were covered in chapter 2. BITs and international investment law provide protection against expropriation by the state. According to these treaties, the property of foreign investors cannot be expropriated without compensation, but should BITs be absent international investment law leaves the decision on compensation to the courts of the host state. As property rights are a matter of state law, BITs do not act as a substitute for weak property rights but only as protection for sovereign expropriation risk. (Guerin, 2011).

Should a foreign investor have a minority interest in a company located in another country a common problem could be the non-protection of minority shareholders as per the country's commercial law. The law should, in fact, enhance approval and disclosure requirements for related-party transactions for the sake of transparency and protection of all shareholder rights. In this respect, some states apply broad disclosure and audit requirements hindering the rights of minority shareholders and shareholder in general as it creates information asymmetries (Dennis and Ramos, 2016). Improvements must also be made on the extent of approval, extent of director liability and ease of shareholder suits (World Bank Doing Business report, 2018)

Issues regarding property rights may also arise in terms of intellectual property right protection. This is especially true in developing countries. Intellectual property (IP) is a term referring to a brand, invention, design or another kind of creation, which a person or business has legal rights over. Almost all businesses own some form of IP, which is business assets to that firm. Common types of IP include copyrights, patents, designs, and trademarks. Copyrights protect written or published works such as books, songs, films, web content and artistic works. Patents, on the other hand, protect commercial inventions i.e. a new product or process. Designs protect designs, such as drawings or computer models. Finally, trademarks protect signs, symbols, logos, words or sounds that distinguish your products and services from those of competitors. Unregistered IP gives the owner automatic legal right over the creation although others will be free to exploit the creation. Registered IPs, on the other hand, will have the rights recognized by a public authority and prevent the use of "creations" by others. Internationally IP protection should be guaranteed by institutions such as the WTO whose members must include some IP protection in their national law. As displayed by the Intellectual Property Office of the UK (2017) "other international treaties include the Paris Convention under which any person from a signatory state can apply for a patent or trademark in any other signatory state and will be given the same enforcement rights and status as a national of that country would be. Or the Berne Convention – under which each member state recognizes the copyright of authors from other member states in the same way as the copyright of its own nationals. Under the Madrid Protocol, on the other hand, a person can file a single trademark application at their national office that will provide protection in multiple countries. The Patent Cooperation Treaty provides for a central system for obtaining a 'bundle' of national patent applications in different jurisdictions through a single application. Finally, The Hague Agreement allows for the protection of designs in multiple countries through a single filing. It is important to note that not all countries are part of all the above-mentioned treaties" (Intellectual Property Office, 2017).

The problems Usually tied to IP rights in developing countries consist in the missed registration to local authorities due to burdensome and non-transparent processes, weak contracts and its clauses especially in the formulation of joint ventures and weak enforcement of the rights by the legal system in case of infringement.

3.6 Labor law

Labor law is another area of a country's legal framework which can be a potential danger zone to foreign investors as they might run into a few issues. This is especially true in developing economies. The regulation of the labor market is essential to achieve primary, economic goals such as the efficient allocation of resources (World Bank Doing Business Report, 2012). It is also essential in protecting vulnerable groups from market failures, such as forced labor and discrimination. Efficient labor regulations help advance a series of economic as well as social goals. These include better responses to economic shocks or the promotion of equal opportunities and social cohesion. Developing countries must pay attention to preventing both over- and under-regulation by balancing labor flexibility with worker protection (Agell, 1999). In fact, as the regulator, the Government stands in the middle of the employees and the employers. Employees want to be protected against unfair termination of employment contract and want to retrieve fair compensation for their labor. Employers, on the other hand, are interested in having friendly labor regulations. This would allow them to exercise their company labor policies and get the best experiences from the employees. Issues thus arise if termination employees are made difficult or costly by the governing laws. This would reduce the flexibility needed by MNCs to maintain best performing workers.

3.7 Governing Institutions and the Enforcement of the Laws and Contracts

This particular chapter serves to highlight the relation between the governing institutions and the enforcement of both the law and contracts as a factor affecting the foreign investor's location decision. The enforcement of the laws and rules of a country by its market regulators and courts is indispensable in protecting foreign investors and/or private investors in general. According to La Porte et al (1998), “the enforcement of the rules theme selves can effectively substitute weak rules”. This, in turn, will attract the foreign investor as he/she will be reassured by the reduced risks of the investment. This is because it would help reduce information asymmetries for the foreign investors as well as indirectly provide more liquid and broad local financial markets. Investor security is deterred if they perceive the enforcement of the law in a specific country to be low. This will essentially cause lower investments as they would feel unsure about the protection of their rights. In addition, foreign investors would feel unsafe in event of a dispute as they would not be guaranteed the proper applicability of the law which could ultimately have negative effects on their possessions and overall return on the investment made in that country. This, of course, would be the situation should the outcome of a case be unjustly unfavorable. An overall sense of unprotection perceived by the investor would surely push him/her away from investing in that specific country.

Enforcement also relates to contracts. The enforcement of contracts is essential to incentivize business. If contracts are not properly enforced it would lead to a reduction of complex and non-self-enforcing transactions (Danner, 2008). According to Clague (1997) a lack of property rights and contract enforcement, either caused by an absence of formally defined law or an arbitrary enforcement of formally defined laws leads to lower volumes of complex, but potentially advantageous transactions. Lerner and Schoar (2005) find that “transaction in high enforcement countries have higher valuations and returns”. This essentially highlights that in a country in which the investor and in this case, the producer cannot confidently depend on third-party enforcement, they will tend to limit the extension of credit to trustworthy individuals because they know them personally or due to reputation. This occurs because they cannot be guaranteed the positive outcome of the transaction nor will they be able to avail to an efficient governing institution (the court) for dispute if the overall enforcement of the law is inefficient. Thus, their inclination towards commercial activity is reduced as they will not confidently extend credit to unknown individuals which would result in an increase in the quantity supplied to a more efficient level and ability to extract a higher level of surplus. An investors confidence in the ability, efficiency, and willingness of governments to enforce contracts also reduces the costs tied to ascertaining an individual's creditworthiness prior to exchange (Danner, 2008). Overall inefficient, antagonistic, and arbitrary enforcement of laws and regulations usually lead to substantial delays and costs to the investors, which could lead them to locate elsewhere. In contrast, a good enforcement of procedures improves and enhances the predictability of commercial relationships. It also reduces uncertainty by ensuring assuring investors that their contractual rights and legal rights, in general, are guaranteed by local courts.

3.8 Governing Institutions, Administrative Procedures, and Corruption

Kaufmann et al (1999a and 1999b) propose that the infrastructure of a countries governance is a multifaced, complex concept which is typically displayed by its accountability, government effectiveness, regulatory burden, political stability, rule of law and control of corruption. Should the overall infrastructure of the relevant institutions be ineffective and inefficient then investors will be held back from investing in the country. The efficiency of the governing institutions is crucial and determinant in all the issues outlined until now. It is, in fact, difficult to separate each element from the remaining ones in the framework in order to analyze them due to their interdependence and interconnectivity. In this case, though it is important to highlight the possible issues for foreign investors tied to the inefficiencies of the procedures and the connection between these ineptitudes and the running of the institutions themselves.

According to the World Bank the location of a MNCs can be influenced by administrative procedures, and the costs and delays associated with them (world Bank Doing Business report, 2012). In many developing countries the regulatory framework and its procedures are perceived by a substantial number of investors as an administrative obstacle rather than a "fix" as a means to incentivize investment. Administrative barriers in these cases become highly burdensome for foreign investors particularly if they don't have local partners to take care of a multitude of procedural obstacles and/or associated payments, if they are not politically connected or if they are forced to operate under strict internal corporate guidelines.

Clarity and rationale of the laws and procedures is directly tied to the efficiency of the governing institutions and are a first possible issue encountered by foreign investors. Such issue may arise in developing countries undergoing a considerable amount of reforms. In this case, typically poor coordination within the reform process will lead to the possibility of laws and clauses to overlap or contradict each other. While the laws are being reformed, associated regulations, normative instructions and procedures are made available. This often occurs with time lags and without considering how the implementation of one regulation will interact with the implementation of another or with pre-existing ones. This will, of course, lead to complex and redundant procedures which generally lead to bottlenecks in the system and obviously deter foreign investor incentive to invest.

This is not the only issue related to the application of laws, regulations, and procedures which can be encountered by foreign investors. Many developing countries, as mentioned, are going through a series of reforms to improve their laws and regulations as well as ultimately their projected business environment. Problems start to arise when these legal reforms seem well designed on paper but then fail to translate into practical improvements on the playing field. This will again deter investment incentives for foreign MNCs as the changed and newly introduced procedures become burdensome and time consuming for them. It is once again important to highlight that the capacity and efficiency of the supporting governing institutions is critical attracting the foreign investor.

A further problem encountered by foreign investors is tied to the link between transparency and the governing institutions. In many developing countries a lack of transparency is a true reality. This is probably also induced by the possible presence of unclear, burdensome laws, regulations and procedures to which local or foreign companies must abide. A lack of transparency can be associated with bribery and corruption. This is ultimately a sign of a bad functioning of governing bodies (World Bank Doing Business Report, 2003). It is commonplace to view corruption as an indicator of economic inequality, a negative factor in terms of governance and downright immoral (Hasan, Rahman, Iqba, 2017). Foreign firms are less likely to enter a country characterized by non-transparency because of the increased risks, uncertainty, and costs of doing business. Thus, they pay close attention to its possible presence. Corruption can occur in government offices in order to follow through with procedures as required by the law or even in the case of obtaining proper protection of rights. Both through bribing of government officials. Corruption may also occur in tenders resulting in the unfair loss to the hands of other politically connected firms for example. Many MNCs are prohibited from entering any bribe and or corruption process either by their own internal policies or because of their home country laws. Such is the case with United States' Foreign Corrupt Practices Act, which has outlawed foreign bribery (Conklin, 2002). Internal policies and home country laws against corruption or bribery although correct may also turn out to be an issue when bribery is customary in another country as firms often find themselves in deadlock situations either to close deals or follow through with government required procedures.

A final issue related to the predictability in the application of the laws, regulation, and procedures which must be followed by foreign firms, is the capacity of the administrative personnel. Developing country public offices are often characterized by a lack of qualified and competent civil servants. This leads to the incorrect application of laws, regulations, and procedures ultimately resulting in higher costs to foreign firms in the form of time consumed. This is naturally caused by unclear or wrong instructions. Of course, this is also tied to the clarity and simplicity of the laws, regulations, and procedures themselves. In addition, the streamlining administrative procedures may also take time as it requires a change in mentalities and behaviors, strong political commitment, and determined actions. Usually, administration tends to resist change, especially if it leads to the removal of their own power and discretion (Sun, 2002).

3.9 Insolvency

Strong insolvency measures are conducive to an efficient regulatory framework. This occurs if viable businesses are given a chance to survive, while loss-prone, inefficient firms exit the market thus placing resources to better use elsewhere in the economy. When a strong legal bankruptcy legislation is missing the balance between firm survival and efficient exit is distorted. The efficient regulation of corporate insolvency is also associated with increased access to credit for firms and on better terms (World

Bank Doing Business Report, 2018) (Cirmizi, Klapper and Uttamchandani, 2010) (Klapper and Love, 2011). Major issues arise when there are no procedures for applying to have insolvent debtors wound up, to recover debts that are owed or when insolvency laws do not allow for an investment to be voluntarily dissolved.

3.10 Settlement of Disputes

A healthy economy is characterized by an effective commercial dispute resolution mechanism as provided by the local judicial system (World Bank Doing Business Report, 2018). The two most notable forms of disputes resolutions related to investment are litigation and arbitration. What are known as alternative measures also exist and these include: conciliation and mediation. Due to the fact, the foreign investor will be subject to the domestic laws, litigation is not always a favorable way to resolve investment dispute. This is especially the case if the host country has a poor legal tradition and inefficient legal and judicial system. Inefficiency, in this case, can also be given by the corruption of judges and the bias of favoring the domestic party in the dispute. In addition, unknown laws, regulations, and language would also constitute a barrier. As a result, arbitration which was originally also an alternative method has become increasingly popular mainly because each party to a dispute does not want the trial to be held in the opposing party's court. Through international conventions such as New York Convention on Recognition and Enforcement of Arbitral Awards, Arbitration has gained more value and has become more appreciated than domestic courts. One main benefit is its characteristic of allowing investors to deal directly with a country. Arbitration is also generally used in bilateral and multilateral investment agreements where the aggrieved parties are allowed to directly access an arbitration tribunal specifically appointed for the purpose.

In the case of conciliation and mediation, these are the resolution of disputes on amicable terms. Although preferable as it would result in less time consumption and lower costs given they do not entail a full-fledged court case, they have the negative aspect of not providing for a legally binding solution. This, of course, would increase the insecurity of foreign investors as they would prefer a legally binding solution in their favor under the circumstances that the costs of a full-fledged court case will not be excessively high and/or super to the value in question during the case.

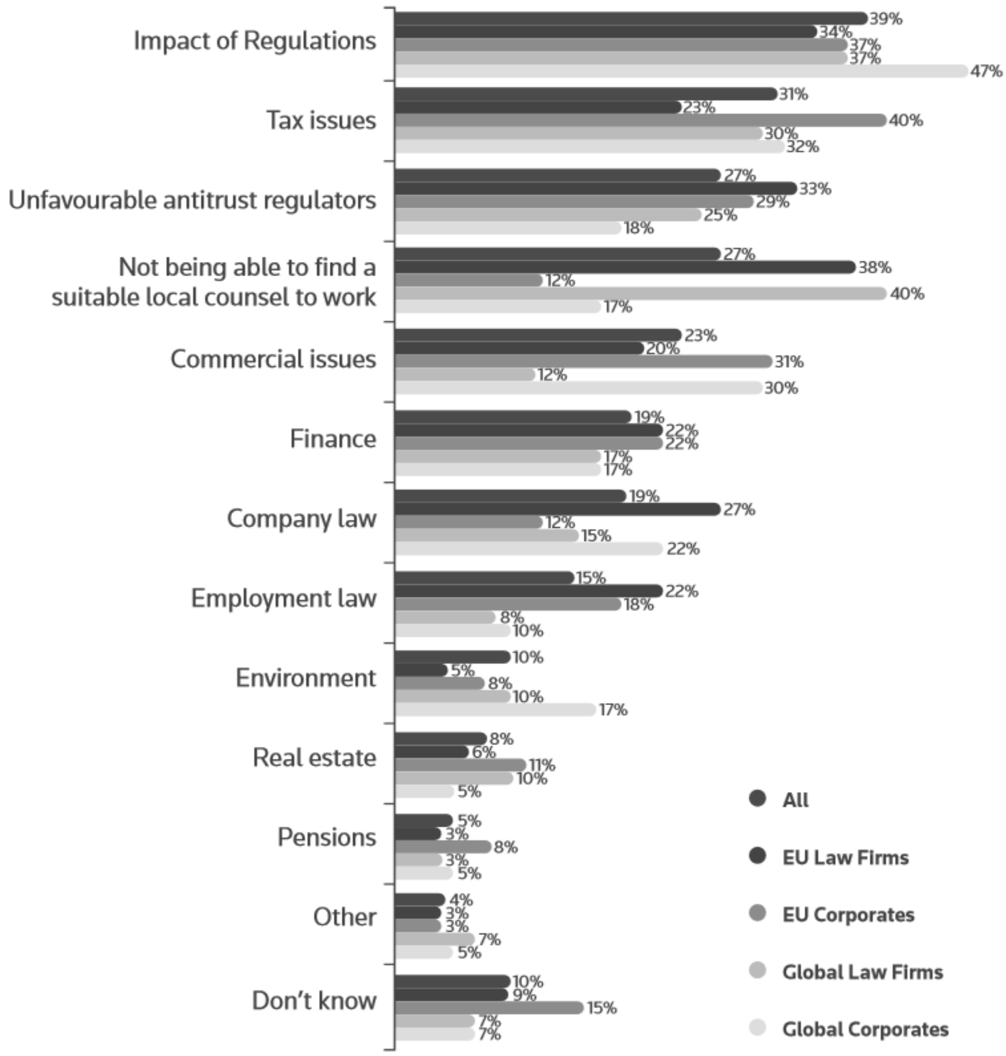
Other issues arise when management systems supporting the manual case flow through forms and files contribute to the overall timeliness and efficiency of the justice system. This is especially true when the above is combined with increased court automation and information communication technology solutions (World Bank Doing Business Report, 2018).

Generally, problems for foreign investors arise in the form of lengthy, time consuming and costly processes, non-enforceability of dispute resolution agreements and the immunity of the local government. The last of course ties to the discussion related to the equality of all persons under the law including the government itself. A case in which this is not true would severely hinder the rights of a foreign investor as he/she would be powerless in the defense of property rights (i.e. unjust or unpaid expropriation), or in the case of taxation disputes. An above-mentioned situation would obviously result in the deterioration of the investor's incentive to invest as the associated legal risks would turn out to be too high.

3.11 Remarks

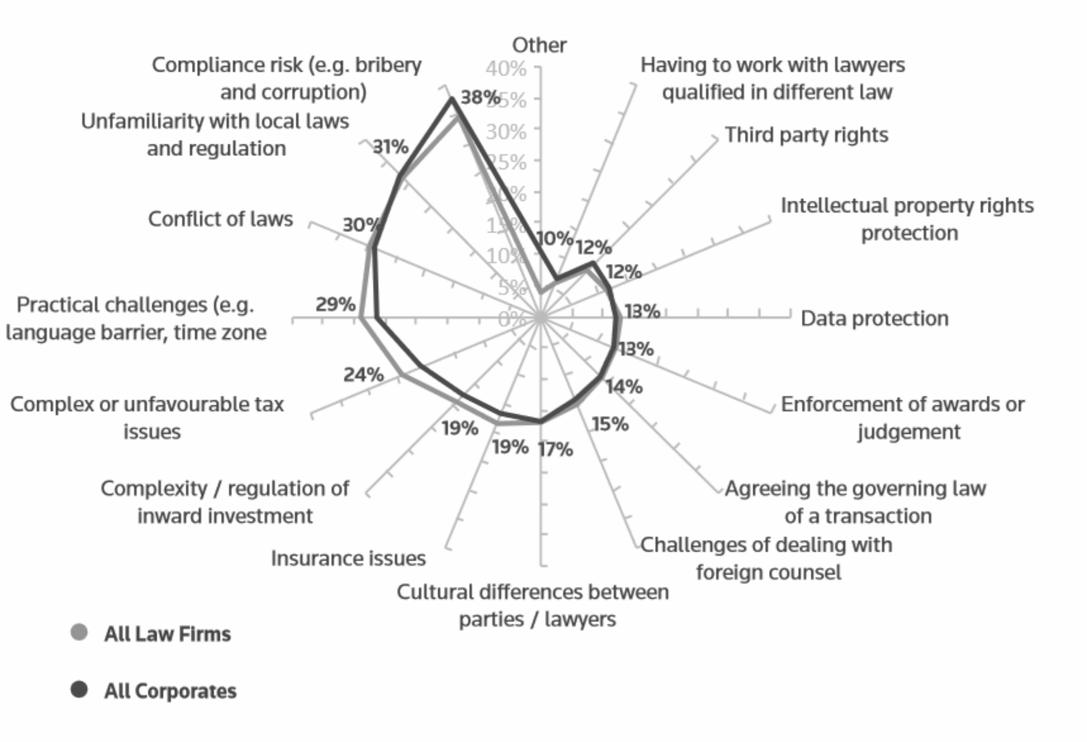
According to a study by Thomson Reuters based on a series of companies and law firms involved in cross-border transactions 81% of lawyers worldwide and 84% of international corporations deemed legal risks in cross-border transactions higher than in domestic transactions. In particular, it is possible to see that, the impact of regulation resulted on average as the most relevant factor negatively affecting the decision-making process of an investor and a potential issue once the investment is made (**figure 6 at end of the chapter**). Tax issues represented on average the second source of risk. The study conducted by Thomson Reuters in 2016, also discovered that the legal challenges faced by foreign firms are led by compliance risk. Also high in the responses are the unfamiliarity with local laws and regulations, the possibility of conflicting laws, practical challenges (i.e. language barriers) and complex and unfavorable tax issues (**figure 7 at end of the chapter**). It is clear that, although many countries are undergoing deep reforms in order to make the business environment within their country favorable, there are a series of potential issues which require constant and further change, especially within the context of legal investment regimes.

Figure 6. Reasons Expected to deter Cross-Border Deals



Source: Thomson Reuters 2016

Figure 7. Aspects in Cross-Border Transactions Discouraging Companies or Law Firms from Engaging in a Specific Deal



Source: Thomson Reuters, 2016

CASE STUDY: LEGAL ENVIRONMENT AND ISSUES SURROUNDING FOREIGN INVESTORS IN INDIA

Until now, this work has covered an analysis of the legal aspects and possible issues affecting foreign investors in their decision to invest abroad as well as their permanence in a specific country. Although legal issues may also arise when foreign investors invest in developed countries, one can easily deduce from an array of readings that the incidence of legal risk is higher when investing in developing countries. As examined above developing countries offer a variety of elements which are highly attractive for MNCs. These range from the lower cost of production principally due to factors such as lower wages or better endowment of resources, to geographical and market advantages necessary to again lower costs (i.e. transportation) as well increase the amount of business and sales. Contemporaneously developing countries may also be plagued by a series of issues which could hinder foreign investments and reduce the true value of the investment altogether. As described above, one of the main issues one may come across when investing in a developing country are those pertaining to legal structure and environment of the destination country. These matters may not only shape the decision to invest in a specific country but also modify the success of their investment once it has been made. Problems may initiate from the starting stages of the investment, namely when the investor must go through the legal processes and compliances of incorporating the company, to complications in the protection of their rights, payment of taxes and possible issues pertaining to the labor legislation. These areas of the issue together with the others explained in the previous chapters may not only place a burden on the foreign firm in terms of complications in the management of the firm but may also turn into severe losses of capital and time.

To better understand the actual complication areas of the legal environment in a developing country and how these legal risks affect the overall business of a foreign investor, it is crucial at this stage to turn the analysis to a material case. In particular, this paper will proceed by looking at the aspects of the legal environment and its related issues to foreign investors investing in India. It will start doing so by giving an overview of the current economic situation in the country in order to comprehend the attractiveness of the country, its importance and the advantages it offers to foreign

MNCs. The analysis will then look at the legal environment, its structure and the issues faced by foreign investors which are un the other hand eventually deterring their business. What is meant to be conveyed is that although the government is under the process by which it is resolving many issues, thus improving the business environment and attracting more foreign investors, there is still great room for improvement? Foreign investors are still suffering from legal risks in various fields and there is a clear divide between new laws and regulations and their actual application. It is important to note that the descriptions of the issues have been backed up with real-life examples which have been collected through a series of meetings and interviews to: Managing Directors (MD), Chief Financial Officers (CFO) as well as members of various foreign trade and political institutions (i.e. chambers of commerce, Consulates and Embassies) located throughout India. This material has been recorded over a six-month period working at an advisory firm specialized in handling issues related to foreign MNCs namely strategy, legal and tax.

4. ECONOMIC OVERVIEW OF INDIA

4.1 *Economic Trends*

Overview of Economic Policy and GDP Growth Trend

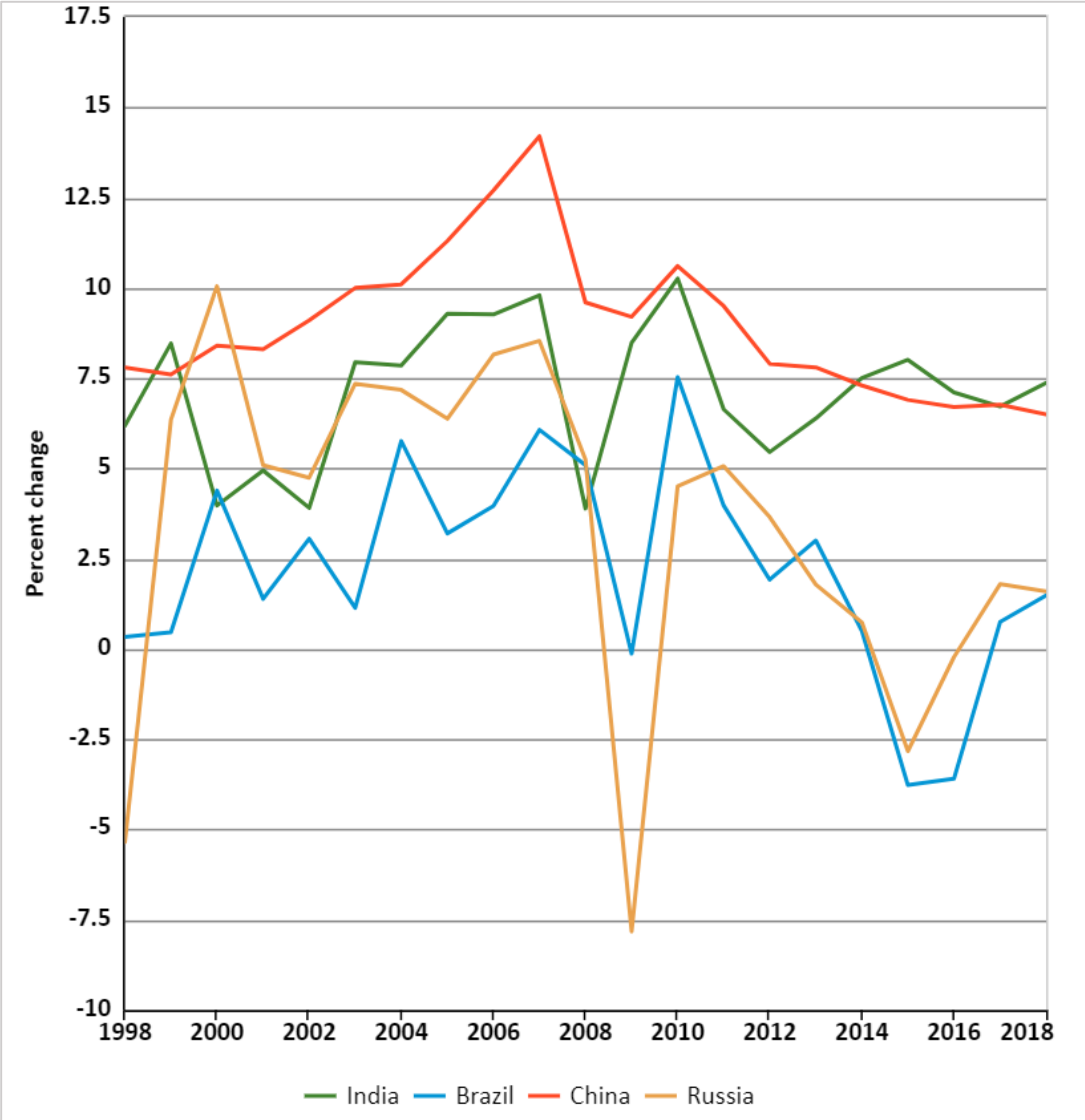
Situated in South Asia, India is the seventh largest country in the world by area, the second in terms of country population with around 1.33 billion people and prides itself of being the world's biggest democracy. India is characterized by an enormous variety and richness of cultural diversity and heritage. This unique characteristic has in many ways allowed it to comfortably adapt itself to adapt to international change. Although this is true, its market remains quite complex for foreign firms to decipher unless tackled with the correct strategy. This is mainly due to the immensity of the country and a high rigidity in consumer tastes but it to enter into further detail in such topic would distort the reader's main attention from the true goal of this study. The economy has more than welcomed international companies since it began its internationalization during the 1990s, nonetheless, the governments have been pro-active but at the same time quite prudent in adopting global skills and approaches. In fact, the government has placed a high emphasis on the areas of farming, advanced agriculture, and unique handicrafts while its industry and service sectors are rapidly growing. The government has already indicated that the next budget will focus on further developing rural India. This development will also be aided by attracting new foreign investments which could possibly assist in driving growth in the sector as has been done in the past year with the food sector through active promotions (i.e. World Food India 2017) and various memorandums of understanding with other countries.

The range of industries India has to offer together with the investment possibilities, and a supportive government is constantly attracting many investors. The positive characteristics also include a large and young population which in turn translates into a large consumer and ample manpower base (IBEF, 2017).

According to the International Monetary Fund (IMF), India has emerged as the fastest-growing major economy in the world and is expected to be one of the top three economic powers over the next 10-15 years. As mentioned above, since the early 1990s the country has been steadily developing into an open market economy through a series of economic liberalization measures, including industrial deregulation, privatization of state-owned enterprises, and reduced controls on foreign trade and investment, all serving the purpose to accelerate the country's growth (IBEF, 2017).

Figure 8 below shows the percentage change in GDP for India as compared to other BRIC countries (Brazil, Russia, India, and China). India's growth has averaged nearly 7% per year from 1998 to 2017. After recovering from the effects of the 2008 crisis by reaching a GDP growth rate of above 10% in 2010, economic growth slowed once again in 2011 because of a decline in investment caused by high interest rates, rising inflation, and investor pessimism about the government's commitment to further economic reforms and in general about a slowing down of world growth. These macroeconomic imbalances within the country together with a strengthening of the economic conditions in Western world countries led foreign investors to shift capital away from India causing a sharp depreciation of the rupee through 2016. Nonetheless, the economy was able to reinitiate recovery by 2014 becoming the fastest-growing G20 economy, with annual growth rates around 7.5%. This recovery was mainly due to a reduction of the current account deficit and expectations of post-election economic reform, resulting in a surge of inbound capital flows and stabilization of the rupee. The economy slipped yet again during 2015 to around 6% mainly caused by India's government-owned banks which faced a mounting bad debt during 2015 and 2016 resulting in low credit growth and restrained economic growth. Since the elections in 2014, foreign investor's perception of India is greatly changing. This is because the government has passed many reforms to its laws including its tax legislation with the establishment of the Goods and Service Tax (GST). Other reforms have focused on administration and governance in an effort by the party in the rule to rebalance its minority in India's upper house of Parliament. This is crucial as it is the body which oversees the approval of most bills. Overall, India is growing faster than any other large economy except for China with which it alternates first place in terms of GDP growth as by 2050, India's economy is projected to be the world's second-largest, behind China (CIA Factbook, 2017) (OECD, 2017).

Figure 8. BRIC Countries GDP Growth Rate (% Change from 1998-2018)

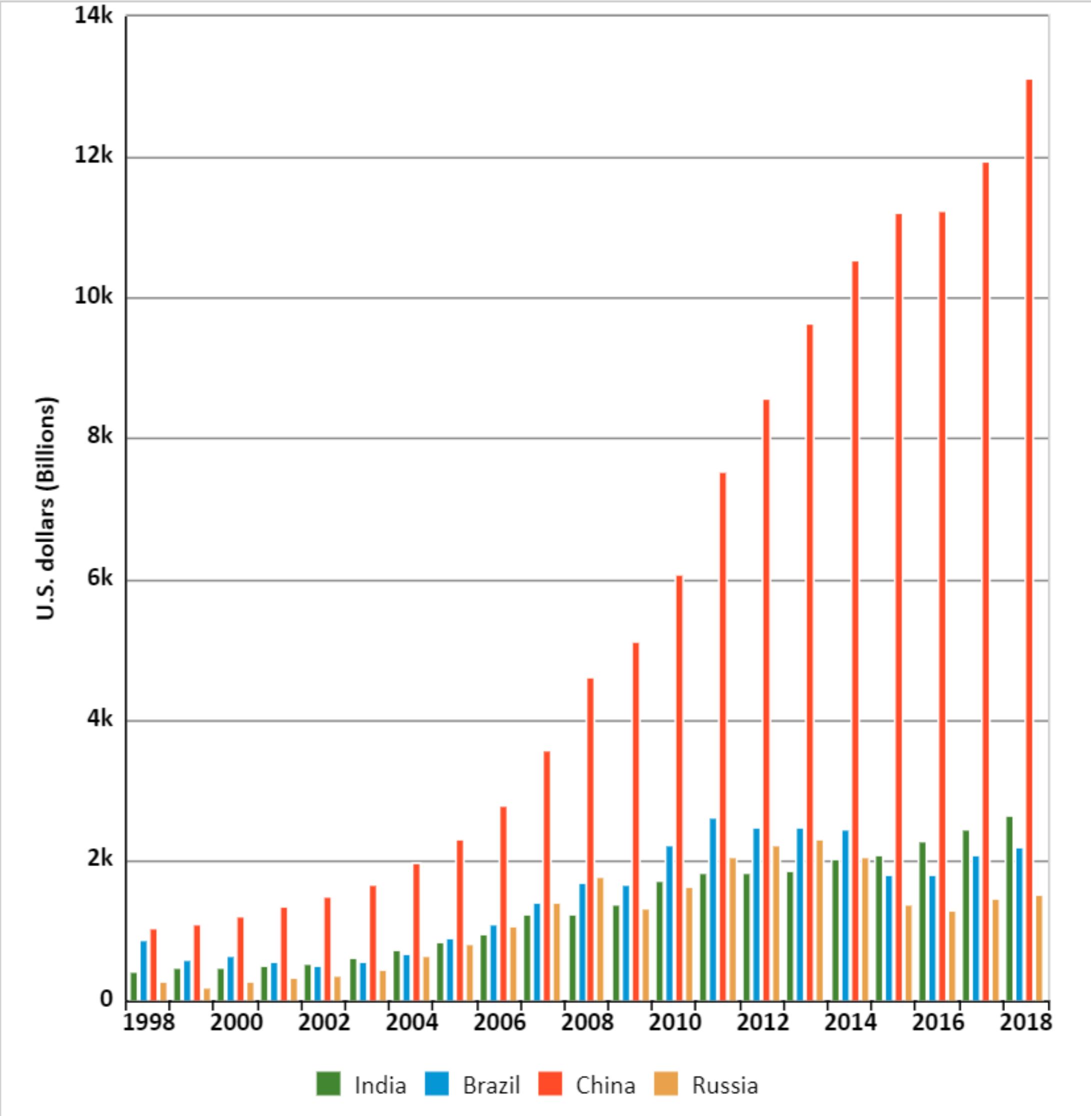


Source: Data by International Monetary Fund (IMF, 2018). Graph constructed using Knoema.

India together with China as the two leading BRIC economies with higher overall GDP percentage growth changes by year since the crisis in 2008. Brazil and Russia, on the other hand, have displayed both a sharper fall and recovery from the 2008 crisis although both countries have dipped from 2010 to 2015-16 showing signs of recovery. India and China have on the other hand mostly been registering growths of around 7%. The Indian economy is recovering from the twin policy shocks of demonetization and GST, and the pace of growth is likely to be higher in 2018. According to the World Economic Forum (2018), economic growth is likely to be around 7.3% in 2018.

Growth may be limited by fiscal discipline and higher inflation which could cause a tighter monetary stance. By 2019 GDP growth should reach 9.4%.

Figure 9. BRIC Countries GDP (at Current Prices from 1998-2018)

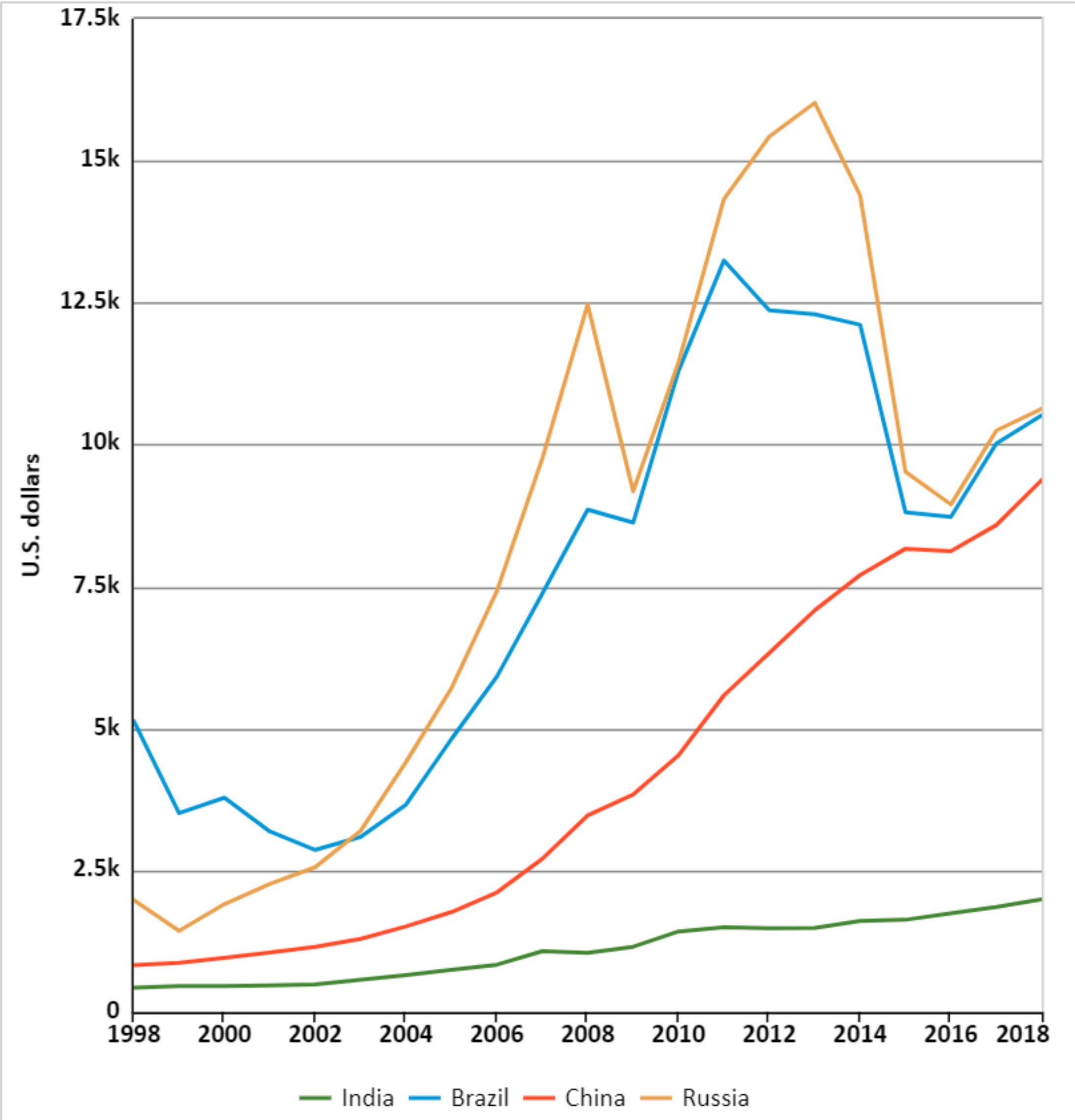


Source: Data by International Monetary Fund (IMF, 2018)

In terms of total GDP in absolute terms **(figure 9)** it is clear that China has a very strong upper hand with respect to the other three BRIC countries whose total GDP is substantially lower. India is the second largest country of the list followed by Brazil and Russia. India's sharpest growth has occurred in the past 5 years largely due to the government policies which have been greatly favoring economic growth. Through digitization, globalization, favorable demographics, and strong reforms, India's GDP is expected to reach 6 trillion USD by 2027 and achieve upper-middle income status. It is also expected to become the third largest consumer economy as its consumption may triple to 4 trillion to USD by 2025 mainly caused by a shift in consumer behavior and expenditure patterns. It is also estimated to become the second largest economy in terms of purchasing power parity (PPP) by the year 2040 (IBEF, 2017).

Figure 10 below on the other hand shows a different side of the story. While Russia and Brazil display higher figures for GDP per capita dipping down and recovering in line with their GDP growth rates displayed above, India shows a very low GDP per capita. It is evident that compared to Brazil and Russia the growth is positive although substantially low below 2.5 thousand USD. China has instead displayed undisrupted growth in this measure although still below Brazil and Russia but only slightly.

Figure 10. BRIC Countries GDP per Capita (at Current Prices from 1998-2018)

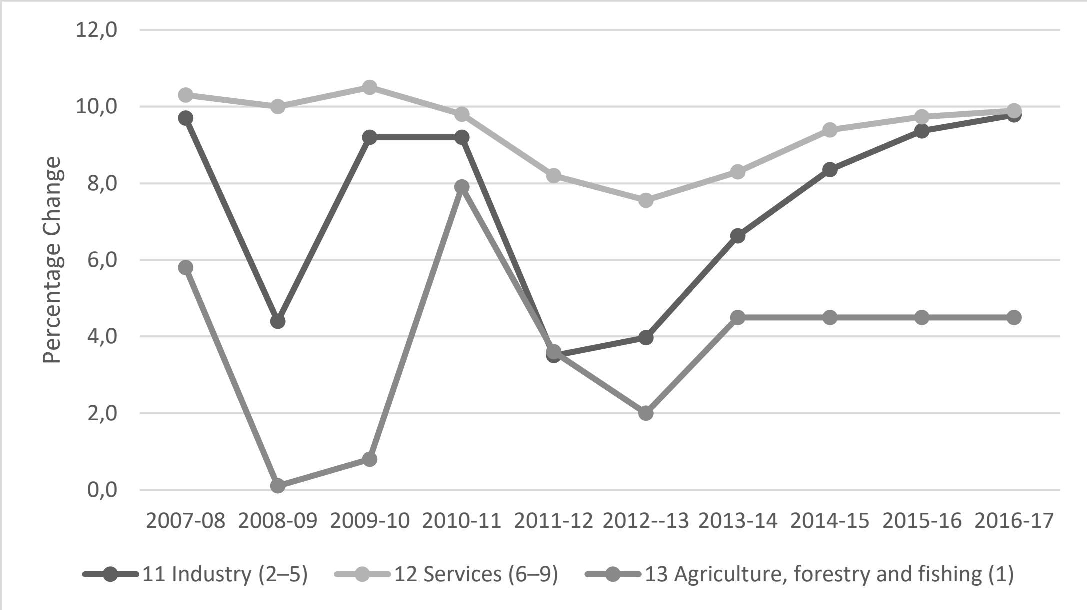


Source: Data by International Monetary Fund (IMF, 2018). Graph constructed using Knoema.

Industrial Structure of GDP

Figure 11. GDP Growth in India by Sector (from 2007-2008 to 2016-2017)

No.	Sector	2007-08	2008-09	2009-10	2010-11	2011-12	2012--13	2013-14	2014-15	2015-16	2016-17
1	Agriculture, forestry and fishing	5,8	0,1	0,8	7,9	3,6	2,0	4,5	4,5	4,5	4,5
2	Mining and quarrying	3,7	2,1	5,9	4,9	-0,6	1,0	5,0	7,0	7,0	8,5
3	Manufacturing	10,3	4,3	11,3	9,7	2,7	2,2	6,0	8,5	9,5	9,5
4	Electricity, gas and water supply	8,3	4,6	6,2	5,2	6,5	5,2	7,5	8,0	8,0	8,0
5	Construction	10,8	5,3	6,7	10,2	5,6	8,0	8,0	8,5	10,0	11,0
6	Trade, hotels and restaurant	10,1	5,7	7,9	11,5	6,2	5,5	6,0	8,0	8,7	8,7
7	Transport, storage and communication	12,5	10,8	14,8	13,8	8,4	7,3	11,1	13,0	13,6	14,1
7a	Trade, hotels and restaurants and Transport, storage and communication	10,9	7,5	10,4	12,3	7,0	6,2	8,0	10,0	10,7	11,0
8	Financing, insurance, real estate and business services	12,0	12,0	9,7	10,1	11,7	9,8	9,5	10,0	10,0	10,0
9	Community, social and personal services	6,9	12,5	11,7	4,3	6,0	7,3	7,2	7,2	7,2	7,2



Source: CIA Factbook, 2017

India's main industrial sectors are occupied by service and Industry activities (**figure 11** above). GDP the service sector has hovered at around 10% growth per year since 2007. Dipping only between 2010 to 2012. GDP growth by the industry sector on the other hand fluctuated more with falls in 2008, due to the crisis, and again from 2010 to 2012. Beginning with 2012 GDP growth in the industrial sector has sharply risen to around 10%. The Agriculture sector has displayed a sharp rise since 2008, probably as an indirect affect by the decrease of the other sectors due to the 2008 crisis. After dropping to around 2% in 2012 it grew back to a growth of around 4%. This has induced the current government to tackle the issue by focusing the 2018 budget on the development of rural areas and agriculture.

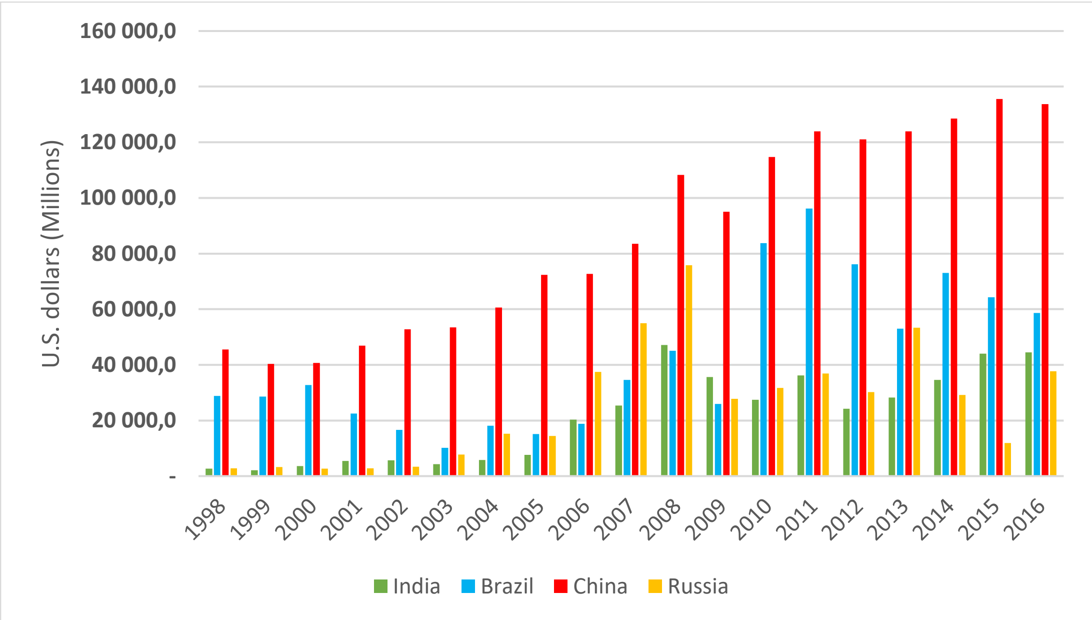
One can conclude that overall long-term growth outlook is moderately positive due a variety of factors. These include a young population and corresponding low dependency ratio, healthy savings and investment rates and increasing integration into the global economy. A series of long-term challenges must however still be addressed. Examples are the discrimination against women of all ages, a low quality of basic and higher education, a low power generation and network, insufficient transport system and agricultural infrastructure, slow civil litigation processes, high spending and poorly targeted subsidies, limited non-agricultural employment opportunities and the focus on improving the migration from rural-to-urban areas(CIA World Factbook, 2017). These combine with shorter-term challenges faced the government. The goods and services tax (GST) continues to face implementation issues and there is some distress in the agriculture sector. After announcing that the next budget will focus on rural development, the major issue lays in the management of government finances as it must find a balance where it is able to address problems in the agriculture sector, with the minimum fiscal impact. The government has already reached a fiscal deficit of 112% of the full-year target during April-November 2017 and is expected to breach the fiscal deficit target of 3.2% of GDP in 2018. One major cause could be revenue shortfall caused by GST.

4.2 Foreign Direct Investment Trends

As mentioned previously foreign direct investment (FDI) is a major source of non-debt financial resource for the economic development of a country as well as a driver for economic growth. This is true for India as well and is why the government is trying to attract ever more quantities of FDI with a favorable policy and initiatives such as Make in India, Digital India, and Startup India. The Indian government's favorable policy regime (reducing restrictions, caps and increasing automatic route investments) and interesting business environment have ensured continuous inflow of FDI. Foreign investors in India are mainly looking to take advantage of relatively lower wages and special investment privileges (i.e. tax exemptions, etc.) as well as the large market it has to offer and its geographic location. For India, this means generating employment and receiving key technical know-how to further foster the growth of the economy and its businesses.

FDI forecasts seem positive in most regions, except Latin America and the Caribbean according to the OECD (OECD, 2017). Global investments have seen a moderate recovery. This is due to higher expectations in growth, an increase in expected corporate earnings and growth in trade. Developing economies have gained altogether around 10% in growth with a dominance by the Asian economies which translates into an increase in investor confidence. **Figure 12** below shows the amount of FDI stock in India as compared to the other BRIC countries for the period running from 1998 to 2016. As can be seen, China is the country with the overall biggest accumulated quantity of FDI stock. Amounts have decreased just after the crisis of 2008 but then quickly rose again hitting other slumps but having an overall increasing trend. Brazil had increased its stock together with China in the late 90s and early 00s but the figures drastically dropped until they rose again after the 2008 crisis. Currently, Brazil displays the second biggest stock in FDI although the trend is downward looking. Russia, on the other hand, has seen peeks between 2006 and 2008 as well as in 2013. The stock then decreased until 2015 and started to rise again by 2016. India, which is the country of interest, has instead displayed all around very low levels of FDI stock. Although this is true the trend has been increasing since 2012-13. This is most probably due to the change in government and the new governments very favorable FDI policy which has been attracting more and more investors. As of 2016, India is above Russia in terms of FDI stock.

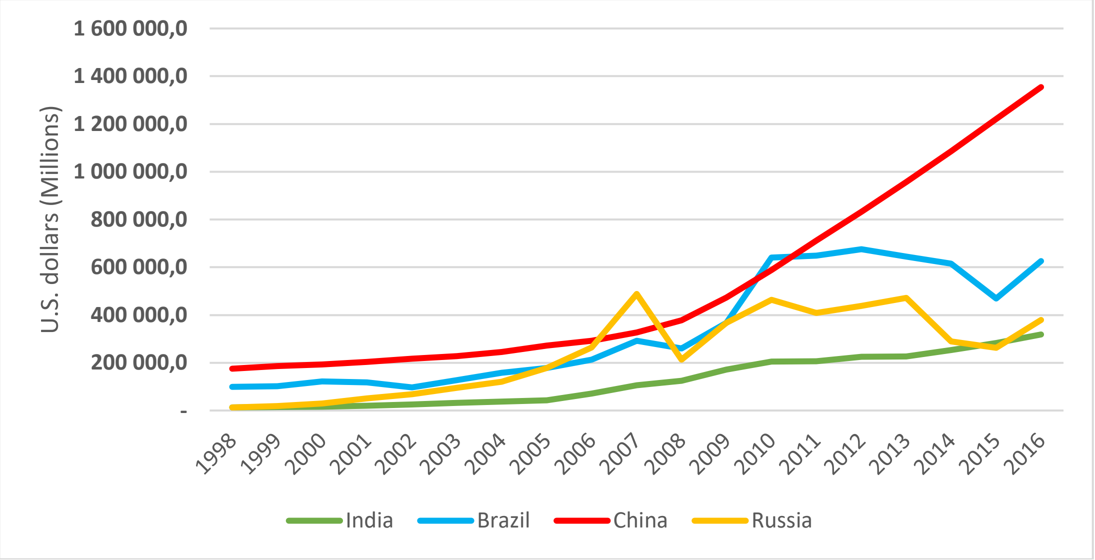
Figure 12. FDI Stock in BRIC Countries (in U.S. Millions of Dollars, 1998-2016)



Source: Data by OECD (OECD, 2018)

In **figure 13** below, it is possible to analyze the FDI inflow from 1998 to 2016 in U.S. millions of Dollars for the BRIC countries. While China has demonstrated the most evident and constant high growth in FDI flow, the three remaining countries have risen at a lower rate. Russia and Brazil have seen a radical increase in between 2006-2007 and 2008-2010 respectively. Theses increase have been followed by a subsequent extreme fall for Russia and a gradual fall for Brazil until 2015. As of 2016, the amounts of inflow of both countries has been on the rise again. India, on the other hand, has seen a gradual and constant slow-paced increase in FDI inflow mostly since 2005. After stalling from 2010-2013 growth in the amount of FDI inflow rose again and is rising till today. Again, this is most probably concurrent with the election of the new government whose policies favor FDI.

Figure 13. FDI Inflow for BRIC Countries (In U.S. Millions of Dollars, 1998-2016)



Source: Data by OECD (OECD, 2018)

5. THE INDIAN LEGAL SYSTEM

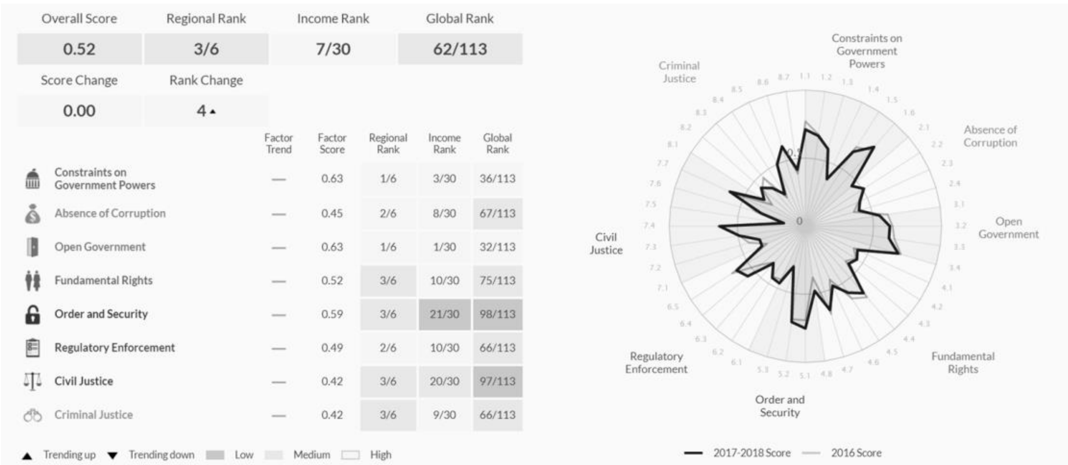
In contrast to many emerging countries around the world, India has slowly developed a mature legal, tax and financial infrastructure since it gained its independence from British rule in 1947. Despite this positive trait, foreign investors continue to consider the country as a difficult place to carry out business. It is thus essential to understand the reasons behind such distrust in the legal environment and how its perceived inefficiencies are affecting foreign business.

India is a Sovereign and the Democratic Republic founded on Socialist and Secular ideals, characterized by a parliamentary system of government. Its system of law is characterized by a mixture of civil, common and customary law. The legal framework was inherited from the colonial era and many legislations introduced during the British era are still in effect today although in modified forms. In chapter 3, the argument of the difference between civil and common law as a factor of attraction for inward foreign investments was introduced. The conclusion reached was that common law seen in a better light to the eyes of the foreign investor as laws and regulations are less stringent and overall protection of the investor is higher. India, being a mixture of a series of legal systems has possibly caused that the "worst" traits of each system typology are being implemented. An instance of this is the extremely long duration of court cases, atypical of common law, but almost a "trademark" in India. In such example, the higher protection of investor rights seen in common law legal systems is instead completely deterred providing the foreign investor with less protection, greater uncertainty and overall more susceptible to legal risks.

5.1 India and the Rule of Law

Tracking back to the initial discussion on the importance of having a strong legal environment as a basis to attract foreign investment, it had been described that the most renown measurement to understand how well a given country has established institutions (not physical but as the "rules of the game in a society or, more formally, the humanly devised constraints that shape human interaction." (North, 1990, p. 3)) as well as the effectiveness in enforcing them is defined by what is known as the rule of law. A weak rule of law is conducive to higher legal risk for foreign investors in the form of corruption, less transparency and lower protection of rights thus reducing their attractiveness to a specific country. A strong rule of law, on the other hand, causes the opposite effect. Strengthening the rule of law is an important objective of all members of a given country is it, citizens, business or government. The World Justice Project (WJP) is “an independent, multidisciplinary organization working to advance the rule of law around the world” (World Justice Project, 2018). Through their rule of law index 2017–2018 it is possible to grasp the strength of the rule of law in a country. It measures the rule of law based on the experiences and perceptions of the public and in-country experts worldwide. As can be seen from the graph below **(figure 14)**, India has not recorded a very high score for the rule of law parameters pertaining to the year 2017-2018. The report suggests that India is below average in terms of strength in rule of law. It ranks 62nd out of 113 countries analyzed although it has gained four positions since the previous year’s standings. India also ranks 3rd out of 6 countries in the south Asia region behind Nepal and Sri-Lanka. Among all factors taken into consideration, India ranks relatively low in all (corruption, fundamental rights, order and security, regulatory enforcement, civil justice and criminal justice) but two parameters those being the constraints on government power and openness of the government (W orld Justice Project, 2018).

Figure 14. India: Rule of Law Index 2017–2018



Overall Score	Regional Rank	Income Rank	Global Rank
0.52	3/6	7/30	62/113

Score Change	Rank Change
0.00	4 ▲

	Factor Trend	Factor Score	Regional Rank	Income Rank	Global Rank
Constraints on Government Powers	—	0.63	1/6	3/30	36/113
Absence of Corruption	—	0.45	2/6	8/30	67/113
Open Government	—	0.63	1/6	1/30	32/113
Fundamental Rights	—	0.52	3/6	10/30	75/113
Order and Security	—	0.59	3/6	21/30	98/113
Regulatory Enforcement	—	0.49	2/6	10/30	66/113
Civil Justice	—	0.42	3/6	20/30	97/113
Criminal Justice	—	0.42	3/6	9/30	66/113

▲ Trending up ▼ Trending down Low Medium High

source: World Justice Project-Rule of law index 2017-2018

It is clearly perceivable that with such low scores India’s attraction of foreign investment and overall trust on the legal framework is hindered.

5.2 Key Indian Authorities Related to Foreign Business

The Indian Judiciary

The judicial system is formed by a unified three-tier structure. The Supreme Court is the highest court and is located in New Delhi. The second level is represented by the High Courts which stand at the head of the state judicial system. The district and sessions courts in the judicial districts into which the states are divided represent the third level of the justice system. It should be mentioned that a further level also exists characterized by civil courts and criminal jurisdiction (judicial/metropolitan magistrates).

One Chief Justice and more than 25-30 judges constitute the supreme court which is the court of the last appeal. High courts are instead the last court of regular appeal. High Courts supervise the subordinate courts falling within its territorial jurisdiction and enforce other rights. They are dedicated to hearing first appeals from the decisions of the district courts. Both the High Court and Supreme Court have the power to resolve disputes between the union and the State, State and State, State and the citizen as well as cases of appeal arising out of private disputes involving substantial questions of law. District courts have autonomous civil jurisdiction and can hear appeals from local courts including courts of civil judges, judicial magistrates, and metropolitan magistrates. A lower level also consists of industrial courts, family courts, co-operative courts, and various tribunals (DOJ, 2018).

British judicial system characteristics still influence the structure and working of the judiciary. English is the official language in both high and supreme court proceedings. At the same time, procedural law for land and most commercial and corporate laws are modeled on English laws while English case law is relied upon by both judges and lawyers (PWC, 2012).

Department of Industrial Policy and Promotion (DIPP)

Has been established in 1995 and reconstituted in 2000 merging with the Department of Industrial Development. Initially, the department was set-up to regulate and administer the industrial sector. Today its role is to monitor industrial development and facilitate investment as well as technology inflows. It formulates and implements the measures aimed at the promotion and development of the industrial sectors. It does so by balancing both national priorities and socio-economic objectives (DIPP, 2018).

Government of India Reserve Bank of India (RBI)

The RBI comprises of commercial banks, financial institutions, and non-banking finance companies. It was established in 1935 to supervise the financial sector as a whole. (RBI, 2018).

Securities and Exchange Board of India (SEBI)

Through the Securities and Exchange Board of India Act of 1992 the government established the SEBI to "protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto" as described in the preamble of the Exchange Board of India Act of 1992 (SEBI, 2018)

Directorate General of Foreign Trade (DGFT)

After being re-designed in 1991, the DGFT is involved in the regulation and promotion of foreign trade. It is part of the Ministry of Commerce and Industry. Before 1991 it had the aim of prohibiting and controlling imports and exports. Today its role has changed into promoting and facilitating the same (DGFT, 2018).

Government of India Ministry of Corporate Affairs (MCA)

The ministry's main objective is to administer the Companies Act of 2013, the amendments of 2015, the Companies Act of 1956, the Limited Liability Partnership Act of 2008. It regulates the functioning of the corporate sector making sure it is in line with the law. The MCA is also in charge of administering the Competition Act, 2002 which oversees competition within the Indian market ensuring, promoting and sustaining the same. It also carries out functions of the central government as it administers the Partnership Act, 1932, the Companies (Donations to National Funds) Act, 1951 and Societies Registration Act, 1980. The MCA is also in charge of supervising the Institute of Chartered Accountants of India(ICAI), Institute of Company Secretaries of India(ICSI) and the Institute of Cost Accountants of India (ICAI) (MCA, 2018).

Government of India Income Tax Department (ITD)

The ITD is in charge of overseeing the correct execution and recipect of the tax policy, efficient and effective tax administration and ensures compliance with tax laws and regulations. It, therefore, administers all tax reporting (ITD, 2018).

Industry-specific ministries

All industry specific ministries might be related to the business doings of a foreign investor as each ministry oversees the functioning of the designated sector. An example is the ministry of energy overseeing all business within the energy sector of the industry.

5.3 Key Laws and Regulations Related to Foreign Business

Foreign Trade (Development and Regulation) Act, 1992.

Passed by the Indian government due to the increases in trade, the Foreign Trade Act of 1992 is intended to ease imports and increase exports. The current policy runs from April 2015 to March 2020.

Foreign Exchange Management Act, 1999 (FEMA) and Regulations

FEMA regulations are necessary to regulate foreign exchange transactions. This, of course, includes investments from abroad such as FDI. It was issued in 1999 as a means to promote the foreign exchange market in India. FEMA allows the Indian government and the Reserve Bank of India to adjust India's trade and or foreign investment policy in order for it to match with foreign exchange regulatory mechanisms, facilitating external trade and payment. The inflow and outflow of foreign exchange and investments into and from India are regulated through FEMA compliances which are under the control of the RBI (RBI, 2018).

Securities and Exchange Board of India (SEBI) Act, 1992 and Regulations

Act through which the SEBI (described previously) was established in 1992.

Banking Regulation Act, 1949

Serves the dual purpose of regulating private banking companies as well as manage banks in the country. Amended by the Banking Law amending Act of 2012, the RBI became empowered to restrict the voting rights and share acquisitions of a bank. A

Depositor Education and Awareness Fund was also established by the RBI. Through the amendments, Banks were given the ability to issue both equity and preference shares under RBI guidelines (MFGI, 2017).

Companies Act, 2013 and 2015

The original Companies Act of 1956 has been amended by the companies act of 2013 and that of 2015. Its role is to regulate business and investors throughout the country. The 2013 amendment included provisions regarding mergers and acquisitions, board-room decision making, related party transactions, corporate social responsibility (CSR) and shareholding. The 2015 amendment, on the other hand, eliminated the procedural common seal, declarations for the commencement of businesses, and minimum paid-up capital requirements. It laxed governing-related party transactions while at the same time continue to limit access to strategic corporate resolutions (Overseas Indian Facilitation Center-OIFC, 2014). Due to the recent developments in the E-commerce sector and online expansion of companies the government found itself forced to pass regulations covering cyber law and security compliances, such as the techno legal regulatory provisions of the act (Overseas Indian Facilitation Center-OIFC, 2014).

Information Technology Act, 2000

The Information Technology Act regulates e-commerce in India. It was amended in 2008 to provide explicit legal recognition of electronic transactions (MEITY, 2016).

Indian Contract Act, 1872

The Indian Contract Act of 1872 is part of a series of laws which have been in force since before India's independence in 1947. It regulates contract law in India. It does so by stating the general principles concerning the formation and enforceability of contracts. Further acts were passed throughout the years as a supplement to the act covering specific contracts and the sale of goods (Overseas Indian Facilitation Center-OIFC, 2014).

Partnership Act, 1932

The partnership Act of 1932 is an example of the above mentioned as it covers contract law relating solely to partnership firms in India (MCA, 2018).

Competition Act, 2002 and Limited Liability Act, 2008

The Competition Act of 2002 and the Limited Liability Act of 2008 were designed to promote sustainable competition in the Indian markets. They are meant to forbid anti-competitive business practices as well as protect consumer interests and guarantee free trade. In particular, the Competition Act of 2002 enforced merger control legislation in the country. It prohibited mergers and or acquisitions that may cause considerable adverse effects on competition (Parsons and Patel, 2009).

Business laws regarding copyrights, patents, and trademarks

India is a founding member of the World Trade Organization (WTO), established in 1995. It was thus crucial for the country to update all laws relating to intellectual property rights in order to its trade-related aspects contained in the WTO agreements in order for India and Indian companies to abide by global IP rights. To this matter, it is possible to find differences in for example music copyrights, which are different in India. This has caused both western and Indian IP owners to suffer from great losses due to digital piracy. Though this is true only few important IP related disputes have occurred in India most of which were linked to the pharmaceutical sector.

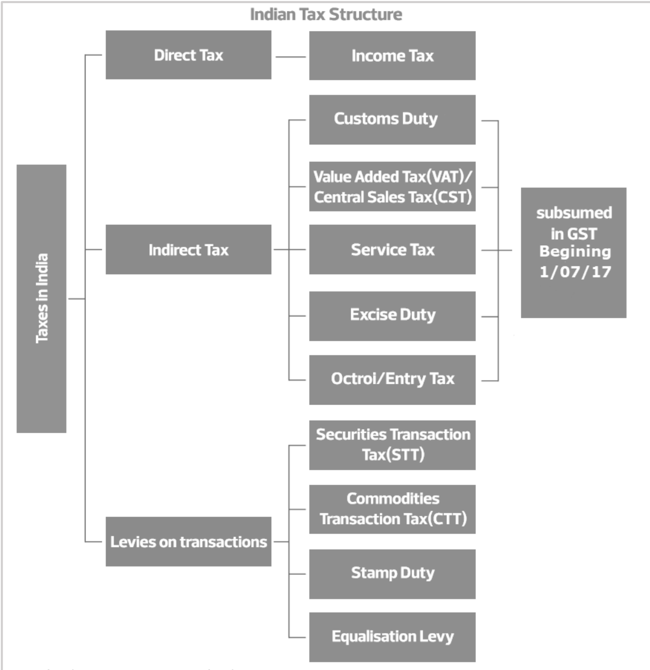
Arbitration and Conciliation Act, 1996

The Arbitration and Conciliation act of 1996 regulates domestic arbitration in India. Since 1996 many amendments and changes have been made in order to decrease the gap between arbitration in India with respect to global standards. The BALCO decision in 2012 for instance, placed a restriction on Indian court jurisdiction over foreign-seated arbitrations. Another example includes the amendment of 2015 by which key changes were made with respect to: the clarity in the appointment of arbitrators, reducing the delays by placing time limits on the rendering of awards and including a fast-track system, a greater enforcement of the arbitral awards, a definition of costs as well as the definition of "court" strictly referring to the high courts and thus excluding first instance courts which had often taken an anti-arbitration stance (Petit, Jane and Jacobs, 2016).

Tax laws

Figure 15 represents the current structure of the Indian tax system subdivided into direct, indirect and transaction levies. The authority over the tax system is split up between the Central, State Governments and Local bodies.

Figure 15. Current Tax Structure in India

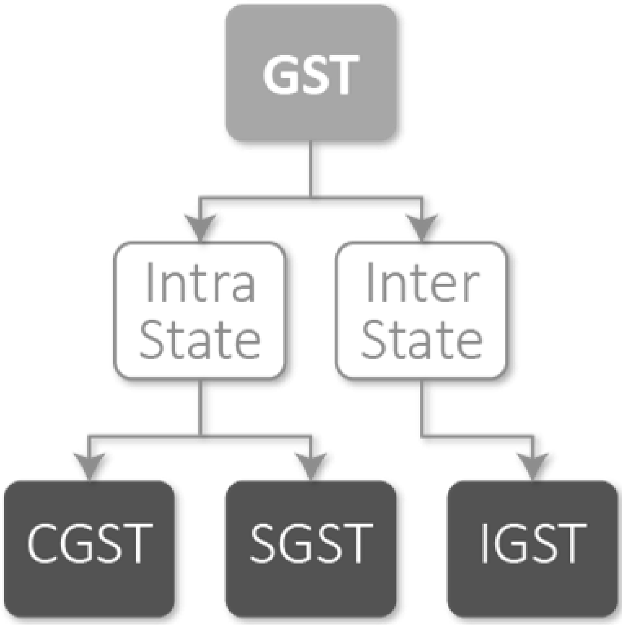


Source: Adapted from RSM Guide to doing business, 2016

Direct taxes are governed by the Income-tax Act, 1961. The Ministry of Finance (Department of Revenue) has the duty to implement and regulate the direct tax laws by use of the Central Board of Direct Taxes (CBDT). The annual Finance Act and its amendments revise the tax rates and other duties. Changes in the tax legislation cannot be made by the tax administrators who are instead empowered by the statutes to make rules carrying out the provisions of law. As with the rest of the tax system, many amendments are made in order to continuously simplify the structure. For example, in 2015 the Wealth-tax was abolished, and the corporate tax rate was reduced from 30% to 25% which will take effect over the years until 2019 in parallel to a phasing out of exemptions and other deductions. The subdivision of the control over indirect taxes, on the other hand, changed on July 1st, 2017 with the introduction of the Goods & Service Tax (GST). Through GST both the Central and State Governments have the power to levy taxes on the supply of goods and services. This has lead to an improvement of tax collection and minimization of leakages (figure 16). Taxes are levied at supply of goods and services. GST is composed of the Central GST (CGST), State GST (SGST) and Integrated GST (IGST). Through the first, Centre and States will simultaneously levy GST across the value chain. This will also occur in the case of SGST. IGST is instead levied on all inter-state transactions and only by the central government. In particular, the Central level levies will subsume the “Central Excise

Duty, Additional Excise Duty, Service Tax, Additional Customs Duty commonly known as Countervailing Duty and Special Additional Duty of Customs. The State level taxes will instead subsume: the State Value Added Tax/Sales Tax, the Entertainment Tax (other than the tax levied by the local bodies), the Central Sales Tax (levied by the Centre and collected by the States), Octroi and Entry tax, Purchase Tax, Luxury tax, and taxes on lottery, betting and gambling" (GSTIndia, 2018).

Figure 16. Subdivision of GST



Source: XATAX, 2018

Labor laws

Payment of Wages Act, 1936; Industrial Employment Act, 1946; Industrial Disputes Act, 1947; Payment of Bonus Act, 1965; Payment of Gratuity Act,1972; Construction Workers Acts, 1996; Workmen's Compensation Act, 1923 (amended in 2000); Industrial Disputes Act,1946, and the Trade Unions Act**,** 1926 are all acts offering protection to employees (Kochhar & Co, 2018). It is also important to mention that India is a member of the International Labor Organization (ILO) which safeguards the rights of workers worldwide.

6. ISSUES ENCOUNTERED BY FOREIGN FIRMS IN WITHIN THE INDIAN LEGAL ENVIRONMENT

A crucial aspect for foreign investors and companies entering or already operating in India is that that they must thoroughly understand the Indian legal system and its regulatory environment. Failing to do so might lead to extreme complications many times deterring the convenience and attractiveness of having invested in India. It is commonplace that a foreign investor is put off by the Indian regulatory environment as it is often criticized for being incredibly complex. In many cases, this criticism is often unfounded as the laws are in reality much simpler that U.S. laws (Amritt Ventures, 2018). In fact, the laws are consistent throughout the country and the government has made tremendous efforts to systematically make amendments in order to lessen the gap with world standards. These changes have not only made life easier for the Indian population but have also improved the business environment of the country. It comes to no surprise that in the last publication of the World Bank on Doing Business 2018, India was evaluated as one of the top improving countries in the study, jumping 30 ranks and placing itself in 100th place **(figure 17)**. According to the World Bank, The most regulatory reforms implemented in the top 10 improving countries were in the area of getting credit, starting a business, dealing with construction permits and paying taxes.

Figure 17. World Bank most improving countries for doing business in 2018

Economy	Ease of doing business rank	Change in DTF score	Reforms making it easier to do business: Starting a business	Dealing with construction permits	Getting electricity	Registering property	Getting credit	Protecting minority investors	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency
Brunei Darussalam	56	5.77	✔	✔		✔	✔	✔	✔	✔	✔	
Thailand	26	5.65	✔		✔	✔	✔	✔	✔		✔	✔
Malawi	110	5.42		✔			✔			✔		✔
Kosovo	40	4.94	✔				✔					✔
India	100	4.66	✔	✔			✔	✔	✔	✔	✔	✔
Uzbekistan	74	4.50	✔	✔	✔			✔	✔			
Zambia	85	3.94					✔		✔	✔		
Nigeria	145	3.82	✔	✔		✔	✔		✔			
Djibouti	154	3.79	✔	✔		✔	✔	✔				
El Salvador	73	3.56		✔	✔				✔	✔		

Source: World Bank Doing Business Report, 2018

Although improvement is above and beyond a positive aspect for improving the business environment in the country and further attracting new foreign investors to reap the benefits offered by the prospering economy, change itself may also have its side effects. The continuous change of laws and regulations make large improvements to the legislation itself but could ultimately hinder business through two mechanisms. The first ultimately being the lack of transparency in the new legal and regulatory information and the second being the actual implementation of the law itself. As will be demonstrated in the following sections these two elements will be a recurring theme many times frustrating Managing Directors of foreign companies to continuously change their internal strategies to abide by the new regulations. The next sections will dissect various areas in which foreign investors typically run into legal issues. These sections have been chosen based on the work experience carried out in India during the past six months in an Advisory and chartered accountant firm specialized in the foreign companies operating in India. The selected areas of interest relate to the distinct elements described in the third chapter of this work as being potentially risky for encountering legal issues while either deciding to invest or already operating in developing countries. To recap, these areas are the openness and attractiveness of the FDI policy, the ease of starting a business, tax regulations, property rights, labor laws, the enforcement of laws and contracts, the system of procedures, issues related to insolvency and the settlement of disputes.

6.1 Indian FDI policy: Restrictions and Incentives

The Indian FDI policy has been mostly receptive to foreign investments flowing into the country. This has been mostly true since the Modi government has been governing the country as of 2013. It is possible to distinguish between six phases in the advancement of an evolution of the FDI policy in India. The first phase (1948-1969) began directly after the independence of the country in 1947. This phase was characterized by protectionism and thus a cautious approach to foreign investment and a limited participation of foreign capital. The second phase spanned from 1969 to 1991 and consisted of a selective opening of the Indian economy with for example the adoption of the Monopolistic and restrictive trade practices Act (MRTP) and the Foreign exchange regulation act (FERA) of 1973. From 1991 to 2000, the third phase of liberalization, saw FERA replaced by the FEMA, already explained above, regulating all foreign exchanges. In addition, FDI automatic route was allowed up to 51% in 35 high priority sectors. These were later increased to 111 industries by 1996.

The Foreign investment promotional board (FIPB) was established (later repressed due to advancements in the trade policy) to consider all FDI related cases. The period was as whole fixated on the importance of improving private sector participation. The first seven years of the new century (2000-2007) also tagged as the fourth phase of liberalization were instead focused on the increase in investment caps leading to a great increase in foreign capital inflow which was vital in spurring the great growth of the economy. More FDI was permitted through the opening of new sectors (i.e. integrated townships, mass rapid transit systems and tea plantations were all opened with no cap restrictions). The fifth phase which went from 2007 to 2013 was mainly characterized by the crisis of 2008 and as a result, the government giving Non-Resident Indians (NRI) companies the possibility to have 100% owned subsidiary in India. Unfortunately, while the global economies were, for the most part, recovering from the recession, India instead saw its growth rate slow growth mainly because of the outflow of capital and widening current account deficit as well as currency depreciation, high inflation, an excessive oil and gold import bill and falling foreign exchange reserves (Sandeep Singh, 2013). The period going from 2013 till today, the sixth phase, is a reaction period highlighted by a series of amendments to many business-related laws, such as the Companies Act of 2013 and 2015, a continuous extension of permissible 100% FDI under automatic route and a lowering of the restricted sectors. Entry procedures were also facilitated as the government placed a high focus on attracting as much foreign investment as possible as a means to push economic growth within the country.

The Department of Industrial Policy and Promotion under the guidance of the Ministry of Commerce and Industry promotes the FDI policy of the country although the RBI is in charge of putting the rules, regulations, and circulars into effect. The FDI policy is changed every year and supplemented by various press notes ones a policy change is announced (UK-India Business Council, 2017).

Inward FDI entry process can take one of two possible routes. Through the first, the automatic route, the policy permits FDI up to 100 % (depending on the sector) from a foreign/NRI investor without prior approval of the government or the RBI. Through the second path, the government route, FDI is instead subject to approval by the government itself and the RBI. The figure on the following page **(figure 18)** shows the sectors currently open to FDI, the amount of cap and the type of route applicable. As is seen many sectors do not have restrictions and the government is making a great effort to increase the number of sectors open to automatic route as well as increase the permissible investment cap. To this respect, the sectors currently restricted to FDI include the: Lottery Business, Chit funds, Nidhi company (borrowing from members and lending to members only), Trading in Transferable Development Rights (TDRs), Real Estate Business or Construction of Farm Houses, Manufacturing of Cigars, cheroots, cigarillos and cigarettes as well as tobacco and/or substitutes. There are also private sectors which are not open to private investment altogether including the Atomic Energy sector, Legal, accounting and architecture services (UK-India Business Council, 2017).

Figure 18. Sectors with no FDI Restrictions, Restrictive Cap Limits and Approval Route

SECTOR/INDUSTRY	FDI CAP	APPROVAL ROUTE
Advanced Engineering		
Automobile	100%	Automatic
Defence	49% +	Government up to 100% of local defence ventures after obtaining approval
Aviation		
Airports -Greenfield projects	100%	Automatic
Airports -Existing projects	100%	Automatic
Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline	100%	Automatic
Non-Scheduled Air Transport Service	100%	Automatic
Helicopter services/seaplane services requiring DGCA approval	100%	Automatic
Ground Handling Services subject to sectoral regulations and security clearance	74% (100% for NRIs)	Automatic up to 49% Government beyond 49%
Maintenance and Repair organizations; flying training institutes; technical training institutions.	100%	Automatic
Finance & Banking		
Banking- Private Sector	74% (FDI+FII/FPI)	Automatic up to 49% Government beyond 49%
Banking- Public Sector subject to Banking Companies Acts 1970/80.	20% (FDI+FII/FPI)	Government
Asset Reconstruction Company	100% of paidup capital of ARC (FDI+FII/FPI)	Automatic up to 49% Government beyond 49%
Commodity Exchange	49% (FDI+ FII/FPI)	Automatic
Credit Information Companies	74% (FDI+FII/ FPI)	Automatic
Infrastructure companies in Securities Markets, namely, stock exchanges, depositories and clearing corporations, in compliance with SEBI Regulations	49% (FDI + FII/FPI)	Automatic up to 26% Government beyond 26%
Non-Banking Finance Companies (selected activities)	100%	Automatic
Infrastructure		
Railway Infrastructure	100%	Automatic
Construction-development projects (development of townships, construction of residential /commercial premises, roads or bridges, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure, townships)	100%	Automatic
Industrial Parks - new and existing	100%	Automatic
Satellites- establishment and operation, subject to the guidelines of Department of Space/ISRO	74%	Government
Telecom Services (including Telecom Infrastructure Providers Category-I)	100%	Automatic up to 49% Government beyond 49%
Power Exchanges registered under the Central Electricity Regulatory Commission (Power Market) Regulations, 2010.	49% (FDI+FII/FPI)	Automatic

SECTOR/INDUSTRY	FDI CAP	APPROVAL ROUTE
Retail		
Cash & Carry Wholesale Trading/Wholesale Trading (including sourcing from MSEs)	100%	Automatic
Business to Business (B2B) e-commerce	100%	Automatic
Single Brand product retail trading	100%	Automatic
Multi Brand retail trading	51%	Government
Healthcare		
Pharmaceuticals – Greenfield	100%	Automatic
Pharmaceuticals – Brownfield	100%	Automatic up to 74% Government beyond 74%
Manufacturing of medical devices	100%	Automatic
Hospitals Sector	100%	Automatic
Petroleum and Natural Gas		
Exploration activities , infrastructure related to marketing, petroleum product pipelines, natural gas/pipelines, LNG Regasification infrastructure, market study and formulation and Petroleum refining in the private sector, subject to the existing sectoral policy and regulatory framework	100%	Automatic
Petroleum refining by the Public Sector Undertakings (PSU), without any disinvestment or dilution of domestic equity in the existing PSUs	49%	Automatic
Floriculture, Horticulture, Apiculture and Cultivation of Vegetables & Mushrooms under controlled conditions Development and Production of seeds and planting material Animal Husbandry (including breeding of dogs) Pisciculture, Aquaculture Services related to agro and allied sectors	100%	Automatic
Tea sector including tea plantations	100%	Government
Mining and Exploration of metal and non-metal ores subject to the Mines and Minerals (Development & Regulation) Act, 1957.	100%	Automatic
Coal & Lignite mining subject to the provisions of Coal Mines (Nationalization) Act, 1973.	100%	Automatic
Media and Broadcasting		
Teleports (setting up of up-linking HUBs /Teleports) Direct to Home (DTH) Cable Networks Mobile TV Headend-in-the Sky Broadcasting Service(HITS)	100%	Automatic up to 49% Government beyond 49%
Terrestrial Broadcasting FM (FM Radio) Up-linking of 'News & Current Affairs' TV Channels	26%	Government
Up-linking of Non-'News & Current Affairs' TV Channels/ Down-linking of TV Channels	100%	Government
Publishing of newspaper and periodicals dealing with news and current affairs Publication of Indian editions of foreign magazines dealing with news and current affairs	26%	Government
Publishing/printing of scientific and technical magazines/specialty journals/ periodicals, subject to guidelines by Ministry of Information and Broadcasting Publication of facsimile edition of foreign newspapers	100%	Government
Others		
Education	100%	Automatic
Courier services	100%	Automatic
Private Security Agencies	49%	Government

Source: Adapted from UK-India Business Council, 2017

As emphasized by Prime Minister Narendra Modi in the last World Economic Event (2018) in Davos, "Investment, manufacturing and production are being made easier than ever before through government efforts in the opening to FDI and the gradual elimination of red tape”. The affirmation made by Prime Minister Modi is not an understatement. In the last year alone, the government has approved automatic routes to new sectors including single retail (100% and automatic), in the airline industry (automatic up to 49%, while above requiring government approval) as well as in manufacturing (100% automatic), non-banking financial services (100% automatic) and the construction sector (100% automatic) while at the same time it further liberalized the pension and insurance sectors (OECD, 2017) (Srivats, 2018). It has also streamlined the procedures for government approval by abolishing the Foreign Investment Promotion Board (FIPB) in charge of approving FDI while at the same time introducing of the Foreign Investment Facilitation Portal (FIFP) as an administrative body meant to facilitate FDI applicants. It has also introduced Standard Operating Procedures (SOP) to process FDI proposals. It sets out a detailed procedure and timeline for applications which can be made online as well as the list of ‘competent authorities’ for processing government approvals for FDI in India (Rishabh Shroff, 2017). Start-Ups have also been favored by allowing them to raise up to 100 percent of the capital from a foreign fund through the issuance of convertible notes. This must, however, be registered with Securities and Exchange Board of India (SEBI) as a foreign venture capital investor (FVCI - incorporated and established in a foreign country) (Sandeep Soni, 2017).

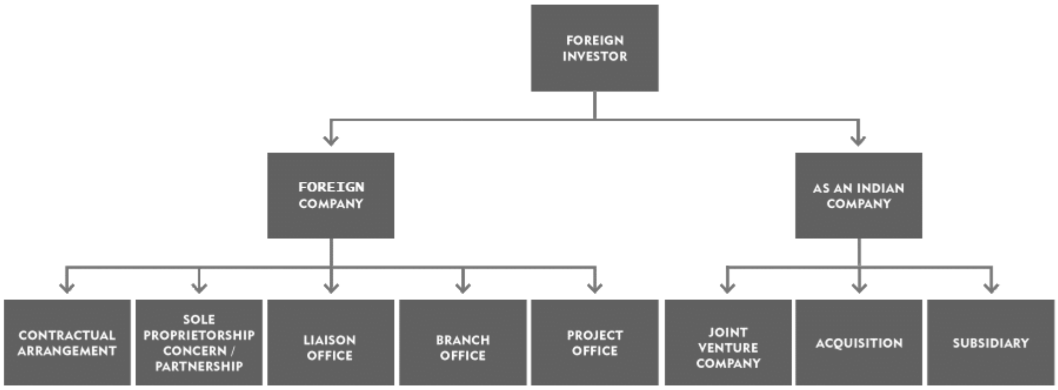
Overall, it is evident that the government is in no way holding back from making the appropriate modifications in order to attract as many foreign investors as possible. It does so because it has understood the importance of FDI in terms of bringing capital into the country as well as stimulate production, the economy and spur growth. From the point of view of the investor, India’s FDI policy appears more than welcoming. As more and more sectors are permitted automatic route as well as 100% cap for investment, foreign investors are more than incentivized to invest in the country. In addition, the number of restricted sectors has also been reduced. The receptiveness and openness of the FDI policy can be considered a solid basis to conclude that the policy itself is not a threat to investors. This strong trend of liberalization, specifically regarding the last four to five years, will possibly extend in the near future. Foreign investors looking to invest in India could possibly re-think their position on the receptiveness of the country should the government change as the advancement of policy might take a more protective stance.

6.2 Starting a Business in India

The Indian government has made a strong push to improve the ease of starting a business in India, a crucial trait for foreign investors. After improving the application process in 2015 with the INC-29 which significantly reduced interaction with authorities by clubbing a series of forms, it further streamlined the process by introducing the Simplified Proforma for Incorporating a Company Electronically (SPICe) form or INC-32 in 2017. Through this new form the application for the Permanent Account Number (PAN), equivalent to the Italian Codice Fiscale or U.S. Social Security Code, and the Tax Account Number (TAN), equivalent to the Italian Partita Iva, into a single submission. This again reduced timing and interaction with competent authorities decreasing the burden of the process on foreign investors. The standard procedures within SPICe are: "the simplified and completely digital form for Company Incorporation, standard format of e-Memorandum of Association (MOA) as per Companies Act, 2013, standard format of e-Articles of Association (AOA) as per Companies Act, 2013, memorandum and Articles can be filed as linked e-forms (except for Section 8 companies), provision to apply for Company Incorporation with a pre-approved Company Name, mandatory Digital Signature (DSCs) of Subscribers and Witnesses (max 7+1) in SPICe MOA and SPICe AOA and back Office productivity gains due to faster review of e-MOA and e-AOA by approving authorities" (RMS, 2017).

Prior to applying for incorporation of a company in India, a foreign investor must first design a strategy to properly enter the market, suiting the nature and characteristics of the company itself, the sector in question and the commercial objectives. To this regard, there are a series of options made available to the foreign investor depending on the degree of risk they are willing to take, the control resources they require, the commitment to the same and the return on investment they are seeking. Entry may occur either through equity or non-equity modes. The second relates to exports and contractual agreements while the first involves creating a physical structure in India and is thus of higher importance to the cause of this study. **Figure 19** below shows that a foreign investor may either choose to invest as a foreign company or on the other hand invest as an Indian company (UK-India Business Council, 2017).

Figure 19. Foreign Investment Modalities to Enter the Indian Market



Source: Adapted from UK-India Council, 2017

It is highly important to choose the correct entry strategy in order to reap the most out of the investment in a foreign country and thus increase the return. A wrong strategy could lead to heavy operational and monetary burdens which could result in the overall disinvestment and closure of the foreign project. Therefore, foreign investors must carefully study and consider the available options in order not to fail on their investment.

Broadly speaking, a foreign investor may either decide to enter the market as a foreign company through either a contractual relationship, a sole proprietorship concern, a liaison office, a branch office or a project company. It may also enter the market as an Indian company, that is by incorporating a company under the Companies act of 2013. It can thus either for a Joint Venture (JV) with an Indian counterpart, or it can establish a wholly owned subsidiary. A third alternative would be to acquire an already existing firm. Another available option would be to establish a Limited Liability Partnership (LLP) which is governed by a different law, the Limited Liability Partnership Act of 2008.

Entering as a foreign company:

Contractual arrangements

Contractual agreements are the easiest means of establishing a relationship between a foreign company and an Indian partner (i.e. Distribution partnership). They do not involve possibly lengthy procedural formalities as no legal entity is being established. This form also reduces ongoing administrative needs such as statutory filings which are not required. In addition, costs are reduced as the only cost is that of negotiating and concluding a contract with the partner. All additional cost as related to finding the potential Indian partner. This form also allows for a higher degree of privacy. There are multiple disadvantages. There may be difficulties in formulating a contract safeguarding the foreign counterpart due to wrong advice received from an advisor or unconsidered scenarios. The contract must be targeted at forming an agreement and not leading to possibilities of forming either a partnership or a subsidiary which would carry different costs and the following of different laws. If not correctly specified, the investor may run into this risk. There is also a risk of the Intellectual property being protected inefficiently if the arrangement is poorly formulated. From a monetary standpoint there are no tax/fiscal advantages although taxation is overall easier. Another disadvantage is that the success of the project and/or investment depends on the Indian counterpart (UK-India Business Council, 2017).

Sole proprietorship concern/ Partnership

Sole Proprietorship concern or partnerships are governed by the Partnership Act of 1932 and are substantively different in form from contractual arrangements. The advantages of this legal form are the simplicity in its formation and absence once again of possibly burdensome administrative procedures, the greater amount of privacy, the overall higher control on the project and the possible gains which can be reaped from the Indian partner. The greatest disadvantage is the absence of a separate entity and possible liability risks between partners. Practical difficulties, on the other hand, include FDI, sectoral and banking restrictions for foreign investors (excluding Non-resident Indians) (UK-India Council, 2017).

Branch Office

A branch office is simply an extension of the home entity of the foreign investor. The Reserve Bank of India grants permission for the activities that branch office can carry out thus determining their scope. Usually, Branch offices are in charge of sales/commercial activities in India. Manufacturing activities are not permissible through branch offices. It is instead allowed to subcontract manufacturing to an Indian manufacturer. As stated by UK-India Business Council (2017), "the main purpose of a branch office includes: Export and import of goods, rendering of professional or consultancy services, carrying out research work (relevant to the mother company), promoting technical or financial collaborations between Indian companies and mother or overseas group company, representing the mother company in India and acting as a buying or selling agent, rendering services in Information Technology and development of software, rendering technical support to the products supplied by the mother/ group companies". Branch offices are allowed to remit profit of the branch to the mother company, but this must be net of applicable taxes and under the guidelines and permissions of the Reserve Bank of India. The main advantages include that it is a separate legal entity which can also be involved in activities generating revenue. Disadvantages, on the other hand, are also multiple. For example, the home company may be exposed to unlimited claims and liabilities in India generated by the operations of the branch office. Other instances include restrictions on the activities carried out by the branch office, the higher amount of formalities and related legal costs to establish the branch office and the higher taxes which are paid with respect to an incorporated company (D. Batra & Co., 2017) (UK-India Business Council, 2017).

Liaison office

The main purpose of a Liaison office is to represent the mother company on the Indian market and be involved in marketing activities. It is, therefore, a communication link between the mother company and the entities in India. It may not be involved in manufacturing activities in any way. Approval must be granted by the Reserve Bank of India for its establishment. The advantages of Liaison offices are that they have a low administrative and cost burden for setting up and at the same time offer the foreign investor the possibility of establishing a formal presence without the creation of a new and separate legal entity. Disadvantages are instead related to the fact that the Liaison office may not be involved in trade or revenue generating activities. It also incurs the risk of being exposed to claims and liabilities in India (UK-India Business Council, 2017) (D. Batra & Co., 2017).

Project office

Project offices are set up solely when the foreign investor/company has secured a project form an Indian company or government body. They are temporarily established to perform specific projects in India. They may not commence or be involved in activities which are not related nor related to the execution of the project. At its completion, they are allowed to remit the surplus' derived from the project outside of India as per Reserve Bank Guidelines. The main advantage is the permission to operate a bank account in order to receive revenue and remit surplus from the project. The main disadvantage is the limitation of the project office to deal solely with the activities related to the project itself and non-other (UK-India Council, 2017) (D. Batra & Co., 2017).

Entering as an Indian company:

When foreign companies enter the Indian market as an Indian firm they may hold up to 100% of equity amount in the company. This though, depends on the requirements of the investor and the equity caps outlined in the FDI policy (D. Batra & Co., 2017).

Joint Venture (JV) with Indian counterpart

Through the forging of an alliance with an Indian partner, the foreign investor and the partner can incorporate a JV company through which they carry on business. It is also possible for them to do so by using an LLP. The main advantages of a JV include the creation of a separate legal entity thus limiting liability for the foreign company, the business benefits which can be reaped from the Indian business partner in terms of market presence and contracts, new financed can be raised through the issuing of shares secured by the assets of the JV only and may have tax advantages. Disadvantages, on the other hand, include the time needed to set up the JV due to the finding of the adequate partner, the contractual phase and due diligence to be carried out prior to the signing of the contract. The major risk is the choice of a wrong partner which could lead to heavy losses in terms of mismanagement and loss of intellectual property if not properly safeguarded during the contractual stages (D. Batra & Co., 2017) (UK-India Business Council, 2017).

Wholly Owned Subsidiary (WOS) Company

In sectors where 100% FDI is allowed according to the FDI policy, a foreign investor may set up a wholly owned subsidiary. They carry out business in India as the mother company. They are allowed to manufacture. The advantages include 100% control over the company and the possibility to raise capital through the sale of shares keeping liability of mother company distinct from that of the subsidiary. Disadvantages, on the other hand, involve the time consumed to set up a subsidiary as well as all formalities involved in the setting up process (UK-India Business Council, 2017) (D. Batra & Co., 2017).

Share acquisition of Indian company directly or indirectly

Through this method, a foreign investor acquires a controlling stake in an Indian firm. The advantages include the acquisition of all assets including any goodwill, reputation, and licenses if 100% of the shares are acquired. Tax efficiencies may be reaped through the specific structuring of taxes. In contrast disadvantages include: the foreign investor being liable for any past and existing obligations as well as hefty due diligence process must take place prior to acquiring stake in the firm which can be time consuming and difficult according to the available records of the company which are often misplaced in Indian firms (UK-India Business Council, 2017) (D. Batra & Co., 2017).

Incorporating a private or public company in India involves a substantial amount of paperwork for approvals and other formalities. Depending on the sector of reference and the type of business that they carry out, companies may be obliged to register with the competent sector regulators. The incorporation and registration of a new company involve a set of applications which have to be filed with Registrar of Companies (ROC). In addition to this, post-registration, the foreign investor must open a bank account for the company in India. Once opened, the Company must make FDI reporting to the Reserve Bank of India. This procedure is relatively simple although requires an Indian legal or accounting professional. This together with all FEMA and Income Tax compliances are crucial for the foreign company to abide by in order to avoid hefty fines. The figure below **(figure 20)** summarizes the incorporation procedures necessary to incorporate a company in India irrelevant of whether it is a JV or a WOS.

Figure 20. Incorporation Process in India

Step No:	Procedure	Time to complete:	Cost to complete:
1	Obtain director identification number (DIN) online from the Ministry of Corporate Affairs portal (National)	1 day	INR 100
2	Obtain digital signature certificate online from private agency authorized by the Ministry of Corporate Affairs (National)	3 days	INR 1,500
3	Reserve the company name online with the Registrar of Companies (ROC) (National)	2 days	INR 500
4	Stamp the company documents at the State Treasury (State) or authorized bank (Private)	1 day	INR 1,300 (INR 200 for MOA + INR 1,000 for AOA for every INR 500,000 of share capital or part thereof + INR 100 for stamp paper for declaration Form 1)

5	Get the Certificate of Incorporation from the Registrar of Companies, Ministry of Corporate Affairs (National)	5 days	INR 14,133 (see comments)
6	Make a seal (Private)	1 day	INR 350 (cost depends on the number of seals required and the time period for delivery)
7*	Obtain a Permanent Account Number (PAN) from an authorized franchise or agent appointed by the National Securities Depository Ltd. (NSDL) or the Unit Trust of India (UTI) Investors Services Ltd., as outsourced by the Income Tax Department (National)	7 days	INR 67 (INR 60 application fee + 12.36% service tax + INR 5 for application form, if not downloaded)

8*	Obtain a Tax Account Number (TAN) for income taxes deducted at source from the Assessing Office in the Mumbai Income Tax Department	7 days	INR 57 (INR 50 application fee + 12.36% service tax)
9*	Register with the Office of Inspector, Shops, and Establishment Act (State/Municipal)	2 days	INR 6,500 (INR 2000 + 3 times registration fee for trade refuse charges)
10*	Register for Value-Added Tax (VAT) at the Commercial Tax Office (State)	12 days	INR 5,100 (registration fee INR 5000 + stamp duty INR 100)
11*	Register for Profession Tax at the Profession Tax Office (State)	2 days	No cost
12*	Register with Employees' Provident Fund Organization (National)	12 days	No cost
13*	Register for medical insurance at the regional office of the Employees' State Insurance Corporation (National)	9 days	No cost

*Takes place simultaneously with another procedure.
Source: Track.in, 2017

Once the company is incorporated it must abide to the statutory compliances which include: the preparation and filing of the audited financial statements as per the Accounting Standards (AS) issued by the Institute of Chartered Accountants of India (ICAI), the mandatory audit of accounts by a certified professional under the Companies Act, 2013, the holding of an Annual General Meeting (AGM) within every 15 months, filing of financial statements and annual return with the Registrar of Companies (ROC) within 30 and 60 days respectively from the date of the annual general meeting, the Directors and the Auditors reports and finally the filing of applications, documents, inspections etc. through electronic form (RSM, 2017).

Incorporation in India is usually publicized as being relatively low of a cost for registering and incorporating the company as well as low in time consumption, taking only a few weeks. While the government has made extensive progress in simplifying the process, by reducing redundancies, amount of paperwork to be completed and increasing transparency, the overall process rarely takes a few weeks as commonly publicized. It is true that this also depends on the proactive involvement of the foreign investor in providing the necessary documents. It also crucial for the foreign investor to make use of a local advisor who can carry out all the procedures. The procedures involved can be difficult to follow without the knowledge of a local person. This extra intermediary raises the costs of incorporation to an average of 5,000 to 6,000 USD. The main problem lays in the procedural difficulties of the process. Theoretically, the process is very much streamlined but, every step is risk-prone to advancement being blocked by the government authorities. In fact, after evaluating a small sample of over 10 incorporation processes (12) only one resulted in being completed within one month. According to a study, “the 13 procedures to complete in the initial set up of a business cost 49.8% of income per capita and it takes almost a month (27 days) to complete the tasks on average, which is well above the OECD average of 12 days” (TMF Group, 2016). The timing recorded in the study were still lower than what was personally observed as stated above. The others all took an average of a one month and a half to two months. The main issue encountered was tied to the non-approval of certain forms by government authorities, leading to the resubmission and thus time consumption of at least one week. Most times these forms would be declined for minor inexistent issues or no issue at all. The problem here is in the inexperience of government officials, the training they have received and the possibility to incur minor events of corruption in which a small fee (as low as 5 USD) is asked for the form and documentation to be approved. These inefficiencies in procedural matters and the slight presence of corruption turn an otherwise highly improved system in performing below its potential. The higher amount of time taken to finalize the incorporation process translates into lost business for the foreign investor. In addition, the presence of corruption, although small, is warning signal for many international companies whom by corporate statute are morally not permitted to engage in such activity, many times creating a roadblock in the process which can last for several days. Therefore, improvement must be made on the actual application of a system which could, in fact, be almost trouble free. The proper application combined with a higher training of civil servants would highly improve the ease of starting a business in India and thus meet the demand of foreign investors who are seeking to start a business in the most efficient and fast way possible in order not to miss out on business opportunities.

6.3 Taxation System in India

The Indian tax system is structured in such a way that it is regulated by different levels of government. Direct taxes are instead levied by the central legislation through the Income Tax Act of 1961. The corporate tax rate is slowly being reduced from 30% (excluding surcharge and cess) to 25%. The 2017-2018 budget reduced the corporate tax rate for smaller companies with annual turnover up to 500 million rupees for the financial year 2016 to 25%. Foreign companies with no incorporated company in India must susceptible to a corporate tax rate of max. 43.26% thus making it convenient to incorporate a company in India in order to reap the benefits of the lower corporate tax rate **(figure 21)**.

Figure 21. Effective Tax Rates in India for Domestic and Foreign Firms

Entity	Effective Tax Rates		
	Companies having total income up to Rs 10 Million	Companies having total income above Rs 10 Million but less than Rs 100 Million	Companies having total income above Rs 100 Million
Domestic Company	30.90%	33.063%	34.608%
Foreign Company	41.20%	42.024%	43.26%

Note: Special rates of 29% & 25% as against 30% (i.e. base tax rate) are prescribed for Domestic Companies in certain cases

Source: Adapted from RSM, 2017

Indirect taxes were once subdivided into value added tax, customs, and excise duty all subject to both Central and State laws. Since July 1st, 2017 Indirect taxes were subsumed into one single pan Indian tax called the Goods and Service Tax (GST) as explained in the previous chapter. Goods and Services coming under GST taxation are subdivided into four slabs, 5%, 12%, 18% and 28% according to the good in question taxed at the destination. As of late, there have been many talks in order to merge the 12% and 18% slabs while keeping the 28% slab for a very small amount of luxury goods. The ultimate goal of GST was to reduce complexity and eliminate multiple taxations as well as create a single unified market across India allowing for the continuous movement and supply of goods to every part of the country. In many ways GST has been successful in increasing transparency, eliminating redundant taxes and most of all eliminating intra-state double levies from state and central government. In fact, prior to the GST coming into effect, companies had to pay a series of levies both to the state and central government including a tax at the border between the 29 states of India when well produced in one state were shipped to another to be sold. Of course, the elimination of such levies increased foreign investor's attractiveness to the country. GST also eased compliances and mitigated the cascading effect of taxation and lead to a reduction of tax rates for a majority of goods and services.

The main issue surrounding GST is therefore not in the substance of the law itself which can be seen as a business simplifier but in the application of GST itself. The tax law is still very young and under in a transition phase thus it is normal to encounter a few problems. Prior to GST coming into effect, the government made sure to hold conferences and lectures in order for professionals to be aware of the changes and the application of the law. This, however, resulted in being inefficient given the many cries for help made by chartered accountants, company accountants, and professionals in general. As mentioned by the MD of an Italian company based in the state of Maharashtra, "the GST is a great idea on paper, the big problem like all new laws in India is in the way it is applied". From the interview, it was possible to understand that the transition to GST has created a series of headaches for companies, especially foreign companies. Some issues related to the transfer of tax credits from the old system to the new system. In this case, the deadlines to hand in all documents and finalize all procedures to transfer the credits were too short in term. In particular, this entailed that companies retrieve C-forms (identification forms) from all their out of state customers for every sale. Due to the difficulty in retrieving the C-forms for many companies in such short time (60 days), this resulted in the shift of the deadline in one occasion and ultimately the loss of tax credits once the deadline passed. For some companies who found themselves substantially unprepared and had not collected many C-forms over the years, these found themselves losing large sums worth of credits. This example is one of many indicating that the application of GST and the rollout of the deadlines were not efficient enough. They were detrimental to companies and doing business as they created losses in terms of money and in terms of time given that many accountants found themselves unsure and hesitant in many cases on how to apply the tax. This is due to the non-availability of appropriate Manuals for GST procedures made by the government (Gayam and Khullar, 2017). In addition, the whole system lacks a proper automation system simplifying the whole process. On final element hindering business caused by GST, is the need to register for GST in every state the company operates. This could turn out to be very tedious as supposing one must submit 36 filings per year per state taking 243 hours approximately. Supposing one has business in 25 states in India, the number of times he/she will have to file returns is 36 x 25= 900 times (Hardy, 2017). It is clear that to properly surpass the problems related to GST, foreign companies must trust in a strong advisor again adding to the costs of the firm.

In terms of taxation, India offers a variety of exemptions open to foreign investors. These include up to 100% tax exemption for investing in depressed regions of the country as an incentive to bolster the economy of that area or free trade zones which have the intent to increase exportation from the country. In this case, the newly incorporated company operating in these specialized zones will be exempted from payment of tax. India also has double taxation treaties with many countries are the world.

Overall it is possible to conclude that the Indian tax system is on the right track to offer an inviting business environment. The tax system itself is very clean and clear especially after the introduction of GST. The problem remains in the application and once again the procedures which have done nothing but create headaches for foreign and national investors.

6.4 Protection of Investor Rights and Enforcement of Contracts

In recent years, protection of investor rights, with an eye on foreign investors, has seen a downturn in India. The suggested reason for this is twofold. On one hand, foreign investors see their rights dwindling due to the inefficiencies of the judicial system. On the other hand, the government's stance, in particular towards, BITs have been concerning after it has decided to terminate at least 50 of them in the past two years.

In the first case presented, foreign investors are relying less on the efficiency of the Indian judicial system as a means to protect their rights. In fact, on a sample of over 25 contractual agreements either for JV incorporation, partnership or M&A, the International Chamber of Commerce (ICC) arbitration court mentioned in contracts was never Indian. In fact, stated courts within contracts were often Singapore or London (U.K.). This contraposes itself to the efforts made by the government in order to convert Indian courts into international arbitration courts of reference through a series of reforms. An example of this includes the establishment of the SEBI and the digitalization of the infrastructure in order to streamline processes. Although Indian courts do not suffer from corruption the main issue remains the lengthy and almost "never-ending" court cases. The extended timing of court cases depletes the protection of foreign investor rights as foreign investors never see their contracts, agreements enforced. Many time times this may lead to a loss of money depending on the gravity of the case. Returns may be lost as clients of a company may never pay for a shipment of goods and or engage in illegal activity by placing an order and then dissolving the company from which the order was made. Absence of controls mixed with lengthy timing of cases (sometimes lasting over 5 years) leads to a distrust by foreign investors are they are never legally guaranteed a resolution to the dispute. In an interview with the Managing Director (MD) of an Italian company based in Maharashtra which has been carrying out business in India for over ten years these issues came afloat. The MD stated that "Over a period of almost ten years our company has been involved in over ten disputes which are still to be concluded, some of which have lasted almost five years. The cases in which we are involved are all due to the missed payment of supplied goods mostly because the buyer has closed the company and stated inability to pay. This is also caused by the fact that we work in a disorganized sector where controls are difficult to enforce, but it is impossible that I am yet to receive an answer on a court dispute for five years. There is a lot of money on the table, money which can make a difference for the operations of a foreign Small Medium Enterprise (SME) operating in India". It is thus clear that the lack of efficiency in enforcing the rights of an investor and the resulting distrust in the legal apparatus creates a depressing environment among foreign investors who many times lose hope on seeing their case resolved and are unwilling, especially SMEs to continue to pay fees for keeping the court case alive. The enforcement of contracts is an area that the Indian government must look at. India ranks as one of the worst countries in the world in terms of the ability to enforce contracts. In fact, research has shown that it takes an average of 1,420 days (World Bank Report, 2018). The enforceability of contracts in some cases also involves the state directly. In a recent case, due to the falling renewable energy tariffs in India, some state governments, namely Andhra Pradesh and Karnataka, were prompted to tell generators that they wouldn't buy energy at the pre-agreed prices, thus exposing businesses to risks due to poor enforcement of contracts (Upadhya and Trivedi, 2017). This backtrack on many purchase agreements in order to lower prices, can extend to every single contract causing quite a largescale problem given the long-term commitment of the contracts. The contracts themselves lose validity if they are not enforced and the investor cannot depend on them again, possibly causing hefty economic losses. In addition to the previously mentioned, a low protection of rights and enforcement of contracts has also led to cases where for example an Indian Managing Director of a foreign subsidiary gains full control over the percentage of shares controlled by the mother company. This is possible through for example the granting of full power of attorney for all business activities by an incomplete board of directors with the foreign directors being absent and without informing the mother company. Another example is that mentioned by an interviewed diplomat while working in India. The diplomat mentioned that "JVs are an extremely risky tool for foreign investors due to contracts not being enforced as well as the laws. This leaves many Indian counterparts with the ability to take intellectual property and sometimes overtake control over the whole firm".

The second side to the story involves the protection of investor rights guaranteed by international treaties such as Bilateral Investment Treaties (BITs). To this regard, although India has been rolling out a series of pro-investment reforms such as the

“Make in India” initiative to attract foreign investors, it has also engaged in the termination of over fifty BITs. According to Ranjan and Anand (2016), “These treaties play a critical role in protecting foreign investments by holding host states accountable for the exercise of their regulatory power through an independent international arbitration mechanism, thus furthering international rule of law. In addition, the recently adopted Indian model BIT tilts the balance towards the host state’s regulatory power by severely limiting the substantive and procedural protection to foreign investment” (Ranjan and Anand, 2016). India decided to undertake this current strategy after a series of BIT cases presented by many foreign companies which have been lost by the Indian government. In fact, according to the United Nations Conference on Trade and Development (UNCTAD, 2017), “India is one of the most frequent respondent-states in the investor-state dispute settlement (ISDS) arbitrations”. This has forced the Indian government to reconsider and possibly change its current framework. The abolition of these BITs forces foreign investors to rely solely on Indian domestic laws in order to safeguard their interests and rights. Intuitively from what has previously been mentioned, this is not an attractive proposition for foreign investors. Two risks can be encountered by the foreign investor. The risk of sudden changes in the laws (i.e. Vodafone case in which Parliament retrospectively made amendments to the Income Tax Act. In doing so it overruled the decision in favor of Vodafone made by the Supreme Court (Global Investment Protection, 2016)) and the lengthy timings of the Indian judicial system, as has been described above which is not characterized by a “speedy” infrastructure for the resolution of disputes.

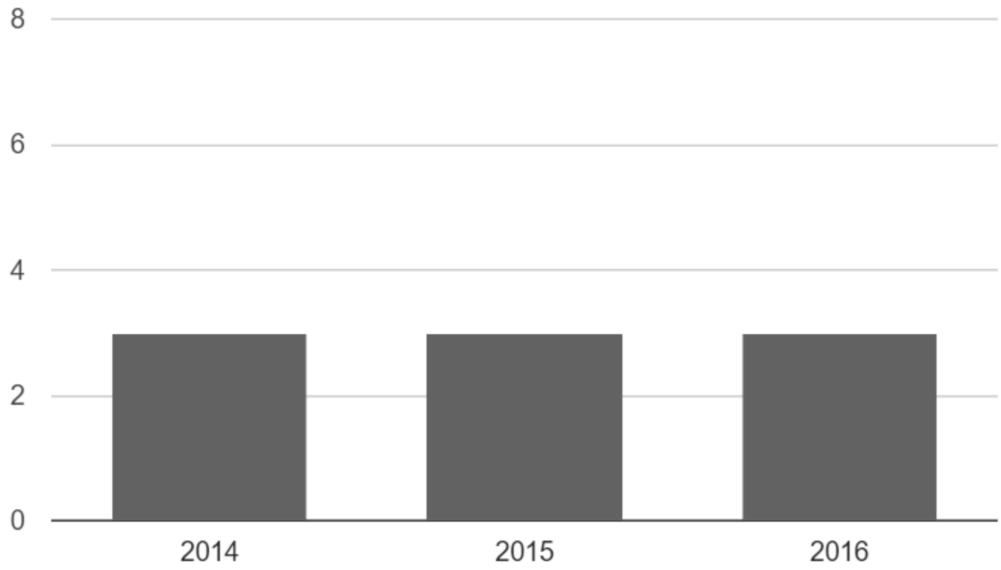
The termination of the fifty plus BITs will not have an impact on the existing foreign investments, as these had a survival clause which ensures treaty protection for up to ten to fifteen years after expiration of the treaty. It will, however, affect new investments which will come under new BITs being proposed by the Indian government. These new BITs will have a different approach as the government is trying to reduce the number of claims made against it while at the same time attract foreign investors by having the BITs in place. The new treaties are characterized by a different design. They include a definition of investment which is enterprise-based, non-discriminatory treatment through due process, protection against expropriation, a refined ISDS provision and limits on the power of the tribunal to awarding monetary compensation. The new ISDS provision also requires that investors turn to all local legal remedies before they are allowed to engage in international arbitration (Ranjan and Anand, 2016) (Nataraj, 2016). The Most Favored Nation clause will also be removed from within the new treaty. Overall, concerns for foreign investors lay in the requirement for all local remedies to be exhausted as the Indian judiciary is known for its lengthy processes and delays. The concern is also placed on the limits on the scope of protected foreign investments as it excludes portfolio investments and goodwill. These new BITs are clearly biased towards safeguarding India's interests and raise many doubts in the heads of foreign investors who find themselves less protected in a country in which protection should on the other hand rise (Nataraj, 2016) (Baker Mckenzie, 2017).

In addition to the above-mentioned issues, there are others that may also concern foreign investors. In the last years, the Securities and Exchange Board of India (SEBI) has been set up to ensure investor protection. Although it can be seen as an improvement the SEBI has actually permitted companies to squeeze out minority shareholders. In fact, section 100 permits a company to extinguish capital. Many delisting companies have thus increased the face value of their shares after the delisted and erased the shares of minority shareholders as they have become fractional. Unfortunately for them is that minority shareholders see their rights completely shattered as no court or regulator may intervene to help these investors (Nayak, 2014).

In terms of property rights, since 2016 all IPR is administered by the Department for Industrial Property and Promotion (DIPP). When investing in India it would be advisable (not required) for foreign investors register their copyrights as a way of proving ownership should a criminal proceeding be initiated against and infringing entity. This is true even though India is a signatory to the Berne Convention on copyright. Patents are protected by the Patents Act of 1970 and 2003, the Patent Rules and the 2016 Patent Amendment Rules. Once an a foreign investor files application for a Patents and it is granted it will be valid for 20 years. Renewals of patents are subject to fees. Trademarks must be registered in India either through domestic procedures or the Madrid system. Designs are protected by the Designs Act 2000; the Designs Rules 2001 and they last for ten years. They can then be renewed for another five. Trademarks are also protected by the law with the 1999 Trade Marks Act and the Trade Marks Rules of 2002 and 2017. Enforcing of IP rights occurs through civil courts. Of course, this is a disadvantage as large damages are rarely recovered. Punitive damages against an infringer are also rare. The only advantage is if the infringer is identified and a civil litigation initiated, an interim injunction may be granted resulting in the infringement being halted pending the outcome of the case (UK Intellectual Property Office, 2017). After almost all regulation relating to IP has been amended mainly due to the country's accession to the World Trade Organization in 1995, the current IP legislation covers every significant aspect of protection. Problems arise mainly due to the perceived inefficient enforcement of the rights as the India judicial system is plagued with bureaucratic delays, and an excess of previously filed but yet to be resolved cases at both the civil and criminal courts. These cases may run for five to ten years and often lack transparency. This is true, particularly at the local level. These characteristics are not well received by a foreign investor who is in need of efficiently protecting IP which is potentially crucial in giving the company a competitive advantage in the market. Another trait of the intellectual property environment is that the majority of infringers are very small. This, in turn, causes seizures to be small as well requiring a substantial financial effort to have an effect on the damaged owner (UK Intellectual Property Office, 2017).

Expropriation, on the other hand, is not an issue which should concern foreign investors more than needed. There have not been any known instances of an asset being seized by the government (Parsons and Patel, 2009). In fact, this is supported by the data issued by the Credendo group. The figure below **(figure 22)** shows the expropriation risk in India in the last three years. The average value recorded was a 3 indicating a low risk of expropriation.

Figure 22. Expropriation Risk in India (8=high, 1=low; 2014-2016)



Source: The Global Economy (Credendo group), 2017

6.5 Labor Laws

Labor legislation is one area which can result in being troublesome for foreign investors in India. Although the power of labor laws and unions has decreased throughout the last twenty to thirty years, there are still strong pro-worker labor laws which could go to the disadvantage of the foreign investor. India has in many cases a very restrictive labor policy quite often criticized by foreign investors. An example of this is the Industrial Dispute Act of 1947 which regulates the lay-off of the employees. According to the act lay-off of the employee if the employer has more than 100 workers, is permissible only after approval is granted by the competent Governmental body. Of course, this typology of law is high to the disadvantage of foreign investors whom many times are not accustomed to this restrictiveness in their home economies.

A second threat is posed by the possibility of union strikes. These are no longer as common as they were in the 1980's although they can still hinder many foreign companies once a strike occurs (Parsons and Patel, 2009).

The last issue concerning employment regulation is that of compliances. Foreign companies should be familiar with Indian labor laws. This might arise as an intricate task as they must not only become accustomed to with employment laws passed by the central government, they must also understand the specific labor laws passed by the state governments which differ across all states. To ensure that appropriate registrations are held, that Human Resources records, files, documents, and correspondences are filed according to requirements of the labor law, foreign firms should seek professional advice. This would ensure the correct drafting of compliant policies and practice manuals, the structuring of compliant employment contracts and the reduction of co-employment risks issues. The need for such professional figure will, of course, increase the costs of a foreign firm but it saves them from compliance issues which could turn into fines (UK-India Business Council, 2017).

6.6 Governing Institutions, Procedures and Corruption

The major problem arising from Indian legislation is a chain of aspects which trigger one another and ultimately turn out to have a negative effect on the foreign investor. The first aspect relates to the legislation itself and the awareness investors have of them as well as their overall clarity. A negative perception in the two previously mentioned aspects leads to an increase in legal risks. The problem here can be caused by two issues. Either the laws are poorly drafted, or they are changed too frequently. Unpredictable and frequently changed regulations and laws are not only caused by a continuous push for improvement by the government but also because India is renowned for passing laws on a trial error basis. This means that the passed laws may not be as efficient as expected to turn out to have negative consequences on foreign investors. Awareness and clarity are also affected by the fact that foreign investment policy is typically issued through press notes and releases, which then turn out to become de facto policy. The problem not only arises from this but also from the badly drafted and inconsistent nature of these laws (Amritt Ventures, 2018). A High turnover of laws and their poor drafting lead to high uncertainty for the foreign investor increasing the legal risk of the country and the investor's interest in investing in the country. The mic of low clarity given by badly drafted regulations and poor awareness of them leads to another issue which is the interpretation of these laws. Although indications on the interpretation of the rules can be made available to investors by some authorities before a decision is made, these rules may still remain open to different interpretation, yet again creating uncertainty for investors.

Room for interpretation and unpredictability, in turn, lead to another issue which is that of corruption. Corruption is seen in a negative light for foreign investors as it creates high insecurity for the foreign investor and very frequently makes him or her adverse to investing in the country. As previously demonstrated corruption frequently happens when filing documents to government authorities or in general when interacting with these authorities for any needed procedure. In many studies such as the one proposed by (Hasan, Rahman, and Iqbal, 2017) Corruption is concurrent with lower levels of FDI. According to Transparency International, India is ranked 79th out of 176 countries in their corruption perception index. In fact, a score of 40 recaps the state's inability to effectively deal with petty corruption as well as large-scale corruption scandals. Many foreign companies are unwilling to engage in petty corruption in order to streamline compliance procedures. They are unwilling to do so because of their moral soundness and most times due to their company internal policies which prohibit such actions. Home country regulations such as the American Foreign Corrupt Practices Act may also play a role in this as they prohibit firms coming from their country to engage in corruption practices (Amritt Ventures, 2018). During an interview to the CFO of a German company based in Maharashtra, it was mentioned that "In no way will we engage in corruption even if it's for 5 Euro in order to get our compliances approved. We are a German company and for us, it is immoral to engage in such activity. It is also against the policy of our firm to do so".

Corruption is also due to the often-inefficient procedures present in India. Many times, these procedures be it for compliances or income tax filing to name a few are conducive to corruption due to fact that they can at times be too lengthy. Corruption arises by government officials in order to streamline the procedures. Typically, procedures are time-consuming in India due to the poor infrastructure (i.e. slow internet filing and old-style paper documentation), the generally untrained staff working of government offices and because of the overall unclear rules. Often, due to frequent law changes causing overlaps with previous laws, investors find themselves in situations where they are confused and often in deadlocks. Confusing and contradictory regulations not only create headaches for foreign investors but also impair the public officials' ability to implement the relevant policies and laws efficiently ultimately leading to bottlenecks in procedures and leaving room for corruption to quicken the process.

As former Prime Minister H.D. Deve Gowda mentioned during the recent World Economic Forum 2018 in Davos, Switzerland, "the country was perceived as "most corrupt by other countries at the Forum during my period… When I visited the WEF in Davos as the Prime Minister, the atmosphere that prevailed there among other countries was that India was the most corrupt nation…. while things are quite different for the current Prime Minister Modi" (Economic Times India, 2018). Although it is true that the overall situation has slightly improved, as mentioned by Transparency International, the last years have seen no progress made by India to this respect (Transparency International, 2018).

6.7 Dispute Resolution and Insolvency in India

India's judiciary is structured by a single court system which administers both central and state laws. It is a three-tier system consisting of the lower District courts, the High Courts and the Supreme Court of India which is the highest ranked of the three. As previously mentioned, India's legal system is characterized by the use of the common law which is perceived as more favorable to business. The choice of dispute resolution mechanism is a delicate one. Investors may choose among litigation before Indian courts or arbitration. The choice may potentially generate commercial, financial and legal outcomes to the investor. Thus, they should consider both the advantages and disadvantages that the dispute resolution mechanisms offer (Petit and Jacobs, 2016).

Court litigation in India is characterized by delays mainly due to the accumulation of filed cases. This is the result of an archaic system consisting of large volumes of paperwork for every pleade. In addition, corruption and a relatively still poor legal system also pose a threat to foreign investors because it can lead to capital losses and a low protection of their rights. Due to this foreign investors prefer to use Indian courts as a means of achieving interim results. Companies will go to these courts to get injunctions (i.e. in the case of IP) otherwise they would simply avoid them whenever possible. While interviewing the MD of an Italian company based in Maharashtra India it was claimed that "we currently have more than ten court cases ongoing one of which is several years old. All of them were initiated due to nonpayment of receivables by clients which are unwilling to pay".

Given the lengthy times taken by disputes to be resolved many foreign companies build in clauses into their contracts allowing for arbitration, usually international. In fact, from personal experience during the period spent working in India all formulated contracts referred to international arbitration for dispute resolution. The stated courts were typically Singapore or London, U.K.. Arbitration is indeed the preferred option for dispute resolution. The UNCITRAL model is the basis of India's Arbitration Act. It forbids local courts from taking any view on the merits of a case where there is an arbitration clause. The act is divided into two parts: domestic and international arbitration. As mentioned many companies operating in India prefer to include international arbitration in their contracts. India though aspires to become a major international center of arbitration. This aspiration has until now been hindered by its current arbitration laws and their judicial interpretation (Chris Parsons and Nimi Patel, 2009). A bill passed a few years ago made the most significant progress towards this goal. The provisions include modifications to reduce delays and other recommendations of the Law Commission. This is seen as a necessary step to encourage more FDI and give more protection to foreign investors (Gill, Biger, Mathur and Tibrewala, 2010) (Parsons and Patel, 2009).

The main concern for foreign investors is linked to the lack of sufficient skills by Indian arbitrators. This is because most arbitrators in are retired judges, which tend to conduct the arbitration proceeding, in the same manner, they were conducting the court proceeding. The obstacle to foreign investors also includes the high cost, often more than litigation and the time consumption. is often time-consuming and expensive (Hilmer, 2007).

Insolvency, on the other hand, takes almost four and a half years resolve. This is far longer than average recorded in the South Asia region and among OECD countries. This is mostly due again to the lengthy times of the court system which slows down the whole mechanism (TMF Group, 2016).

CONCLUSIONS

The globalization process has allowed for the economic, commercial and technological boundaries to gradually disappear. Developing countries have been focused on trying to attract foreign investments due to the lack of domestic savings and capital. This is not the only positive trait of Foreign Direct Investments. They have been linked to multiple positive effects on macroeconomic variables such as productivity, production capacity, level of employment, factor prices, technological know-how and overall economic growth. These are the main reasons for which developing countries are interested in FDI. Investors, on the other hand, seek to reap the benefits found in the destination country, including but not limited to reduced production costs and market expansion possibilities. The benefits which can potentially be gained by investing in a foreign country, especially a developing one, are multiple and highly interesting. Though this is true Foreign investors are also susceptible to a series of risks such as political and exchange rate risk. The aim of this thesis has been to demonstrate that the legal environment of a developing country and its related risks can pose a non-negligible threat to foreign investment.

It has done so by initially understanding what Foreign Direct Investments (FDI) are and what determines them. The analysis then shifted to understand the relationship between FDI and the legal environment of the country. The study first assessed that a weak legal environment characterized by frail laws and an inefficient, complex legal system altogether has a strong negative effect on the investment decision of a foreign investor and their feeling of protection once the investment has been made. This is because an inefficient legal structure is conducive to a feeling of insecurity and uncertainty increasing the risks posed to the foreign investor. The study then followed by analyzing specific cases of legal issues present in developing countries which may hinder a foreign investment. FDI policy may trouble investors due to the restrictions which might be placed on the permissible equity amounts of the investments or the sectors in which the investments are allowed. In addition, a policy which is FDI prone and thus consisting of incentives is also crucial in raising the attractiveness of the foreign investor and reduce the fears of entering a new market. The second analyzed element was the ease of starting a business. Problems here arise due to the possible presence of inefficient and or redundant procedures as well as the costs and length of the process'. A country hosting an easy, streamlined structure to start a business is far more attractive for foreign investors and reduces insecurity, at least in the initial phase. The third analyzed area of issue regarded tax legislation. In this case, issues may arise due to the poor quality, the clarity and the amount of the taxes. High taxes, as well as a poorly structured, confusing and unclear taxation system, pose a threat to a foreign investor as uncertainty, especially in form of amounts to be paid and mistakes in compliances arise. The non compliance leading to further costs and sanctions. The fourth possible problem area touched upon was that relating to property rights. A poor enforcement of the of property rights is an enormous deterrent to foreign direct investments. Investors are unwilling to invest in a country where their assets are not properly protected. Such situation would create uncertainty in the investment which is too high for an investor to stand. This also connects to the issue of the functioning of the legal infrastructure. Inefficient courts characterized by corruption, inefficiencies and lengthy procedures make foreign investors averse to an investment in a given country. Corruption and inefficient procedures may also create complications in any instance in which an investor must interact with authorities. This may occur when applying for licenses, filing documents and fulfilling compliances. Procedures are often lengthy due to the unclear, overlapping or frequently changing regulation as well as inadequate and uneducated personnel in public offices in developing countries. Procedures which are not streamlined and are surrounded by uncertainty make way for corruption. Another point of the issue within the legal system which was touched upon included labor laws by which pro-employee laws with a restriction on layoffs are seen in a negative light by foreign investors. A final area which could possibly lower the incentive of a foreign investor to invest in a particular country is that of dispute resolutions and insolvency. In the first case, slow and lengthy court cases, with a weak enforcement of the laws lead investors away from investing in a county. In the second case, major issues arise when there are no procedures for applying to have insolvent debtors wound up, to recover debts that are owed or when insolvency laws do not allow for an investment to be voluntarily dissolved. An attractive and predictable regulatory framework is an extremely important prerequisite for the host country in order for the investor to gain the benefits which foreign direct investments are carrying.

When applied to the Indian case, the initial biggest risk for foreign companies when entering the country is the lack of preparation. If time is taken to fully understand the characteristics of the country and its business culture one can extract the huge rewards. The Indian market offers relatively low-cost labor, an enormous pool of possible consumers and many other benefits. If on the other hand investors take quick decisions and do not fully review all aspects which might create risks, the investment may result in serious and substantial failures with large losses of capital.

As in many developing countries, Indian laws and regulations are constantly evolving. In the Indian case, these laws are a reflection of the political compromise needed to balance the complex and conflicting demands of multiple constituencies (Nelivigi, Olier, Ray, Shabharwal, 2014). The government must satisfy a series goals and maintain a balance among safeguarding the home market, businesses and consumers, while protecting legitimate business' and property rights, creating jobs and recognizing the demands of labor unions. Concurrently the government should also focus its actions to attract foreign investments, facilitate the transfer of foreign technology and know-how and promote industrial growth.

The result of these compromises is a high turnover of laws and regulations which among other things are passed through a trial error basis. This entails that ineffective and inefficient laws may be passed and then substituted once they are tested as not working, having unintended consequences and being impracticable. Often laws may also overlap and contradict each other. Such scheme reflects the fact that these laws are typically loosely drafted policies, press notes, circulars, clarifications, pronouncements on digital bulletin boards, amendments and occasional policy reversals which are often passed and become law without previously going through a standard legislative process and approval. The challenge for foreign companies is thus given by their difficulties in navigating the government's evolving rules and FDI policy. It should, however, be emphasized that in terms of FDI policy the government is taking the right steps in order to incentivize foreign investors to invest in India. Problems, however, are quite evident in the clarity of the laws. Many times, do to the constant change and their poor formulation, these laws and regulations leave room for interpretation which in turn allows for the possibility of corruptions especially when interacting with government officials. In addition to this, the resolution of disputes characterized by extremely lengthy court cases creates a perfect recipe for an inefficient legal system. The discussion on lengthy disputes also ties to that on the protection of property rights. Given the poor enforcement of laws in India, foreign investors do not feel as if their interests are protected enough and thus increase the sense of uncertainty. Adding to this the government has also retrieved more than fifty BITs and substituted them with new ones which favor the country rather than the foreign investor. This action was taken as a “remedy” to the number of claims made by foreign investors against India.

The quality of regulations and procedures also effects the ease of starting a business. In this regard, the government has made sensational improvements to streamline the process. Although it has, the procedure often takes more time than estimated and the costs needed to pay for professionals aiding the process may be substantial. Extensive time spent to incorporate a company is equivalent to lost profit for the inability to initiate carrying out business. The main problem lays in the procedural difficulties of the process. Theoretically, the process is very much streamlined but, every step is risk-prone to advancement being blocked by the government authorities and their own inefficiency. Such inefficiency is given not only by the poor education level of state employees but also by their unawareness of the rapidly and constantly changing regulations at times difficult to interpret correctly.

The Indian tax system is also on the right track to offer an inviting business environment with a series of incentives. The tax system itself is very clean and clear especially after the introduction of GST. GST has unified the market giving investors enormous advantages in the form of fewer taxes and compliances to be followed. The problem remains in the application of the new system and the various related procedures which have done nothing but create headaches for foreign and national investors. An example includes the fact that a company must register and file taxes in all states it operates in. This creates issues in the form of heavy fees to be paid to professionals for filing.

Labor laws in India have also been identified as an area where investors might run into some complications. The power of labor laws and unions has decreased throughout the last twenty to thirty years. There are still strong pro-worker labor laws which foreign investors might not favor. Restrictive labor policy such as in the case of layoffs needing to be approved by competent authorities if the company has over 100 employees is an example of the restrictive measures that still exist. While the second major issue relates to the complexities in the compliances of human resource regulations.

In conclusion, it is possible to assess that the Indian government has made tremendous advancements in combating the inefficiencies of its legal environment. It has done so by making numerous amendments to its laws, such as in the case of the Companies act of 2013 and the application of GST substituting nine separate indirect taxes and unifying the country from a taxation standpoint. It has also streamlined electronic use for a series of processes and procedures. These include the amelioration of the incorporation process as well as the electronic use of the court system procedures. However, the last has seen an only slight improvement. The government has, in addition, maintained a very attractive FDI policy with the increase of automatic route sectors and increases in the cap amount of foreign investment. It comes to no surprise that the World Bank Doing Business report has seen India jump more than thirty places in the last years now finding itself in 100th place.

The main areas of concern for foreign investors, however, can be summarized as follows. A large issue is the presence of corruption which greatly hinders the perception of the legal system by the investor. This is because corruption can trace back to an inefficient legal system overall. The often unclear, repetitive, and turnover prone laws and regulations which create the need for interpretation and in turn high uncertainty. This together with the inefficient judiciary, due not to its quality, but to the extensive time in court cases leads the investor to have a low protection of property rights. This is also increased by the occasionally low enforcement of contracts and the law. Concern also arises from the lower quality and time-consuming procedures in the various application and filing processes. In many times, however, the government has made efforts to improve all the above mentioned but the major issue remains the actual application of the law once they are passed. Sometimes good law changes as GST are very positive, but their troublesome application with the problem it causes to investors turns the laws into another problem to be solved. Nelivigi, Olier, Ray, Shabharwal (2014) suggest that "the Companies which understand the motivations driving policies are more likely to understand how the rules will be interpreted in the future – and they will be better able to position themselves for success". Although this is true, it is clear that the Indian government must place more effort in order to make significant improvements especially to further streamline process and procedures, better apply laws, fight corruption and increase the protection of foreign investment right in order to create a more attractive business environment.

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