ABSTRACT

INVESTMENT POLICY AND PERFORMANCE OF
U.S. SUBSIDIARIES IN INDIA

By

Daya Ram Singh

This study is an examination and evaluation of the investment policies and performance of U.S. (manufacturing and petroleum) subsidiaries in India. The basic approach, based on published financial data, questionnaires and interviews, is to compare the investment policies and performance (profitability and risk) of the U.S. subsidiaries with their parent corporations.

From a total population of 37 U.S. subsidiaries eligible (widely-held corporate subsidiaries, with at least 10% American equity investment, operating throughout the 1963-67 period) for the present study, the annual reports of 27 U.S. subsidiaries were made available for the years 1963 to 1967. These participating subsidiaries accounted for about 90% of the total assets, net worth and total sales of total population and constituted a reasonable cross-section view in terms of nature of products, age, ownership, management and size. To get more information regarding the objective of investment, the application of

capital budgeting approach in international investment, etc., all of these 27 parent corporations were contacted through the questionnaire. Fourteen returned the completed questionnaire. Personal interviews were conducted in the case of eight U.S. corporations.

Before comparing the investment policy and performance of the subsidiaries with their parent corporations, the financial statements of the participating subsidiaries were adjusted for the price level changes in India. The U.S.A. also experienced some inflation during the period under study and the adjustment process followed for the U.S. subsidiaries allowed for this also. The adjusted financial statements of the subsidiaries were used as the basis for the present study.

Study of comparative financial ratios indicated that the subsidiaries' investment policies differed from their parents in the following ways. Subsidiaries had relatively more investment in net fixed assets and inventories than their parent corporations while the parents, of course, had invested relatively more in cash, marketable securities, and accounts receivable. Regarding comparative financial structures, most striking was the subsidiaries' lesser reliance (even among those well established) on retained earnings as a capital source. Consistent with this, the U.S. subsidiaries in the study, on the whole, paid a higher percentage of their earnings as dividends than did their

parent corporations. Their payout ratios were noted to be similar to those of other Indian public limited companies. However, there were greater fluctuations in the high and low dividend payout ratios of the subsidiaries than their parent corporations.

One hypothesis tested was that the performance (rate of return, considering risk) of the Indian subsidiaries is greater than their American parent corporations. The findings of the research indicate that the five-year average rates of return on total assets and on net worth of subsidiaries were less than their parents' returns. On the other hand, the subsidiaries' return on total sales generally exceeded those of their parent corporations. However, the well established subsidiaries were earning higher rates of return on net worth than their parent corporations. These two empirical evidences, i.e., higher rate of return on total sales and on net worth (well established subsidiaries) suggest that the U.S. subsidiaries were able to operate efficiently and earn higher profit in the long run. The optimistic attitude of the parent corporations, as revealed by the questionnaire survey and personal interviews, regarding their future plan in India also supports the above findings. Moreover, the period of the present study (1963-67) exhibits unusual features of the Indian economy such as inflation, drought, acute food shortage, border conflicts with neighboring countries, recession in industrial production,

postponement of Fourth Plan, political instability, etc. On the other hand, 1963-67 was unusually good period for the U.S. economy. With the normal situation in India, there is greater possibilities for the better performance of the subsidiaries.

The business risk, as evidenced by profit variability, of all subsidiaries (either higher or lower rate of return) was greater than for their parent corporations. Despite their subsidiaries' earnings variability, the parent corporations were more concerned, as revealed by the questionnaire survey and personal interviews, with the environmental or non-business risks, i.e., currency exchange risk, political risk and economic risk. The parent corporations feel that the Indian currency exchange risks are minimal while political risks have increased. Uncertainties of procuring raw materials, changes in the priorities of Indian government economic policies and the rate of inflation were viewed as important factors affecting the attitude of the U.S. corporations regarding economic risks of the country. To minimize the various environmental risks, the parent corporations indicated that they took various measures such as guarantee of risk by the U.S. Government, minimum equity investment, joint venture between U.S. corporations and Indian investors, etc.

The present study is limited by the inability to incorporate transfer pricing, management fee, royalties, etc.,

in studying the performance of the U.S. subsidiaries. However, the evidence did seem substantial that in general the subsidiaries' earnings were less than the parents', this in addition to greater risks. Yet many of the U.S. subsidiaries are fairly new. There seemed to be evidence that with maturity of the subsidiaries (and assuming an improvement in the economic situation of India and continuation of a reasonable foreign investment climate) the performance of the U.S. subsidiaries in the long run will improve, becoming consistent with the parents' risk-return expectations.

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CHAPTER I

INTRODUCTION

Many of the developing countries have recently emerged as independent political entities. The governments of these countries endeavor to accelerate the rate of growth of their countries and thereby to improve the economic conditions of the people. However, the developing countries with their low level of income and savings find their internal resources inadequate to achieve the desired rate of growth. These countries recognize the importance of foreign private investments to achieve these goals. Such investments not only increase the capital resources of these countries but act as the chief mechanism through which managerial and technical skills of the advanced countries are made available. Thus despite their fear of foreign domination and other ideological and political differences, the governments of these countries are anxious to attract foreign investors by providing financial and non-financial incentives, and the business enterprises of the developed countries are realizing the needs of developing countries and are expanding their foreign business in these countries.

In the case of India, the outstanding foreign investment increased from Rs. 2.60 billion in June 1948 to Rs. 9.36 billion by March 1965, that is, an increase of Rs. 6.76 billion during these years. The total inflow of private foreign capital of Rs. 6.25 billion during the three Five-Year Plans (1951-52 to 1965-66) constituted about 25% of the total private sector investment of about Rs. 25.00 billion in the industrial field in India. Most of the foreign private investments in India came from the U.K. and the U.S.A. Prior to the year 1963, the British investment occupied the leading position by a considerable margin. During 1963-64 and 1964-65, the U.S.A. was the largest supplier of foreign capital to India and accounted for 61% and 51% of the aggregate net inflow of foreign capital in 1963-64 and 1964-65 respectively.

Purpose of the Study

The main purpose of the present study is to examine and evaluate the investment policy and performance of the U.S. subsidiaries working in India. In other words, due to differences in the economic, political and financial situations, legal and other restrictions, government policies, management ownership and control, and other environmental variables in the U.S.A. and India, the investment policy and performance of the U.S. subsidiaries in India could be quite different to that of the U.S. parent corporations.

The investment policy of the subsidiaries is of crucial significance as in the aggregate it involves huge capital expenditure in foreign countries and hence it is the most carefully controlled aspect of the operation of the foreign subsidiaries by their parent corporations. But the investment policy of these subsidiaries may be different from their parent corporations due to the economic, political and other factors of both countries. The investment policy of the subsidiaries will be compared with their parent corporations to analyze these differences, if any.

Theoretically, it is argued that the developing countries provide vast natural resources, cheap labor, and growing market potentialities for the product. Due to these factors, the profits earned on foreign private investment in developing economy are high as compared to the developed economy like the U.S.A. On the other hand, it is also argued that the rate of return in developing countries would be lower than in the U.S.A. because of the inefficiency of the factors of production, lack of economies of scale, high cost and/or lack of availability of inputs. Besides these views, there is another thinking which points out that though the rates of return in the poor countries are greater they are not great enough to offset the Westerner's well-developed sense of risk. The

rate of discount for risk is high because of the less experience about these countries and its environment.[1]

To analyze the above controversy on the basis of empirical data, the performance of the U.S. subsidiaries in India will be compared with their parent corporations. While evaluating the performance, the business risks associated with the variability of the rate of return would be examined. But this variability over a few years would not measure the environmental or non-business risks considered to be the major hazard faced by the U.S. subsidiaries operating in foreign countries. The environmental risks encountered by the U.S. subsidiaries in India will also be discussed.

Review of the Literature

Despite the growing importance of the U.S. investment in India, there are a few studies conducted in the general area of foreign investment in India but there is not a single study which has exclusively dealt with the investment policy and performance of the U.S. subsidiaries working in India.

Most of the studies of the foreign investment in India are directed toward discovering the attitudes and

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[1]Richard D. Robinson, "The Global Firm-to-be: Who Needs Equity?" Columbia Journal of World Business (January-February 1968), p. 24.

views of the foreign investors regarding the climate for foreign private investment in India.[2] These studies are primarily based on the opinion survey and the personal experience of the foreign investors.

Subrahmanian[3] made a case study of the efficiency of the foreign-controlled and Indian-controlled firms working in India and came to the conclusion that the inter-firm comparison of foreign vis-a-vis Indian controlled joint ventures does not show that the foreign ownership (direct foreign investment) by virtue of its presumed dynamic business attitudes, provides built-in-conditions for higher management efficiency.[4]

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[2]Anant R. Negandhi, Private Foreign Investment Climate in India (Graduate School of Business Administration, Michigan State University, 1965); Kapoor, A. "Foreign Collaboration in India-Problems and Prospects" (University of North Carolina, 1966) Dissertation Abstract, Feb. 1967, p. 2245-A; "Indian Investment Center's Study, Market, Profit Prospects in India attract U.S. Capital despite many disincentives," The Economic Times, Bombay, May 5, 1965, pp. 1 and 4; M. Gopala Menon, "U.S. Views of Investment in India," Commerce, Bombay (India) Annual Number, December, 1965, Vol. CXI, No. 2825, p. A-24.

[3]K. K. Subrahmanian, "Foreign Control--No Index of Efficiency," Commerce, Bombay (India), November 18, 1967, pp. 1188-89.

[4]The 'efficiency' has been measured in terms of four ratios, i.e., financial structure ratios (net worth to total capital, reserve to net worth and net worth to net block), assets utilization ratios (value of production to net fixed assets, to inventory and to total assets), cost structure ratios (raw material, manufacturing cost, and total expenditures each to value of production)

Hazari and Lakhani's study of the 88 pharmaceutical private limited companies of Maharashtra State (India) for the years 1958, 1962 and 1964 shows that wholly foreign-owned companies were earning a cash profit (profit after tax but before depreciation) which would bring their investment back within two years. The foreign majority-controlled companies were taking a little more than four years to get back their investment.[5] The study is based on the annual reports of these companies. The findings of this study, however, suffer from a number of serious shortcomings. Its conclusion is based on the 'cash profit.' Moreover, the pharmaceutical companies are highly profit-oriented[6] and any conclusion based on a particular industry cannot be generalized for the foreign-owned companies of other industries.

The Reserve Bank of India has conducted, on a regular basis, a study of the international investment

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and profitability and appropriation ratios (gross profit to total capital, net profit to net worth, and retained profit to profit before tax). The foreign controlled companies showed overall better rates of return than the Indian public limited companies. But the inter-firm comparison of 22 foreign and Indiancontrolled companies did not support this better performance.

[5]R. K. Hazari and H. G. Lakhani, "Pharmaceutical Companies in Maharashtra--Financial Structure and Ownership," The Economic and Political Weekly, Bombay (India) July 1, 1967, pp. 1169-82.

[6]Reserve Bank of India, Finances of Indian Joint Stock Companies, 1965-66, Reserve Bank of India Bulletin, December 1967, Esp. Table 4 on page 1541.

position of India for different years. These surveys provide information, on aggregate basis, on the inflow of foreign investment, volume of foreign investment, etc. The Reserve Bank's study is of general nature and is based on the information collected through the foreign investment survey report for balance of payment statistics.[7]

Besides the above general survey, the Reserve Bank of India has also surveyed, on an annual basis, the finances of branches of foreign companies and foreign controlled rupee companies operating in India.[8] Out of the 208 foreign branches covered in the study, the U.K. and the U.S.A. branches are 174 and 24 respectively while the branches of the remaining countries are only 10. In the case of the 320 foreign-controlled rupee companies covered in the study, the U.K.'s foreign controlled rupee companies are 207 whereas U.S.A.'s companies are only 35. The remaining 78 companies are controlled by 'other countries.' The study presents financial data regarding the income, expenditure and profit; profitability ratio; assets formation and sources of finances; and pattern of distribution of assets and liabilities of all the foreign

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[7] Reserve Bank of India Bulletin, Bombay (India) January, 1967; pp. 36-59.

[8] Finances of Branches of Foreign Companies and Foreign Controlled-Rupee Companies, 1965-66, The Reserve Bank of India Bulletin, June 1968, pp. 737-753.

branches and foreign controlled rupee companies separately. A separate discussion of the U.K. and the U.S.A. foreign branches and foreign controlled rupee companies is also provided. At the end of the study, a comparison between the profitability ratios of the Indian public and private limited companies on the one hand and the foreign controlled rupee companies on the other is presented. The study shows that the foreign controlled rupee companies were earning 12.0% and 12.3% in 1964-65 and 1965-66 as compared to 8.9% and 7.8% for the corresponding years by the 1,644 Indian-owned public and private limited companies in India. It also shows that the U.S. foreign controlled rupee companies were earning 13.2% and 12.7% respectively for these years.[9]

The above study suffers from a number of shortcomings. First, this study is primarily a factual assessment of the various items of the profit and loss account and of balance sheet. No detailed analysis, based on the size, age, ownership, control and nature of product of subsidiaries, of the rate of return and the composition of the various items of balance sheet are presented. Secondly, this study compares the profitability ratio of

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[9] K. K. Subrahmanian has reached the same conclusion when he compares the over-all performance of the foreign controlled companies with the Indian public limited companies. See Footnote Number 3.

the foreign controlled rupee companies and Indian companies without making any analysis of the differing business risk factor, if any, associated with the investment by the foreign investors and the Indian investors. Any conclusion reached without analyzing the risk factor cannot be accepted on a scientific basis.

Besides the above studies, there are some studies which cover, in a single volume, the various aspects of the foreign investment in India, including the performance of the foreign investment in India based on the aggregate data.[10] In some cases the researchers have tried to compare the profit of two or three foreign-owned companies with their parent corporations.[11] These studies suffer from a number of defects. First, they have not studied a number of foreign controlled companies operating in different industries. Second, these studies have not taken into account the differences in the inflation rates of both parent and subsidiary countries and its effects on conventional accounting data.

The review of the literature indicates that some studies have been conducted regarding the performance of

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[10]Michael Kidron, Foreign Investments in India, (London: Oxford University Press, 1965).

[11]Michael Kidron, "Behavior of Foreign Capital; Its Method of Control in India," The Economic Weekly, Bombay (India). Special Number, July 1964, p. 1265.

the foreign subsidiaries in India. But no detailed study has been made regarding the investment policy and performance (including risks) of a broad group of foreign subsidiaries working in India. In the present study, an attempt will be made to study the investment policy and performance of U.S. subsidiaries in India.

Hypothesis of the Research

Based on the purpose of the study, the following hypotheses have been developed.

1. The investment policy of the U.S. subsidiaries in India is similar to that of their parent corporations.(Ho) The alternative hypothesis is that the investment policy of the U.S. subsidiaries in India is materially different from their parent corporations in the U.S.A.(Hi)
2. (a) The mean rate of return of all U.S. subsidiaries in India is similar to that of their parent corporations in the U.S.A.(Ho) The alternative hypothesis is that the mean rate of return of all U.S. subsidiaries is materially different from their parent corporations in the U.S.A.(Hi)
   (b) The business risk of U.S. subsidiaries in India is similar to that of their parent corporations in the U.S.A.(Ho) The alternative hypothesis is that the business risk of U.S. subsidiaries in

India is materially different from their parent corporations in the U.S.A.(Hi)

In other words, the evaluation of the investment policies and performance of U.S. subsidiaries in India will be based on an empirical search based on published financial statements for the similarities and differences between parent-subsidiary pairs. Because every subsidiary may in general be assumed to be similar to its parent in industry class and because the top management of each is identical (whether the parent has a controlling interest), one might propose there will be "no material difference." If differences are found (alternative hypotheses) explanations or evaluations of such differences will be attempted, Any differences in business and environmental risk would, of course, be important in such explanation. Other potential explanatory factors considered will include age of the subsidiaries, degree of ownership and management, industry, size of subsidiaries and other factors as brought out by the questionnaire survey and personal interviews.

Usefulness of the Study

The present study will be useful to the business community, government, teaching and research.

The study will provide some useful information to the U.S. corporations which have made investment or are planning to invest in India or other developing countries.

The present study would also provide some insights as how the adjustments for the price-level changes in subsidiary's country affect the reported performance of the foreign subsidiaries.

This study will provide a basis of reference for the Indian corporations which may compare and evaluate their own investment policy and performance in the context of the findings of the present study and may be able to determine their own level of efficiency. Indian corporations which are taking an active interest in establishing operations in Afro-Asian countries may find the experience of the U.S. corporations quite useful. The findings of the research may be of some interest to the financial executives of U.S. subsidiaries in India.

Both the U.S. and Indian Governments and the various international agencies may find this study quite useful as they are anxious to know that the corporations should make the best possible use of their resources in the interest of both countries.

Finally, the present research findings of this project would provide some insights to the teachers and students who are interested in the area of international operation of the foreign controlled companies in the developing economy. This can throw some light regarding the

differences in the investment policies and performance of business units in different environments.

Limitations of the Study

The present research has the following limitations.

1. The study is confined to the years 1963 through 1967. This period exhibits some special features of the Indian economy such as inflation, devaluation of monetary unit, recession, etc. The annual rate of growth of all industrial classes was down (Refer to Table 2.2).
2. The study was conducted only in the U.S.A. and no questionnaire was sent to the executives of the U.S. subsidiaries in India.
3. The chief criterion for the selection of U.S. subsidiaries working in India is the willingness of the corporations to participate in the study and to provide the annual reports. This limitation should be taken into account while evaluating the findings of the project (For details, refer to Chapter III).
4. The study covers only direct foreign investment by the U.S. corporations with at least 10% equity investment in one subsidiary. The subsidiaries with small investment (below 10%) have been excluded from the present study. This study also

does not include public capital, portfolio investment, government loans, aid and assistance. Moreover, the study does not discuss the impact of direct foreign investment on the balance of payment and the national economy.

5. The U.S. subsidiaries included in this research are engaged in the manufacturing and petroleum industries. The major U.S. investments are concentrated in these industries.

Organization of the Study

Chapter II describes, in brief, the environmental situations such as economic, political, financial, of the Indian economy along with the different policies and regulations affecting the foreign private investment in India. The main purpose of this chapter is to provide background information which may be halpful in understanding the materials developed in the later chapters.

Chapter III deals with the data collection. Primarily it describes the selection of participating subsidiaries and their size, ownership, management, nature of product, and age composition. A discussion of the questionnaire and personal interviews is also given in this chapter. This discussion is used in analyzing the investment policy and performance of the sample subsidiaries.

The annual reports of the U.S. subsidiaries have been reconstructed to facilitate the comparison. These

reconstructed statements of financial positions have been adjusted, on common currency basis, for the price-level changes which have been used as a basis for the next two chapters. This forms the subject matter of Chapter IV.

Chapter V examines the investment in assets, financial structure, and dividend policy of the U.S. subsidiaries and their policy is compared with their parent corporations. The information concerning the investment objectives and the application of the capital budgeting theory in the area of international business finance, obtained through the questionnaire and personal interviews with the executives of the parent corporations, is also presented in this chapter.

Chapter VI deals with the performance (return and risk) of the U.S. subsidiaries. The first part describes the rate of return of the U.S. subsidiaries and another part examines the business risk, as measured by the variability of the rate of return, associated with the investment. The performance of the U.S. subsidiaries is compared with that of their parent corporations. The last part discusses the environmental risks associated with U.S. investment in India.

A summary of the main findings of the study is presented in Chapter VII.

CHAPTER II

INDIAN ECONOMY--PROBLEMS AND PROSPECT

The main purpose of this chapter is to provide background materials on the Indian economy so that the reader may be able to understand the important environmental situation in India. This may be helpful in the later chapters to examine and evaluate the investment policy and performance of the U.S. subsidiaries in India. The present chapter is based on the information collected from library research. The chapter is divided into two parts. The first part discusses the economic, political and financial situations in India. The second part describes the various policies and regulations of the government affecting the foreign private investment in India.

PART I

(1) Economic Situation

1.1 Introduction

With the attainment of political independence in 1947, the Government of India encountered acute problem of the economic development of the country. This problem

was greatly aggravated due to the weak and imbalanced economic development of the country during British rule and partition of the country and its severe repercussion on the economy. To solve these problems, the Government of India decided to follow a systematic and orderly economic development of the country, and hence set up a Planning Commission in 1950 to formulate the Five-Year Plans for the country.

The Planning Commission followed the Directive Principles of State Policy as laid down in the Constitution of India for the economic and social welfare of the country. The main objectives of planning in India are to utilize the resource, human and materials, in the most planned and effective ways and thereby to raise the standard of living of people and to reduce the inequalities of income, wealth and opportunities.[1] The circumstances and reasons for the acceptance of planned development by the Government of India after independence have been described by an American economist.[2]

(1) That the Indian Government has a politically inescapable responsibility for leading the development efforts;

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[1]Planning Commission, Government of India, First Five-Year Plan, 1952, pp. 7-11.

[2]John P. Lewis, Quiet Crisis in India, (Garden City, New York: Doubleday & Company, Inc.) 1964, p. 123.

(2) that it has to provide a growth perspective, fill decision-making gaps and supply infrastructure;

(3) that consequently it must try to do what it does in a way that seeks an optimal allocation of the economy's scarce resources;

(4) that Indian markets have a variety of infirmities that make them unacceptable as the economy's dominant allocative machinery during its period of accelerated development; and

(5) that the Government has a resultant obligation to run an allocative system that implements the development goals in a coherent, internally consistent machinery while, at the same time, stimulating, not impairing, idle resource activation and private productive energies.

Because of the above reasons, the Government of India emphasized the dominant role of the public sector in the Indian economy. But this does not mean that the private sector plays insignificant role in the economic development of the country. In 1960-61, the net output of the private sector was 89.7% of the net domestic product and only 10.3% was contributed by the public sector. The country further reemphasizes the role of private sector in the Third Plan.

> In the context of the country's planned development, the private sector has a large area in which to develop and expand, functioning always within the framework of national planning and with an understanding of obligations towards the community as a whole.[3]

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[3]Planning Commission, Government of India, Third Five-Year Plan--Summary, Delhi, p. 3.

The public and private sectors are supplementary and complementary to each other. Thus the government intends to develop a mixed economy where the public and private sectors coexist each with its own objectives, motivations and method of operation.

1.2 Five-Year Plans

The first Five-Year Plan started in 1951 and the country has already completed three Five-Year Plans. In view of the difficult resource position and adverse economic situation, the Fourth Five-Year Plan scheduled to start in April 1966 was postponed for three years and was launched in April 1969.

1.2.1 First and Second Plans (1952-1961) and their Achievements.--The main objective of the First Plan was to lay down a strong and sound base for the future economic development of the country and hence greater emphasis was placed on the agricultural development and irrigation projects. The Second Plan laid emphasis on the development of basic and heavy industries. The total investments during the two plans amounted to Rs. 101 billion, i.e., Rs. 52 billion in the public sector and Rs. 49 billion in the private sector. Out of the total outlays of the public sector, 90% of the total in the First Plan and 76% of the total in the Second Plan were raised from the internal sources and the remaining amount came from external sources.

During the first two plans, the national income increased by 42% but the increase in the per capita was only 16% due to the growth of the Indian population. Agriculture production increased by 41% whereas the industrial production registered an increase by 94%. During this two-plan period, the country witnessed a substantial growth in number of various industries. The country set up big steel mills, heavy electrical, heavy engineering and machine tools, chemicals and many other industries. The index number of industrial production increased from 100 in 1950-51 to 194 in 1960-61. Some of these achievements are given in Table 2:1.

1.2.2 Third Five-Year Plan (1962-1966).--The main objectives of the Third Plan were (1) to secure an increase in the national income of over 5% per annum; (2) to achieve self-sufficiency in food grains and increase in agricultural production to meet the requirements of industry and export; (3) to expand basic and heavy industries so that the requirement of further industrialization could be met; (4) to utilize to the fullest possible extent the manpower resources of the country and to insure a substantial expansion in employment opportunities; and (5) to establish progressively greater equal opportunities and to bring about a reduction of disparities in income and wealth.[4]

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[4] Ibid., p. 17.

Table 2:1.--*Selected economic indicators of India.*

Item	1950-51	1955-56	1960-61	1961-62	1962-63	1963-64	1964-65	1965-66	1966-67	1967-68
	1	2	3	4	5	6	7	8	9	10
1. Population (millions)	361.09	-	439.23	453.41	464.53	475.53	486.99	498.86	-	-
2. Net National Output (at 1948-49 prices) (Rs. 1000 million)	88.5	104.8	127.3	130.6	133.1	139.7	150.5	-	-	-
3. Per Capita Income (at 1948-49 prices) (in rupees)	247.5	267.8	293.2	294.3	293.4	301.1	317.0	-	-	-
4. Industrial Production (General Index 1956=100)	73.5	91.9	130.1	141.0	152.6	165.8	177.0	186.9	191.6	-
5. Agricultural Production (1956=100)	95.6	116.8	142.2	144.8	137.4	142.4	158.4	131.7	-	-
6. Wholesale Prices (1952-53=100)	-	92.5	124.9	125.1	127.9	135.3	152.7	165.1	191.2	212.4
7. Consumer Prices (1949=100)	101	96	124	127	131	137	157	169	191	213
8. Money supply with the public (Rs. 10 million)	2016.0	2217.0	2868.6	3045.8	3310.0	3752.1	4080.3	4529.4	4953.8	5351
9. Foreign Exchange Reserve (Rs. 10 million)	1029.2	902.4	303.6	297.3	295.1	305.8	249.7	298.0	478.4	-
10. Trade (Rs. 10 million)										
a. Import	650.2	779.2	1121.6	1091.6	1131.5	1222.8	1349.0	1410.1	207.7	1950
b. Export	600.6	608.9	642.1	660.6	685.3	793.2	816.3	805.7	115.6	1197
c. Net Balance of Trade	-49.6	-165.4	-479.6	431.0	-448.2	-429.6	-532.7	-604.5	-92.1	-753

Source: Report on Currency and Finance, 1966-67 and the Reserve Bank of India Bulletins (Monthly) 1967-68.

The total outlay of the Third Plan was Rs. 104 billion--Rs. 63 billion for the public sector and Rs. 41 billion for the private sector. Thus the total outlays of the Third Plan was bigger than those of the First and Second Plans put together. The achievements of the Third Plan and the various problems encountered during this period have been described, in detail, under the caption 'Major Economic Development During 1962-67.'

1.2.3 Fourth Five-Year Plan.--In order to assess the various difficulties and problems experienced by the country during the period of Third Plan, the Government of India decided to postpone the commencement of the Fourth Plan for a period of three years. In April 1969, the Fourth Plan was started as 'growth with stability' the main aim of the Plan. The Fourth Plan expects a growth rate of 5% and 8-10% per annum, respectively, in the agricultural sector and industrial sector during the Fourth Plan period.[5]

1.3 Major Economic Development (1962 to 1967)

The Indian economy witnessed, during these six years, a number of significant and unexpected changes and developments unparalleled in the history of the country's

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[5]Planning Commission, Government of India, Approach to the Fourth Five-Year Plan, (New Delhi) May 1968, p. 1.

planned economic development. The whole period was marked with the various stresses and strains, one after another, on the Indian economy.

The major events of the Indian economy during this period may be summarized as stagnation in the agricultural production and acute food shortage due to severe drought for the two successive years (1965 and 1966), Chinese aggression in 1962 and border conflict with Pakistan in 1965, substantial increase in money supply due to increase in government expenditure on defense and development, continuous drain on froeign exchange reserve of the country and devaluation of Indian currency on June 6, 1966, suspension of foreign aid by the major countries, recessionary trend in the industrial production, continuous pressure on the general price level, etc. The following discussion is based on Table 2:1.

1.3.1 Price Level.--The index number of wholesale price increased from 125.1 in 1961-62 (1952-53 = 100) to 212.4 in 1967-68, i.e., an increase of about 72% in these years. The increase has been continuous throughout these years. Moreover, the rise in the index of food articles was higher than that of the increase in the index of wholesale prices. The same inflationary trend was noticeable in the case of consumer prices and the index of consumer prices increased from 127.0 in 1961-62 (1949 = 100) to 213.0 in 1967-68.

1.3.2 Agricultural Production.--Although India is trying to industrialize as soon as possible agriculture is still the mainstay of two-thirds of the population. Moreover, agriculture and allied activities provide half of the national income of the country. Besides this, it provides raw materials for some industries and is an important source of exports. Despite its critical position, the agricultural outputs could not increase and it was more or less stagnant during these years. The index of agricultural production declined from 144.8 in 1961-62 (1950 = 100) to 137.4 in 1962-63. In 1963-64 it showed a recovery trend but this trend, however, could not continue for a long time. In 1965-66 the agricultural outputs were the lowest since 1960-61 (Table 2:1). The situation improved in the later part of 1967-68. The stagnation was mainly due to the less emphasis placed on the agriculture in the Second Plan and the failure of monsoon for the successive two years (1965 and 1966).

1.3.3 Industrial Production.--An examination of the index number of the rate of growth of industrial production reveals that the annual rate of growth in industrial production showed a declining trend since 1963. Between 1961 and 1963 the rate of growth was between 8.4% and 9.4%. From 1964 it started decreasing and reached to the lowest point of 1.4% in the year 1967.

Among the major industrial groups, the rate of growth in Basic Industries declined from 15.5% in 1962 to 2.8% in 1964. In 1965, it showed a recovery trend but again decreased to 2.1% in 1967. The rate of growth of Capital Goods increased from 9.0% in 1961 to 24.4% in 1964 and declined to 1.0% in 1967. In the case of Intermediate Goods the fall in the growth rate of output was gradual, i.e., 8.8% in 1962 to 5.4% in 1965, thereafter it declined sharply to 1.3% in 1966. However, it showed a recovery trend in 1967. The growth rate in the case of Consumer Goods fluctuated widely, i.e., an increase from 2.2% in 1962 to 7.5% in 1964 and then declining to -3.5% in 1967. Table 2:2 shows this picture.

Table 2:2.--Annual rate of growth in industrial production in India, 1961-67 (in percentages).

Year	All Industries	Basic Industries	Capital Goods	Intermediate Goods	Consumer Goods
1961	8.4	12.7	9.0	4.5	7.5
1962	8.4	15.5	16.6	8.8	2.2
1963	9.4	14.5	13.5	8.4	5.4
1964	6.3	2.8	24.4	7.4	7.5
1965	5.8	6.0	10.6	5.4	3.4
1966	2.4	5.2	2.2	1.3	0.7
1967	1.4	2.1	1.0	8.9	-3.5

Source: Reserve Bank of India Bulletin, July 1968, p. 863.

The decline in the production of industrial goods is mainly due to the fall in agricultural production causing a fall in the output of agro-based manufacturing industries and the decline in the import of raw materials needed for some major industries. The slow-down of investment in the public sector also affected, to some extent, the growth of industrial production. But the impact of these factors was not uniform in all the industries. Some industries suffered to a greater extent than the others.

1.3.4 Money Supply.--The money supply with the public increased from Rs. 30.4 billion in 1961-62 to Rs. 53.5 billion in 1967-68, i.e., an average increase of Rs. 3.3 billion in each year (Table 2:1). The increase in the money supply was mainly due to the greater increase in the government expenditure on defense after the Chinese aggression in 1962 and the border conflict with Pakistan in 1965. The increase in the government expenditure on the developmental activities was also responsible for the substantial increase in the money supply.

1.3.5 Balance of Payment.--The imports of the country increased from Rs. 10.9 billion in 1961-62 to Rs. 20.7 billion in 1966-67 whereas the export could not increase substantial. It increased from Rs. 6.6 billion in 1961-62 to Rs. 11.5 billion in 1966-67 (Table 2:1). The volume of imports increased because of the import of

substantial foodgrains to meet drought situation and the much needed machinery and raw materials for the industrialization of the country. Thus, the net balance of trade was always deficit in these years and this had a continuous pressure on the foreign exchange reserve of the country. The reserve declined from Rs. 10.2 billion in 1950-51 to Rs. 2.9 billion in 1965-66. In 1966-67, it increased to Rs. 4.7 billion (Table 2:1).

To promote the exports of the country, the government adopted many promotional measures but their over-all result was not encouraging and hence the government decided to devalue the Indian currency by 36.5% on June 6, 1966. The devaluation of the currency intensified the inflationary pressure on the economy. To meet the above situation the Government of India took a number of corrective steps to create a condition in which steady planned growth with relative financial stability could take place. The important measures include the postponement of Fourth Plan, decrease in deficit financing, abolition of food subsidies to state governments, economies in budgetary expenditure, etc. During the closing months of 1967, the Indian economy started showing the signs of recovery. The unexpected good harvest of foodgrains and a fall of 6% in the general level of price have provided a right environment for the recovery of the Indian economy.

(2) Political Situation

Since the attainment of political independence in 1947, India adopted the democratic form of government. The country had four general elections, i.e., in 1952, 1957, 1962 and 1967. In each general election the voters have shown increasing interest in the democratic system and the turnout of the voters increased from 45% in first general election to 46.6% in second, 55.4% in third and as high as 61% in last general election.

Prior to the fourth general election, the country has a strong and stable government both at national and state levels. The political scene of India has significantly changed in 1967 as a result of the fourth general election. The politically dominating and the ruling party of the country since the independence, the Congress Party, suffered an unprecedented setback in this election and its majority has been significantly reduced at the national level and in the many states it could not form the government. In some states, a coalition of opposition parties formed the government but there is lack of cohesion in non-Congress groups. Besides the Congress Party, there is not a single strong opposition party which can be considered as the alternative to the Congress Party.

The above situation has provided instability to the Indian political system and doubts are being expressed regarding the very basic foundation of the Indian democracy.

But there are certain inherent and orderly factors in the Indian democracy which continue to provide basic strength.

> First and most elementary is a majority party in parliament which has enabled the Congress ministry to provide at least minimal stability at the national level. The Union government and the parliament, as a consequence, have been able to respond to crises at the state level within the constitutional framework. Second, the federal framework has provided viable despite the stresses exacerbated by the weaking of the Congress Party and non-Congress governments at the state level. Finally, and most important, is the underpinning to the system provided by the maintenance of democratic values for coping with political problems.[6]

Some political scientists feel that the fourth general election has made a real contribution to the Indian democracy and is considered the 'second Indian revolution' which will be embedded in the end in a party or parties with popular appeals which the Congress Party is losing but which other parties have not yet been able firmly to obtain.[7]

There are others who feel that the fourth general election has given uncertainty to the political situation in India. Norman D. Palmer, an expert on the Indian political situation, feels that "as the Indian political experiment enters a new phrase portents of trouble ahead and

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[6]Paul Wallace, "India: The Leadership Crisis," Asian Survey (Berkeley, California), February, 1969, Vol. IX, No. 2, p. 80.

[7]Eric da Costa, "Poll Results Hearald Second Indian Revolution," The Statesman, March 9, 1967.

signs of an increasingly effective participatory democracy appear in kaleidoscopic confusion, giving an atmosphere of uncertainty and excitement to the changing Indian scene."[8]

Besides the instability of government at the state level, there are other political problems which India is facing. Among these, the most important may be mentioned the regional differences among the people of India, occasional communal disturbances, conflict between the industrial labor and the management, language difference and controversy, etc. The Chinese aggression in September 1962 and the border conflict with Pakistan in September 1965 have provided another dimension to the political situation of the country. Despite these problems, India is able to stand these pressures, because India's leadership is among the most sophisticated in the economically underdeveloped world and its intellectual elite the largest. The Indian Civil Service (now Indian Administrative Service) has a proud, if paternalistic, tradition of competence and integrity. . .the present level of administrative morality and reliability is far above average for an underdeveloped country.[9]

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[8]Norman D. Palmer, "India's Fourth General Election," Asian Survey, May 1967, Vol. VII, No. 5, p. 291.

[9]John P. Lewis, op. cit., p. 4.

(3) Financial Situation

Since the achievement of the political independence in 1947 and particularly with the greater emphasis on the industrialization in the Five-Year Plans, the country has been facing the difficult problem of raising adequate funds to meet financial requirements of industry. A brief description of Indian capital market would provide some idea about the situation.

3.1 Indian Capital Market

The Indian capital market can be broadly divided into three parts, i.e., organized sector, semi-organized sector and unorganized sector. The organized sector comprises well-developed banking system, stock exchanges, financial institutions, etc., whereas the unorganized sector consists of indigenous banking system and money lenders. The semi-organized sector includes cooperative banking and other agencies.

The unorganized sector of the Indian capital market was more or less isolated from the organized sector for a long time but the growing cooperative credit organization in semi-organized sector is becoming the connecting link between the organized and unorganized sections of the capital market. The organized sector of the Indian capital market is well-developed and "the organization of the Indian capital market does not compare unfavorably with

that of some of even the developed countries. . . ."[10] The Indian joint stock companies (including foreign subsidiaries) mainly deal with the organized section of the capital market.

3.1.1 Banking System.--The Indian banking system consists of the Reserve Bank of India (central bank of the country), the State Bank of India (a government-owned commercial bank) and a large number of the "scheduled" and "non-scheduled" banks (as defined below).

The Reserve Bank of India is the central bank of the country and its primary function is to regulate monetary system of the country so as to promote stability and growth of the economy within the framework of the government's general economic policy. The over-all functions include regulation of currency and credit, supervision and control of banks, acting as the bank of government, operation of foreign exchange control, etc.

The State Bank of India started as a private bank but was nationalized by the government. Now government-owned, it is the largest commercial bank and has more than 500 branches all over the country. It accounts for about 30% of the net deposits of all scheduled banks.

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[10]George Rosen, Some Aspects of Industrial Finance in India, (The Free Press of Glencoe) 1962, p. 1.

The scheduled banks are those banks which are included in the 'Second Schedule' of the Reserve Bank of India Act. The conditions for a bank to be included are (1) that it should have a paid-up capital and reserves of an aggregate value of not less than Rs. 500,000; and (2) that it should satisfy the Reserve Bank that its affairs are not being conducted in a manner detrimental to the interest of its depositors. The scheduled banks including State Bank conduct almost all the banking business in India and account for 90% of total deposits of all the scheduled banks (including State Bank) of India. The remaining 10% is the share of foreign scheduled banks in India. Some of the scheduled banks are fairly large having branches all over the country. Recently the government of India has nationalized 14 biggest scheduled banks (excluding foreign banks) of the country. Besides these banks, there are a large number of non-scheduled banks. These are small banks and operate mainly in the small towns.

The banking system in India is primarily modelled on the lines of British banking system and these banks provide mainly short-term finance to the industries. With improvement in financial situation of the country, the banks are showing an increasing interest in providing medium and long term finance to the industries. The share of borrowing from banks as percentage of external sources has

increased from 35.7% in 1961-62 to 49.5% in 1965-66,[11] but most of these finances are in the form of short-term loans which are normally renewed beyond one year. It is gratifying that under the pressure of industrial demand and better financial situation in the country, the commercial banks are modifying their traditional practices.

3.1.2 Financial Institutions.--Due to the inability of the commercial banks in India to provide long-term loans for industrial financing, a network of financial institutions has been developed to fill the gaps in the supply of long-term finance to the industry. These institutions have been set up both by government and private enterprise. These institutions provide long-term finance and other financial facilities to Indian joint stock companies and foreign subsidiaries incorporated in India. The important financial institutions in the field of long-term financing are (1) Industrial Finance Corporation of India, (2) State Finance Corporations, (3) Industrial Credit and Investment Corporation of India, (4) National Industrial Development Corporation, (5) Refinance Corporation for Private Ltd., (6) Unit Trust of India and (7) Industrial Development Bank of India. These institutions were set up after independence.

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[11]Reserve Bank of India, "Finances of Indian Joint Stock Companies, 1965-66," Reserve Bank of India Bulletin. December, 1967, p. 1531.

The main purpose of these financial institutions is to provide or guarantee medium and long-term finance for new industrial enterprises and/or for the expansion of existing ones. Besides this, some institutions also underwrite the issue of securities of the companies. These financial institutions have provided finance, not only to the Indian joint stock companies but also to the foreign subsidiaries working in India. Moreover, an amount of finance provided by these financial institutions to the companies has resulted in attracting a much larger volume of finance from the other sources and especially from the international financial agencies.

These institutions have, no doubt, contributed the much needed funds to many industries but have been always cautious about the security of their finance and have not taken sufficient risk in providing the finance. This aspect of the financial institutions has been adequately described by George Rosen.

> It is important . . . to realize that they are development institutions, that they exist to take risks which ordinary banks will not take, and that as risk-takers they not only may but also probably will have some losses. Their primary purpose is not security, and they should be relatively free from detailed legislative interference in their operations so that they will take the risks they are suppose to take.[12]

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[12]George Rosen, Op. cit., p. 106.

3.1.3 Life Insurance Corporation.--The Life Insurance Corporation was set up in 1956 after the nationalization of all the life insurance companies in India. With the increase in the sources of funds of the L.I.C., its investment in the industry is increasing rapidly--and the L.I.C. has emerged as the single largest investor in the corporate sector. Besides its primary investment in the government securities, the L.I.C. invests in the joint stock companies. About 60% of its total industrial holdings are concentrated in four industries, i.e., electric power, engineering, cotton textile and iron and steel industries. Moreover, it prefers to invest in the large and well-established industries. The L.I.C. also helps the company by underwriting the shares and securities.

3.1.4 Foreign Sources of Capital[13].--Besides the various sources of capital in the Indian capital market, there are a number of international sources of capital which are available to foreign investors interested in investing in foreign countries. The international financial institutions such as International Bank for Reconstruction and Development, International Finance Corporation and International Development Association provide finance to foreign corporations operating in foreign countries and also to the corporations of these countries.

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[13]For a detailed discussion, see Marina Von Neumann Whitman, Government Risk-Sharing in Foreign Investment, (Princeton, New Jersey: Princeton University Press) 1965.

The U.S. Government provides finances to the foreign countries either through the U.S. corporations operating in these countries or directly to the public or private enterprises of the foreign countries. These finances are channelled through three U.S. Government agencies: Export-Import Bank of Washington; Agency for International Development; and Cooley Fund (P.L. 480).

Most of the loans made available to the foreign investors by the U.S. lending institutions are provided in dollars and these dollars are generally used for the procurement of raw material, plant and machinery from the U.S.A. In order to meet the local costs of firms in foreign countries, the Congress passed in 1957 the so-called 'Cooley Amendment' to the Agricultural Trade Development and Assistance Act of 1954 (P.L. 480). Under the P.L. 480, sales proceeds of the U.S.A. surplus agricultural commodities in the particular foreign country are made available to the private enterprises in the form of local currency loans. These loans are mainly provided to the U.S.A. firms and their branches, subsidiaries or affiliates for business development and trade expansion. The loans are made and repayable in the local currency of the country. The interest rates and the maturity of these loans are similar to that of the country concerned.

3.1.5 Stock Exchanges.--There are eight officially recognized stock exchanges in India located in Bombay,

Calcutta, Madras, Ahmedabad, Delhi, Indore, Hyderabad and Banglore. The stock exchanges are regulated under the Securities Contracts (Regulation) Act, 1956. The Bombay Stock Exchange has been granted permanent recognition whereas the other Exchanges get official recognition for a period of five years. The Bombay and Ahmedabad stock exchanges were started before the end of the 19th century and the Calcutta, Indore and Madras exchanges were in existence before the start of World War II. The Delhi and Banglore stock exchanges were set up in 1947 and 1957 respectively.

The number of public limited companies listed on the recognized stock exchanges have increased from 1,125 (or 11%) public limited companies in 1948 to 1,547 (or 24% of the total public limited companies) in 1966. In other words, one out of every four public limited companies was listed on the stock exchanges. The large companies are listed on one or more exchanges. Amongst the eight recognized stock exchanges, the Bombay, Calcutta and Madras exchanges are quite big and the listed companies on these three exchanges represent 50% of the total capital of all the public limited companies in India.

There has been significant change in the pattern of the ownership of corporate shares during the period 1959 and 1965. The ownership of shares by the financial institutions has increased in 1965 as compared to the year

1959. As against this, the individual ownership has declined during this period.[14] This change is mainly due to the steps taken by the government to strengthen the institutional investors in the capital market by setting up of the Industrial Finance Corporation, State Finance Corporations, Unit Trust of India, Industrial Development Bank of India, etc. Moreover, the setting up of Life Insurance Corporation by nationalizing the life insurance companies has emerged as the single largest financial investor in the Indian capital market.

3.1.6 Managing Agency System.--The managing agency system was introduced by British investors to manage their subsidiaries in India after the termination of the East India Company's monopoly trade with India. Due to the lack of sufficient number of managerial personnel, British companies established agency houses to manage a group of concerns on their behalf. Later on the Indian firms also adopted the managing agency system. Under this system, an individual, a partnership firm or a body corporate undertakes to manage another company. With the passage of time, the managing agencies began to represent more than one principal and acted in many capacities such as promoters, issue houses, underwriters, and bankers for the managed

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[14]Reserve Bank of India, "Survey of Ownership of Shares in Joint Stock Companies at the end of December, 1965," Reserve Bank of India Bulletin, February, 1968, p. 145.

companies. They also stood guarantor to the other financial institutions and financiers.

These managing agencies had been very influential in shaping the development of many industries. Because of their managerial skill and strong financial position, they influenced the Indian capital market. The main contributions of the managing agencies in India may be described as the initiation and promotion of many new industries; providing financial resources to the managed companies and other companies; managing the company's affairs as a professional executives; and standing as guarantor to the outsiders for obtaining finance for the company.

Besides their contribution to the development of many industries in India, the managing agency system is also responsible for many malpractices introduced in the management of the companies. They charged high remuneration and office allowance fees for their services and high commission on sales and purchases; invested the managed company's funds for speculative purposes; paid insufficient attention to the right of shareholders; and concentrated the managerial power in their hands. To minimize these defects, the government introduced strict regulations from time to time, on their appointment and tenure, their remuneration, their power of management, etc.

PART II

Government Policies and Regulations Affecting Foreign Investment

The Government of India has formulated various policies and regulations affecting the operation of enterprises including foreign private enterprises in India. The policies describe the general framework of industries, nature of foreign ownership, possibility of remittance of profit, tax incentives, import and exports of goods, etc. The government also uses many regulatory measures such as industrial licensing, foreign exchange control, new capital issues, etc. to influence the activities of the foreign private enterprises.

(1) Industrial Development Policy

The industrial policy of the country is based on the Industrial Policy Resolution of 1948 which was later modified in April, 1956 at the start of the Second Five-Year Plan. The Industrial Policy Resolution of 1956 classifies all the industries into three categories.

The first category includes arms and ammunition, atomic energy, iron and steel, heavy engineering and heavy electrical plants, coal, oil, most mining, aircraft, air transport, railways, ship building, communication, and electrical generation and distribution. The public sector will have the exclusive responsibility for their future

development. The existing private sector in these industries is permitted to continue and may be allowed to expand if considered necessary in the national interest of the country.

The second category includes some mining, aluminum, machine tool, ferrous alloys and tool steels, heavy chemicals, essential drugs, fertilizer, synthetic rubber, and road and sea transport. These industries will be progressively state-owned and in which the state will generally take the initiative in establishing new undertaking but in which private sector is also expected to supplement the effort of the state.

The third category includes all the residual industries whose future development will, in general, be left to the initiative and enterprise of the private sector.

The above classification of the industries should not give the impression that there is a clear-cut demarcation for the setting up industry by public and private sectors. The above division is of general nature and there is no rigid policy for their execution.

> The fact is, however, that the rigid categories and austere phrases of the Industrial Policy Resolution of 1956 in no sense adequately indicate the present disposition of the Indian government toward organized private enterprise. In practice the scope for private expansion is subject to compromise.[15]

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[15]John P. Lewis, op. cit., p. 223.

The economic needs, foreign exchange shortage and national interest of the country have influenced the industrial policies in practice.

It is rather difficult but not impossible to get permission for the establishment and expansion of private enterprise in the first category. The government has already given permission for the expansion of the two private steel companies. Moreover, the government has also allowed foreign collaboration for oil refineries and heavy electrical equipments falling in the first category considered to be necessary in the national interest of the country. In the second category also, there are many cases where the government has allowed the private sector to set up industries such as synthetic rubber, fertilizer, aluminum, etc., with foreign collaboration.

The government has followed a pragmatic approach toward the setting up of industries in the private sector. It has augmented credit facilities to the private sector and has allowed the private sector to operate their business without much control and has a fine reputation of not nationalizing the private sector enterprises.

(2) Foreign Investment Policy

After the attainment of political independence in 1947, the Government of India realized the greater need for the foreign capital. The need was expressed from time to

time in the various statements. The industrial policy statement of 1948 incorporated some of these expressions but the major policy regarding the foreign investment was expressed by the then Prime Minister of the country in his statement on foreign capital to the Indian Parliament on April 6, 1949. This statement proved to be the backbone of India's foreign investment policy. The statement points out the six important elements of this policy.

(1) There would be no discrimination in the treatment of domestic and foreign enterprises and all would have to conform to the industrial policy of the country.

(2) Foreign enterprise would be permitted to earn profits subject only to regulations common to all.

(3) There would be no restriction on the remittance of profit or repatriation of capital but remittance facilities would naturally depend on the foreign exchange situation.

(4) If the foreign interests come to be compulsorily acquired, compensation will be paid on a fair equitable basis and reasonable facilities will be provided for the remittance of the proceeds.

(5) The major interest in ownership and effective control of an industrial undertaking should, as a rule, be in Indian hands.

(6) Indians should be trained and employed in managerial and technical posts as quickly as possible.

On the basis of the above statement, the Government of India developed the various qualifications for the acceptance or rejection of the foreign investment projects. These qualifications have been mentioned in different documents and statements and have not been incorporated in any

single document which may be cited as the official document on the foreign investment policy of the Government of India.

The specific qualifications for the acceptance of the foreign investment projects are that the foreign investment projects must set up manufacturing units in India; their products should be considered important for the economy of the country; and the project should be able to produce such goods which either act as import substitution or encourage export and thereby should be able to meet the foreign exchange requirements of the country. Thus India seeks foreign investment especially in those areas which would help speed the attainment of the Five-Year Plan targets and which at the same time would not impose undue strains on the country's foreign exchange reserve.

When the foreign investment agrees to the above broad qualifications, the negotiations between the different groups are carried out, and plans are submitted to the Government of India for the final approval. The government has developed a long procedure for the scrutinizing and screening of these foreign investment projects. It has been particular regarding the manufacturing scheme of the foreign investment projects and in many cases foreign firms with modest manufacturing scheme have not been permitted to set up the project.

Since the beginning of the Second Plan, the Government of India encouraged joint ventures between the foreign and the Indian firms and insisted that the foreign collaboration should cover all the foreign exchange costs of the project. The main reason behind this attitude was to put less strain on the already adverse balance of payment position. The foreign joint ventures were also attractive to the Indian partners who cannot start the new industry requiring foreign plant and machinery without approaching the government for the release of foreign exchange. The best and only alternative to them was to collaborate with the foreign enterprise and meet the requirement of imported plant and machinery. Moreover, the foreign firms also prefer to collaborate with the Indian firms so as to meet the various local requirements better known to the local firms.

Thus the economic need of country, acute shortage of foreign exchange, adverse historical experience with the British foreign investment and the nationalistic attitude of the political parties have greatly influenced the foreign investment policy of the country in the initial period of its economic development. However, the initial good experience of working with many foreign investors, favorable impact of foreign private investment on the economy, receptive attitude of the government and the greater need for the foreign capital in some industries encouraged

the Government of India to take some encouraging steps towards liberalization of the foreign investment policy. A significant step was to allow majority ownership in some industries and to relax the import controls for the import of components, spare parts and raw materials for top priority industries.

(3) Corporate Taxation Policy

Taxation policy may be considered as an important factor in attracting foreign investment. There are different views on this subject. Some experts feel that tax incentives are of paramount importance for foreign investors[16] while others think that taxation does not affect their foreign investment decision.[17] It is beyond the scope of the present research to examine and evaluate this controversy. In this part, only those aspects of Indian corporate taxation have been discussed which affect foreign subsidiaries.

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[16]Anant R. Negandhi, Private Foreign Investment Climate in India, (Graduate School of Business Administration, Michigan State University, East Lansing, Michigan, 1965) pp. 69-71.

[17]Judd Polk and others, U.S. Production Abroad and the Balance of Payments, (New York: National Industrial Conference Board, Inc., 1966) p. 51; E. R. Barlow and Ira T. Wender, United States Tax Incentives to Direct Private Foreign Investment, (Cambridge, Mass: Harvard Law School, 1954) p. 4.

3.1 Tax Liability of Joint Venture Companies[18]

The tax liability of a company depends upon whether it is a domestic company or a foreign company; whether it is a widely-held company or a closely-held company; and whether it is an industrial company or a trading or service industry. A domestic company, under the Income Tax Act has been defined as a company which has made arrangement for the declaration and payment of dividends within India. Thus if a foreign subsidiary is incorporated in India and declares and pays dividends in India, it is treated as a domestic company for the purpose of Indian taxation. A foreign company is one which does not declare and make payment of dividends in India.

The latest rates of income tax on companies in respect of income other than capital gains are as follows:

	Rate of Tax
1. Domestic company in which public are substantially interested (i.e., widely-held corporation including the wholly-owned subsidiaries of such company)	
(a) if the total income does not exceed Rs. 50,000	45% of the total income
(b) if the total income exceeds Rs. 50,000	55% of the total income

[18] It is based on Indian Investment Centre, Taxes and Incentives, (Delhi: Indian Investment Centre, June, 1968).

	Rate of Tax
2. Foreign companies which have not made prescribed arrangements for declaration and payment of dividends within India	
(a) on the income consisting of royalties and technical services fees received for an Indian concern, where such agreement has been approved by the Government .	50% of the total income
(b) on any other income included in the total income	70% of the total income

3.2 Surtax on Company

Under the provisions of the Companies (Profit) Surtax Act 1964, a company pays surtax on its 'chargeable profits.' The surtax rate on its 'chargeable profits' is 35% of the profits exceeding Rs. 200,000 or a sum equal to 10% of its capital (as determined under the provision of the Surtax Act) whichever is greater.

The income of non-resident corporate investors derived from dividend, interest on loans, royalties and technical fees are not included in 'chargeable profits' and hence are exempted from surtax. Therefore, the incidence of surtax on foreign corporations are negligible.

3.3 Tax on Capital Gains

No capital gains tax is levied on the transfer of short-term capital assets because such income is treated as ordinary income. The transfer of capital assets other

than the short-term assets are treated as capital gains. There are two rates. The capital gains derived from the sales of buildings or land or any rights in the buildings or land are taxed at the rate of 40% whereas in the case of other capital gains the rate is 30%.

3.4 Tax on Intercorporate Dividends

The parent company and its subsidiaries are treated as separate entities under the Income Tax Act. When a parent company receives dividend from its subsidiaries, it has to pay tax on such dividends. But the tax rate is lower than on any other type of income. If the foreign investor is a company, the effective rate is 24.5% of the dividends received from a domestic company.

3.5 Statutory Ceiling on Corporate Taxes

Recently the Government of India has introduced a statutory ceiling on corporate taxes. According to this ceiling, the total tax liability (income tax plus surtax) should not exceed 70% of the total income of a widely-held domestic company whose paid-up equity capital is not less than 25% of the amount of its capital (including reserve) as ascertained for the purpose of surtax. Any excess liability over the 70% is allowed as a reduction in surtax payable by the company.

3.6 Special Tax Incentives

Even though the Government of India has introduced a statutory ceiling on the tax rates, the effective rate of tax on corporation is lower than the actual tax rates mentioned above. This is mainly due to the various tax incentives and tax credit certificates provided under the Indian tax system. For instance, domestic companies engaged in 'priority' industries are allowed a deduction of a sum equal to 8% of the profits for tax purposes. A special deduction for development rebate is allowed which may be up to 30% of the cost of new plant and machinery for 'priority' industries. The new industrial firms get a tax holiday benefits for five years up to 6% of the capital employed. There are a number of other deductions such as additional depreciation allowance for extra shift work, capital expenditure on scientific research, etc. There are as many as 28 tax incentives. Besides these tax incentives, there are other tax benefits in the form of tax credit certificates granted to the taxpayers for their performance in the field of production.[19] The overall impact of these tax incentives and tax credit certificates is to minimize the tax burden on the investors. In the first five years of its working, the effective tax rate in the case of such new industrial company (widely-held

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[19] Taxes and Incentives, op. cit., pp. 49-54.

domestic industrial company engaged in priority industry) may vary from 37.82 to 40.06% inclusive of income tax, surtax and dividend tax.[20]

(4) Import and Export Policy

4.1 Import Policy

The shortage of foreign exchange and the greater need for the import of raw materials, plant and equipment from foreign countries for the rapid industrialization of the country necessitated the Government of India to allocate the foreign exchange in the best possible manner. To meet this situation, the government followed a restrictive import policy and granted quotas to the established importers for the imports of items of special importance for the economy or items which had an export promotion angle.

Thus the main emphasis had been to keep down imports to a minimum possible extent. No import license was given if there was adequate production of the same or similar goods in India. Moreover, the government always encouraged the importers of the goods to make arrangements for providing foreign exchange either through investment from overseas in the form of equity or import of plant and machinery or long-term loans in foreign currency. In many

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[20] Indian Investment Center, Why Invest in India? (New Delhi: Indian Investment Centre, March 1967) p. 21.

cases, the machinery and equipment were supplied by the foreign collaborators in exchange of equity shares.

In 1965, the Government of India adopted an extra-ordinarily strict import licensing program. This was partly due to the greater need for import of foodgrain to meet the drought situation of the country and partly due to the delays in securing foreign aid from the foreign countries. As a result of this policy, there were acute shortage of imported raw materials and components for many industries which were compelled to operate below their capacity.

In 1966, the Government of India liberalized the import restrictions. Under the liberalized import policy (1) 59 specific priority industries are allowed to import the raw materials, components and spare parts necessary to maintain production at full capacity; (2) raw material requirements of certain export industries have been placed on open general license; (3) the value of import license of established importers has been increased for specified essential commodities; and (4) actual users and traders are being granted licenses freely for importation from the U.S. against U.S. AID non-project loans of certain spare parts not produced in India. Thus under the liberal import policy, the producers have to decide the total quantity of materials to be imported and there is no absolute ban on the import of goods which are produced in India.

4.2 Export Duty

In order to augment the foreign exchange reserve, the government had always emphasized the increase in the export of goods from India. The government adopted a system of issuing import entitlement licenses as an incentive to exporters of the non-traditional items. Under this scheme, the exporters were given license equivalent to twice the import content of their exports. Moreover, the government introduced better coordination between import and export policies and more vigorous drive to boost exports. Various promotional measures were adopted so that the Indian exporters may be able to compete in the international market.

Despite these measures, the export of the country could not increase substantially. To meet this situation, the Government of India decided to devalue the Indian currency on June 6, 1966. The old import entitlement scheme was abolished and the government decided for the first time to issue direct import license to export houses on the basis of their export performance. Free foreign exchange is being reserved for those industrial units which have exported 10% or more of their product so that they are allowed preferred sources of supply and facilities for expansion.

It is very hard to judge the impact of devaluation and liberalized import and export policy on the Indian

economy but it can be said that they have greatly improved the structure of prices and incentives and should contribute importantly to raising industrial efficiency and production.[21]

(5) Industrial Licensing

The Industries (Development and Regulation) Act 1951 controls the establishment and expansion of industries by requiring the undertaking to take registration for every existing industrial unit and a license for the setting up of new firms. Foreign subsidiaries are also required to comply with the same provision. The Act is designed to facilitate economic development through a planned economy under a democracy. The main purpose of issuing the industrial registration and the licensing is to regulate establishment and expansion of different industries in the country with a view to utilizing the limited resources and foreign exchange of the country for rapid industrialization. The Act gives the Government of India broad powers over the registered and licensed industrial undertakings to make investigation into their operations and issue direction for change; assume management and

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[21]Kenneth M. Kauffman, "The Indian Economy: Some Recent History and Near Term Prospects," Asian Survey, June 1967, Vol. VII, No. 6, p. 422.

control of the industry; and control the supply, distribution and prices of their production.[22]

Government follows different policies of industrial licensing depending upon the nature and importance of the industries. The key industries such as pig iron, industrial machinery, machine tools, fertilizers, petrochemical, paper and pulp, cement, etc., considered to be important for the promotion of self-sustaining industrial growth are given preferential treatment in respect of release of foreign exchange and for all other clearances such as permission for the issue of new capital, import of capital goods from the foreign country, etc. Certain industries considered to be important but not requiring substantial import of components or raw materials from foreign countries have been exempted from registration and licensing provisions of the Act.

(6) Foreign Exchange Control

The Government of India and the Reserve Bank of India under the Foreign Exchange Regulation Act, 1947, control the proper utilization of foreign exchange reserve. No person is allowed to make payment to persons resident outside India without the permission of the Reserve Bank.

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[22]For details, see Matthew J. Kust, Foreign Enterprise in India--Laws and Policies, (Chapel Hill: The University of North Carolina Press) 1964, esp. Chapter VI.

The remittance of profits and other income (such as royalties, patent fees, commissions, etc.) to a foreign country is permitted without any restriction provided the prior permission of the Reserve Bank of India has been obtained. When the government issues an industrial license for the operation of foreign enterprises it also authorizes them to convert the profit, original investment, loan, etc., from the Indian currency into the currency of foreign countries. The historical evidence shows that the permission for the remittance of profit has been granted without any difficulty. "Few countries in the world have maintained a record of prompt remittance that compares with India's despite the extreme shortage of foreign exchange that has faced the country during the past five years."[23]

The repatriation of original capital plus all reinvested profit and capital appreciation requires the prior approval of the Government of India. Prior to the year 1958, there was no restriction on the remittance of capital from India. In 1958, the government introduced certain restrictions regarding the period when the capital can be remitted. For this purpose the government insists that the prospective investors should not repatriate their capital

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[23]India: Business International Indian Roundtable, (New York: Business International Corporation, 1961) p. 17. Quoted in Anant R. Negandhi, Private Foreign Investment Climate in India, (East Lansing: Graduate School of Business Administration, Michigan State University, 1965) p. 72.

for 10 years or so. This restriction is placed primarily to discourage the heavy drains on the foreign exchange reserve of the country. If the government thinks proper, the time limit may be relaxed.

Besides the freedom of remittance of profit and capital, the Government of India maintains a stable rate of exchange for all international transactions. The foreign exchange is obtained at the official exchange rate. Multiple rates have never been used in India. Indian currency was never devalued between 1949 and 1965 and hence a stable exchange rate was maintained throughout this period. On June 6, 1966 the Government of India devalued the Indian currency and this changed the previous exchange rate. Since then, the new exchange rate is also kept stable.

The above description indicates that

> India offers complete freedom of profits and repatriation of capital and maintains stable exchange rate. All profits and dividends have always been fully convertible into the currency of the country of the original investor. And convertibility is not limited to earnings only; it applies to capital and indeed to capital appreciation. This policy had not altered ever since exchange control was instituted in India more than 20 years ago and India has no intention of altering it in future.[24]

6.1 U.S. Guarantee Program

The security of investment of foreign investors is fortified by the bilateral agreements between the Government

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[24] Indian Investment Centre, Why Invest in India, op. cit., pp. 7-8.

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of India and Governments of foreign countries. The U.S. Government offers a range of investment guarantees for U.S. private investment in India. These are: (1) The Specific Risk Guarantee: the private investment is guaranteed against inconvertibility and losses through expropriation, confiscation, war, revolution or insurrection, for new American investments of cash, commodities, patents or services made by the U.S. individuals or firms in India; and (2) The Extended Risk Guarantee coveres business risks other than those resulting from fraud or misrepresentation or misconduct of investor and those for which commercial insurance is available, such as fire and insurance. The Extended Risk Guarantees cover up to 75% of investment funds extended by American lenders and generally up to 50% of U.S. equity contributions.

(7) Capital Issue Control

The capital issue control was first introduced, to meet the situation arisen due to World War II, under the Defense of India Act (1939) and was replaced on a temporary basis by Capital Issue (Continuance of Control) Act of 1947 and then was made permanent in 1956 as Capital Issue (Control) Act, 1957. The main purposes of the Act are (1) to insure that the investment does not take place contrary to the objectives of the Five-Year Plans or flow into unproductive or wasteful channels; (2) to further the

growth of joint stock companies with sound capital structure and promote a rational and healthy expansion of joint stock sector in the general interest; and (3) to direct and distribute appeals for public subscription to new issues for capital so as to avoid any undue concentration or overcrowding in a particular period or part of the year.

The above objectives indicate that the Act is the most effective regulatory measure in the hands of the government. It influences not only the investment policy of the individual company but is a strong measure to regulate the nature and the different mix of the capital structure. This Act also tries to minimize the heavy load of the capital issue in a particular season and thereby tries to eliminate the season fluctuations in the availability of the new issues in the capital market.

The capital issue control applies generally to all companies which make an issue of capital or make an offer to sell securities in India. Moreover, the Act has the effect of forcing companies to raise enough long-term capital to finance their establishment or major expension, rather than relying on loans from uncertain sources or depending vaguely on self-financing from large future profits.

7.1 Capital Structure

The Act is quite specific in prescribing the ratios of debt-equity and preference-equity in the capital structure

of the companies. According to the Act, the most suitable debt-equity ratio is the 2:1, but this ratio may be increased in the case of some companies. For the companies in the public sector, the government prefers equal debt-equity ratio. In the case of preferred stock-common stock ratio the Act prescribes that preference shares (stated capital) should not exceed one-third of the common stock equity. Like the debt-equity ratio, this ratio may, under some circumstances, go up to 2:3. The above restrictions regarding the ratios are based on the notion that excessive leverage is seldom in the best interest of the company (and the economy) from long-term viewpoint. Thus the individual company is not free to have just any capital structure which the management may desire nor to adjust the capital structure without the prior approval of the Controller of Capital Issues. If a company wants to adopt a different capital structure it has to seek the approval of the Controller of Capital Issues.

Summary

To sum up, the chief features of the Indian economy during this period were the stagnation in agricultural and industrial production, deficit balance of payments and rapid expansion in the money supply to meet the needs of defense and development expenditure. The over-all effect of these factors was the strong pressure on the price

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level. The difficulty in raising resources for investment, the sharp decline in foreign exchange reserve of the country, and the postponement of foreign aid by some major countries aggravated the already deteriorating condition of the economy. By the end of 1965, the Indian economy was undergoing the acute shortage of foreign exchange and many industries were operating below capacity due to inability to import components and raw materials on the one hand and the decreased in the agricultural outputs for the agro-based industries on the other.

The 1963-1967 period also encompassed political developments. The country had a strong and stable government at the national and state levels prior to the fourth general election in 1967. Then the politically dominating and ruling Congress Party, suffered an unprecedented setback in the fourth election, its majority was significantly reduced at the national level, and in many states it could not form the government. Moreover, in two states, the Communist Party along with other parties formed governments. The thin majority of the ruling party in the Indian parliament and the absence of a strong opposition party in the country results in less political stability. Despite political instability, there remain certain inherent and orderly factors in the Indian democracy which may continue to provide basic strength to it.

The increasing emphasis on the industrialization of the country has resulted in greater need for adequate funds to meet the financial requirement of industry. The features of the Indian capital market have undergone significant changes to meet the challenge of the situation.

To facilitate economic development through a planned economy under a democracy, the Government of India has formulated various policies such as industrial development policy, foreign investment policy, corporate taxation policy, import and export policy, etc. The Government has many regulatory measures such as industrial licensing, foreign exchange control, new capital issues, etc. to influence the activities of the foreign investment in India.

These environmental factors, then, form part of the background for understanding and evaluating the data developed in the Chapters V and VI.

CHAPTER III

DATA COLLECTION

The present chapter describes the data collection for this study. The information has been collected from three sources, i.e., annual reports of U.S. subsidiaries, a questionnaire survey and personal interviews. The first part of the chapter discusses the nature of population and subsidiaries included. It describes, in detail, size, industrial products, age composition, management, and ownership of the participating subsidiaries. These data are used in analyzing the investment policy and performance of the participating subsidiaries discussed in Chapters V and VI. A discussion of the representativeness of the participating subsidiaries in the total population is also included. The second section explains the nature and purpose of the questionnaire survey, and emphasizes the relevance of such data for the present study. The last part describes the personal interviews with executives of several parent corporations having equity investment in India.

PART I

To examine and evaluate the investment policy and performance of the U.S. subsidiaries working in India, the

annual reports of the subsidiaries were used as the primary source of information. The financial data about the parent corporations were collected from the Moody's Industrial Manual for the different years.

Selection of Population

To define the type of subsidiary to be included in the present study, the following criteria were adapted.

1. The U.S. subsidiaries in India should have either equity investment or equity/licensing investment from the U.S. Corporations. The U.S. subsidiaries having only licensing agreements or selling and service arrangements with the parent corporations should not be included in the present study, nor should affiliates with less than 10% American equity investment.
2. The U.S. subsidiaries should have been in existence in India prior to the year 1963, must have started production before 1965, and must have continued their operation in India during the period 1963 to 1967.
3. The U.S. subsidiary operating in India should be a widely-held corporation (known as "public limited company" in India) so that its annual reports may be available to the outsider. In other words, the closely-held U.S. subsidiaries (known as "private

limited company"[1] in India) or branch units of the U.S. corporations in India should not be included because they do not publish their annual reports.

On the basis of the above criteria, an attempt was made to identify all Indian companies with U.S. equity investment.[2] Since it was not possible to determine which of those listed were merely branch units nor percentage of equity investment nor continuation and discontinuation of

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[1]The private limited company is more or less family concerns. The minimum number of membership for such a company is two and the minimum number of directors is two and its articles of association which must be registered with the Registrar of Companies, must contain the following distinguishing features:

(a) a clause restricting the right to transfer its share;

(b) a clause limiting the number of its members to fifty, two or more persons holding shares jointly being counted as a single member; and

(c) a clause prohibiting any invitation by the company to the public to subscribe for any shares or debentures of the company.

A public limited company is one which is not a private limited company. The minimum number of members for such a company is seven and the minimum number of directors is three. The Indian Companies Act does not lay down any maximum limit to the number of directors either for a public limited company or for a private limited company. (Indian Investment Centre, Indian Company Law, (New Delhi: Indian Investment Centre) 1967, pp. 14-16.

[2]The details were obtained from a booklet entitled American Business Concerns, Educational and Philanthropic Institutions with Offices in India, published by U.S. Embassy in India, December, 1965.

these subsidiaries, it was decided to contact parent corporations and hence a letter was sent to all U.S. corporations requesting them to participate in the present study. The response of the U.S. corporations enabled the identification of the branch units (14), the U.S. corporation's equity investment with less than 10% in Indian companies (9) and the discontinuation of some subsidiaries (15). Moreover, an intensive search of other sources[3] was also conducted to determine these cases.

Thus there were 42 U.S. subsidiaries constituting the total population, based on the above criteria, for the present study. A check was made to verify the availability of financial data of the U.S. corporations in Moody's Industrial Manual for the different years. Financial data about five U.S. corporations were not available. These corporations were asked to send their annual reports but refused to do so because they are closely-held corporations and are not listed on the stock exchange. This left 37 U.S. subsidiaries (and their parents) as the total population for the study. The details are given in Table 3:1.

Out of 37 parent corporations having direct private investment in India, 28 parent corporations (or 75% of the total) are among the "500" largest U.S. industrial

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[3]Moody's Industrial Manuals (New York: Moody's Investors Service, Inc.); Business International (New York: Business International Corporation); Indian Stock Exchanges (Bombay, Calcutta and Madras) Year Books, Indian Financial Newspapers, etc.

Table 3:1.--Selection of population for the present study.

		Number
1. Total U.S. Subsidiaries selected on the basis of criteria		80
2. Total U.S. Affiliates decided on the basis of response		
(a) U.S. Branch Units	14	
(b) U.S. Affiliates with Minor Investment	9	
(c) U.S. Subsidiaries that could not start their Operation[a]	15	38
3. Total U.S. Subsidiaries eligible for the present study		42
4. Less: closely-held parent corporations		5
5. U.S. Subsidiaries as total population		37
6. U.S. Subsidiaries for which financial data became available		27

[a]This group includes subsidiaries which could not proceed beyond negotiation stage or closed their initial operation.

corporations. Out of 27 parent corporations whose subsidiaries in India have been taken up for the present study, 23 U.S. corporations (or 85% of the total) are among the "500" largest U.S. industrial corporations. This suggests that American equity investment in India comes largely from larger U.S. corporations.[4]

[4]The Fortune Directory, The '500' largest U.S. Industrial Corporations, June 15, 1968.

Selection of Subsidiaries

Some U.S. corporations sent annual reports of their subsidiaries while many of them wrote directly to their subsidiaries in India to send the annual reports. Some of these subsidiaries responded favorably and supplied their annual reports. In the remaining cases, individual letters were sent to the U.S. subsidiaries in India. A follow-up letter was necessary in several cases where the initial letter was not acknowledged. Moreover, some financial data about these subsidiaries were also collected from Indian financial newspapers, Investor's India Year Book, Indian stock exchange year books, etc., available at the Michigan State University, University of Michigan and University of Chicago libraries.

Out of 37 U.S. subsidiaries, the annual reports of 27 U.S. subsidiaries were made available for the years 1963 to 1967. Out of these, 25 U.S. subsidiaries are engaged in manufacturing operation and the 2 U.S. subsidiaries are in the petroleum industry. Thus the participating subsidiaries form 73% of the total U.S. subsidiaries eligible for the present study.

The reason for non-participation may vary greatly. In some cases, the non-participation resulted due to the refusal to take part in the study for the reasons of company policy. In a few cases there might have been a desire to avoid publicizing the results of a very profitable

operation but in some others the motive might well have been a desire to conceal an unsuccessful operation. It is hard to determine the nature of systematic bias, if any, in the study due to the non-participating of the 10 U.S. subsidiaries.

Size of Participating Subsidiaries in Manufacturing Industry

Of the total paid-up capital of Rs. 426.69 million of the U.S. subsidiaries comprising the total population, the participating subsidiaries contributed Rs. 383.14 million (or 89.79% of the total) in 1963. In the case of net worth, the participating subsidiaries provided Rs. 441.58 million out of Rs. 480.96 million (or 91.8% of the total) net worth of the total U.S. subsidiaries. The contribution of the participating subsidiaries in the total assets of all U.S. subsidiaries is 95.57% (or Rs. 1072.41 million out of a total assets of Rs. 1122.08 million). The participating subsidiaries shared 98.35% (or Rs. 656.89 million out of Rs. 667.89 million) of the total sales of all U.S. subsidiaries in 1963. Thus the participating subsidiaries contributed at least about 90% of the total assets, sales, net worth and paid-up capital of the total population. Table 3:2 shows this picture.

Table 3:2.--Size of population and participating subsidiaries in manufacturing industry in 1963 (in millions of rupees).

	Total U.S. Subsidiaries* (N = 31)	Participating Subsidiaries (N = 25)	
	Rs.	Rs.	Percentage of Total
1. Assets	1,122.08	1,072.41	95.57
2. Sales	667.89	656.89	98.35
3. Net Worth	480.96	441.58	91.8
4. Paid-up Capital	426.69	383.14	89.79

Source: (1) Annual Reports of Participating Subsidiaries;
(2) Indian Stock Exchanges (Bombay, Calcutta and Madras) Year Books;
(3) Investors' India Year Book (Calcutta: Orient Longmans, Ltd.)

*Figures for the remaining 3 manufacturing industries not available.

Size of Participating Subsidiaries in Petroleum Industry

Out of the total U.S. subsidiaries in petroleum industry, the participating subsidiaries contributed 50.35% (or Rs. 45.63 million out of Rs. 90.63 million), 61.04% (or Rs. 273.39 million out of Rs. 447.89 million), and 94.21% (or Rs. 427.92 million out of Rs. 454.22 million) of the total paid-up capital, total assets and total sales of the U.S. subsidiaries engaged in petroleum industry in 1963. Table 3:3 gives this picture.

Table 3:3.--Size of population and participating subsidiaries in petroleum industry in 1963 (in millions of rupees).

	Total U.S. Subsidiaries (N = 31)	Participating Subsidiaries (N = 25)	
	Rs.	Rs.	Percentage of Total
1. Assets	447.89	273.39	61.04
2. Sales	454.22	427.92	94.21
3. Paid-up Capital	90.63	45.63	50.34

Sources: Same as Table 3:2.

Products of Participating Subsidiaries

The major product groups of 25 manufacturing subsidiaries represent chemicals, electric equipment, rubber and plastic, machinery, metal and metal products and transport equipment. The distribution of total and participating subsidiaries in different industrial groups is shown in Table 3:4. Thus in each product group the participating subsidiaries are at least 50% (except in electrical goods) of the total population and not a single industrial product group is excluded from the present study.

Many of the subsidiaries have operations which fall under more than one industry classification and do not present any basis for distinguishing their industry lines

Table 3:4.--Distribution by major product group of total and participating subsidiaries.

Product Group	Total Subsidiaries		Participating Subsidiaries	
	Number	Percentage of Total	Number	Percentage of Total
Manufacturing				
1. Transport Equipment	6	16.2	4	14.9
2. Machinery Equipment	7	18.9	5	18.5
3. Metal and Metal Products	3	8.2	3	11.1
4. Electrical Goods	4	10.8	1	3.7
5. Chemicals and Allied	7	18.9	5	18.5
6. Others	7	18.9	7	25.9
Petroleum	3	8.2	2	7.4
Total	37	100.0	27	100.0

of operation clearly. This problem of separating the industrial lines in a company's operation seems to be common in view of company growth and diversification. Despite these difficulties and limitations, the broad classification may be made for the present study.

The subsidiaries of U.S. corporations in India are engaged in the production of many goods in which the parent corporations have specialized. The main products of the parent corporations are identified on the basis of the Moody's Industrial Classification. This broad classification

was verified with the categories of the operations of the parent corporations as given in the U.S. Embassy's Booklet.[6] These groupings were quite similar. After this, the industrial products of each participating U.S. subsidiaries working in India were identified with the help of the information available in annual reports of these subsidiaries, Indian Stock Exchange Year Books, Investor's India Year Book, Indian financial newspapers, etc. These subsidiaries are producing the same general types of products as their parent corporations. These subsidiaries do not normally produce a single product and are of diversified nature.

Inception Dates of Participating Subsidiaries

The dates of inception of 27 participating subsidiaries varied widely (see Table 3:5). Five of the 27 subsidiaries were set up prior to 1950 and another five subsidiaries were started between 1951 and 1956. Thus about a third of the total participating subsidiaries had at least seven years' working experience prior to the year 1963. One subsidiary was started as early as 1922. Between 1957 and 1961, twelve more subsidiaries were set up. The remaining five subsidiaries were started in 1962. Thus

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[6] See Footnote 2 on page 66.

there are both mature and new subsidiaries among the participating subsidiaries.

Table 3:5.--Distribution by date of inception of 27 participating subsidiaries.

Year	Participating Subsidiaries	
	Number	Percentage of Total
Prior to 1950	5	18.5
1951 to 1956	5	18.5
1957 to 1961	12	44.4
1962	5	18.5
Total	27	100.0

Ownership Pattern of Participating Subsidiaries

The ownership pattern of 27 participating subsidiaries is given in Table 3:6. Ten of the participating subsidiaries have majority ownership, i.e., the U.S. equity investment is more than 50% of the total equity investment. As against this, the U.S. investment in eight of the participating subsidiaries is between 10% and 25%. Between the above two groups, there are five subsidiaries where the U.S. ownership is between 26% and 40% and four where the ownership is between 41% and 50%.

Table 3:6.--Distribution by ownership pattern of 27 participating subsidiaries.

Percentage of American Ownership	Participating Subsidiaries	
	Number	Percentage of Total
Between 10 to 25	8	29.6
" 26 to 40	5	18.5
" 41 to 50	4	14.8
" 51 to 75	6	22.3
76 and Above	4	14.8
Total	27	100.0

Management of Participating Subsidiaries

The nature of management of participating subsidiaries is given in Table 3:7. Out of the total participating subsidiaries, 3 subsidiaries have all the directors from the U.S.A. As against this, in the case of 2 subsidiaries, the U.S. corporations have only equity investment and they are controlled by the Indian directors. In 9 subsidiaries, the majority control is in the hands of U.S. directors whereas in the same number of other cases, the U.S. directors are in minority. In the remaining 4 subsidiaries, the management is shared equally by the Indian and U.S. directors.

Table 3:7.--Nature of management of participating subsidiaries.

Number of Directors	Participating Subsidiaries	
	Number	Percentage of Total
1. All U.S. Directors	3	11.1
2. Majority U.S. Directors	9	33.3
3. U.S.-India Directors Equal	4	14.8
4. Majority Indian Directors	9	33.3
5. All Indian Directors	2	7.5
Total	27	100.0

Assets Size of Participating Subsidiaries

The distribution of the participating subsidiaries and their contribution in the different assets size groups is given in Table 3:8.

The seven subsidiaries with assets below $2.08 million accounted for only 2.16% of total assets of the participating subsidiaries. As against this 6 giant subsidiaries with assets of $20.92 million and above own 67.55% of the total assets of the remaining subsidiaries.

Sales Size of Participating Subsidiaries

Table 3:9 shows the sales size of the 27 participating subsidiaries.

Table 3:8.--Size classification of 27 participating subsidiaries based on total assets for the year 1963.

Assets[a]	Participating Subsidiaries		Assets in Million Dollars	
	Number	Percentage of Total	Assets	Percentage of Total
1. Less than $2.08	7	25.93	8.640	2.16
2. $2.08 and less than $4.20	2	7.40	6.549	1.64
3. $4.20 and less than $8.36	5	18.52	31.569	7.89
4. $8.36 and less than $20.92	7	25.93	83.087	20.76
5. $20.92 and above	6	22.22	270.373	67.55
Total	27	100.00	400.218	100.00

[a]In millions of dollars.

Table 3:9.--Size classification of 27 participating subsidiaries based on total sales for the year 1963.

Sales[a]	Participating Subsidiaries		Sales in Million Dollars	
	Number	Percentage of Total	Sales	Percentage of Total
1. Less than $0.52	7	25.93	1.446	0.46
2. $0.52 and less than $1.05	1	3.70	0.626	0.20
3. $1.05 and less than $2.09	4	14.81	6.270	1.98
4. $2.09 and less than $5.23	4	14.81	12.377	3.92
5. $5.23 and above	11	40.75	295.161	93.44
Total	27	100.00	315.880	100.00

[a]In millions of dollars.

The seven subsidiaries with sales less than $0.52 million accounted for only 0.46% of total sales of all the participating subsidiaries. The 11 giant subsidiaries with sales of $5.23 million or above contribute 93.44% of the total sales of the participating subsidiaries. The remaining 6.10% of the total sales is contributed by 9 subsidiaries.

Net Worth Size of Participating Subsidiaries

Net worth size of 27 participating subsidiaries is given in Table 3:10.

Table 3:10.--Size classification of 27 participating subsidiaries based on net worth for the year 1963.

Net Worth	Participating Subsidiaries		Net Worth in Million Dollars*	
	Number	Percentage of Total	Net Worth	Percentage of Total
1. Less than $0.52	3	11.12	0.892	0.53
2. $0.52 and less than $1.05	4	14.81	3.791	2.25
3. $1.05 and less than $2.09	2	7.41	2.348	1.39
4. $2.09 and less than $5.23	12	44.44	49.132	29.10
5. $5.23 and above	6	22.22	112.649	66.73
Total	27	100.00	168.812	100.00

[a]In millions of dollars.

*The dollar figures of Tables 3:9, 3:10 and 3:11 are price-level adjusted amounts converted into dollars.

Three subsidiaries with the net worth less than $0.52 million contribute only 0.53% of the total net worth of all the participating subsidiaries. As against this, there are 6 giant subsidiaries with net worth amount not less than $5.23 million own 66.73% of the total net worth of the participating subsidiaries. The remaining 32.74% of the total net worth is owned by 18 participating subsidiaries.

The participating subsidiaries represent the cross-section view of the total population. The groups of participating subsidiaries cover a variety of industries; include both very large and relatively small subsidiaries; both mature subsidiaries (including those which had been in India prior to the World War II) and new subsidiaries that started their operation only within the last few years; subsidiaries that are fully established and have considerable access to sources of funds and subsidiaries that are quite new; subsidiaries which are wholly or majority owned and subsidiaries which are managed by the Indian partners. In short, the participating companies constitute a reasonable cross-section of the U.S. subsidiaries but differ considerably from each other.

PART II

Questionnaire Survey

To get information regarding objectives of investment, factors influencing foreign investment decisions, techniques used in scrutinizing foreign investment projects, practice of applying capital budgeting techniques in international investment, nature and influence of risk elements in foreign investment decisions, standard of performance expected by the parent corporations, general attitudes regarding Indian investment climates, etc., it was decided to contact, through questionnaire, the parent corporations of all the participating subsidiaries.

In designing of questionnaire, every attempt was made to make it concise so that the total time to complete it should not exceed 20 minutes. This was purposely done to solicit better response from parent corporations.

The preliminary questionnaire was sent to two U.S. corporations for pre-testing purposes. One of them responded and offered many valuable comments and suggestions for the improvement of form and contents of questionnaire. The pre-testing was also helpful in deciding the total time required to complete the questionnaire.

The revised questionnaire was sent to the vice-president in charge of foreign or international operations of all 27 parent corporations in the U.S.A. Wherever possible the questionnaire was sent in the personal name of

these executives. A copy of covering letter and questionnaire are attached in the Appendix. The covering letter indicates the total time required to complete the questionnaire along with a promise to provide a summary of the response of the questionnaire to all the respondents. A follow-up letter with a copy of questionnaire was sent in cases where the initial letter was not responded within 40 days.

Response of Questionnaire Survey

Out of 27 U.S. corporations, 17 corporations (63% of the total) responded. Out of these, three corporations refused to complete the questionnaire and the remaining 14 corporations (52% of the total population) filled out and returned the questionnaire. The details of the mailing and completed questionnaires are given in Table 3:11.

Table 3:11.--Distribution and return of questionnaires.

Industry	Mailing		Return	
	Number	Percentage	Number	Percentage
1. Metal & Metal Products	3	11.1	1	7.1
2. Electrical Goods	1	3.7	-	-
3. Machinery Equipment	5	18.5	3	21.5
4. Transport Equipment	4	14.8	1	7.1
5. Chemical and Pharmaceutical	5	18.5	2	14.3
6. Petroleum	2	7.5	2	14.3
7. Other	7	25.9	5	35.7
Total	27	100.0	14	100.0

The above table indicates that the response of the questionnaire is fairly representative in all the industrial groups. Moreover, it is also representative as to size of subsidiaries.

PART III

Personal Interviews

To understand the various problems in-depth and to get an overall view regarding the investment policy and performance of the U.S. subsidiaries, an interview of the top executives of eight U.S. corporations was conducted. These corporations were selected on the basis of their willingness to participate in the interviews. The limitation of time and the resources of the author were also responsible in selecting the above parent corporations. The Indian subsidiaries of these U.S. corporations are engaged in different industries and vary in size, age and ownership. Moreover, the U.S. corporations operate in many foreign countries and possess operating experience of many years.

In most cases the executives interviewed were chief executives in charge of international operations or of the Indian subsidiary. In some cases, more than one executive were interviewed. In many cases these executives have stayed in India for a number of years.

Each interview lasted for two to three hours. In order to proceed properly, an interview guide was prepared (see Appendix 2). The normal procedure followed for the interview was to start with a brief history of their operation in India. This was followed by a description of the techniques and the procedures adopted by the parent corporations for deciding the foreign investment. In some cases, the parent corporations showed their actual reports for the evaluation of the investment opportunity in foreign countries including India. Then the financial policy and performance of their Indian subsidiaries were discussed. This was followed by the nature of the various risks associated with the investment in India. The various problems and the overall impression of the parent corporations were also discussed. In discussing the policies, etc., corporate position rather than the opinion of the individual executives was asked.

Besides these executives, the two government officials of Indian Investment Centre in New York, were also interviewed. The main purpose of interviewing these people was to know their views and the government's attitudes in attracting the U.S. investors in India. The various problems raised by the executives of parent corporations were also discussed with these Indian government representatives.

The personal interviews were conducted in a congenial atmosphere. While discussing the Indian subsidiary,

the experience of doing business in other foreign countries particularly in Asia and Latin American countries was also solicited.

As has been pointed out earlier, the financial statements will be used as the primary source of information for the study of the investment policy and performance of the subsidiaries and their parent corporations. These financial statements need to be adjusted for comparative study purposes. This forms the subject matter of the next chapter.

CHAPTER IV

PRICE LEVEL ADJUSTMENT AND COMPUTATION OF NET INCOME

Overall View

As has been pointed out in Chapter I, the main purpose of the present research is to analyze and evaluate the investment policy and performance of the U.S. subsidiaries in India. Comparing by means of financial ratios, the investment policy and performance of the subsidiaries with their parent corporations will be a major part of the research, the comparisons to be based on the financial statements of the parents and subsidiaries. Since the price level change in India was much greater than the U.S.A. during 1963-67, use of published Indian financial statements without price level adjustment would reflect inflationary profit and would not give a correct estimate of the economic performance and value of the subsidiaries.

The main reason for adjusting the financial statements for the price level changes is that the purchasing power of the monetary unit in which the financial statements are expressed changes inversely with the price level changes. This affects the economic value of the investment

which cannot be determined properly without taking into account the price level changes.

To measure the economic values involved, the financial statements of the subsidiaries have been adjusted, on the basis of an adjusted consumer price index for price level changes in India. The financial statements of parent corporations have not been adjusted but the price level change in the U.S.A. has been allowed for while adjusting the financial statements of their subsidiaries. The price level adjusted financial statements of the subsidiaries are used as the basis for the ratio study of the investment policy and performance of the subsidiaries.

The chapter is divided into three parts. The first part discusses the technique and procedure adopted for the price level adjustment. The second part describes the procedure adopted for the computation of net income figure of the U.S. subsidiaries. The third part explains the difference in the computation of return from parent and subsidiary viewpoints.

PART I

Price Level Adjustment

As has been pointed out in Chapter II, the Indian economy witnessed a substantial rate of inflation during the period under study; the Consumer Price Index increased

from 116.1 (1958 = 100) in 1963 to 180.5 in 1967. In other words, the general price level increased by 56% in five years. As against this, the Consumer Price Index in the U.S.A. increased from 106.7 (1957-59 = 100) in 1963 to 116.3 in 1967 (see Figure 4.1), i.e. the general price level increased by 9.0% in these years. Due to this increase in the general price level, the purchasing power of the monetary unit has declined. The financial statements of U.S. subsidiaries and parent corporations, prepared per conventional accounting on the assumption of stable monetary unit, do not represent the same purchasing power of their respective unit for the different years. Thus, the 1963 rupee is not the same as that of the 1967 rupee. In the same way, the dollar of 1963 does not express the same purchasing power as the dollar of 1967. The purchasing power of Indian currency declined by 36% during 1963 and 1967 whereas the purchasing power of the dollar decreased by 8% in these years.

As Finney and Miller rightly point out: "Many of the dollar amounts shown in comparative financial statements are 'old' dollars. Therefore, comparative statements are likely to be misunderstood because of variations in the purchasing power of the dollars."[1] This opinion expressed

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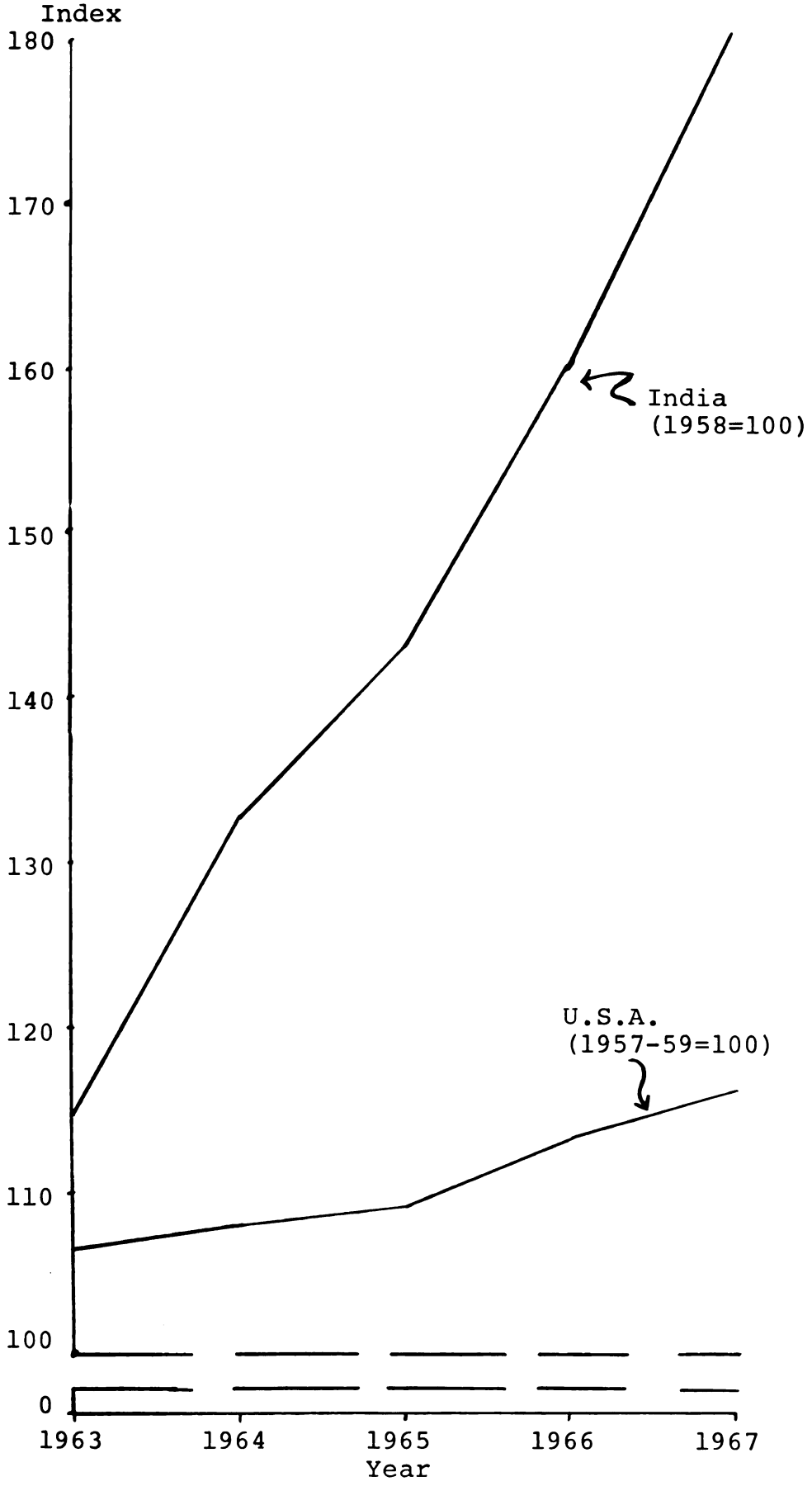
[1]Harry A. Finney and Herbert E. Miller, Principles of Financial Accounting--A Conceptual Approach, (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1968), pp. 341-342.

Figure 4.1.--Consumer price index of U.S.A. and India



Source: See Table 4:1.

in the context of the dollar is also applicable in the case of Indian currency.

Some hold the view that the historical financial statements should be adjusted for the changes in the purchasing power of monetary unit. The Accounting Principles Board of the American Institute of Certified Public Accountants on November 4, 1960 has expressed its opinion that it is unrealistic to ignore the fluctuation in the value of the dollar. Further it is feasible to give recognition to the effects of price level changes on financial statement.[2] The Accounting Research Study No. 6 supports the above view and has pointed out that as the degree of inflation in the U.S.A. increases materially, there would be many corporations which would adjust their financial statements for price level changes.[3]

The Committee on Concepts and Standard Underlying Corporate Financial Statements of the American Accounting Association also studied the problem of price level changes and came to the conclusion that management may present the effects of fluctuation in the value of the dollar upon net

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[2]As quoted from Staff of Accounting Research Division, Reporting The Financial Effects of Price Level Changes (New York: American Institute of Certified Public Accountants, 1963), p. 1.

[3]Ibid., p. 1.

income and upon financial position.[4] In the study of the comparative financial statements of four companies both on historical dollars and uniform-common dollars (price level adjustment) for the year 1941 to 1951, Ralph C. Jones concluded that the adjustments of the financial statements for the price level change have a significant effect on the net earnings of these companies. "The substantial inflation which has cut the purchasing power of the dollar by about half since 1940 has considerably impaired the usefulness of financial statements based entirely on historical costs."[5]

Perry Mason made a study, on the basis of the four companies, of the possibility of improving the usefulness of conventional accounting figures by restating them with the use of a general price level index. He concluded that without adjustment, the figures of financial statements suffer from lack of comparability.[6]

Despite agreement on price level adjustment, there is no well-accepted view regarding the technique to be

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[4]American Accounting Association, Price Level Changes and Financial Statements, The Accounting Review, Vol. XXVI, No. 4, October 1951, p. 472

[5]Ralph C. Jones, Price Level Changes and Financial Statements--Cases of Four Companies (Evanston, Ill.: American Accounting Association, 1955), p. 177.

[6]Perry Mason, Price Level Changes and Financial Statement--Basic Concepts and Method (Evanston, Ill.: American Accounting Association, 1967), p. 11.

adopted for the price level adjustment. There are two broad techniques which are suggested. The first approach recommends adjusting only those items of the financial statements (such as long-term assets, depreciation charges, inventory) which are expressed in historical costs and are severely affected by price level changes. The adjustment is achieved by the use of specific price index numbers. Under this method the main purpose is to arrive at the current replacement cost or the equivalent in terms of services rendered by the assets. The American Institute of Certified Public Accountants and American Accounting Association do not favor this partial adjustment because they believe the measurement of price level change should take into account all the items of the financial statements.[7]

The second method favors the adjustment of all items of financial statements on a constant-value unit equivalent to the purchasing power of the monetary unit of a selected period. The historical figures as recorded on the books should be converted into a constant-value unit by applying a general index of price. The AICPA (not formally) and AAA recommend this approach. The author has

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[7]Staff of the Accounting Research Division, Reporting the Financial Effects of Price-Level Changes, op. cit., p. 54; American Accounting Association, Price Level Changes and Financial Statements, op. cit., p. 471.

followed this technique for the price level adjustment for the present study.

Selection of Index Number[8]

There are two types of price indexes, i.e., specific price indexes and general price indexes. The specific price indexes measure the price movement for specific commodities and services whereas the general indexes reflect the changes in the price level prevailing in the economy as a whole. Since the author is adjusting all the items of the financial statement, the index number adopted for this purpose should measure the changes in the price level in general reflecting changes in the general purchasing power of the monetary unit.

There are three primary general price indexes in the U.S.A., i.e., Gross National Product Implicit Price Deflators, Wholesale Price Index and Consumer Price Index. In India, there are primarily two general price index numbers, i.e., a Wholesale Price Index and a Consumer Price Index. The GNP Implicit Price Deflators prepared by the U.S. Department of Commerce is the most comprehensive and the best currently compiled index of the general

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[8]For a detailed discussion of the index number, see Staff of Accounting Research Division, Reporting The Financial Effects of Price Level Changes (Accounting Research Study No. 6), op. cit., esp. Appendix 'A' on 'The Index Number Problem' by Cecilia Tierney, pp. 61-117.

level of prices in the U.S.A. This index measures the relationship between the total value of all goods and services produced in a given year expressed in current dollars and the total value of the same goods and services expressed in prices of a base-year constant dollars. This index reflects all exchange prices in the economy. There is no such index number in India and hence the question of the use of this index does not arise; rather the choice falls between the wholesale price index and the consumer price index.

The Index of Wholesale Price gives heavy weight to raw materials and semi-finished goods and does not reflect the price behavior of the many goods and services. "It is not a measure of 'wholesale price' as its name implied but a measure of some wholesale prices in specific markets."[9] The Consumer Price Index is a widely used index for the general price level changes in many countries. Moreover, this index is much broader than the whqlesale price index. It reflects primarily the prices of finished goods and services and thus measures the changes in the cost-of-living. For the present study, the consumer price index is used as the measure reflecting the change in the general price level and hence the general purchasing power of monetary units. At the very outset, it should be pointed

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[9] Ibid., p. 73.

out that the preparation of the consumer price index is based on many assumptions and limitations. Any adjustment based on this index number is bound to reflect these assumptions and limitations and may affect the price level adjustment. Moreover, the consumer price index may not reflect all the prices in the economy but "no index of all prices in the economy has ever been computed and none is likely to be computed."[10]

Adjustment of Consumer Price Index

To make proper adjustment for price level changes, the financial statements of parent corporations should be adjusted on the basis of the Consumer Price Index prepared by the U.S. Bureau of Labor whereas the financial statements of U.S. subsidiary should be adjusted with the help of the Consumer Price Index prepared by the Labour Bureau, Government of India. But the financial statements of parent corporations are not adjusted for the changes in the price level in the U.S.A. because the price levels in the U.S.A. during these years were relatively stable (i.e. a 9% increase over the period of five years). However, this does not mean that the price changes in the U.S.A. were ignored in adjusting the financial statements of the U.S. subsidiaries.

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[10]Eldon S. Hendriksen, Accounting Theory (Homewood, Ill.: Richard D. Irwin, Inc., 1965), p. 178.

In order to make proper adjustment, and to compensate for the increase in the price level in the U.S.A. as reflected in the U.S. Consumer Price Index, the Consumer Price Index of India was reconstructed after adjusting for the annual increase in the Consumer Price Index in the U.S.A. The adjusted Consumer Price Index of India reflects only the changes in the general price level after making allowance for the increase in the U.S. Consumer Price Index. The financial statements of the U.S. subsidiaries have been adjusted on the basis of this adjusted Consumer Price Index of India. The same technique is followed for the adjustment of the 4th quarter and the year-end indexes of the Consumer Price of India from that of the 4th quarter and the year-end indexes of U.S. Consumer Price. Table 4:1 gives the unadjusted Consumer Price Indexes of the U.S.A. and India and the adjusted Consumer Price Index of India.

After adjusting the consumer price index for the different periods the conversion ratios and the multipliers were calculated from the adjusted consumer price index on the basis of common-monetary unit. All the items (all five years) are being adjusted to the December 31, 1967 price level. Thus the price index as of December 31, 1967 is used as the numerator and the price index applicable to the previous period is used as the denominator. The multiplier is arrived after dividing the numerator by the denominator.

Table 4:1.--Consumer price indexes of U.S.A. and India.

	Unadjusted Consumer	Adjusted Consumer Price

Table 4:1.--Consumer price indexes of U.S.A. and India.

Period	Unadjusted Consumer Price Index		Adjusted Consumer Price Index of India
	U.S.A. (1957-59=100)	India (1958=100)	[Col(2) ÷ Col(1)] × 100
	(1)	(2)	
1963	106.7	116.1	108.8
4th Quarter	107.4	117.8	109.7
December 31,	107.6	118.6	110.2
1964	108.1	133.0	123.0
4th Quarter	108.7	138.1	127.0
December 31,	108.8	139.0	127.6
1965	109.9	143.2	130.3
4th Quarter	110.7	146.6	132.4
December 31,	111.0	146.6	132.0
1966	113.1	160.2	141.6
4th Quarter	114.6	164.4	143.4
December 31,	114.7	166.9	145.5
1967	116.3	180.5	155.2
4th Quarter	117.8	183.0	155.3
December31,	118.2	181.4	153.3

Sources: (1) U.S. Department of Commerce, Survey of Current Business (U.S Government Printing Office, Washington, D.C.)
(2) The Reserve Bank of India Bulletin, Bombay (India).

Note: The Consumer Price Index of India is prepared on the basis of 1949 as the base year. This has been changed to 1958 as the base year because the U.S. Consumer Price Index is prepared on the basis of 1957-59 as the base year.

These multipliers are used for the adjustment of the various items of the financial statements of U.S. subsidiaries for the price level changes. The conversion ratios and multipliers are given in Table 4:2.

Adjustment of Balance Sheet for Price-Level Changes

There are two approaches in accounting for the measurement of net income of a business entity, i.e., transaction approach and balance sheet or capital (equity) maintenance approach. Under the transaction approach, the income is the excess of revenues over expenses. The revenues and expenses are recorded as changes in assets and equities resulting from an entity's transactions. Under the balance sheet approach, the income is arrived after taking into account the maintenance of capital, and income cannot emerge until "capital" in this case, purchasing power, is maintained. For the present study, the balance sheet approach to the measurement of net income has been adopted and only the balance sheet items have been adjusted on a common currency value expressed in terms of December 31, 1967 price level. [11]

To illustrate the procedure adopted for the price level adjustments let us start with an example of subsidiary's

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[11] Total sales figures have also been adjusted for computing rates of return on total sales discussed in Chapter VI.

Table 4:2.--Multipliers for price level adjustment.

Period	Adjusted Consumer Price Index of India	Conversion Factor	Multiplier
1963			
Annual Average	108.8	153.3/108.8	1.409
4th Quarter	109.7	153.3/109.7	1.397
December 31	110.2	153.3/110.2	1.391
1964			
Annual Average	123.0	153.3/123.0	1.246
4th Quarter	127.0	153.3/127.0	1.207
December 31	127.6	153.3/127.6	1.201
1965			
Annual Average	130.3	153.3/130.3	1.176
4th Quarter	132.4	153.3/132.4	1.158
December 31	132.0	153.3/132.0	1.161
1966			
Annual Average	141.6	153.3/141.6	1.083
4th Quarter	143.4	153.3/143.4	1.069
December 31	145.5	153.3/145.5	1.053
1967			
Annual Average	155.2	153.3/155.2	0.989
4th Quarter	155.3	153.3/155.3	0.987
December 31	153.3	153.3/153.3	1.000

(rupee, historical cost) statement given for the five years in Exhibit 4.1.

Assumptions.--The adjustments of the historical balance sheet figures for price level changes have been made after taking into account the following assumptions.

(1) Fixed assets and capital stock prior to the year 1963 are assumed to be acquired or issued in 1963. The same assumption is made for the accumulation of allowance for depreciation prior to the year 1963.

(2) Fixed assets acquired prior to the year 1963 and during 1963-67 were not retired. (i.e., The fixed assets increase during any period is the net of additions minus retirements; in the absence of data on retirements, the net increase is assumed to represent gross additions).

(3) The year-end inventories were acquired in the 4th quarter of each year and the price index of the 4th quarter of each year is used for adjustment purposes.

(4) In a few cases, the closing date of the balance sheet is different from that of December 31. In such cases it is assumed that the balance sheet is prepared as on December 31 of each year.

Adjustment Procedure.--The following description explains the adjustment procedure: (Refer to Exhibit 4.2,

Exhibit 4.1.--Balance sheet of a subsidiary for five years (1963-67). (Rs. in '000.)

	1963	1964	1965	1966	1967
Assets					
Cash	3,152	1,034	3,604	2,734	1,138
Accounts receivable	3,927	4,063	6,012	7,472	9,453
Inventories	9,553	11,469	10,514	12,465	15,820
Total Current Assets	16,632	16,567	20,131	22,672	26,411
Other assets	6,531	8,552	19,344	26,543	33,032
Fixed assets (Gross)	15,737	16,186	16,712	16,948	17,826
Less depreciation	(4,594)	(6,033)	(7,537)	(9,025)	(10,607)
Net fixed assets	11,142	10,154	9,175	7,923	7,219
Total	34,305	35,274	48,652	57,168	66,662
Liabilities					
Accounts payable	3,033	1,876	3,879	4,500	4,902
Provisions[a]	12,829	16,139	24,656	34,257	40,221
Total Current Liabilities	15,863	18,015	28,536	38,758	45,123
Long term debt	2,031	1,719	4,501	1,094	2,781
Common stock	7,149	7,014	7,014	7,014	7,014
Retained earnings	9,263	8,526	8,601	10,301	11,844
Total	34,305	35,274	48,652	57,168	66,662

[a]Include provisions for taxation, dividends, contingencies, etc.

Exhibit 4.2.--Price level adjustment of a sample balance sheet for 1963-1967 (figures in thousands).

	1963			1964		
	Historical Rs.	Multiplier	Adjusted Rs.	Historical Rs.	Multiplier	Adjusted Rs.
	(1)	(2)	(3)	(1)	(2)	(3)
Assets						
Cash	3,152	1.391	4,384	1,034	1.201	1,242
Accounts receivable	3,927	1.391	5,462	4,063	1.201	4,880
Inventories	9,553	1.397	13,346	11,469	1.209	13,843
Total Current Assets	16,632		23,192	16,567		19,965
Other assets	6,531	1.391	9,085	8,552	1.201	10,271
Fixed assets (gross)	15,737		22,173	16,186		22,732
Acquired in:						
1963	15,737	1.409	22,173	15,737	1.409	22,173
1964				449	1.246	559
1965						
1966						
1967						
Accumulated Depreciation	4,595		6,474	6,033		8,266
1963	4,595	1.409	6,474	4,595	1.409	6,474
1964				1,438	1.246	1,792
1965						
1966						
1967						
Net fixed assets	11,142		15,699	10,154		14,466
Total	34,305		47,976	35,274		44,702

1965			1966			1967		
Historical Rs.	Multiplier	Adjusted Rs.	Historical Rs.	Multiplier	Adjusted Rs.	Historical Rs.	Multiplier	Adjusted Rs.
(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)
3,604	1.161	4,184	2,734	1.053	2,879	1,138	1.000	1,138
6,012	1.161	6,980	7,472	1.053	7,868	9,453	1.000	9,453
10,514	1.158	12,175	12,465	1.069	13,325	15,820	0.987	15,614
20,131		23,339	22,672		24,072	26,411		26,205
19,344	1.161	22,459	26,572	1.053	27,981	33,032	1.000	33,032
16,712		23,351	16,948		23,607	17,826		24,475
15,737	1.409	22,173	15,737	1.409	22,173	15,737	1.409	22,173
449	1.246	559	449	1.246	559	449	1.245	559
526	1.176	619	526	1.176	619	526	1.176	619
			236	1.083	256	236	1.083	256
7,537		10,035	9,025		11,442	10,609		13,211
4,595	1.409	6,474	4,595	1.409	6,474	4,595	1.409	6,474
1,438	1.246	1,792	1,438	1.246	1,792	1,438	1.246	1,792
1,504	1.176	1,769	1,504	1.176	1,612	1,504	1.176	1.769
			1,488	1.083	1,564	1,488	1.083	1.612
						1,582	0.989	1,564
9,175		13,316	7,923		12,165	7,219		11,264
48,652		59,114	57,168		64,218	66,662		70,501

Exhibit 4.2 Continued.

	1963			1964		
	Historical Rs.	Multiplier	Adjusted Rs.	Historical Rs.	Multiplier	Adjusted Rs.
	(1)	(2)	(3)	(1)	(2)	(3)
Liabilities						
Accounts payable	3,033	1.391	4,216	1,876	1.201	2,253
Provisions	12,829	1.391	17,845	16,139	1.201	19,383
Total Current Liabilities	15,863		22,061	18,015		21,636
Long term debt	2,031	1.391	2,825	1,719	1.201	2,065
Common stock	7,149		10,073	7,014		9,905
1963	7,149	1.409	10,073	7,149	1.409	10,073
1964				-135	1.246	-168
1965						
1966						
1967						
Retained earnings	9,263		13,017	8,526		11,096
Total	34,305		47,976	35,274		44,702

1965			1966			1967		
Historical Rs.	Multiplier	Adjusted Rs.	Historical Rs.	Multiplier	Adjusted Rs.	Historical Rs.	Multiplier	Adjusted Rs.
(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)
3,879	1.161	4,504	4,500	1.053	4,739	4,902	1.000	4,902
24,656	1.161	28,626	34,257	1.053	36,073	40,221	1.000	40,221
28,536		33,130	38,758		40,812	45,123		45,123
4,501	1.161	5,226	1,094	1.053	1,152	2,781	1.000	2,781
7,014		9,905	7,014		9,905	7,014		9,905
7,149	1.409	10,073	7,149	1.409	10,073	7,149	1.409	10,073
-135	1.246	-168	-135	1.246	-168	-135	1.246	-168
8,601		10,853	10,301		12,349	11,844		12,692
48,652		59,114	57,168		64,218	66,662		70,501

columns (1), (2) and (3).)

(a) Cash, Accounts Receivable, etc: The cash, accounts receivable, marketable securities and other monetary assets of each year are adjusted in terms of December 31, 1967 price. For instance, Rs. 3152 of cash at December 31, 1963 (column (1)) has a purchasing power equivalent to Rs. 4384 (column (3)) at December 31, 1967 price, i.e., Rs. 3152 x 1.391 (153.3/110.2) and that Rs. 1034 of cash at December 31, 1964 is equivalent to Rs. 1242 at December 31, 1967 price level (Rs. 1034 x 1.201). The cash amounts of Rs. 3879 at December 31, 1965 and Rs. 2734 at December 31, 1966 have a purchasing power equivalent to Rs. 4504 (Rs. 3879 x 1.116) and Rs. 2879 (Rs. 2734 x 1.053) respectively at December 31, 1967 price. The cash amount at December 31, 1967 requires no adjustment because it is automatically expressed in the rupee of that date. The same procedure is followed for accounts receivable, marketable securities and other monetary assets.

(b) Inventory: The year-end inventory is converted at the average price of the last quarter of each year with the assumption that they were acquired at the average rupee value of the last quarter of each year. For instance, the inventory of Rs. 9553 at December 31, 1963 (column (1)) assumed to be acquired at the average price for the last quarter of 1963 and were adjusted to Rs. 13346 (column (3); Rs. 9553 x 1.397). The same procedure is followed for each year.

(c) Fixed assets: The fixed assets as of year-end 1963 have been adjusted by multiplying the recorded amount by the multiplier of 1.409 (153.3/108.8). Thus Rs. 15737 of the fixed assets (column (1) in 1963) has a equivalent purchasing power of Rs. 22173 (column (3)) at December 31, 1967 price level. The addition to the fixed assets in subsequent years has been adjusted by multiplying with the multiplier of each year. For instance, Rs. 449 of fixed assets added in the year 1964 has an equivalent purchasing power of Rs. 559 (Rs. 449 x 1.246) at December 31, 1967 price level. The same technique has been followed for the years 1965, 1966 and 1967. The amount of depreciation has been adjusted for the price level changes similar to that of fixed assets.[12]

(d) Current Liabilities and Long Term Debts: For the adjustment of the current liabilities and long term debt, the procedure as followed in the case of cash, accounts receivable, etc. has been adopted. That is, each year's amounts of current liabilities and long term debt have been multiplied by the year-end multiplier of that year.

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[12]Strictly speaking, the total depreciation amounts of each year do not represent the amount charged against the fixed assets of that particular year and hence a single multiplier for each year's depreciation allowance should not be used. But for the sake of simplicity, a single multiplier of each year is used for adjustment purposes.

(e) Common Stock: The common stock is adjusted like the fixed assets. The common stock prior to the year 1963 is assumed to be issued in the year 1963. Rs. 15737 of common stock of 1963 (column (1)) has a purchasing power equivalent to Rs. 22173 (column (3); Rs. 15737 x 1.409) at December 31, 1967 price level. The addition in the common stock in each year has been adjusted at the year-average multiplier of the respective year.

(f) Retained Earnings: The amounts of retained earnings in the adjusted balance sheet (column (3)) are simply the residuals required to balance the accounts. This balance of the retained earnings represents the completely adjusted undistributed earnings or loss, plus or minus the gains and losses on all the items of the balance sheet from price level adjustment. The common stock and retained earnings taken together represent the amount of the stockholders' interest in the business after all the items have been adjusted for the change in the value of the rupees.

PART II

Computation of Net Income

After adjusting the various items of the balance sheet the net incomes for the years 1963 to 1967 have been computed. The net incomes for these years were computed

by a comparison of the retained earnings at the beginning and end of the year after adjusting for the dividend of that year. The details are given in Exhibit 4.3.

Column (1) analyzes the net income as reported (historical cost basis) in the income statement of the subsidiary for each year. Column (2) gives the net income as derived after making provision for the price level adjustment. It is arrived on the basis of the capital maintenance concept of income and is, therefore, an all inclusive income (Note especially inclusive of purchasing power gain or loss).

Assumptions for Computation of Net Income

The net income has been computed on the basis of the following assumptions:

(1) The amount of the divident given in column (1) has been adjusted for the price level change (column (2)) on the basis of the adjusted year-average Consumer Price Index of each year. The amount of dividend has been assumed to be declared and paid uniformly throughout the year.

(2) Since the information necessary to compute the price level adjusted retained earnings for the year-end 1962 is not available, the net income of 1963 (Rs. 2943) is adjusted by the use of price multiplier of the year 1963 (i.e., 1.409) which comes to Rs. 4150 (Rs. 2946 x 1.409).

Exhibit 4.3.--Sample computation of net income for 1963-1967 (Figures in thousand rupees).

	1963		1964	
	Historical	Adjusted	Historical	Adjusted
	(1)	(2)	(1)	(2)
Stated retained earnings at current year-end	9,263	13,017	8,526	11,096
Correction[a]	-	-	+1,654	+2,061
Year-end retained earnings	9,263	13,017	10,180	13,157
Plus Dividend paid	2,400	3,382	2,805	3,495
Total	11,663	16,399	12,985	16,652
Less retained earnings at previous year-end	8,720	-	9,263	13,017
Net Income	2,943	4,150[b]	3,722	3,635

	1965		1966		1967	
	Hist.	Adjusted	Hist.	Adjusted	Hist.	Adjusted
	(1)	(2)	(1)	(2)	(1)	(2)
State retained earnings at current year-end	8,601	10,853	10,301	12,349	11,844	12,692
Correction[a]	-1,814	-2,133	-207	-224	-710	-702
Year-end retained earnings	6,787	8,720	10,094	12,125	11,134	11,990
Plus dividend paid	4,347	5,112	3,155	3,417	3,156	3,121
Total	11,134	13,832	13,249	15,542	14,290	15,111
Less retained earnings at previous year-end	8,526	11,096	8,601	10,853	10,301	12,349
Net Income	2,608	2,736	4,648	4,689	3,989	2,762

[a]Refer to Item 3, p.111

[b]Refer to Item 2, p.109

(3) The amount with the (a) shows the difference between the net income as reported in the subsidiary's published income statement for each year and the net income amount as arrived by the aggregation of the retained earnings of the current year plus dividend minus retained earnings of the previous year. In fact, there should not have been any difference between the net income figure as shown in the income statement and the net income figure as arrived through this method. This difference is due to the retained earnings reserve figures. This difference has been seen in a few subsidiaries and care has been taken to correct this difference.

PART III

Return: Parent Versus Subsidiary Viewpoint

The translation (into dollars) of the financial statement of a foreign subsidiary is often recommended on the following grounds:[13]

1. Since the U.S. parent company's investment is in dollars, the operations of the foreign subsidiary must be expressed in dollars in order to evaluate the return produced by the dollar investment.

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[13]National Association of Accountants, Management Accounting Problems in Foreign Operations, (New York, March 1960), pp. 10-11.

2. Management in the United States is accustomed to thinking in terms of dollars rather than in foreign currency units.

3. The objective of business operations abroad is profit which benefits shareholders of the U.S. parent company through dividends paid in U.S. dollars or through an increase in dollar values of the U.S. shareholders' equity. Translation of local currency is a prerequisite to determining the periodic loss or gain sustained by the U.S. parent company from movements in exchange rates. This figure measures the degree of success which management has had in protecting the U.S. company's dollar investment against erosion from currency depreciation. [Emphasis supplied]

4. In order to consolidate foreign financial statements with domestic statements, all of the statements to be consolidated must first be expressed in homogeneous monetary units.

Among the above reasons, the determination of the periodic gain or loss sustained by the U.S. parent company from movements in exchange rate appears to be of paramount importance for this study. When the rate of exchange changes greatly, the translation of the financial statements of foreign subsidiary from the foreign currency into dollars would, no doubt, provide substantially different results. Under such a situation, the translation would be essential to fully determine the parent's financial interests.

The rate of exchange at which the Indian currency is converted into a stable foreign currency has fluctuated within a narrow range. In other words, throughout the 1963-67 period of this study, the dollar-rupee exchange rate remained fairly stable (except for the devaluation of 1966). Under such circumstances, it may be argued that

translation of the balance sheets of the subsidiary into dollars would produce more or less identical ratio relationships. Thus the main argument for translating the balance sheet of the U.S. subsidiary into dollars (from the parents' viewpoint) would be to take into account formally the exchange loss suffered by the parent corporations on account of the devaluation of the Indian currency which occurred during the period under study (i.e. on June 6, 1966).

However, for this study the computation of income is important both from the subsidiaries' and parents' viewpoint. We are interested in the subsidiaries' rate of return as they operate in the Indian economy and the business risk (variability) associated with their performance. We are also interested in the parent corporations' income (change in dollar-measured equity) and rate of return on their equity. In the present study, the annual income from each of the two viewpoints would not be the same although the five-year average rate of return would be about the same. The main difference would be due to the differing pattern of inflation rates in both countries and the 1966 devaluation of the exchange rate.

Let me illustrate this point with an example using the actual price level indices, as derived from Table 4:1

data, and exchange rates.[14]

Exhibit 4.4.--Illustration of the joint effect of host country inflation and exchange devaluation on the dollar value of a parent company's investment.

	Asset Purchase (in 1963)	At Year-End				
		1963	1964	1965	1966	1967
Historical Cost						
A. rupees	478	478	478	478	478	478
B. dollars	100	100	100	100	100	100
Adjusted Rupees						
C. December 31, 1967 price index	746	746	746	746	746	746
D. Price index as of each year-end		488	574	602	688	746
E. Exchange Rates (rupee)		4.78	4.79	4.78	7.57	7.56
F. Equivalent Dollar Value	100	102	120	126	91	99

Assume an American parent company transmits in 1963 $100 to the Indian subsidiary. The subsidiary invests the

[14]The rate of exchange between Indian and U.S. currencies is given as follows:

As of December 31	Exchange Rate (One Dollar Equivalent To)
1963	Rs. 4.780
1964	Rs. 4.794
1965	Rs. 4.789
1966	Rs. 4.787 (January '66 to June 5,'66)
	Rs. 7.576 (June 6, '66 to Dec. 31, '66)
1967	Rs. 7.564

Source: International Financial Statistics, (Washington: International Monetary Fund) Vol. XXI, No. 12.

Rs. 478 obtained in an asset (non-depreciating, for simplicity's sake). Line A of Exhibit 4.4 shows how conventional (historical cost) accounting would treat that assets as it is held over the remainder of the five-year period. Conventional translation into dollars (which assumes historical cost in the subsidiary's statements) uses the exchange rate in effect at the purchase date and thus the pattern resulting would be that of line B.

Line C illustrates the method used for price level adjustment in this case;[15] that is, all statements were restated at the price level prevailing as of year-end 1967. The Rs. 746 thus represents the purchasing power invested in the asset in terms of the 1967 rupee, i.e., Rs. 478 times 1.56 (1.56 equals 181.4, the 1967 index, divided by 116.1, the 1963 index). Through this sort of adjustment, all the price level adjusted subsidiary statements were made internally consistent and comparable over time.

Of course, the price level increase took place gradually while the exchange rate change (devaluation of the rupee) was sudden. Lines D, E and F together illustrate their joint year-by-year effect on the dollar valuations of the economic value of the asset. Here a slightly different approach to price-level adjustment is needed. Noting

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[15]For the present study, the adjusted consumer price index has been used; for details, see p. 97 of this chapter.

line D (1963), the Rs. 488 figure represents the original investment of purchasing power in terms of the year-end 1963 rupee--there was a slight (1.7%) inflation during 1963 (478 times 1.017 = 488). Then, the Rs. 488 is translated (line F) into dollars at the Rs. 4.78 = $1 exchange rate, which remained constant.

Line F thus illustrates the effects, from the parents' view, of their capital gains from Indian inflation in every year, less in 1966 the capital loss from devaluation. The reasoning that the Line F value pattern actually does represent gains and losses to the parent is as follows. I am assuming that the "real" value of the asset in the Indian economy remains constant. This means that under inflation it is "worth" progressively more rupees, either in immediate sale or in any value derived from the value of its future output of "products." So long as the dollar-rupee exchange rate remains stable, the asset is thus worth progressively more dollars, a capital gain to the parent. However, devaluation of the rupee (while not influencing directly the rupee value of the asset) results in the asset being suddenly worth, either in sale or in use, less dollars, a capital loss to the parent.

As line F also illustrates, the gains and the loss roughly offset. The price level increase of the five-year period was 56% while the devaluation in 1966 was 58%.

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The income figures computed for the present study, after price level adjustment but not translated into dollars, exclude (1) parents' capital gains (in all years) from the price level adjustment (inflation with no exchange rate change) and (2) parents' capital loss from devaluation (in 1966). Thus the income figures represent essentially the subsidiary's experience in the Indian economy and hence the variability of return would be an indicative of business risk as it does not include the parents' capital gain or loss.

From the parent company's viewpoint, the profit figures would have been higher in 1963, 1964, 1965 and 1967 if the capital gains were included in the computation of income figures but the income figures would have been lower in 1966 due to the exchange loss on account of devaluation of Indian currency. These profit figures would have shown more variability in returns because of larger exchange loss in 1966 and higher rates of return in other years. But as indicated above, we can assume rough equality of these factors over five-year total returns (from parent corporations' viewpoint).

Summary

The present chapter described the techniques and procedures followed for the price level adjustment and computation of the net income of one subsidiary. The same

techniques and procedures described in the case of the example have been adopted for all participating subsidiaries. The financial statements of the parent corporations have not been adjusted. Through the use of the "adjusted price-level index" (developed in Table 4.1) the parents and subsidiaries have been placed in a roughly equal position, so far as adjusting for the effects of inflation is concerned, in computing the comparative financial ratio (though the absolute amounts so derived are not meaningful). The adjusted financial statements of the U.S. subsidiaries and the unadjusted financial statements of the parent corporations have been used as the basis for the analysis of the investment policy and performance discussed in Chapters V and VI.

CHAPTER V

INVESTMENT POLICY

The present chapter is divided into three parts. The first part discusses the objectives of the U.S. corporations for investing in India. The second part describes the procedure and the practice of incorporating the capital budgeting theory in the field of international business investment. The last part tests the hypothesis regarding the investment policy of the U.S. subsidiary in India. The information for parts I and II is collected from library research, questionnaire survey and personal interviews whereas part III is mainly based on the adjusted financial statements of the subsidiaries. The information about the U.S. corporations was collected from the Moody's Industrial Manuals for various different years.

PART I

Objectives of Investment

Why do U.S. corporations invest their capital in foreign countries? In other words, what is the motive for investing in the overseas operations? The general view is to earn profit from foreign operations. It is generally

assumed that to pursue and induce U.S. corporations to invest in and operate manufacturing facilities abroad, the rate of return on foreign investment should be higher than the U.S. return to compensate for the greater risk. A number of studies have been conducted regarding the objectives of investing corporations in foreign countries.

Barlow and Wender, and Gordon and Grommers point out that manufacturing companies invest abroad primarily to maintain a market.[1] Casanova's article regarding the idealogy of the U.S. corporations concerning foreign investment mentions that "the objective of foreign investments is to solve the economic problems of the United States, which are related to over-production and the accumulation of capital." The policy of investment abroad is to obtain a higher rate of profit.[2]

The survey conducted by Dr. J. N. Behrman regarding the motives of companies investing abroad led to the conclusion that "the motives (are) complex and not singularly

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[1]E. R. Barlow and Ira Wender, Foreign Investment and Taxation, (Englewood Cliffs, New Jersey: Prentice-Hall, 1955), p. 160; L. Gordon and E. L. Grommers, United States Manufacturing Investments in Brazil, (Harvard University, 1962) p. 148.

[2]Pablo G. Casanova, "The Idealogy of the United States Concerning Foreign Investment," Foreign Investment in Latin America, (Edited by Marvin D. Bernstein)(New York: Alfred A. Knopf, 1966), p. 238.

profit-directed."[3] These motives include to increase exports and imports, to obtain raw materials at lower costs from abroad, diversification and to maintain supplier relations with a customer. McLean has divided the sound business reasons for international investment into two categories--profit opportunities and competitive necessities. A steadily increasing number of American businesses are finding excellent growth prospects and rewarding profit opportunities from participation in foreign industrial development. The development of local industries abroad has in some cases made it impossible from a competitive and economic standpoint to continue shipments from the U.S.A., and the manufacturers so affected have been forced to establish plants abroad to retain their business.[4] Falk emphasizes that there would be no plausible reason for expanding activities into a foreign market unless there was a distinct purpose and this purpose, in its last analysis, can be only additional profit. Whether the profit goal is achieved in the short-run or the distant future,

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[3]J. N. Behrman, "Foreign Associates and Their Financing," United States Private and Government Investment Abroad (Edited by Raymond F. Mikesell)(Eugene, Oregon: University of Oregon Books, 1962), p. 88.

[4]John G. McLean, "Financing Overseas Expansion," Harvard Business Review, (March-April 1963), pp. 53-65.

there can be no doubt that the ultimate purpose of a foreign operation must be profit.[5]

Stonehill's study of foreign investment in Norway indicates that in about one-half of the cases "a reduction in the cost-of-goods sold" was the general goal for investment. The strategic considerations (such as tariff or other import restrictions) and rate of profit were mentioned respectively by one-fourth and one-fifth of the cases. His final conclusion was that the cost-of-goods sold by the investing firms, strategic considerations and profits in the Norwegian enterprises were really subsets of an overall goal of profit for the investor.[6]

Brash's extensive study of American investment in Australian industries indicates that "by far the most important single reason given for the decision to invest was to take the advantage of the expected growth of the Australian market." Besides this, the tariff barriers and import restrictions were also mentioned as important motives for investment.[7] In the National Industrial

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[5]Baldhard G. Falk, "Management Requirements of Foreign Operations," Management International, Vol. 6 (1963), pp. 51-52.

[6]Arthur Stonehill, Foreign Ownership in Norwegian Enterprises, (Oslo: Central Bureau of Statistics of Norway, 1965) p. 79-80.

[7]Donald T. Brash, American Investment in Australian Industry, (Cambridge, Mass.: Harvard University Press, 1966) pp. 35-36.

Conference Board study of U.S. production abroad and the balance of payment, Judd Polk and others conclude that the investment decisions are made in response to competitive necessities that affect the entire earning position of their operation abroad ". . . while profit is correctly seen as the motivation of investment, few instances were encountered where a company executive felt that further investment could cease or to be materially slowed down without prejudice to the entire earning position."[8] Thus the study points out that the marketing strategy was the dominant element in the investment decision.

The review of these studies indicates that the main motives of the corporations investing in foreign countries are profit-oriented. These various motives are related either to cost considerations (i.e., reduction of cost-of-goods sold, availability of raw materials, tariff barriers, lower labor costs, transportation cost, etc.) or to revenue considerations (i.e., good market potential, expected growth of the economy, etc.). To find out the view of U.S. corporations regarding their motives of investing in India, the questionnaire survey indicates the following objectives.

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[8]Judd Polk and others, U.S. Production and the Balance of Payments, (New York: National Industrial Conference Board, Inc., 1966) pp. 35-36.

Objectives of Investing in India

The response of the U.S. parent corporations regarding their objectives of original investment in India (Question 1 of Appendix 1) is given in Table 5:1.

Table 5:1.--Objectives of original investment in India.

	Number of Companies
1. Expectation of profit	13
2. Taking advantage of future growth of Indian economy	10
3. Expansion of market for their products	7
4. Lower cost of production	2
5. Tariff or other import restrictions	2
6. Supply of raw materials	-
7. Any other (please specify)	-
Total	34[a]

[a]14 U.S. corporations surveyed by questionnaire responded but several mentioned more than one reason for the investment in India.

The response of U.S. corporations indicates that the expectation of profit was the main objective of original investment in India. However, taking advantage of future growth of Indian economy and expansion of market for the products were mentioned as two important sub-objectives for original investment in India. The lower

cost of production and tariff or import restrictions in India were also pointed out as the objectives for investing in India but these were not the common motives for attracting these U.S. corporations in India. Not a single corporation pointed out the supply of raw material as the reason for starting investment project in India. It may be emphasized that the objectives of taking advantage of future growth of Indian economy, expansion of production, lower cost of production and tariff or import restriction are closely related with the main objective of original investment, i.e., expectation of profit.

When the objective of the U.S. corporations going abroad was asked, during the course of personal interviews, the profit motive was usually clearly mentioned. Many of them (firms) also emphasized the better market opportunity for their products in the expanding Indian economy. But these executives pointed out that their corporations were interested not in short run profits, but in the long-run profit objective. If the demand for their products was increasing in India, the parent corporations professed to be not overly concerned about the near-term rate of return on their investment.

PART II

Capital Budgeting Theory and International Investment

The main purpose of describing the capital budgeting approach in the context of international business investment is, not to test the applicability of this approach in the context of U.S. corporations' investment in India,[9] but to provide a general idea regarding the techniques and the practices followed by the U.S. corporations for evaluating their investment decisions in the international field. This part, based on questionnaire survey personal interviews, covered some aspects, such as who makes the various types of decisions, what techniques are used for evaluation, what factors are considered, etc.

During the course of personal interviews, the basic processes of making foreign investment decisions was asked. The narrations of the eleven executives in eight U.S. corporations[10] point out a general pattern followed by the

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[9]Hardly any study has been conducted regarding this aspect of the problem. One author has described the situation in the following words. ". . . No organized efford has even been made successfully to extend the scope and application of the capital budgeting theory to the international field. . . ." (J. R. Bugnion, "Capital Budgeting and International Corporation," The Quarterly Journal of AIESEC International, Vol. I, No. 5, (Geneva, Switzerland) November, 1965, p. 31.

[10]Refer to Chapter II, p. 83

U.S. corporations. Information regarding the various aspects of the capital budgeting approach was also collected with the help of the questionnaire survey. A brief description of the process of evaluating foreign investment decisions is presented here. The process is described in the context of their investment in India. However, the same process may not be followed by each corporation and may vary depending upon the financial resources of the corporations, their experience of working in foreign countries, nature of their business, attitudes of the top management, etc.

To explore the opportunity and the possibility of investing in a foreign country, U.S. corporations typically conduct a broad survey of the economic, political and social environments of the foreign countries. The various government policies and regulations affecting the foreign investment are studied carefully. On the basis of such a survey, the corporations try to evaluate the investment climate and form a broad opinion about the opportunities and the various obstacles presented in the foreign country. If corporation has a favorable attitude, then it proceeds to conduct a detailed survey of the marketing and manufacturing possibilities of their products. This involves the estimates of the possible demand for their products, the competition in the particular product market, the cost of producing the goods, etc. These estimates are prepared

from the short and long term point of views. Then the corporation examines the financial aspects of the project. At this stage, the corporation also decides the nature of ownership, the possible Indian partner to be included in the project, size of units, area of country, product lines, trade channels, etc. Once this detailed analysis is evaluated, a decision is made regarding the possibility of starting the project in India; and the U.S. corporation, as the case may be, either talks to the potential Indian partner, soliciting his collaboration, or proceeds to negotiate with the Government of India.

For evaluating the specific capital expenditure decisions, the U.S. corporations utilize various quantitative and qualitative techniques. In evaluating various aspects of the investment, top priority is given to the subjective evaluation of the project. The personal experience and the observation of the top executives of the corporation about India, their business experience in other developing countries and the suggestions of other foreign investors in India greatly influence the foreign investment decisions of the U.S. corporations.

While analyzing the technical aspect, the U.S. corporations examine the expected rate of return, both from short and long term viewpoint, on the investment. They try to develop a sort of trade-off between the expected rate of return and the growth and expansion of their

products' market. In the short run the corporations emphasize the development of market but in the long-run the corporations expect that their subsidiaries should be able to earn at a greater rate than the domestic applications (parent's rate of return would indicate this with given allowance for risks).

The final decisions for the investment in foreign country is affected by the internal factors of the parent corporation and the external factors of the foreign country. Judd Polk and others have pointed out that"the components of the company system [U.S. corporations] coming from within and the environmental factors coming from outside converge on management in the formulation of international investment decisions . . . executives mutually consider the possibilities through objective analysis but they envitably inject subjective opinion and feeling."[11]

Some aspects of the above process are discussed, in brief, under the following headings.

Who Makes the Final Decision?

The final decision regarding the major capital expenditures (larger than 5% of equity investment), choosing the sources of financing of capital expenditures and employment of top executives of subsidiaries are mainly

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[11]Judd Polk and others, op. cit., p. 55.

taken by the parent corporation.[12] In some cases, even the minor capital expenditure decisions are under the jurisdiction of the parent corporation. In two cases, it was pointed out that their Indian subsidiaries also shared the responsibility for deciding the nature of the major capital expenditures. In general, though, the financial aspects of the subsidiaries' operations appear to be under control of the parent corporation.[13] The production planning, marketing planning, purchase of raw materials and day-to-day operations of the subsidiary are the main responsibility of the subsidiary and the parent corporation does not usually become involved in these affairs. The details of this (Question 2 of Appendix 1) are given in Table 5:2.

Choosing Among Alternative Proposals

As regards the detailed economic surveys of the most likely investment opportunities, the response of the parent corporations (Question No. 3 of Appendix 1) indicates that nine of the U.S. corporations conduct such

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[12]Even where U.S. ownership is nominal (10% to 25%), the parent corporations have greater influence on major decisions.

[13]Similar findings were reported by Jean-Luc Rocour, "Management of European Subsidiaries in the United States," Management International, I, (1966) pp. 22-23.

Table 5:2.--Authority for making decisions for different policies.

	Parent Corporation	Indian Subsidiary	Total
a) Major capital expenditures (larger than 5% of the equity investment)	14	2	16[a]
b) Minor capital expenditures (below 5% of the equity investment)	7	7	14
c) Choosing sources of financing of capital expenditure	9	5	14
d) Production planning	1	13	14
e) Marketing planning	-	14	14
f) Purchase of raw materials, equipment, etc.	-	14	14
g) Day-to-day operations	-	14	14
h) Employment of top executives	9	5	14

[a]Two corporations mentioned that the decision is made jointly by the parent corporations and subsidiaries. Thus in none of the sample firms does the management of the subsidiary act unilaterally.

surveys whereas the other five U.S. corporations[14] do not conduct such surveys.

[14]These corporations rely on personal impression, prior knowledge and other sources of information.

For the evaluation of foreign investment alternatives, the U.S. corporations apply both formalized quantitative models and subjective evaluation, though their emphasis on the different techniques differs from corporation to corporation. More than one-half of the U.S. parents pointed out that they placed great emphasis on formalized quantitative models, while two-thirds of the same U.S. corporations also mentioned that they utilized subjective evaluation (Question 4 of Appendix 1). The details are given in Table 5:3.

Table 5:3.--Techniques used for evaluation of alternative proposals.

	Emphasis Given					
	Very Much		Somewhat		None	
	No. of Comp.[a]	% of Total	No. of Comp.[a]	% of Total	No. of Comp.[a]	% of Total
a) Formalized Quantitative Models	7	58	4	33	-	-
b) Subjective Evaluation	5	42	8	67	-	-
Total[b]	12	100	12	100	-	-

[a]Comp. = Companies.

[b]Two corporations did not mention any techniques.

Among the U.S. corporations using the formalized quantitative models for the evaluation of alternative proposals, the payback and the internal rate of return methods are more prevalent than the net present value method and the average rate of return on book value. A few other methods were also reported (Question 4(A) of Appendix 1). The details are given in Table 5:4.

Table 5:4.--Formalized quantitative models used by U.S. corporations.

	Number of Companies
a) Payback method	8
b) Internal rate of return	6
c) Net present value method	4
d) Average rate of return on book value	3
e) Any other method	4
Total[a]	25

[a]Many of the corporations responded that they follow more than one method.

Among these methods, the payback method is the most popular method of capital budgeting. Out of the fourteen U.S. corporations, eight corporations followed this technique.[15] But many corporations supplemented this

[15]The payback method is also a popular method used by the U.S. corporations for evaluating the capital

method with other methods.

Variables Affecting the Risks of Foreign Investment Decisions

There are a number of environmental variables which are considered to be important for the foreign investment decisions. Some of these variables are of major importance while others are considered as minor variables in affecting the foreign investment decisions. Among the various variables, present or absence of limitations on remittance of profit, stability of exchange rate, convertibility of currency, repatriation of capital, political stability and rapid economic growth of the foreign country are considered to be of paramount importance and the parent corporations placed major emphasis on these variables.

Six of the fourteen give major emphasis to the rate of inflation and tax considerations as an important but not of primary significance. The encouragement provided by the U.S. Government for foreign investment is not considered at all as an important variable influencing the foreign investment decision of the U.S. corporations. Amont these variables, none (except encouragement provided

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budgeting decisions for the domestic investment. A survey made by the Machinery and Allied Products Institute indicates that 60% of the survey-firms (U.S. corporations) use the payback period. (J. Fred Weston and Eugene F. Brigham, Managerial Finance, Third Edition, (New York: Holt, Rinehart and Winston, 1969) p. 180.

by the U.S. Government) is treated as insignificant in making the foreign investment decisions (Question No. 8 of Appendix 1). The details are given in Table 5:5.

Table 5:5.--Variables affecting foreign investment decisions.

	Emphasis Given by Number of Companies			
	Major	Minor	None	Total
1) Repatriation of capital	11	3	-	14
2) Convertibility of currency	13	1	-	14
3) Stability of exchange rate	13	1	-	14
4) Remittance of profit, etc.	14	-	-	14
5) Foreign tax considerations	6	8	-	14
6) Inflation	6	8	-	14
7) Political stability	12	2	-	14
8) Rapid economic growth	9	5	-	14
9) Encouragement by U.S. Government	-	10	4	14
10) Any other	-	-	-	-

Alternative Methods of Treating Risks

While evaluating the investment possibilities for foreign countries, twelve of the fourteen U.S. corporations indicated that they consider risk element explicitly in their decision making process (Question 5 of Appendix 1). Most of these 12 corporations use more than one technique

for incorporating the risk aspects. About one-half of the U.S. corporations vary the required rate of return on investment. Some corporations use shorter payback period and higher discounting rate but these two methods are not as popular as the varying rate of return on investment. In some cases, the U.S. corporations do not use the formalized techniques (Question No. 5(i) of Appendix 1). The details are given in Table 5:6.

Table 5:6.--Techniques used to incorporate risk in foreign investment.

	Number of Companies		Percentage of Total
A) Formalized Techniques		20	91
1. Varying the required rate of return on investment	10	45	
2. Varying the payback period	3	14	
3. Higher discounting rate	2	9	
4. Sensitivity analysis	2	9	
5. Adjusting the cost of capital in present value method	1	4	
6. Simulation by model	2	9	
B) Subjective Evaluation		2	9
Total[a]		22	100

[a]Many corporations used more than one technique.

Cost of Capital

In the evaluation of capital budgeting decisions, the cost of capital is considered as important variable. Some U.S. corporations use different cost of capital for their domestic and foreign investments. The response of the U.S. companies (Question No. 6 of Appendix 1) indicates that about two-thirds of these (nine of the fourteen) corporations use the same cost of capital for the domestic and foreign investment purposes. The other five firms do, however, make this distinction and use separate cost of capital for domestic and foreign investment.[16] These five apply various techniques for adjusting the cost of capital for foreign investment decision purposes; as detailed in Table 5:7.

Table 5:7 indicates that no single method of calculating the cost of capital for the foreign investment decision is especially popular among the U.S. corporations in this sample and each uses different technique to adjust it.

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[16]"In a recent survey of ninety-two U.S. companies with substantial direct investment, thirty-nine of them said that, in making up their capital budgets, they made no distinction between foreign and domestic investment alternatives." Sanford Rose, "The Rewarding Strategies of Multinationalism," Fortune, Vol. LXXXVIII, No. 4, September 15, 1968, p. 101.

Table 5:7.--Adjustment of cost of capital for foreign investment.

	Number of Companies
1. Varying cost of capital subjectively	1
2. Use parent corporation's cost of capital	1
3. Use prime interest rate of U.S.A.	1
4. Use cost of capital of foreign subsidiary	2
5. Any other	1
Total[a]	6

[a]One corporation reported two methods.

PART III

Investment Policy

The main purpose of this part of the chapter is to test the following hypothesis:

> The investment policy of the U.S. subsidiaries is similar to that of their parent corporations. (Ho) The alternative hypothesis is that the investment policy of the U.S. subsidiaries is materially different from their parent corporations. (H1)

The criterion for testing the above hypothesis is to compare components and forms of investments, financial structure, and dividend payout ratios of the U.S. subsidiaries with their parent corporations. These comparisons will be made, not on the individual basis, but

on an aggregate basis and also on the basis of nature of industry, age, ownership, management and size of the U.S. subsidiaries. In each comparison, the parent and its subsidiary are paired. The comparison is made on the basis of ratio scale.

It is widely assumed that when the U.S. corporations take decisions to invest in the foreign country, they examine the various aspects of the investment projects. Among these aspects, the nature of their investment and the sources of financing are of great significance. Since the major capital expenditures and the sources of financing are mainly governed by the parent corporations, it may be hypothesized that their subsidiaries will follow similar investment patterns, and financial structure as that of their parent corporations. And if they follow similar investment patterns and financial structure, it will be reflected on the financial statements of their subsidiaries. Lindsay and Sametz have pointed out that "Every time management makes its decisions to undertake a new investment project, it is at the same time making a decision as to the appropriate capital structure the firm should have."[17] Thus the investment pattern and the financial structure of

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[17]J. Robert Lindsay and Arnold W. Sametz, Financial Management, Revised Edition, (Homewood, Illinois: Richard D. Irwin, Inc., 1967) p. 319.

the subsidiaries would reflect all the previous decisions made by the parent corporations.

On the other hand, it is also argued that, although the investment and financial policies of the subsidiaries are mainly under the jurisdiction of the parent corporations, the subsidiaries operating in foreign countries try to adjust their investment and financial policies to suit the foreign environment. In other words, economic, political and other situations may influence the investment and financial policies. Moreover, nature of industry, age, ownership, management and size of the subsidiaries may influence investment pattern, and financial structure of the subsidiaries.

The main hypothesis mentioned above has been divided into the following three sub-hypotheses:

(1) The ratio of investment in the asset composition of the U.S. subsidiaries is the same as that of their parent corporations. (Ho) The alternative hypothesis is that the ratio of investment in the asset composition of the U.S. subsidiaries is different from their parent corporations. (H_1)

(2) The financial structure of the U.S. subsidiaries is similar to their parent corporations (Ho). The alternative hypothesis is that financial structure of the U.S. subsidiaries is different from their parent corporations. (Hi)

(3) The dividend payout ratio of the U.S. subsidiaries is equal to their parent corporations (Ho). The alternative hypothesis is that the dividend payout ratio of the U.S. subsidiaries is not equal to their parent corporations (Hi).

The above three sub-hypotheses have been discussed under the captions 'Investment in Assets,' 'Financial Structure,' and 'Dividend policy' respectively. The discussion in each part is based on the price level adjusted financial statements of 27 participating U.S. subsidiaries and the unadjusted financial statements of their parent corporations.[18]

Investment in Assets

It is hypothesized that the investment of the U.S. subsidiaries in the various major asset types is similar to their parent corporations. If the subsidiaries follow the same general pattern of investment policy as that of their parent corporations, the null hypothesis will be accepted and the alternative hypothesis will be rejected.

The term 'investment' refers to the amount of the capital invested in the different assets of the firm. It incorporates the total current assets, fixed assets and other assets and is reflected on the asset side of the balance sheet. While analyzing the investment projects,

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[18]For details, refer to Chapter IV.

the financial experts in the academic world place greater emphasis on the permanent nature of the assets (such as investment in plant and machinery) and ignore the investment in current assets. However, any analysis without current assets would be misleading because cash, marketable securities, accounts receivable and inventory also represent investment and the same capital budgeting theory is applicable in these types of current assets also.[19] Their composition and pattern in the case of each firm also reflects the previous decisions taken by the management.

Overall Comparison.--Table 5:8 represents a comparative picture of the investment in the different assets by the subsidiaries and the parent corporations for the years 1963-67. The table indicates that the U.S. subsidiaries invested approximately one-half (48%) of their total resources in net fixed asset whereas their parent corporations invested about two-fifths (40%) in this asset. On the other hand, the parent corporations had more than one-half (53%) of their total assets in the form of total current assets as against about two-fifths (46%) by their subsidiaries. Moreover, the investment of subsidiaries in the net fixed assets had always been greater than their parent corporations in each year. The opposite situation

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[19]Seymour Friedland, The Economics of Corporate Finance, (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1966) pp. 52-144.

Table 5:8.--Investment pattern of subsidiaries and their parent corporations (1963-1967). (In percentage.)

	1963	1964	1965	1966	1967	Average 1963-67
Cash and marketable securities						
Parent	11.69	11.69	11.11	8.76	7.35	10.12
Subsidiary	4.92	3.55	4.16	3.43	3.49	3.91
Accounts receivable						
Parent	17.98	18.42	19.32	19.70	19.42	18.96
Subsidiary	11.80	11.85	13.41	11.98	13.65	12.54
Inventories						
Parent	23.11	22.59	23.38	24.43	24.33	23.57
Subsidiary	25.54	26.08	25.65	25.95	26.62	25.97
Other current assets						
Parent	0.52	0.93	0.10	0.41	0.76	0.55
Subsidiary	1.31	2.79	3.81	4.91	4.25	3.41
Total current assets						
Parent	53.30	53.63	53.91	53.30	51.86	53.20
Subsidiary	43.57	44.27	47.03	46.27	48.00	45.83
Other assets						
Parent	6.58	7.10	7.51	7.63	7.55	7.27
Subsidiary	8.44	6.00	5.72	5.68	6.98	6.57
Fixed assets						
Parent	40.12	39.27	38.58	39.07	40.59	39.53
Subsidiary	47.99	49.73	47.25	48.05	45.02	47.60
Total assets						
Parent	100.00	100.00	100.00	100.00	100.00	100.00
Subsidiary	100.00	100.00	100.00	100.00	100.00	100.00

is found in the case of current assets. The investment of the parent corporations in the 'other' assets is slightly higher than their subsidiaries.

Out of the total current assets, the investment of subsidiaries in inventories was more than one-half as against two-fifths by the parent corporations. More than one-third of the total current assets of the parent corporation was in the form of accounts receivable whereas this asset was slightly more than one-fourth in the case of the subsidiaries. The parent corporations kept a higher proportion of their total investment in the form of cash and marketable securities than their subsidiaries.

From the above aggregate level analysis, it is evident that the subsidiaries had relatively more investment in net fixed assets and inventories than their parent corporations and, of course, the parent corporations had invested relatively more in cash and marketable securities, and accounts receivables than their Indian subsidiaries. The difference is great enough to conclude that in general the U.S. subsidiaries did not follow an investment pattern similar to that of their parent corporations. The main reason for the higher percentage of investment in fixed assets by the subsidiaries may be attributed to the high initial investment in plant and machinery and the lesser depreciation write-off on the fairly new fixed assets. Moreover, due to the shortage of foreign exchange and

constant fear of import restrictions, the U.S. subsidiaries might have tried to install excess plant and machinery. This situation has also affected the decisions of the subsidiaries to accumulate raw materials and build inventories. The economic uncertainties and difficulties in procuring raw materials might have induced the subsidiaries to build large buffer stocks for any emergency.

The lower percentage of investment in accounts receivable of the U.S. subsidiaries may be due to the underdeveloped nature of credit system and facilities and stagnation in the Indian economy during these years resulting in the lower demand for the products. Moreover, the increasing inflationary pressure on the economy might have induced to the subsidiaries to give less credit to their customers.

As against this, the parent corporations did not experience economic stagnation, shortage of foreign exchange and import restrictions. Moreover, the parent corporations are fairly old and their fixed assets have been depreciated more than their Indian subsidiaries. Due to better technological and transport facilities, the U.S. corporations did not experience the severe problems of procuring raw materials, plant and machinery.

Group-Wise Comparison.--A further analysis of the assets composition on the basis of nature of industry, age, ownership, management and size of the U.S. subsidiaries

and their parent corporations points out some different features.

Industry-Wise Comparison.--Table 5:9 shows that the parent corporations have a greater percentage of investment in total current assets than their subsidiaries operating in transport, machinery, metal and metal products and 'other' industries. On the other hand, the U.S. subsidiaries operating in petroleum industry have one-half of their investment in total current assets as against only one-third by their parent corporations. The investment of the parent corporations and their subsidiaries operating in the chemical and allied industry in total current assets is more or less the same.

The investment in the net fixed assets of the parent corporations operating in the petroleum and chemical industries is greater than their subsidiaries. On the other hand, the subsidiaries operating in other industries have more investment in net fixed assets than their parent corporations.

The U.S. subsidiaries operating in transport, metal and metal products and electrical industries have smaller investment in inventories than their parent corporations. Moreover, the subsidiaries operating in machinery and transport had more than one-fourth of their investment in inventories as against less than one-seventh by the subsidiaries engaged in metal and metal products

Table 5:9.--Investment pattern of subsidiaries and parent corporations on the basis of industry (average of 1963-67). (In percentage.)

	Transport Equipment n=4		Machinery n=5		Metal and Metal Products n=3	
	Parent	Subsidiary	Parent	Subsidiary	Parent	Subsidiary
Cash and marketable securities	6.92	3.34	7.87	2.83	5.96	1.41
Accounts receivable	22.67	8.15	22.26	11.99	16.10	9.40
Inventories	30.45	25.66	37.69	39.25	16.59	13.95
Other current assets	1.47	0.96	0.87	2.34	0.18	4.46
Total current assets	61.51	38.11	68.69	56.41	38.83	28.86
Other assets	8.13	3.00	4.94	9.89	7.72	6.87
Fixed assets	30.36	58.89	26.37	33.70	53.45	64.27
Total assets	100.00	100.00	100.00	100.00	100.00	100.00

Table 5:9.--(Continued)

	Electrical n=1		Chemical and Allied n=5		Others n=7		Petroleum n=2	
	Parent	Sub-sidiary	Parent	Sub-sidiary	Parent	Sub-sidiary	Parent	Sub-sidiary
Cash and marketable securities	3.98	0.79	12.52	8.89	7.19	2.34	7.89	4.50
Accounts receivable	17.29	5.49	15.44	14.87	21.82	9.99	11.55	31.42
Inventories	7.20	1.99	19.56	23.56	21.54	23.00	8.71	13.67
Other current assets	0.82	1.18	6.60	6.77	0.19	3.38	0.97	1.22
Total current assets	29.29	9.45	54.12	54.09	50.85	38.70	29.13	50.81
Other assets	4.90	15.93	6.32	13.57	6.72	3.64	11.10	0.33
Fixed assets	65.81	74.62	39.56	32.34	42.43	57.66	59.77	48.86
Total assets	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

and petroleum industries. The share of accounts receivable of the parent corporation is higher than their subsidiaries in all the industrial groups except petroleum industry.

Age-Wise Comparison.--Table 5:10 indicates that the older subsidiaries started prior to 1956 tend to have more investment in current assets than their parent corporations. On the other hand, the new subsidiaries have larger investment in net fixed assets than their parent corporations. This is mainly due to the fact that less depreciation has been written-off in the case of new subsidiaries.

The subsidiaries in all the age groups have a greater proportional investment in inventories than their parent corporations. The U.S. subsidiaries started during 1951-1956 have larger investment in accounts receivable than their parent corporations. The U.S. subsidiaries have less cash and marketable securities than their parent corporations in all age groups.

Ownership-Wise Comparison.--Table 5:11 indicates that the subsidiaries with more than 75% U.S. ownership have more investment in total current assets and less investment in net fixed assets than their parent corporations. The U.S. subsidiaries in other ownership groups, have less investment in total current assets and more in net fixed assets than their parent corporations.

Table 5:10.--Investment pattern of subsidiaries and their parent corporations on the basis of age (average of 1963-67). (In percentage.)

	Before 1950 n=5		1951-56 n=5		1957-61 n=12		1962 n=5	
	Parent	Sub-sidiary	Parent	Sub-sidiary	Parent	Sub-sidiary	Parent	Sub-sidiary
Cash and marketable securities	9.40	4.22	7.32	4.49	8.60	3.28	10.94	8.07
Accounts receivable	19.15	13.65	17.28	19.73	18.16	7.31	22.38	14.57
Inventories	21.57	25.18	24.82	26.82	21.89	23.80	29.58	30.95
Others	0.89	8.35	0.78	7.59	2.44	0.65	1.30	0.43
Total current assets	51.01	51.40	50.20	58.63	51.09	35.04	64.20	54.02
Other assets	7.72	8.90	7.56	4.73	6.92	5.16	7.17	4.49
Fixed assets	41.27	39.70	42.24	36.64	41.99	59.80	28.63	41.49
Total assets	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Table 5:11.--Investment pattern of subsidiaries and parent corporations on the basis of ownership (average of 1963-67). (In percentage.)

	10%-25% n=8		26%-40% n=5		41%-50% n=4		51%-75% n=6		76% and Above n=4	
	P[a]	S[a]	P	S	P	S	P	S	P	S
Cash and marketable securities	9.72	2.71	7.05	3.13	9.73	9.53	9.67	3.44	7.15	1.23
Accounts receivable	21.27	10.22	15.29	9.62	20.81	13.91	16.99	12.18	20.07	16.74
Inventories	24.02	26.28	18.89	17.95	23.27	19.49	24.23	29.16	29.39	39.55
Others	0.31	1.90	0.88	3.09	1.29	2.58	5.21	0.39	0.88	8.71
Total current assets	55.32	41.11	42.11	33.79	55.10	45.51	56.10	45.17	57.49	66.23
Other assets	7.32	5.71	9.56	2.10	8.77	10.04	4.97	9.80	6.02	5.58
Fixed assets	37.36	53.18	48.33	64.11	36.13	44.45	38.93	45.03	36.49	28.19
Total assets	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a]P = Parent; S = Subsidiary.

Management-Wise Comparison.--Table 5:12 shows that 50% U.S. managed subsidiaries have larger total current assets than their parent corporations whereas in other management groups the subsidiaries have smaller total current assets than their parent corporations. The subsidiaries have more investment in net fixed assets than their parent corporations in all the management groups except 50% U.S. managed subsidiaries.

The wholly U.S.-managed subsidiaries have more investment in accounts receivable than their parent corporations. On the other hand, the majority-managed U.S. subsidiaries have less investment in inventories than their parent corporations. In others, the opposite situation is found.

Size-Wise Comparison.--Tables 5:13(A), 5:13(B), and 5:13(C) show the investment pattern of the subsidiaries in the different size groups based on total assets, total sales and total net worth respectively. Table 5:13(A) indicates that in all the size groups, total current assets of the subsidiaries form smaller percentage of total assets than their parent corporations. On the other hand, the subsidiaries in all the size groups have more investment in net fixed assets than their parent corporations but the smallest subsidiaries have relative more investment in net fixed assets than their parent corporations.

Table 5:12.--Investment pattern of subsidiaries and parent corporations on the basis of management (average of 1963-67). (In percentage.)

	All U.S. Directors n=3		Majority U.S. Directors n=9		50% U.S. Directors n=4		Minority U.S. Directors n=9		All Indian Directors n=2	
	P[a]	S[a]	P	S	P	S	P	S	P	S
Cash and marketable securities	7.40	1.86	8.64	6.26	8.75	3.67	9.59	2.50	9.03	0.94
Accounts receivable	21.67	24.08	21.13	11.74	16.67	10.58	16.78	8.68	19.55	14.60
Inventories	28.35	29.15	25.42	24.77	22.46	30.27	20.64	22.56	26.61	29.76
Others	0.85	0.80	4.17	4.26	0.16	7.66	0.49	1.10	0.54	5.96
Total current assets	58.27	55.89	59.36	47.03	48.04	52.18	47.50	34.84	55.73	51.26
Other assets	4.10	6.22	6.27	5.61	7.96	8.53	8.50	6.51	9.05	7.84
Fixed assets	37.63	37.89	34.37	47.36	44.00	39.29	44.00	58.65	35.22	40.90
Total assets	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a]P = Parent; S = Subsidiary.

Table 5:13(A).--Investment pattern of subsidiaries and parent corporations on the basis of total assets (in millions of dollars) size (average of 1963-67). (In percentage.)

	Less than $2.08 n=7		$2.08 and less than $4.20 n=2		$4.20 and less than $8.36 n=5		$8.36 and less than $20.92 n=7		$20.92 and above n=6	
	P[a]	S[a]	P	S	P	S	P	S	P	S
Cash and marketable securities	10.43	5.75	6.60	0.26	8.33	3.02	9.47	4.65	7.55	3.00
Accounts receivable	21.78	12.31	22.07	10.32	15.78	8.63	17.73	11.47	18.73	16.22
Inventories	30.09	28.91	41.40	45.42	15.95	16.37	21.49	26.73	19.83	18.86
Others	0.94	0.43	0.68	0.62	5.69	3.02	0.34	0.88	1.22	1.81
Total current assets	63.24	47.40	70.75	56.62	45.75	31.04	49.03	43.73	47.33	39.89
Other assets	6.91	7.06	2.89	14.00	5.89	6.60	9.93	7.75	7.03	2.15
Fixed assets	29.85	45.54	26.36	29.38	48.36	62.36	41.04	48.52	45.64	57.96
Total assets	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a]P = Parent; S = Subsidiary.

Table 5:13(B).--Investment pattern of subsidiaries and parent corporations on the basis of total sales (in millions of dollars) size (average of 1963-67). (In percentage.)

	Less than $0.52 n=7		$0.52 and less than $1.05 n=1		$1.05 and less than $2.09 n=4		$2.09 and less than $5.23 n=4		$5.23 and above n=11	
	P[a]	S[a]	P	S	P	S	P	S	P	S
Cash and marketable securities	8.46	2.59	3.98	0.79	13.92	10.64	7.24	2.86	8.32	2.53
Accounts receivable	22.26	9.32	17.29	5.49	14.62	16.42	20.37	9.11	18.08	14.06
Inventories	30.15	29.65	7.20	1.99	21.55	22.94	27.38	27.23	20.77	24.05
Others	0.83	0.50	0.82	1.18	1.12	0.79	-	3.54	3.30	8.25
Total current assets	61.70	42.06	29.29	9.45	51.21	50.79	54.99	42.74	50.37	48.89
Other assets	7.23	4.99	4.90	15.93	6.42	7.78	6.97	4.93	7.85	6.89
Fixed assets	31.07	52.95	65.81	74.62	42.37	41.43	38.04	52.33	41.78	44.22
Total assets	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a]P = Parent; S = Subsidiary.

Table 5:13(C).--Investment pattern of subsidiaries and parent corporations on the basis of total net worth (in millions of dollars) size (average of 1963-67). (In percentage.)

	Less than $0.52 n=3		$0.52 and less than $1.05 n=4		$1.05 and less than $2.09 n=2		$2.09 and less than $5.23 n=12		$5.23 and above n=6	
	P[a]	S[a]	P	S	P	S	P	S	P	S
Cash and marketable securities	13.51	10.76	6.97	1.61	8.87	1.04	9.00	6.87	7.55	3.04
Accounts receivable	21.67	18.76	20.57	10.01	26.66	5.24	16.92	10.20	18.73	16.22
Inventories	30.22	26.67	31.12	35.12	38.20	36.22	19.18	22.41	19.83	18.86
Others	1.15	-	0.60	1.04	-	.19	2.56	4.80	1.22	1.77
Total current assets	66.55	56.19	59.26	47.78	73.73	42.69	47.66	44.28	47.33	39.89
Other assets	6.42	13.22	5.59	3.92	6.29	11.01	8.25	7.27	7.03	2.15
Fixed assets	27.03	30.59	35.15	48.30	19.98	46.30	44.09	48.45	45.64	57.96
Total assets	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a]P = Parent; S = Subsidiary.

The smallest and the largest subsidiaries have less investment in inventories than their parent corporations but in other groups the subsidiaries have larger inventories than their parent corporations. The investment in cash and marketable securities, and accounts receivable of the subsidiaries in all the size groups is smaller than their parent corporations. Tables 5:13(B) and 5:13(C) reveal similar patterns of investment, as noticed in the case of Table 5:13(A).

The comparison of the investment pattern of the parent corporations and their Indian subsidiaries on the basis of industry, age, ownership, management and size indicates the similarity and dissimilarity of their pattern. The analysis indicates that the general pattern of investment as emerged from the aggregate level analysis is also found in most of the group-wise comparisons. But in some cases, this pattern is not noticed. For instance, the aggregate level comparison indicates that the U.S. subsidiaries have smaller accounts receivables than their parent corporations but the subsidiaries operating in the petroleum industry have more investment in this item than their parent corporations. The majority-managed U.S. subsidiaries have less investment in inventories than their parent corporations. In the same way, the smallest and the largest-sized subsidiaries (based on total size of assets) have smaller inventories than their parent corporations.

On the basis of the group-wise comparison, it is hard to draw broad conclusions because there are not enough number of subsidiaries in each group. However, the above analysis indicates that the U.S. subsidiaries operating in India did not follow similar investment pattern as that of their parent corporations.

Financial Structure

It is hypothesized that the financial structure of the U.S. subsidiaries is similar to that of their parent corporations. This hypothesis is proposed to be tested by comparing the financial structure of the subsidiaries with their parent corporations. If the subsidiaries follow the same financial structure as that of their parent corporations, the null hypothesis will be accepted and the alternative hypothesis will be rejected.

The term "financial structure" incorporates current liabilities, long term debt, preferred stock, common stock, retained earnings, etc. It refers to the "Liabilities and Stockholders' Equity" side of the balance sheet. The "financial structure" is different from that of the "capital structure" which is the permanent financing of the firm and includes long term debt, preferred stock and net worth. The main purpose of incorporating current liabilities (short-term borrowing) in the financial structure is that this source constitutes an important source of financing; and given the great importance of the bank

loans and advances and the trade credit, it seems artificial to omit the short term borrowings from the capital structure of the firm. Moreover, these short term loans and advances are often rolled forward year after year and take the form of medium-term loans and advances.

Overall Comparison.--Table 5:14 presents the financial structure of the subsidiaries and parent corporations for the years 1963-1967.

Among the different sources of finance, the total debts (current and long term) were approximately one-half of the total sources of finance of the U.S. subsidiaries whereas this source provided one-third of the total finance of the parent corporations. The current liabilities alone were one-third of the total source of finance as against one-fifth in the case of the parent corporations.

The U.S. subsidiaries raised approximately one-fifth of the total source of finance from the short term loans and advances whereas this source was insignificant for the parent corporations. Retained earnings accounted for more than one-half of the total finance of the parent corporations whereas this source provided less than one-sixth of the total finance of the subsidiaries.

Preferred stock played an insignificant role as a source of capital in the case of both subsidiaries and the parent corporation. But the share of the parent corporations was greater than the subsidiaries.

Table 5:14.--Financial structure of subsidiaries and their parent corporations (1963-67). (In percentage.)

	1963		1964		1965	
	P[a]	S[a]	P	S	P	S
Accounts payable	7.43	8.37	7.65	8.64	8.06	8.65
Loans and advances	3.38	20.19	3.74	19.30	2.46	21.32
Provisions[b]	4.81	7.28	5.51	7.79	6.69	5.58
Other current liabilities	1.90	0.16	1.59	0.32	2.72	0.59
Total current liabilities	17.52	36.00	18.49	36.05	19.93	36.15
Other liabilities	2.10	0.20	-	0.10	0.68	0.05
Long-term debts	11.75	12.48	14.45	14.44	12.87	16.15
Preferred stock	5.17	0.10	4.11	0.20	4.48	0.86
Common stock	11.39	38.74	10.66	35.79	10.25	31.85
Retained earnings	52.07	12.53	52.29	13.42	51.79	14.94
Total stockholders' equity	68.63	51.36	67.06	49.41	66.52	47.65
Total liabilities and stockholders' equity	100.00	100.00	100.00	100.00	100.00	100.00

	1966		1967		Avg. of 1963-67	
	P	S	P	S	P	S
Accounts payable	8.69	8.30	8.33	9.34	8.03	8.66
Loans and advances	4.34	18.63	5.19	17.46	3.82	19.38
Provisions[b]	5.57	6.46	4.67	5.28	5.45	6.50
Other current liabilities	2.94	0.30	2.35	1.53	2.30	0.58
Total current liabilities	21.54	33.79	20.54	33.61	19.60	35.12
Other liabilities	1.33	0.80	1.26	0.21	1.08	0.27
Long-term debts	14.45	13.20	15.54	14.41	13.81	14.14
Preferred stock	3.08	1.46	2.83	1.65	3.93	0.85
Common stock	9.55	32.03	9.30	30.40	10.23	33.77
Retained earnings	50.05	18.72	50.53	19.72	51.35	15.85
Total stockholders' equity	62.68	56.21	62.66	51.77	65.51	51.27
Total liabilities and stockholders' equity	100.00	100.00	100.00	100.00	100.00	100.00

[a] P = Parent; S = Subsidiary.

[b] Provisions for taxations, dividend and contingencies.

Thus the participating subsidiaries, on the whole, showed a total debt-equity ratio of 0.95 which is greater than the total debt-equity ratio of 0.56 of their parent corporations. It indicates that the U.S. subsidiaries relied more on the short and long term debts for financing their operations than their parent corporations. But the debt-equity ratio did not increase beyond the limit prescribed by the Controller of Capital Issues. The parent corporations depended more on the equity financing--particularly on the retained earnings. Retained earnings, on the whole, were not the major source of finance in the case of U.S. subsidiaries operating in India.

Group-Wise Comparison.--From the above analysis it is evident that the average subsidiaries did not adopt the same financial structure as their parents. A further analysis of the financial structure of the participating subsidiaries on the basis of nature of product, age, ownership, management and size of these subsidiaries would throw some more light on the comparison of the financial structure of the subsidiaries and their parent corporations.

Industry-Wise Comparison.--Table 5:15 gives the details of the financial structure of the subsidiaries and their parent corporations in the different industrial classifications. It indicates that the total current liabilities of the U.S. subsidiaries engaged in all the industrial groups were greater than their parent corporations.

Table 5:15.--Financial structure of subsidiaries and their parent corporations on the basis of industry. (In percentage.)

	Transport n=4		Machinery n=5		Metal and Metal Products n=3	
	P[a]	S[a]	P	S	P	S
Accounts payable	9.60	8.18	10.61	14.83	7.35	7.48
Loans and advances	4.80	20.50	2.57	13.65	2.56	14.39
Provisions[b]	4.24	3.00	5.90	5.28	3.16	6.93
Other current liabilities	2.89	0.24	2.33	0.56	3.04	0.36
Total current liabilities	21.53	31.92	21.41	34.32	16.11	29.16
Other liabilities	6.02	0.06	0.93	0.11	5.45	-
Long-term debts	10.76	16.48	13.33	20.01	29.78	16.56
Preferred stock	6.63	1.54	7.57	1.13	3.16	2.98
Common stock	16.09	43.50	9.07	29.75	9.50	35.50
Retained earnings	38.97	6.50	47.69	14.68	36.00	15.80
Total stockholders' equity	61.69	51.54	64.33	45.56	48.66	54.28
Total liabilities and stockholders' equity	100.00	100.00	100.00	100.00	100.00	100.00

[a] P = Parent; S = Subsidiary

[b] Provisions for taxations, dividend and contingencies.

Electrical n=1		Chemical n=5		Other n=7		Petroleum n=2	
P	A	P	A	P	A	P	A
9.19	5.99	5.73	8.28	7.72	7.23	7.16	6.85
4.05	26.64	1.78	13.43	4.05	19.05	3.38	16.26
1.41	-	7.84	20.01	5.70	5.34	4.03	5.92
3.11	6.03	6.21	0.54	1.70	0.44	2.36	0.50
17.76	32.66	21.56	42.26	19.17	32.06	16.92	29.43
7.80	-	2.02	0.30	1.37	0.20	6.86	0.13
39.24	-	10.29	6.46	15.39	18.36	12.58	4.17
0.03	-	3.13	5.12	2.22	2.24	-	1.25
1.27	59.34	5.94	28.27	9.05	32.76	9.73	32.09
33.90	8.00	57.06	17.59	52.80	14.38	53.91	32.93
35.20	67.34	66.13	50.98	64.07	49.38	63.64	66.27
100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

As against this the long term debt of the parent corporations is larger than their subsidiaries engaged in petroleum, chemicals and metal and metal products industries.

All the subsidiaries operating in the different industries raised more capital through the issue of common stock than their parent corporations. On the other hand, the share of retained earnings of the subsidiaries is smaller than their parent corporations. Among the U.S. subsidiaries, the subsidiaries operating in the petroleum industry have retained more earnings than the other subsidiaries engaged in other industries.

The debt-equity ratios of the subsidiaries operating in transport, machinery, metal and metal product, chemical and petroleum industries are 0.99, 1.22, 1.06, 1.08 and 0.52 respectively whereas the same ratios of their parent corporations are 0.58, 0.61, 1.00, 0.50 and 0.47.

Age-Wise Comparison.--Table 5:16 gives the details of the financial structure of subsidiaries and their parent corporations in the different age groups. The table indicates that the proportion of the total current liabilities of the subsidiaries in all age groups is larger than their parent corporations. With the increasing maturity of the subsidiaries and better reputation in capital market they find it easier to raise current debt as the source of financing. On the other hand, the new subsidiaries established after 1957 have a greater percentage of long-term debt than

Table 5:16.--Financial structure of subsidiaries and parent corporations on the basis of age. (In percentage.)

	Before 1950 n=5		1951-56 n=5		1957-61 n-12		1962 n=5	
	P[a]	S[a]	P	S	P	S	P	S
Accounts payable	5.89	7.43	9.21	8.71	7.64	7.68	9.86	9.99
Loans and advances	2.74	11.65	3.10	19.94	3.72	17.77	1.98	13.66
Provisions[b]	6.76	24.49	5.13	10.21	4.98	4.81	5.69	5.76
Other current liabilities	4.32	0.19	2.39	0.67	2.04	-	4.66	-
Total current liabilities	19.71	43.76	19.83	39.53	18.38	30.26	22.19	29.41
Other liabilities	1.33	0.47	2.32	-	3.63	-	3.57	0.05
Long-term debts	12.90	9.22	17.64	13.32	14.73	15.89	10.80	20.40
Preferred stock	-	1.44	0.05	3.33	3.75	1.18	12.19	5.32
Common stock	10.75	21.65	11.70	21.45	10.48	43.68	7.39	40.21
Retained earnings	55.31	23.46	48.46	22.37	49.03	8.99	43.86	4.61
Total stockholders' equity	66.06	46.55	60.21	47.15	63.26	53.85	63.44	50.14
Total liabilities and stockholders' equity	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a]P = Parent; S = Subsidiary

[b]Provisions for taxations, dividend and contingencies.

their parent corporations but an opposite situation is noticed in the case of old subsidiaries set up prior to 1957.

As would be expected, the proportion of the common stock of the new subsidiaries is much greater than their parent corporation and even greater than the old subsidiaries. As the subsidiary grew older, the proportion of the retained earnings had also increased.

The newest subsidiaries started in 1962 showed a debt-equity ratio of the 1.11 as against a debt-equity ratio of 1.18 for the oldest subsidiaries set up prior to 1950. Their parent corporations have a debt-equity ratio of 0.64 and 0.50 respectively.

Ownership-Wise Comparison.--Table 5:17 indicates that the U.S. subsidiaries in all the ownership groups have larger share of total current liabilities than their parent corporations. The share of long-term debt of subsidiaries is similar to that of their parent corporations. In each group, the U.S. subsidiaries have larger share of common stock and smaller share of retained earnings than their parent corporations.

The debt-equity ratio of the subsidiaries in ownership groups 10%-25%, and 76% and above, are 1.13 and 1.08 as against 0.91, 1.00, and 0.92 for the subsidiaries falling in the 26%-40%, 41%-50% and 51%-75% ownership groups respectively. The debt-equity ratio of their parent

Table 5:17.--Financial structure of subsidiaries and parent corporations on the basis of ownership (average of 1963-67). (In percentage.)

	10%-25% n=8		26%-40% n=5		41%-50% n=4		51%-75% n=6		76% and Above n=4	
	P[a]	S[a]	P	S	P	S	P	S	P	S
Accounts payable	8.24	9.07	6.48	9.24	8.23	8.80	7.92	8.63	9.44	5.40
Loans and advances	2.77	24.25	2.76	10.86	2.93	16.86	2.81	9.40	4.89	18.44
Provisions[b]	5.04	5.12	4.24	6.47	5.81	6.69	6.28	13.29	6.31	15.27
Other current liabilities	2.75	0.26	2.45	0.42	4.88	2.01	2.70	-	2.77	0.08
Total current liabilities	18.80	38.70	15.93	26.99	21.85	34.36	19.71	31.32	23.41	39.19
Other liabilities	1.64	-	5.09	-	4.17	-	2.17	0.14	2.89	0.47
Long-term debts	13.34	13.93	19.26	20.10	13.88	13.93	13.85	16.76	10.39	11.93
Preferred stock	4.46	1.61	7.23	1.82	5.86	5.77	1.80	-	0.06	0.62
Common stock	10.19	37.24	11.10	41.77	10.49	36.47	8.61	34.90	11.10	19.68
Retained earnings	51.56	8.52	41.39	9.32	43.75	9.47	53.86	16.88	52.15	28.11
Total stockholders' equity	66.21	47.37	59.72	52.91	60.10	51.71	64.27	51.78	63.31	48.41
Total liabilities and stockholders' equity	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a]P = Parent; S = Subsidiary

[b]Provisions for taxations, dividend and contingencies.

corporations are 0.51, 0.53, 0.67, 0.66 and 0.53 respectively.

Management-Wise Comparison.--The nature of management may influence the financial policy of the subsidiaries. Table 5:18 indicates that 50% U.S.-managed and wholly Indian managed subsidiaries have relied heavily on the total current liabilities than their parent corporations. The U.S. subsidiaries under the 50% American management have smaller long term debts than their parent corporations. In other cases, the parent corporations have more long term debts than their subsidiaries.

The subsidiaries in all management groups have raised more capital by the issue of common stock than their parent corporations. The share of common stock in the case of subsidiaries with minority, 50% management and majority U.S. management is greater than the subsidiaries under wholly-American and wholly-Indian management. The above discussion shows that the American management does not influence the financial structure of the subsidiaries.

The wholly-Indian managed subsidiaries have a debt-equity ratio of 1.54 as against a debt-equity ratio of 0.68 in the case of wholly-American managed subsidiaries. This ratio of the majority, 50% U.S. and minority U.S.-managed subsidiaries were 1.11, 1.15 and 1.02 respectively. The debt-equity ratio of their parent corporations were 0.36, 0.43, 0.64, 0.60, and 0.54 respectively.

Table 5:18.--Financial structure of subsidiaries and parent corporations on the basis of management (average of 1963-67). (In percentage.)

	All U.S. Directors n=3		Majority U.S. Directors n=9		50% U.S. Directors n=4		Minority U.S. Directors n=9		All Indian Directors n=2	
	P[a]	S[a]	P	S	P	S	P	S	P	S
Accounts payable	6.89	8.58	8.67	9.17	9.83	6.81	7.24	7.85	6.65	10.59
Loans and advances	4.63	11.85	3.38	11.25	1.79	10.73	3.41	18.84	0.77	27.26
Provisions[b]	6.46	3.21	6.06	13.04	5.32	18.48	4.25	2.52	7.13	11.33
Other current liabilities	2.00	0.36	4.01	2.12	2.13	7.09	2.61	-	3.63	0.36
Total current liabilities	19.98	24.00	22.12	35.58	19.07	43.11	17.51	29.21	18.18	49.54
Other liabilities	3.50	0.33	1.50	0.17	1.98	0.02	3.87	0.08	0.98	-
Long-term debts	8.81	15.53	13.57	15.30	17.93	10.43	14.14	19.75	7.80	7.25
Preferred stock	-	0.83	6.29	2.84	0.06	-	5.49	2.62	-	6.43
Common stock	14.97	19.30	7.91	36.85	10.78	33.19	8.66	41.56	18.93	22.18
Retained earnings	52.74	40.01	48.61	9.26	50.18	11.99	50.33	6.78	54.11	14.60
Total stockholders' equity	67.71	60.14	62.81	48.95	61.02	45.18	64.48	50.96	73.04	43.21
Total liabilities and stockholders' equity	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a]P = Parent; S = Subsidiary

[b]Provisions for taxations, dividend and contingencies.

Size-Wise Comparison.--Tables 5:19(A), 5:19(B), and 5:19(C) present the information based on the size of total assets, total sales and total net worth, respectively. In all the size-groups, the U.S. subsidiaries have raised more funds from the total current debts than their parent corporations. The subsidiaries falling in the size groups (3) and (4) (Total Assets) and size-group (5) (Total Sales) have less share of long-term debt than their parent corporations.

The subsidiaries in the size-groups (4) and (5) (Total Assets) have larger proportion of preferred stock investment than their parent corporations. However, the smallest subsidiaries have more capital from the preferred stock than the other subsidiaries in other size-groups. The share of retained earnings of the subsidiaries in all the size groups is smaller than their parent corporations but the largest U.S. subsidiaries have raised more funds from the retained earnings than the other subsidiaries.

The above analysis shows that the U.S. subsidiaries followed a different financial structure than their parent corporations. The relative importance of the various sources of finance are determined by the provisions of the Control of Capital Issues Act, availability of loans from the Cooley funds,[20] development of various financial

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[20]For details, refer to Chapter II, p. 37

Table 5:19(A).--Financial structure of subsidiaries and parent corporations on the basis of total assets (in millions of dollars) size (average of 1963-67). (In percentage.)

	1. Less than $2.08 n=7		2. $2.08 and less than $4.20 n=2		3. $4.20 and less than $8.36 n=5		4. $8.36 and less than $20.92 n=7		5. $20.92 and above n=6	
	P[a]	S[a]	P	S	P	S	P	S	P	S
Accounts payable	8.31	10.58	6.54	13.29	9.16	8.64	9.05	6.16	6.01	6.76
Loans and advances	3.36	16.37	2.83	23.72	2.01	10.91	3.77	19.16	3.00	15.90
Provisions[b]	6.10	3.66	7.75	4.15	4.50	7.49	5.15	17.26	5.16	4.69
Other current liabilities	4.14	-	1.69	0.65	2.11	0.64	2.30	4.03	3.75	-
Total current liabilities	21.91	30.61	18.81	41.81	17.78	27.68	20.27	46.61	17.92	27.35
Other liabilities	0.45	0.03	0.98	-	4.32	-	1.45	0.30	3.56	0.16
Long-term debts	7.37	17.40	7.61	14.16	19.46	17.78	16.50	9.29	17.28	19.38
Preferred stock	11.07	4.54	-	2.83	3.81	-	0.37	1.21	1.56	2.66
Common stock	10.60	42.19	19.06	19.97	7.90	43.44	8.68	31.23	10.40	22.99
Retained earnings	48.60	5.23	53.54	21.23	46.73	11.10	52.73	11.36	49.28	27.46
Total stockholders' equity	70.27	51.96	72.60	44.03	58.44	54.54	61.78	43.80	61.24	52.51
Total liabilities and stockholders' equity	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a]P = Parent; S = Subsidiary

[b]Provisions for taxations, dividend and contingencies.

Table 5:19 (B).--Financial structure of subsidiaries and parent corporations on the basis of total sales (in millions of dollars) size (average of 1963-67). (In percentage.)

	1. Less than $0.52 n=7		2. $0.52 and less than $1.05 n=1		3. $1.05 and less than $2.09 n=4		4. $2.09 and less than $5.23 n=4		5. $5.23 and above n=11	
	P[a]	S[a]	P	S	P	S	P	S	P	S
Accounts payable	9.67	9.96	9.19	5.99	5.78	11.46	7.31	9.53	7.93	6.15
Loans and advances	3.68	12.16	4.05	26.64	1.34	23.79	2.33	20.16	3.55	12.19
Provisions[b]	4.74	4.77	1.41	-	6.97	1.92	6.45	3.31	5.40	14.56
Other current liabilities	2.85	2.01	3.11	0.03	3.44	1.87	1.74	0.26	3.44	3.69
Total current liabilities	20.94	28.90	17.76	32.66	17.53	39.04	17.83	33.26	20.32	36.59
Other liabilities	1.52	0.03	7.80	-	2.15	-	1.61	0.01	2.81	0.29
Long-term debts	9.62	16.35	39.24	-	10.98	11.87	10.94	16.71	17.19	14.06
Preferred stock	9.33	0.88	0.03	-	6.93	2.18	-	-	1.18	2.46
Common stock	10.33	46.16	1.29	59.34	11.33	37.76	17.38	31.82	7.87	25.45
Retained earnings	48.26	7.68	33.90	8.00	51.08	9.15	52.24	18.21	50.63	21.15
Total stockholders' equity	67.92	54.72	35.22	67.34	69.34	43.09	69.62	50.03	59.68	49.06
Total liabilities and stockholders' equity	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a]P = Parent; S = Subsidiary

[b]Provisions for taxations, dividend and contingencies.

Table 5:19(C).--Financial structure of subsidiaries and parent corporations on the basis of total net worth (in millions of dollars) size (average of 1963-67). (In percentage.)

	1. Less than $0.52 n=3		2. $0.52 and less than $1.05 n=4		3. $1.05 and less than $2.09 n=2		4. $2.09 and less than $5.23 n=12		5. $5.23 and above n=6	
	P[a]	S_a	P	S	P	S	P	S	P	S
Accounts payable	9.06	9.81	7.64	8.40	6.77	10.62	9.10	7.20	6.01	7.65
Loans and advances	1.05	7.80	4.35	28.12	4.33	13.08	3.04	15.70	3.00	15.90
Provisions[b]	7.27	9.04	5.80	5.66	6.57	2.36	4.88	13.53	5.16	4.91
Other current liabilities	5.70	-	2.39	-	2.84	0.40	2.21	0.15	3.75	0.13
Total current liabilities	23.03	26.65	20.18	42.18	20.51	24.61	19.23	38.72	17.92	27.35
Other liabilities	-	-	2.93	0.06	3.18	-	2.95	0.18	3.56	0.09
Long-term debts	9.49	24.86	8.37	9.18	2.43	19.40	17.70	12.85	17.28	19.38
Preferred stock	16.57	8.54	4.14	1.66	5.62	2.59	1.61	0.70	1.56	3.10
Common stock	4.75	34.27	13.05	40.03	22.95	36.17	8.36	38.96	10.40	22.99
Retained earnings	56.11	5.68	51.33	6.89	45.31	19.68	50.15	13.47	49.58	27.72
Total stockholders' equity	77.43	48.49	68.52	48.58	73.88	58.44	60.12	53.13	61.54	53.81
Total liabilities and stockholders' equity	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[a] P = Parent; S = Subsidiary

[b] Provisions for taxations, dividend and contingencies.

institutions for providing medium and long-term loans, confidence of the Indian people in the success of foreign collaborated enterprises as demonstrated by the over-subscription of common stock, willingness of commercial banks to provide loans, etc. Besides these, the nature of industry and the age of subsidiaries also have some impact on the financial structure.

The large amount of short and long term loans in the financial structure of the subsidiaries should not be interpreted as the result of the liberal attitude of these subsidiaries regarding debt financing. The willingness of commercial banks,[21] availability of Cooley funds, the development of institutional investors in recent years and the willingness of the parent corporations to provide or guarantee the loans have facilitated the debt financing.

The U.S. subsidiaries have raised insignificant amounts of capital by the issue of preferred stock. The economic uncertainties and stagnation of the period and the change in the tax law in 1959 have made the issue of

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[21] "Indian banks have been very eager to loan to U.S. affiliates even at the expense of long-established relationships with purely local firms. . . . The U.S. firms have usually had no difficulty securing sizeable overdraft lines and large long-term loans either for new projects or for expansion of existing ones. The U.S. affiliates in India can secure banks accommodation on better terms and in larger relative amounts than the average Indian company." (Business International, India-Business Problems and Opportunities, New York: Business International Corporation, 1961), p. 52.

preferred stock expensive.[22] Thus considering the economic uncertainties, higher tax rate and the ease with which U.S. subsidiaries have sold common stock, there seems little reason to issue preferred stock in India during the period under study.

The subsidiaries have smaller amounts of equity financing than their parent corporations. But on this basis, one should not conclude that the U.S. parent corporations invested modest amounts of equity capital and tried to rely heavily on the loans and advances in the financing of their operations in India.[23] The empirical evidence available in the present study points out that the U.S. subsidiaries have more than one-third of their total financing in the form of common stock. Moreover, the newer subsidiaries started during 1957-62 have raised more than two-fifths of their total finance from the common stock.

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[22]For instance, a cumulative redeemable preferred sold for 6.3% tax-free will cost a company about 9% deducting 30% of this payment as a withholding tax. Ibid., p. 56.

[23]Behrman reports from his study of 72 U.S. companies that "by far the majority of the respondents either keep equity dollar financing to the minimum or provide only the initial financing in the form of equity or combine both policies. (J. N. Behrman, Foreign Associates and Their Financing, in U.S. Private and Government Investment Abroad, Edited by Raymond F. Mikesell, op. cit., p. 95. Brash's study also points out that "Many of these companies [U.S. companies] finance their operations in Australia without hazarding 'one dollar of American capital.'" (Donald T. Brash, American Investment in Australian Industry, op. cit., p. 79.

It is also true that as the subsidiaries mature, they tend more and more to utilize retained earnings for the financing of their operation. The larger amount of the retained earnings in the financial structure of the well-established subsidiaries supports this.

It may also be emphasized that even if the U.S. parent corporations intend to adopt a policy of modest initial capital investment in their Indian subsidiaries, the Controller of Capital Issues does not allow any firm, whether foreign or Indian, to start their operation with thin capital resources. He scrutinizes the financial requirements of each enterprise at the time of issue of license and does not intend to repeat the practices of Managing Agency System.[24]

During the course of personal interviews, the executives invariably refuted the idea that the U.S. corporations started their operations in India with modest capital investments. One executive pointed out that the Controller of Capital Issues would not even approve the initial negotiation if the U.S. Corporations proceed with this intention.

Dividend Policy

The hypothesis regarding dividend policy is that the dividend policies of the U.S. subsidiaries are similar

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[24]Refer to Chapter II, p. 39.

to their parent corporations. This hypothesis will be tested by comparing the dividend payout ratios of the subsidiaries with their parent corporations. If the former declares about the same percentage of dividend as the latter, the hypothesis will be accepted; otherwise it will be rejected and the alternative hypothesis will be accepted.

The dividend policy is an important variable affecting the investment policy of the firm. The dividend payout ratio, i.e., the percentage of earnings paid to the stockholders in cash, determines the amount of the earnings available to the firm for reinvestment purposes. Thus the reinvestment policy of the firm is closely associated with the dividend policy of the firm. Moreover, the dividend payout ratio provides some indication regarding the reliance of the U.S. subsidiaries on the retained earnings as a source of finance.

It is commonly assumed that the U.S. subsidiaries in need of funds would prefer to rely more on the internally generated funds than the outside funds. Due to this attitude, the subsidiaries will pay a lesser amount of earnings to the stockholders than do their parent corporations. On the other hand, it is also argued that the U.S. corporations going abroad are primarily interested in the maximization of their profit and the remittance thereof in the form of cash dividends to their parent corporations. In a situation like in India where there is no restriction

on the remittance of profit, the subsidiaries may try to send the maximum amount of their profit to their parent corporations and depend on the Indian capital market for additional funds. Moreover, because of their reputation and the confidence of the general people in their future success it is not difficult for the U.S. subsidiaries to raise funds for financing their operation in India. The testing of the above hypothesis will throw some light on the above controversy.

Overall Comparison.--Table 5:20 presents the dividend payout ratio of the U.S. subsidiaries and their parent corporations for the years 1963 to 1967. The table indicates that on the whole the sample U.S. subsidiaries have paid a larger percentage of their earnings as dividends than their parent corporations. The payout ratio of the subsidiaries is 55.99% whereas this ratio is 47.03% in the case of the parent corporations.

Table 5:20.--Dividend payout ratios of subsidiaries and parent corporations. (In percentage.)

Year	Parent	Subsidiary
1963	50.77	61.72
1964	46.86	51.47
1965	45.79	61.46
1966	41.50	63.44
1967	50.24	41.85
Average	47.03	55.99

Group-Wise Comparison.--The above data show that the subsidiaries have relied less on the reinvestment of their earnings and have paid more dividend than their parent corporations. But such a conclusion based on the overall comparison of the dividend payout ratios of the U.S. subsidiaries and their parent corporations would not be justified, and a detailed analysis of the dividend payout ratios of these subsidiaries based on their nature of industry, age, ownership, management and size may reveal a different picture. In the following pages, the dividend payout ratios of subsidiaries and their parent corporations have been analyzed on the above basis.

Industry-Wise Comparison.--Table 5:21 indicates that the U.S. subsidiaries engaged in transport equipment and petroleum industries have paid less dividend than their parent corporations whereas the subsidiaries operating in the machinery, metal and metal products, and chemical and allied products industries have paid more dividends than their parent corporations. Subsidiaries and parent corporations engaged in 'other' industries have paid similar percentage of their earnings as dividend. The highest dividend payout ratio (i.e. more than 70% of the earnings) was observed in the case of the subsidiaries engaged in the production of machinery, and chemical and allied products.

Table 5:21.--Dividend payout ratios of subsidiaries and parent corporations on the basis of industry. (In percentage.)

	Transport n=4		Machinery n=5		Metal and Metal Products n=3		Electrical n=1		Chemical n=5		Others n=7		Petroleum n=2	
	P[a]	S[a]	P	S	P	S	P	S	P	S	P	S	P	S
1963	45.42	-	33.42	84.59	45.39	65.33	78.27	-	59.59	75.68	53.56	44.68	58.72	1.64
1964	44.44	-	37.43	77.90	33.96	55.42	57.02	-	57.98	54.59	45.93	35.51	60.25	4.17
1965	40.05	14.66	38.04	100.44	28.38	36.66	60.87	-	55.34	83.53	48.41	61.87	59.64	14.74
1966	29.66	47.51	32.10	62.44	23.92	22.80	52.46	-	55.25	88.35	45.84	60.86	56.84	53.17
1967	54.82	39.65	35.74	31.13	31.06	44.48	68.22	-	65.81	52.91	51.36	43.33	54.87	23.62
Avg.	42.88	33.94	35.35	71.30	32.54	44.94	63.37	-	58.79	71.01	49.02	49.29	58.06	19.47

[a]P = Parent; S = Sudsidiary.

Age-Wise Comparison.--Table 5:22 reveals that the well-established U.S. subsidiaries (i.e. started prior to 1956) have paid more dividends than their parent corporations. The same is true for the subsidiaries set up during 1957-1961. Only the new subsidiaries started in 1962 have paid less dividends than their parent corporations. Moreover, the matured subsidiaries started prior to 1950 paid two-thirds of their earnings as dividends as against one-third by the new subsidiaries.

Ownership-Wise Comparison.--Table 5:23 indicates that the U.S. subsidiaries with more than 41% U.S. ownership have paid more dividends than their parent corporations. The payout ratio of the subsidiaries with ownership between 26% and 40% is lower than their parent corporations. But this is not true in the case of the subsidiaries with 10% to 25% U.S. ownership group.

Management-Wise Comparison.--Table 5:24 reveals that the dividend payout ratios of the subsidiaries managed by majority and 50% U.S. directors are greater than their parent corporations. The dividend payout ratios of wholly-Indian Managed and minority U.S. managed subsidiaries are lower than the U.S. parent corporations. The wholly-managed American subsidiaries have paid the lowest amount of the earnings as dividends of any of the management groups.

Table 5:22.--Dividend payout ratios of subsidiaries and parent corporations on the basis of age. (In percentage.)

	Before 1950 n=5		1951-56 n=5		1957-61 n=12		1962 n=5	
	P[a]	S[a]	P	S	P	S	P	S
1963	56.32	65.03	42.68	62.50	55.43	49.17	40.50	-
1964	50.71	56.63	37.67	58.71	49.66	40.74	43.65	16.07
1965	48.37	77.27	36.89	63.39	47.39	51.51	46.82	22.61
1966	49.09	68.03	36.43	53.16	41.08	71.60	38.99	49.15
1967	58.70	60.58	37.21	29.59	48.79	38.07	56.60	38.82
Average	52.64	65.51	38.17	53.47	48.47	50.22	45.31	31.66

[a]P = Parent; S = Subsidiary.

Table 5:23.--Dividend payout ratios of subsidiaries and parent corporations on the basis of ownership. (In percentage.)

Year	10% - 25% n=8		26% - 40% n=5		41% - 50% n=4		51% - 75% n=6		Above 75% n=4	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	44.80	47.44	60.84	65.33	48.17	76.33	55.92	67.05	43.51	64.60
1964	39.34	45.07	52.71	55.42	46.07	27.45	54.53	65.83	42.71	54.96
1965	41.22	75.61	50.13	34.65	44.91	85.26	50.97	78.39	41.35	55.92
1966	38.85	56.41	41.09	45.01	39.85	57.45	47.17	78.91	37.76	77.96
1967	42.82	27.73	49.00	39.52	64.81	44.32	56.09	58.66	42.31	35.17
Average	41.41	51.45	50.75	47.99	48.76	58.16	52.94	69.77	41.53	56.83

[a]P = Parent; S = Subsidiary.

Table 5:24.--Dividend payout ratios of subsidiaries and parent corporations on the basis of management. (In percentage.)

	All U.S. Directors n=3		Majority U.S. Directors n=9		50% - 50% n=4		Minority U.S. Directors n=9		All Indian Directors n=2	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	54.30	1.64	45.26	61.63	43.24	77.14	57.25	76.33	61.51	61.53
1964	52.69	4.17	46.41	44.10	36.22	97.74	49.41	23.70	53.07	45.06
1965	50.01	18.92	46.14	56.27	34.08	91.81	48.29	49.13	50.90	66.02
1966	48.78	40.95	43.09	71.24	34.50	80.51	39.79	46.27	48.83	58.88
1967	51.96	42.06	56.65	38.03	41.43	62.21	47.23	37.65	56.26	27.80
Average	51.55	21.55	47.51	54.25	37.89	81.86	48.39	46.62	54.12	51.86

[a]P = Parent; S = Subsidiary.

Size-Wise Comparison.--Table 5:25 presents the dividend payout ratios of the U.S. subsidiaries and their parent corporations on the basis of size groups (total assets). It is evident that among all the size groups, the smallest and largest sized subsidiary groups have paid about one-third of their earnings as dividend whereas their parent corporations paid about one-half of their earnings. In the case of other size groups, the subsidiaries paid two-thirds as against less than one-half by their parent corporations.

High and Low Payout Ratio.--Besides the difference in the dividend payout ratios, the high and low payout ratios of the subsidiaries differ from their parent corporations. There are greater fluctuations in the high and low dividend payout ratios of the subsidiaries than their parent corporations. In the case of industry, the subsidiaries (operating in petroleum industry) paid as low as 19.47% and as high as 71.30% (engaged in machinery industry). In the case of parent corporations, high and low ratios were 32.54% and 63.37% respectively. In the case of subsidiaries classified on the basis of age, their payout ranged from a low of 31.66% to a high of 65.51%, as against this, the ratios varied between 38.17% and 53.47% respectively for the parent corporations. The high and low payout ratios of the subsidiaries studied on the basis of their management varied between 22% and 82% whereas these

Table 5:25.--Dividend payout ratios of subsidiaries and parent corporations on the basis of total assets (in millions of dollars). (In percentage.)

Year	Less than $2.08 n=7		$2.08 and less than $4.20 n=2		$4.20 and less than $8.30 n=5		$8.30 and less than $20.92 n=7		$20.92 and above n=6	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	50.66	-	62.17	84.62	38.38	72.20	46.42	73.86	64.40	26.88
1964	50.40	16.07	57.24	54.48	36.92	80.67	43.51	73.87	52.62	22.56
1965	49.53	18.66	45.56	88.70	37.78	62.98	44.26	63.28	49.68	36.26
1966	40.11	51.09	42.17	54.05	36.92	93.75	42.70	85.26	45.97	39.36
1967	42.43	39.26	57.72	4.00	63.32	33.69	48.01	53.83	50.56	42.00
Average	46.63	31.27	52.97	57.17	42.66	68.66	44.98	70.62	52.65	33.41

[a]P = Parent; S = Subsidiary.

ratios were 38% and 54% respectively in the case of the parent corporations.

The group-wise comparison of the dividend payout ratios of the U.S. subsidiaries and their parent corporations indicates that in few cases the parent corporations have paid higher dividends than their Indian subsidiaries while in most of the cases the U.S. subsidiaries have paid more dividends than their parent corporations. In response to the reasons (Question No. 10 of Appendix 1) for the retention of the earnings of their Indian subsidiaries, one-half parent corporations pointed out that their subsidiaries had retained their earnings because of better return or just for reinvestment purposes. One-fourth of the parent corporations mentioned that they did not retain their earnings. One-fifth pointed out that their subsidiaries retained their earnings in India because of the majority ownership by the Indian partner or some restrictions on the remittance of profit. The details are given in Table 5:26.

Table 5:26.--Reasons for retentions of earnings in India.

	Number of Companies
1. Better return on reinvestment in India	4
2. Don't retain	4
3. Majority ownership by Indian partner	3
4. Restriction on remittance of profit	2
5. Other reason (reinvestment)	3
Total[a]	16

[a]Two U.S. corporations mentioned two reasons each.

From the above discussion one should not conclude that the U.S. subsidiaries as a uniform policy, have tried to remit an unusual share of profits to their parent corporations in the U.S.A. A comparison between the dividend payout ratios of the Indian Public limited companies and U.S. participating subsidiaries reveals this fact. The dividend payout ratios of 1,333 selected Indian public Limited companies[25] for the years 1963-64, 1964-65, and 1965-66 were 61.3%, 61.5% and 64.1% respectively whereas these ratios were 61.72%, 51.47% and 61.46% of the subsidiaries in this study.[26] It indicates that the U.S. subsidiaries, no doubt, have paid higher dividends than their parent corporations but these ratios were not at all higher than the Indian public limited companies. Moreover, the dividend payout ratios of U.S. corporations, on the whole, for the years 1963, 1964, 1965 and 1966 were 49%, 45%, 43% and 43% respectively[27] whereas these ratios were 50.77%, 46.86%, 45.79% and 41.50% for the 27 U.S. parent

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[25]Reserve Bank of India, "Finances of Indian Joint Stock Companies--1965-66," Reserve Bank of India Bulletin, December, 1967, p. 1537.

[26]The figures of selected Indian public limited companies are based on historical cost while the figures of U.S. subsidiaries are on price-level adjustment.

[27]Economic Report of the President, (Washington, D.C.: U.S. Government Printing Office, 1967), p. 290.

corporations. Thus the dividend payout ratios of these parent corporations were similar to that of U.S. corporations on the whole. On the above basis, it is not appropriate to conclude that the U.S. subsidiaries have tried to remit more profit to their parent corporations.

Summary

The main purpose of original investment by the U.S. corporations in India was the expectation of profit. But the U.S. corporations were not overly concerned about profit in the short-run but to expand their market and earn profit in the long-run. To explore the opportunity and the possibility of investing in a foreign country, the U.S. corporations typically conduct a broad survey of the economic, political and other environmental situations of the foreign country. U.S. corporations use various quantitative and qualitative techniques for evaluating the various alternative proposals.

The comparison of the assets composition of the subsidiaries and the parent corporations, on the aggregate level, indicates that the subsidiaries did not follow similar investment patterns as that of their parent corporations. Subsidiaries had relatively more investment in net fixed assets and inventories than their parent corporations. The parent corporations had invested relatively more in cash and marketable securities and accounts

receivable than their Indian subsidiaries. The comparison of the investment pattern of the parent corporations and their Indian subsidiaries on the basis of industry, age, ownership, management, and size indicates that the general pattern of investment as emerged from the aggregate level comparison is not found in the case of some subsidiaries.

The over-all comparison of financial structure of the parent corporations and their Indian subsidiaries indicates that the subsidiaries have not adopted a similar financial structure as that of their parent corporations. The U.S. subsidiaries relied more on the short- and long-run debts and common stock than their parent corporations. The parent corporations depended more on retained earnings whereas the retained earnings, on the whole, were not the major source of finance in the case of subsidiaries. Preferred stock played an insignificant role as a source of capital in the case of both parent corporations and subsidiaries.

The group-wise comparison indicates that the proportion of the common stock of the newer subsidiaries is much greater than their parent corporations and even greater than the older subsidiaries. The management and ownership do not seem to influence the financial structure of the subsidiaries.

The U.S. subsidiaries, on the whole, have paid higher percentage of their earnings as dividends than

their parent corporations; but not greater than other Indian companies. Moreover, the well-established subsidiaries have paid higher dividends than the newer subsidiaries. The ownership and management do not seem to have significant influence on the dividend payout ratios. But there were greater fluctuations in the high and low dividend payout ratios of the subsidiaries than their parent corporations.

CHAPTER VI

PERFORMANCE OF SUBSIDIARIES

It is often assumed that a developing country like India provides vast natural resources, cheap labor, a growing market and weaker local competition. Due to these factors, the profits earned by foreign enterprises on their investment in India are high as compared to their domestic investment. On the other hand, others argue that the rates of return in such a country would be lower than in the U.S.A. because of the inefficiency of factors of production, high cost and/or lack of availability of inputs, lack of economies of scale, etc. Besides these opposite views, there is another that though the rates of return may be greater in India, they are not great enough to offset the high degree of risks associated with doing business in India. The main purpose of the present chapter is to examine and evaluate this aspect by studying the parent corporations' goals for subsidiaries, noting actual rates of return, and the nature of risks (both business and non-business risks) associated with foreign investment.

As has been pointed out in Chapter V, the main objective of the U.S. corporations investing in India was to

earn profit. But the parent corporations were not overly concerned with the short-run profit so long as they expand their market and earn profit in the long-run.[1] The performance of U.S. subsidiaries would be evaluated in the context of the above objective. It is proposed to be done by testing the following hypothesis:

> The performance of U.S. subsidiaries in India is similar to that of their parent corporations in the U.S.A. (Ho). The alternative hypothesis is that the performance of U.S. subsidiaries in India is materially different from their parent corporations in the U.S.A. (Hi).

There are different ways and techniques to measure the performance of a subsidiary. It may be measured on the basis of profitability, market penetration, productivity, industrial and labor relations, personnel development, public and government relations, etc.[2] In the present study, the performance of the U.S. subsidiary is measured on the basis of the "return-risk" concept of the performance. The "return-risk" concept suggests that while evaluating the performance of the firm, we should consider

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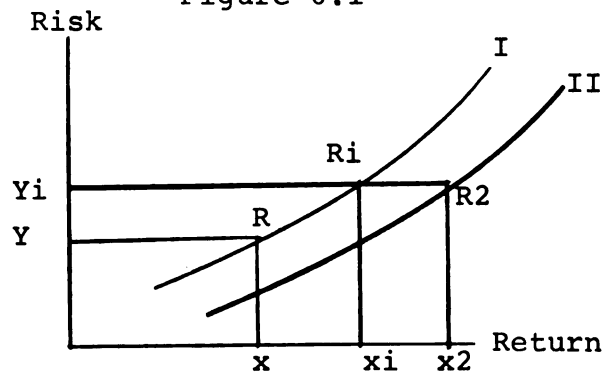
[1]Refer to Chapter V,

[2]For a detailed discussion, see Business International, Evaluating Foreign Subsidiary Performance, Management Monograph No. 14, (New York: Business International Corporation, 1964), pp. 2-14.

both rate of return and nature of risks associated with such performance.

Financial theory indicates that rational management will not choose riskier investments unless the expected rate of return increases sufficiently to offset the increased risk. In other words, "as risk increases, higher and higher expected return on investment are required to compensate investors for the additional risk."[3] The "return-risk" concept can be explained with the help of a two-parameter model. The model describes the trade-off between the expected rate of return and the risk. This can be explained with the help of Figure 6.1.

Figure 6.1



Suppose the firm can be visualized at point R on the indifference curve I with an expected rate of return of X and of risk y. Suppose the risk increases from Y to Yi. If the rational manager is indifferent, he would

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[3] J. Fred Weston and Eugene F. Brigham, Managerial Finance Third Edition, (New York: Holt, Rinehart and Winston, 1969) p. 224.

expect that his rate of return should increase to Xi to offset, at least, the increased risk. He will be at the point Ri. To compensate for the increased risks, he would expect higher expected rate of return, i.e., he would be at point R2 on new indifference curve II. Thus a rational management would invest money only when the increase in risk is compensated by the higher rate of return.

Part I discusses the rate of return while Parts II and III describe the nature of business risk and environmental or non-business risk respectively.

PART I

Rate of Return

The rate of return is measured on the basis of the profitability ratio which gives us an indication of the firm's efficiency of operation. This can be evaluated in two ways; those showing profitability in relation to sales and those showing profitability in relation to investment (i.e., total investment in the firm and total stockholders' investment.) The rate of return on total sales measures the former whereas the rates of return on total assets and net worth measure the latter.

Measurement of Rate of Return

The rate of return of subsidiary and parent corporations is measured for each year on the following basis:

(1) Return on Total Assets: The ratio of net profit after tax to total assets measures the rate of return on total investment in the firm.

$$\text{Return on Total Assets} = \frac{\text{Net Profit After Tax}}{\text{Total Assets}}$$

(2) Return on Net Worth: The ratio of net profit after tax to net worth measures the return on stockholders' investment.

$$\text{Return on Net Worth} = \frac{\text{Net Profit After Tax}}{\text{Total Net Worth}}$$

(3) Return on Total Sales: The ratio of net profit after tax to total sales measures the profit margin of the firm.

$$\text{Return on Total Sales} = \frac{\text{Net Profit After Tax}}{\text{Total Sales}}$$

After calculating the rate of return on the above three bases for each subsidiary and parent corporation for each year (from 1963 to 1967), the arithmetic mean of rates of return on total assets, net worth and total sales of all subsidiaries and their parent corporations were calculated for each year. From these figures, the five-year mean rates of return of subsidiaries and their parent corporations were computed. The same procedure was followed for computing the annual and five-year mean rates of return for the different groupings of subsidiaries and their parent corporation.

Overall Comparison[4]

Table 6.1 gives the annual and five-year average rates of return on total assets, net worth and total sales of all subsidiaries and their parent corporations for the years 1963 to 1967. The data indicate that the five-year average rates of return of the U.S. subsidiaries on total assets and net worth were 5.20% and 10.24% as compared to 7.81% and 12.09% respectively for the parent corporations. On the other hand, the five-year average rate of return of the U.S. subsidiaries on total sales was 7.94% as against 7.22% in the case of parent corporations. Thus the parent corporations were earning higher five-year rates of return on total assets and net worth than their Indian subsidiaries. As against this, the subsidiaries were earning higher rates of return on total sales than their parent corporations over the five-year period.

The main reason for the lower rate of return on total assets may be due to the lower turnover of total assets of the subsidiaries as compared to their parent corporations. Moreover, the subsidiaries were often newer enterprises with relatively undepreciated assets. The fear of the continuing import restrictions on plant and machinery, expectation of long term growth of market

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[4]The U.S. subsidiaries' figures are based on adjusted financial statements.

Table 6:1.--Rate of return of subsidiaries and parent corporations on total assets, net worth and total sales (in percentage).

	Total Assets		Net Worth		Total Sales	
	Parent	Subsidiary	Parent	Subsidiary	Parent	Subsidiary
1963	7.08	2.90	10.50	5.15	6.83	1.60
1964	7.94	4.60	11.88	9.48	7.31	5.56
1965	8.18	5.75	12.47	11.09	7.48	7.87
1966	8.43	7.57	13.59	15.17	7.67	16.32
1967	7.27	5.19	11.72	10.30	6.79	8.34
Average	7.81	5.20	12.09	10.24	7.22	7.94

for their products, inflationary trend in the developing economy and a precautionary attitude on the part of the subsidiaries might have induced the U.S. subsidiaries to build excess capacity. Moreover, Indian economy experienced recessionary trends in industrial production and general stagnation in the economy during these years. Due to this situation, there was underutilization of the capacity of the manufacturing sector.[5] The annual rate of growth of industrial production declined from 9.4% in 1963 to 1.4% in 1967. It indicates the adverse economic

[5]Reserve Bank of India, "On Recent Recessionary Trends in Organized Industry," Reserve Bank of India Bulletin, XXII, (July, 1968) pp. 866-867.

situation in India during the period under study. As against this, the turnover rates of total assets of parent corporations were much higher than their Indian subsidiaries. During these years, the U.S. economy witnessed sustained growth unparalleled in the history of this country. Due to this, there was hardly any idle capacity.

The higher rate of return on total sales of the subsidiaries indicates that the profit margin on their total sales was greater than their parent corporations during these years. As against this the parent corporations typically face much more competition from the many firms operating in the same business and their capacity to charge higher prices for their products is significantly limited.

Group-Wise Comparison

From the above analysis, one should not conclude that all U.S. subsidiaries were earning lower rates of return on their total assets and net worth or higher rate of return on total sales than their parent corporations. A detailed analysis of the rates of return of these subsidiaries on the basis of their products, age, ownership, management and size indicates that some subsidiaries were earning higher rates of return than their parent corporations.

Industry-Wise Comparison.--Table 6.2 shows that the U.S. subsidiaries engaged in all the different industries included (except metal and metal products) have lower five-year average rates of return on total assets than their parent corporations although the difference was only slight for petroleum and 'other' industries. In other cases, this average rate of return on total assets is much lower than their parent corporations.

Table 6.3 indicates that five-year average rates of return on net worth of the subsidiaries operating in all the different industries (except metal and metal products) were lower than their parent corporations. The subsidiaries engaged in machinery, and chemical, industries were earning slightly less than their parent corporations. The subsidiaries engaged in petroleum industry showed heavy losses in 1963 and because of this the overall average rate of return declined significantly; otherwise the four-year average rate of return would have been higher than their parent corporations.

Table 6.4 reveals that the five-year average rates of return on total sales of the subsidiaries engaged in transport equipments, machinery, metal and metal products and 'other' industries were higher than their parent corporations. The metal and metal products subsidiaries were earning more than thrice as much as their parent corporations.

Table 6:2.--Rate of return on total assets of subsidiaries and parent corporations (Industry-wise). (In percentage.)

	Transport Equipment n=4		Machinery n=5		Metal and Metal Products n=3		Electrical n=1		Chemical and Allied n=5		Others n=7		Petroleum n=2	
	P[a]	S[a]	P	S	P	S	P	S	P	S	P	S	P	S
1963	5.94	-2.54	6.34	5.40	4.63	1.15	8.02	-0.29	10.91	7.72	6.23	10.06	7.48	-1.34
1964	5.94	-1.92	8.38	4.53	4.93	3.55	12.68	-3.59	11.73	7.92	6.93	3.69	7.27	7.46
1965	6.42	3.15	9.11	3.84	4.93	4.45	12.68	6.35	12.60	7.60	6.42	4.60	7.10	13.30
1966	7.07	6.75	9.00	5.45	5.39	14.62	14.13	4.11	12.36	8.29	6.97	6.59	6.78	7.24
1967	5.89	3.95	8.19	3.60	4.45	3.07	8.51	-0.95	10.40	6.25	6.30	5.67	6.86	8.19
Avg.	6.25	1.88	8.20	4.56	4.87	5.37	11.20	1.13	11.60	7.56	6.47	6.12	7.10	6.97

[a]P = Parent corporations; S = Subsidiaries.

Table 6:3.--Rate of return on net worth of subsidiaries and parent corporations (Industry-wise). (In percentage.)

	Transport Equipment n=4		Machinery n=5		Metal and Metal Products n=3		Electrical n=1		Chemical and Allied n=5		Others n=7		Petroleum n=2	
	P[a]	S[a]	P	S	P	S	P	S	P	S	P	S	P	S
1963	9.16	-2.71	9.04	13.01	9.31	2.71	8.02	-0.61	15.54	17.33	9.18	1.51	11.11	-7.64
1964	9.44	-4.36	11.42	10.54	9.76	6.87	12.68	-6.85	17.51	17.94	10.61	9.16	10.91	13.34
1965	10.88	6.37	12.39	9.16	10.76	9.47	14.48	13.42	18.63	17.16	9.94	8.86	10.89	19.27
1966	13.03	13.40	13.53	12.75	11.62	29.40	16.43	8.64	18.39	16.72	11.57	12.95	11.56	10.04
1967	9.45	11.50	12.97	8.50	10.08	6.61	9.83	-2.56	15.41	13.52	10.43	10.78	11.79	11.33
Avg.	10.39	4.84	11.87	10.79	10.31	11.01	12.29	2.41	17.09	16.53	10.34	8.65	11.25	9.27

[a]P = Parent corporations; S = Subsidiaries.

Table 6:4.--Rate of return on total sales of subsidiaries and parent corporations (Industry-wise). (In percentage.)

	Transport Equipment n=4		Machinery n=5		Metal and Metal Products n=3		Electrical n=1		Chemical and Allied n=5		Others n=7		Petroleum n=2	
	P[a]	S[a]	P	S	P	S	P	S	P	S	P	S	P	S
1963	4.01	0.45	5.51	8.20	5.71	5.21	11.88	-1.33	10.40	8.03	5.83	-2.06	9.43	-18.23
1964	4.19	5.64	6.20	5.61	5.93	3.09	14.16	-16.99	11.07	7.53	6.31	6.33	9.14	10.07
1965	4.61	4.29	6.09	6.40	6.39	14.05	14.48	17.89	11.82	7.45	6.07	5.56	8.91	13.57
1966	4.80	10.37	6.32	8.09	6.83	61.16	14.83	9.85	11.19	9.74	6.74	14.08	8.97	9.04
1967	3.81	7.88	6.37	7.52	6.10	9.84	9.88	-1.65	9.60	7.65	6.07	8.96	8.78	10.05
Avg.	4.28	5.73	6.10	7.16	6.19	18.67	13.05	1.55	10.81	8.08	6.20	6.58	9.05	4.90

[A]P = Parent Corporations; S = Subsidiaries.

The subsidiaries engaged in the chemical and allied products and petroleum industries earned less than their parent corporations.

The variations in the rates of return in different industries may be attributed to the varying degree of impact of the recession on the different industries. For instance, the rate of growth in basic industries declined from 14.5% in 1963 to 2.1% in 1967; the rate of growth of capital goods industries increased from 13.5% in 1963 to 24.4% in 1964 and then declined to 10.6% in 1965 and 2.2% and 1.0% in 1966 and 1967, respectively. The growth rate in the case of consumer goods industries increased from 5.4% in 1963 to 7.5% in 1964 and then started declining and was -3.5% in 1967.

Age-Wise Comparison.--Table 6:5 indicates that the subsidiaries in all the age groups were earning lower five-year average rates of return on total assets than their parent corporations. However, the old subsidiaries were earning higher rates of return than the newer subsidiaries.

Table 6:6 shows that the well-established U.S. subsidiaries which started prior to 1950 were earning a five-year average rate of return of 15.98% on net worth as compared to 12.97% by their parent corporations. The subsidiaries falling in other age-groups were earning less than their parent corporations. A striking feature of the over-all average rates of return is that the five-year

Table 6:5.--Rate of return on total assets of subsidiaries and parent corporations (Age-wise). (In percentage.)

	Before 1950 n=5		1951-56 n=5		1957-61 n=12		1962 n=5	
	P[a]	S[a]	P	S	P	S	P	S
1963	8.25	5.15	6.22	5.64	6.16	-0.79	8.83	-0.68
1964	8.93	8.81	6.72	4.81	7.15	2.52	9.83	0.80
1965	9.14	6.99	7.42	3.83	7.54	6.18	9.51	4.01
1966	8.74	7.11	6.87	5.46	8.55	9.52	9.40	5.43
1967	7.11	5.26	6.86	4.17	7.49	5.58	7.31	3.06
Average	8.43	6.66	6.82	4.78	7.27	4.60	8.83	2.52

[a]P = Parent Corporations; S = Subsidiaries.

Table 6:6.--Rate of return on net worth of subsidiaries and parent corporations (Age-wise). (In percentage.)

	Before 1950 n=5		1951-56 n=5		1957-61 n=12		1962 n=5	
	P[a]	S[a]	P	S	P	S	P	S
1963	12.43	12.90	9.52	11.48	8.97	-1.52	13.02	2.21
1964	14.03	20.77	10.75	10.73	10.45	5.40	14.09	1.43
1965	14.15	16.60	11.65	7.90	11.39	11.21	14.17	8.51
1966	14.03	16.73	12.08	13.49	13.50	16.43	14.89	12.26
1967	11.23	12.91	12.37	7.37	11.67	9.71	11.68	10.73
Average	12.97	15.98	11.27	10.19	11.20	8.25	13.57	7.03

[a]P = Parent Corporations; S = Subsidiaries.

average rates of return showed an increasing trend with the maturity of the subsidiaries and after some time the U.S. subsidiaries started earning greater rates of return on net worth than their parent corporations. This may be attributed to the fact that with the passage of time the subsidiaries try to adjust with the Indian condition and explore the various opportunities of earning high profit. The new subsidiaries take some time to overcome the initial obstacles.

Table 6:7 reveals that the U.S. subsidiaries started after 1951 earned higher five-year average rates of return on total sales than their parent corporations.

Table 6:7.--Rate of return on total sales of subsidiaries and parent corporations (Age-wise). (In percentage.)

	Before 1950 n=5		1951-56 n=5		1957-61 n=12		1962 n=5	
	P[a]	S[a]	P	S	P	S	P	S
1963	8.00	5.31	6.36	7.07	6.85	-6.39	6.06	14.11
1964	8.36	8.36	6.70	6.23	7.46	3.57	6.53	5.90
1965	8.73	7.13	6.31	4.83	7.89	11.43	6.41	3.11
1966	8.48	8.13	6.33	8.47	8.46	26.17	6.30	8.72
1967	6.91	5.91	6.72	6.49	7.43	10.10	5.18	8.11
Average	8.10	6.97	6.48	6.62	7.62	8.98	6.10	7.99

Ownership-Wise Comparison.--Table 6:8 indicates that the U.S. subsidiaries in all ownership-groups were earning lower five-year average rates of return on total assets than their parent corporations.

Table 6:9 presents the rates of return on net worth of the subsidiaries in the different age groups along with their parent corporations. The subsidiaries with above 75% U.S. ownership earned higher five-year average rate of return than their parent corporations. In other ownership groups, the five-year rates of return were smaller than their parent corporations.

Table 6:10 indicates that the five-year average rate of return on total sales of subsidiaries falling in 10% to 25% ownership groups was higher than their parent corporations. In other ownership groups, the rates of return of subsidiaries were lower than parent corporations.

Management-Wise Comparison.--Tables 6:11, 6:12 and 6:13 present the rates of return on total assets, net worth and total sales, respectively, of U.S. subsidiaries on the basis of their management along with their parent corporations (Tables 6:11 and 6:12 (except above 75%) indicate that subsidiaries in all the management groups were earning lower five-year rates of return than their parent corporations.

Table 6:13 indicates that the subsidiaries in all management groups except wholly-American managed, earned higher five-year average rates of return on total sales

Table 6:8.--Rate of return on total assets of subsidiaries and parent corporations (Ownership-wise). (In percentage.)

	10% to 25% n=8		26% to 40% n=5		41% to 50% n=4		51% to 75% n=6		Above 75% n=4	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	5.39	2.29	5.58	-4.23	9.28	-1.43	8.76	4.16	7.22	7.49
1964	7.23	2.07	5.92	3.43	9.08	1.19	9.76	6.09	7.83	6.68
1965	7.60	3.60	6.09	7.68	8.94	4.55	10.21	6.32	8.14	6.23
1966	7.70	7.51	6.64	10.66	8.38	5.31	10.93	8.81	8.47	4.21
1967	6.72	3.62	5.85	6.73	6.82	5.35	8.87	5.52	8.15	5.05
Avg.	6.93	3.82	6.02	4.85	8.50	2.99	9.71	6.18	7.84	5.93

[a]P = Parent Corporations; S = Subsidiaries.

Table 6:9.--Rate of return on net worth of subsidiaries and parent corporations (Ownership-wise). (In percentage.)

	10% to 25% n=8		26% to 40% n=5		41% to 50% n=4		51% to 75% n=6		Above 75% n=4	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	8.00	7.01	8.96	-9.79	13.81	-0.84	12.38	7.77	10.65	17.65
1964	10.02	5.94	9.58	6.46	14.17	1.89	14.53	12.59	11.76	16.67
1965	10.54	8.51	10.36	13.46	14.79	8.28	15.39	12.45	12.26	14.07
1966	11.72	14.77	12.17	22.38	14.98	10.37	16.63	16.85	13.18	9.23
1967	10.41	8.16	10.53	12.31	11.60	9.40	13.91	10.92	12.65	10.39
Avg.	10.14	8.89	10.32	8.96	13.87	5.82	14.57	12.12	12.10	13.60

[a]P = Parent Corporations; S = Subsidiaries.

Table 6:10.--Rate of return on total sales of subsidiaries and parent corporations (Ownership-wise). (In percentage.)

	10% to 25% n=8		26% to 40% n=5		41% to 50% n=4		51% to 75% n=6		Above 75% n=4	
1963	5.49	5.01	6.75	-17.70	7.15	7.80	7.87	7.59	7.71	6.24
1964	6.57	2.34	6.97	3.13	7.27	9.91	8.49	9.23	7.85	5.83
1965	6.24	7.34	7.28	14.44	7.36	1.79	8.94	7.00	8.15	6.97
1966	6.57	24.39	7.88	25.91	7.01	8.07	8.93	10.64	8.39	4.95
1967	5.86	7.45	6.84	12.71	5.91	7.68	7.63	6.75	8.16	5.97
Avg.	6.17	9.31	7.14	7.70	6.94	7.05	8.37	8.24	8.05	5.99

[a]P = Parent Corporations; S = Subsidiaries.

Table 6:11.--Rate of return on total assets of subsidiaries and parent corporations (Management-wise). (In percentage.)

	All U.S. Directors n=3		Majority U.S. Directors n=9		50%-50% Directors n=4		Minority U.S. Directors n=9		All Indian Directors n=2	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	8.07	3.29	8.14	3.36	6.07	1.85	6.11	-1.04	7.47	5.38
1964	8.64	5.20	8.90	3.85	6.90	7.16	7.17	1.10	8.25	7.29
1965	8.94	8.20	9.00	4.69	6.77	8.40	7.28	4.34	10.19	4.38
1966	8.92	4.77	9.27	7.67	6.76	8.90	8.28	8.60	7.98	4.03
1967	8.21	4.25	7.57	6.06	6.08	5.69	6.95	3.52	8.24	3.86
Avg.	8.56	5.14	8.58	5.13	6.52	6.40	7.16	3.30	8.43	4.99

[a]P = Parent Corporations; S = Subsidiaries.

Table 6:12.--Rate of return on net worth of subsidiaries and parent corporations (Management-wise). (In percentage.)

	All U.S. Directors n=3		Majority U.S. Directors n=9		50%-50% Directors n=4		Minority U.S. Directors n=9		All Indian Directors n=2	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	11.66	6.25	12.22	9.26	9.16	1.74	9.12	-1.05	9.29	15.03
1964	12.46	9.74	13.73	9.26	10.61	14.22	10.58	2.71	10.42	17.84
1965	13.21	13.15	13.98	10.25	10.75	14.99	11.36	9.48	13.03	11.29
1966	13.63	7.85	15.08	15.44	11.30	19.91	13.26	16.18	12.97	10.90
1967	12.44	6.55	12.04	15.07	10.54	11.15	11.61	6.12	12.00	8.28
Avg.	12.68	8.71	13.41	11.86	10.47	12.40	11.18	6.69	11.54	12.67

[a]P = Parent Corporations; S = Subsidiaries.

Table 6:13.--Rate of return on total sales of subsidiaries and parent corporations (Management-wise). (In percentage.)

	All U.S. Directors n=3		Majority U.S. Directors n=9		50%-50% Directors n=4		Minority U.S. Directors n=9		All Indian Directors n=2	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	8.23	3.28	6.71	7.00	6.37	-4.33	6.75	-3.45	6.49	7.34
1964	8.32	4.04	7.40	10.60	6.94	9.00	7.21	-1.39	6.67	9.46
1965	8.63	6.85	7.55	4.84	6.99	10.32	7.56	10.56	6.02	5.64
1966	8.65	4.80	7.58	10.78	7.03	12.49	8.15	29.49	5.79	5.92
1967	8.23	4.61	6.49	10.29	6.19	7.95	7.02	7.53	6.14	6.01
Avg.	8.41	4.72	7.15	8.70	6.70	7.09	7.34	8.55	6.22	6.87

[a]P = Parent Corporations; S = Subsidiaries.

than their parent corporations. The above analysis suggests that there is no evidence that the nationality of directors is of great significance.

Size-Wise Comparison.--Tables 6:14, 6:15 and 6:16 give the rates of return on total assets, net worth and total sales respectively of the corporations. Table 6:14 indicates that the five-year average rates of return of U.S. subsidiaries falling in all the size groups were lower than their parent corporations. As compared to their parent corporations, the large-sized subsidiaries with total assets $8.36 million and above, earned relatively lesser five-year average rates of return than the small-sized U.S. subsidiaries.

Table 6:15 reveals that the U.S. subsidiaries in size group between $8.36 million and $20.92 million were earning higher rates of return on net worth than their parent corporations. In other size groups, the parent corporations were earning more than their Indian subsidiaries but the rates of return of the largest subsidiaries ($20.92 millions and above) were slightly less than their parent corporations.

Table 6:16 indicates that the five-year average rates of return on total sales of the subsidiaries in size groups less than $2.08 million, between $4.20 million and less than $8.36 million, and $20.92 million and above, were greater than their parent corporations. In the other

Table 6:14.--Rate of return on total assets of subsidiaries and parent corporations (size based on total assets).* (In percentage.)

	Less than $2.08 n=7		$2.08 and less than $4.20 n=2		$4.20 and less than $8.36 n=5		$8.36 and less than $20.92 n=7		$20.92 and Above n=6	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	6.69	-0.40	9.25	3.86	8.73	-0.26	6.31	2.38	3.61	6.71
1964	8.13	1.26	10.31	4.91	8.72	-0.85	7.48	5.84	7.22	7.84
1965	8.62	6.97	12.14	4.44	8.69	0.62	6.43	7.00	7.27	6.43
1966	9.15	6.96	10.49	4.34	9.04	12.57	7.69	6.53	7.28	6.62
1967	8.18	5.10	9.79	3.39	7.07	4.61	6.60	5.62	6.30	4.10
Avg.	8.15	3.98	10.40	4.19	8.45	3.40	6.90	5.47	6.96	5.72

*In millions of dollars.

[a]P = Parent Corporations; S = Subsidiaries.

Table 6:15.--Rate of return on net worth of subsidiaries and parent corporations (size based on total assets).* (In percentage.)

	Less than $2.08 n=7		$2.08 and less than $4.20 n=2		$4.20 and less than $8.36 n=5		$8.36 and less than $20.92 n=7		$20.92 and Above n=6	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	9.23	0.88	11.28	11.58	13.83	-0.06	9.19	6.20	10.60	7.00
1964	10.91	2.97	12.75	12.05	14.13	-2.42	11.05	14.52	11.98	15.86
1965	12.09	14.58	15.57	9.64	14.74	0.16	9.34	14.95	12.07	12.11
1966	13.82	13.04	15.63	10.12	15.05	23.53	12.39	13.98	12.83	13.76
1967	12.58	9.95	13.74	5.69	11.31	12.27	11.08	11.55	11.12	8.04
Avg.	11.73	8.28	13.79	9.82	13.81	6.70	10.61	12.24	11.72	11.35

*In millions of dollars.

[a]P = Parent Corporations; S = Subsidiaries.

Table 6:16.--Rate of return on total sales of subsidiaries and parent corporations (size based on total assets).* (In percentage.)

	Less than $2.08 n=7		$2.08 and less than $4.20 n=2		$4.20 and less than $8.36 n=5		$8.36 and less than $20.92 n=7		$20.92 and Above n=6	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	4.89	14.11	8.19	5.93	8.43	5.52	7.24	-0.88	6.80	3.62
1964	5.48	2.96	8.32	6.29	8.87	-5.06	7.91	5.54	7.13	14.59
1965	5.87	10.35	8.45	6.53	9.05	-0.10	7.45	9.93	7.31	9.67
1966	6.08	9.70	8.19	7.02	9.19	46.01	8.23	8.51	7.45	11.51
1967	5.62	7.55	8.24	6.54	7.53	13.44	7.15	6.96	6.61	6.03
Avg.	5.59	8.93	8.27	6.46	8.61	11.96	7.60	6.01	7.06	9.08

*In millions of dollars.

[a]P = Parent Corporations; S = Subsidiaries.

size groups, the parent corporations earned more than their Indian subsidiaries.

Tables 6:17, 6:18 and 6:19 give the rates of return on total assets, net worth and total sales respectively of subsidiaries on the basis of net worth size along with their parent corporations. Tables 6:20, 6:21 and 6:22 present the rates of return on total assets, net worth and total sales respectively of subsidiaries on the basis of total sales size along with their parent corporations. The data of these tables do not indicate that in all the cases the larger subsidiaries were generally earning higher rates of return on total assets, net worth and total sales than the smaller subsidiaries.

Minimum Rate of Return

The above analysis indicates that the U.S. subsidiaries were earning smaller rates of return on investment and higher rates of return on total sales than their parent corporations. But on the basis of the above information it is difficult to evaluate whether the parent corporations are satisfied with the performance of their Indian subsidiaries. To elicit this information, the parent corporations were asked to mention the minimum rate of return (excluding royalties, management fees and any transfer pricing at other than market rates) on net worth expected by them on their investment in India (Question

Table 6:17.--Rate of return on total assets of subsidiaries and parent corporations (size based on total net worth).* (In percentage.)

	Less than $0.52 n=3		$0.52 and less than $1.05 n=4		$1.05 and less than $2.09 n=2		$2.09 and less than $5.23 n=12		$5.23 and Above n=6	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	9.46	5.79	4.79	-0.81	6.64	1.36	7.32	1.28	6.71	3.61
1964	11.54	3.56	5.76	1.35	7.64	1.31	7.99	3.05	7.21	7.84
1965	11.16	7.19	8.23	6.19	9.12	5.66	7.36	4.34	7.26	6.43
1966	10.92	6.55	8.09	5.83	9.96	6.51	8.25	9.05	7.27	6.62
1967	8.91	5.30	7.80	4.37	9.46	4.54	6.80	5.20	6.30	4.10
Avg.	10.40	5.68	6.93	3.39	8.50	3.88	7.54	4.58	6.95	5.72

*In millions of dollars.

[a]P = Parent corporations; S = Subsidiaries.

Table 6:18.--Rate of return on net worth of subsidiaries and parent corporations (size based on total net worth).* (In percentage.)

	Less than $0.52 n=3		$0.52 and less than $1.05 n=4		$1.05 and less than $2.09 n=2		$2.09 and less than $5.23 n=12		$5.23 and Above n=6	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	13.29	14.36	6.25	0.28	8.62	5.74	11.12	3.59	10.59	7.00
1964	15.36	7.73	7.78	4.11	9.85	2.61	12.33	7.46	11.98	15.86
1965	15.35	15.00	11.36	13.85	12.14	10.47	11.59	8.79	12.06	12.11
1966	15.85	13.77	13.04	11.78	14.16	11.53	13.50	17.96	12.83	13.76
1967	14.25	12.40	11.95	6.80	12.49	8.31	11.18	11.85	11.12	8.04
Avg.	14.82	12.65	10.08	7.36	11.45	7.73	11.94	9.93	11.72	11.35

*In millions of dollars.

[a]P = Parent Corporations; S = Subsidiaries.

Table 6:19.--Rate of return on total sales of subsidiaries and parent corporations (size based on total net worth).* (In percentage.)

	Less than $0.52 n=3		$0.52 and less than $1.05 n=4		$1.05 and less than $2.09 n=2		$2.09 and less than $5.23 n=12		$5.23 and Above n=6	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	6.70	14.11	4.32	4.37	6.66	7.49	7.73	-2.27	6.80	3.62
1964	7.47	3.05	4.63	7.62	7.03	-3.17	8.31	1.68	7.12	14.59
1965	7.26	7.30	4.85	11.91	8.41	7.98	8.11	5.75	7.31	9.67
1966	7.17	9.42	5.03	9.13	8.64	8.59	8.63	24.14	7.45	11.51
1967	6.49	10.25	5.13	5.32	7.92	6.96	7.31	9.66	6.61	6.03
Avg.	7.01	8.82	4.79	7.67	7.73	5.57	8.02	7.79	7.06	9.08

*In millions of dollars.

[a]P = Parent Corporations; S = Sudsidiaries.

Table 6:20.--Rate of return on total assets of subsidiaries and parent corporations (size based on total sales).* (In percentage.)

	Less than $0.52 n=7		$0.52 and less than $1.05 n=1		$1.05 and less than $2.09 n=4		$2.09 and less than $5.23 n=4		$5.23 and Above n=11	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	6.39	-0.87	3.86	-0.50	9.74	-2.44	7.33	-0.99	7.00	5.39
1964	7.43	-0.66	3.60	-1.64	11.47	0.70	7.90	6.37	7.71	7.30
1965	7.68	3.70	3.36	0.36	11.52	6.08	8.27	7.96	7.29	5.98
1966	8.42	6.54	3.30	24.03	10.49	6.83	8.30	7.98	8.21	6.87
1967	6.89	4.15	3.44	2.00	8.31	4.79	7.17	5.66	7.51	5.14
Avg.	7.36	2.57	3.51	4.85	10.31	3.19	7.79	5.59	7.54	6.14

*In millions of dollars.

[a]P = Parent Corporations; S = Subsidiaries.

Table 6:21.--Rate of return on net worth of subsidiaries and parent corporations (size based on total sales).* (In percentage.)

	Less than $0.52 n=7		$0.52 and less than $1.05 n=1		$1.05 and less than $2.09 n=4		$2.09 and less than $5.23 n=4		$5.23 and Above n=11	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	9.29	0.70	10.66	-0.07	13.00	-4.28	10.07	-2.59	10.72	11.96
1964	10.53	-1.12	9.89	-2.96	15.02	2.25	11.03	13.93	12.38	15.96
1965	11.38	8.08	10.46	0.64	15.63	12.11	12.07	12.80	11.48	12.97
1966	13.31	13.74	9.27	34.21	15.62	13.58	12.83	16.45	13.71	14.46
1967	10.68	11.27	9.71	2.66	12.55	8.02	11.00	9.62	12.52	10.85
Avg.	11.04	6.53	10.00	6.90	14.36	6.34	11.40	10.04	12.16	13.24

*In millions of dollars.

[a]P = Parent Corporations; S = Subsidiaries.

Table 6:22.--Rate of return on total sales of subsidiaries and parent corporations (size based on total sales).* (In percentage.)

	Less than $0.52 n=7		$0.52 and less than $1.05 n=1		$1.05 and less than $2.09 n=4		$2.09 and less than $5.23 n=4		$5.23 and Above n=11	
	P[a]	S[a]	P	S	P	S	P	S	P	S
1963	4.46	14.11	5.72	-	9.60	-11.76	7.42	-6.03	7.21	6.38
1964	4.95	3.39	5.63	-18.21	10.24	-6.77	7.73	15.70	7.75	9.22
1965	5.21	6.33	6.11	1.67	9.76	7.70	8.19	10.39	7.71	8.56
1966	5.53	10.24	6.23	33.50	9.70	19.03	8.39	14.01	8.17	9.39
1967	4.69	8.24	5.92	12.71	7.94	9.54	7.42	9.26	7.55	6.47
Avg.	4.97	8.50	5.92	5.93	9.45	3.55	7.83	8.67	7.68	8.00

*In millions of dollars.

[a]P = Parent Corporations; S = Subsidiaries.

No. 7 of Appendix 1). Their response indicates that eight of the fourteen parent corporations expect to get above 15% rate of return; three corporations mention that they expect above 10% whereas another three corporations do not have a definite rule regarding the minimum rate of return. No parent corporations expect 5% rate of return on net worth from its subsidiary. Table 6:23 gives the details.

Table 6:23.--Minimum rate of return acceptable by parent corporations on net worth.

Rate of Return	Number of Companies
(1) Above 20 percent	4
(2) Above 15 percent	4
(3) Above 10 percent	3
(4) Above 5 percent	-
(5) No Definite Rule	3
Total	14

A comparison of actual rate of return and the expected minimum rate of return on net worth of the U.S. subsidiaries[6] would give some insight regarding the

[6]The minimum rate of return as suggested by the parent corporations does not take into account the price level adjustment. Moreover, this is annual rate of return expected by the parent corporation. The five-year average

individual performance of the subsidiaries. Table 6:27 gives the details of the five-year average rates of return of individual subsidiaries which were earning more than their parent corporations. The data indicate that there were four subsidiaries earning more than a 15% rate of return on net worth. Another seven subsidiaries earned more than 10% rate of return on net worth. This suggests that only 41% of the subsidiaries were able to meet the minimum rate of return expected by 80% of the parent corporations. It is striking to note that one parent corporation was earning above 15%; seven parent corporations were earning above 10% and not a single parent corporation was earning above 20% rate of return on net worth. In other words, out of 27 parent corporations, only eight corporations were earning above a 10% rate of return on net worth as against eleven subsidiaries earning above a 10% rate of return.

The above discussion may give the impression that the Indian subsidiaries could not meet the expectations of their parent corporations. Such a conclusion would not necessarily be realistic because the subsidiaries, while earning lower five-year mean rates of return on total assets and net worth than their parent corporations, at the

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rates of return as computed for the present study take into account the price level adjustment. Moreover, these rates are the average rate of return. Despite these differences, the comparison would provide some rought idea regarding their performance.

same time earned higher rates of return on total sales than their parent corporations. This indicates that the subsidiaries were able to expand their product market in India and earn higher rates of return on total sales. As has been pointed out earlier, the U.S. corporations emphasize the expansion of their subsidiaries' markets and so long as they are able to do that, the lower rates of return on their investment do not greatly concern them in the short term. However, the rates of return on net worth of subsidiaries on the basis of their age groups substantiate their well-planned approach. The well-established subsidiaries were earning higher rates of return on net worth than their parent corporations (see Table 6:6). It indicates that with the passage of time, the subsidiaries may be able to earn higher rates of return on investment than their parent corporations.

This pattern or strategy is further substantiated by the parent companies' response to the question of whether the performance of their subsidiary in India lived up to their expectations (Question No. 13 of Appendix 1). Approximately two-thirds of the parent corporations pointed out that the performance of their subsidiaries was reasonable considering the economic situation of India. One corporations mentioned that the performance of Indian subsidiary exceeded the expectation. As against this one-fifth of the parent corporations felt that the performance of

their Indian subsidiary was disappointing. One parent corporation was very much disappointed with the result of its Indian subsidiary. Table 6:24 gives the details.

Table 6:24.--Expectation of parent corporations regarding the performance of their Indian subsidiaries.

Expectation	Number of Companies
(1) Reasonable in early period	9
(2) Disappointed today	3
(3) Exceeded	1
(4) Very disappointed	1
(5) Early to judge	-
Total	14

Beside the above attitude, the parent corporations have also expressed their views regarding future programs of their Indian subsidiaries. Their positive or negative attitudes would reflect their views regarding the performance of their Indian subsidiaries. Table 6:25 gives the details of their attitudes regarding future investment in India (Question No. 12 of Appendix 1).

Half of the parent corporations expressed their willingness to expand the operation of their Indian subsidiaries; one-fifth of the parent corporations expected to maintain the present level; and the remaining parent

Table 6:25.--Attitudes of parent corporations regarding future investment in India.

Expectation	Number of Companies
(1) To expand the operation	7
(2) To maintain present level	3
(3) To reduce present level	-
(4) Uncertain	4
Total	14

corporations were uncertain regarding their future investment in India. It is striking that no corporation is planning to reduce the present level operation of its Indian subsidiary.

During the course of personal interviews, the executives pointed out that their corporations realized that, in view of the adverse Indian economy during the period under study, it was difficult for their Indian subsidiaries to earn higher rates of return. Despite this situation, the parent corporations were not disappointed with the performance of their Indian subsidiaries. Many of them emphasized that their corporations had either expanded the existing operation in India or had already started a new subsidiary in India. These actions on the part of the parent corporations demonstrate their satisfaction with the performance of their Indian subsidiaries.

PART II

Business Risk

The term 'business risk' refers, in the present study to the variability of the past rates of return on total assets, net worth and total sales. The variability of the rates of return means the dispersion in the rates of return. This risk rationale may be illustrated with the help of the following example. Suppose there are two investments 'A' and 'B' and both of them earn a mean rate of return of 10% over a five-year period. Investment A's annual rate of return in each year is fairly consistent whereas investment B's annual rate of return is fluctuating widely. In other words, though the mean rate of return is the same, there is vast difference in the variability of the measurements about the mean for the two investments. A rational investor, given the choice, would prefer investment A than investment B because there are greater uncertainty in the case of latter than the former.[7]

Measurement of Variability

There are numerous measures of variability. Among these, the range, quartiles and percentiles, variance and standard deviation are considered to be the most important

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[7]For details see, J. Fred Weston and Eugene F. Brigham, Managerial Finance, op. cit., pp. 215-19.

for the measures of variability.[8] For a number of reasons which are complex and need not be discussed here, the most generally accepted measure is the standard deviation.[9] Thus the variability is measured by standard deviation from the mean return of each company for the five-year period (1963-67). The standard deviation is calculated by using the following formula:

$$s = \sqrt{\frac{\sum_{i=1}^{n} (Yi - \bar{Y})^2}{n - 1}}$$

where

s is standard deviation,

$\bar{Y}$ is arithmetic mean,

Y is the set of measurements of Yi,Y2, ... Yn,

$(Y1-\bar{Y})^2$ is the square of the deviation of a measurement from the mean, and

n is the number of cases.

With the help of the above formula, the standard deviations of the rates of return on total assets, net worth and total sales of subsidiaries and parent

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[8]William Mendenhall, Introduction to Probability and Statistics, (Belmont, California: Wadsworth Publishing Company, Inc., March, 1969), pp. 29-42.

[9]Harry M. Markowitz, Portfolio Selection (New York: John Wiley & Sons, Inc., 1959), pp. 294-97.

corporations on individual basis were calculated. The greater the standard deviation, the greater the variability of return by definition, the greater the business risk.

It is possible that the higher rates of return may be associated with higher business risk or the lower rates of return may be associated with lower business risks. To evaluate the business risks associated with the higher and lower rates of return of subsidiaries, the business risks are studied in two parts, i.e., business risk of higher return subsidiaries and business risk of lower return subsidiaries.

Business Risk of Higher Return Subsidiaries

Tables 6:26, 6:27 and 6:28 present the information regarding the variability of returns of subsidiaries with rates higher than their parent corporations.

Table 6:26 indicates that with the higher rates of return on total assets of subsidiaries, the variability was also greater than their parent corporations. The standard deviation of subsidiaries varied from 2.0 to 7.6 as against a variation of 0.3 to 2.0 for the parent corporations. Thus the business risks of the subsidiaries were relatively greater than their parent corporations (Fig. 6.2 shows this picture).

Table 6:27 shows that there were eleven subsidiaries which were earning higher rates of return on net

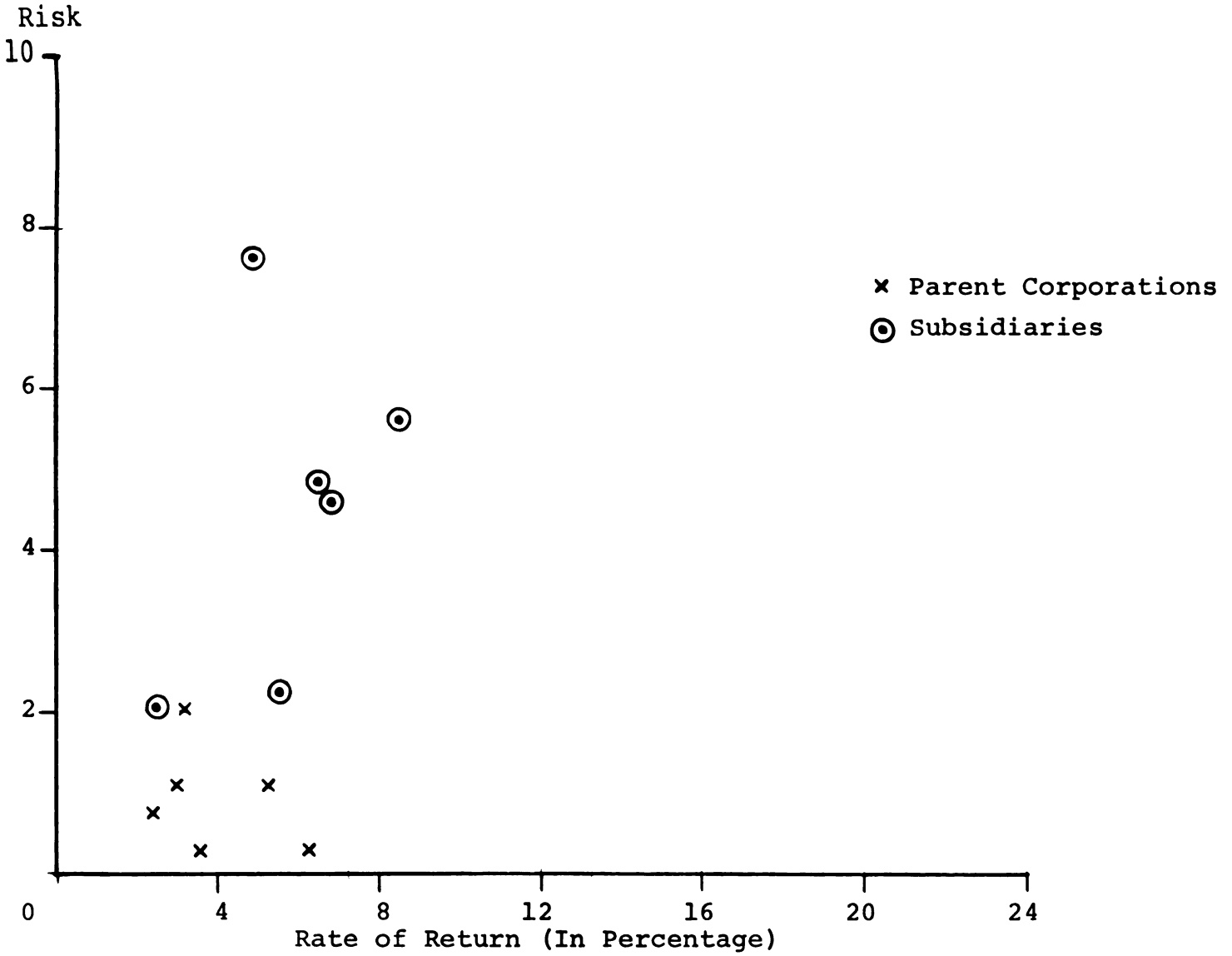

Figure 6.2.--Risk and return on total assets of subsidiaries (higher) and parent corporations.

Source: Based on Table 6:26.

Table 6:27.--Higher mean rate of return on net worth and standard deviation of subsidiaries and their parent corporations.

Parent/ Subsidiary*	Mean Rate of Return[a]		Standard Deviation	
	Parent	Subsidiary	Parent	Subsidiary
1. X3	10.8	12.1	1.1	10.1
2. X5	13.8	16.6	1.9	2.9
3. X10	10.1	14.1	2.6	9.8
4. X11	10.1	14.1	1.6	9.7
5. X13	6.6	11.1	1.8	3.5
6. X16	15.1	24.7	1.0	7.2
7. X17	10.1	10.3	0.8	16.8
8. X20	7.1	10.7	2.7	3.8
9. X21	9.1	12.5	3.1	9.4
10. X22	10.2	16.4	0.9	5.6
11. X25	14.9	15.1	2.9	6.0

* These are the number of subsidiaries (11) paired with parent corporations having higher mean rates of return on net worth than their parent corporations.

[a]In percentage

Table 6:26.--Higher mean rate of return on total assets and standard deviation of subsidiaries and their parent corporations.

Parent/ Subsidiary*	Mean Rate of Return[a]		Standard Deviation	
	Parent	Subsidiary	Parent	Subsidiary
1. X2	3.5	4.9	2.0	7.6
2. X10	3.9	6.7	0.3	4.6
3. X13	3.2	3.5	0.8	2.0
4. X17	6.1	8.7	0.3	5.6
5. X20	3.1	5.8	1.5	2.1
6. X21	5.2	7.0	1.1	4.8

* These are the number of subsidiaries (6) paired with their parent corporations having higher rates of return on total assets than their parent corporations.

[a]In percentage.

worth than their parent corporations. The standard deviations of subsidiaries were varying between 2.19 to 16.8 as compared to 0.8 and 3.1 for the parent corporations. Moreover, the variability of the rates of return of each subsidiary was relatively greater than parent corporations (Fig. 6.3 depicts this picture).

Table 6:28 reveals that the standard deviations of subsidiaries were varying between 1.6 and 14.6 as compared to 0.2 and 1.4 in the case of parent corporations. The business risk of each subsidiary was relatively greater than its parent corporations. (Fig. No. 6.4 shows this picture.)

From the above analysis, it is evident that the business risk of all subsidiaries with higher rates of return is greater than their parent corporations. The lower variability of parent corporations may be due to the fact that the parent corporations are generally older, have more regularized and diversified processes and trade channels, and perhaps are more particular in choosing accounting methods to achieve income smoothing. The fluctuation in economic situation of India appears to have greater impact on the variability of rates of return of subsidiaries.

Business Risk of Lower Return Subsidiaries

Tables 6:29, 6:30 and 6:31 present the data regarding the variability of returns of subsidiaries with rates lower than their parent corporations.

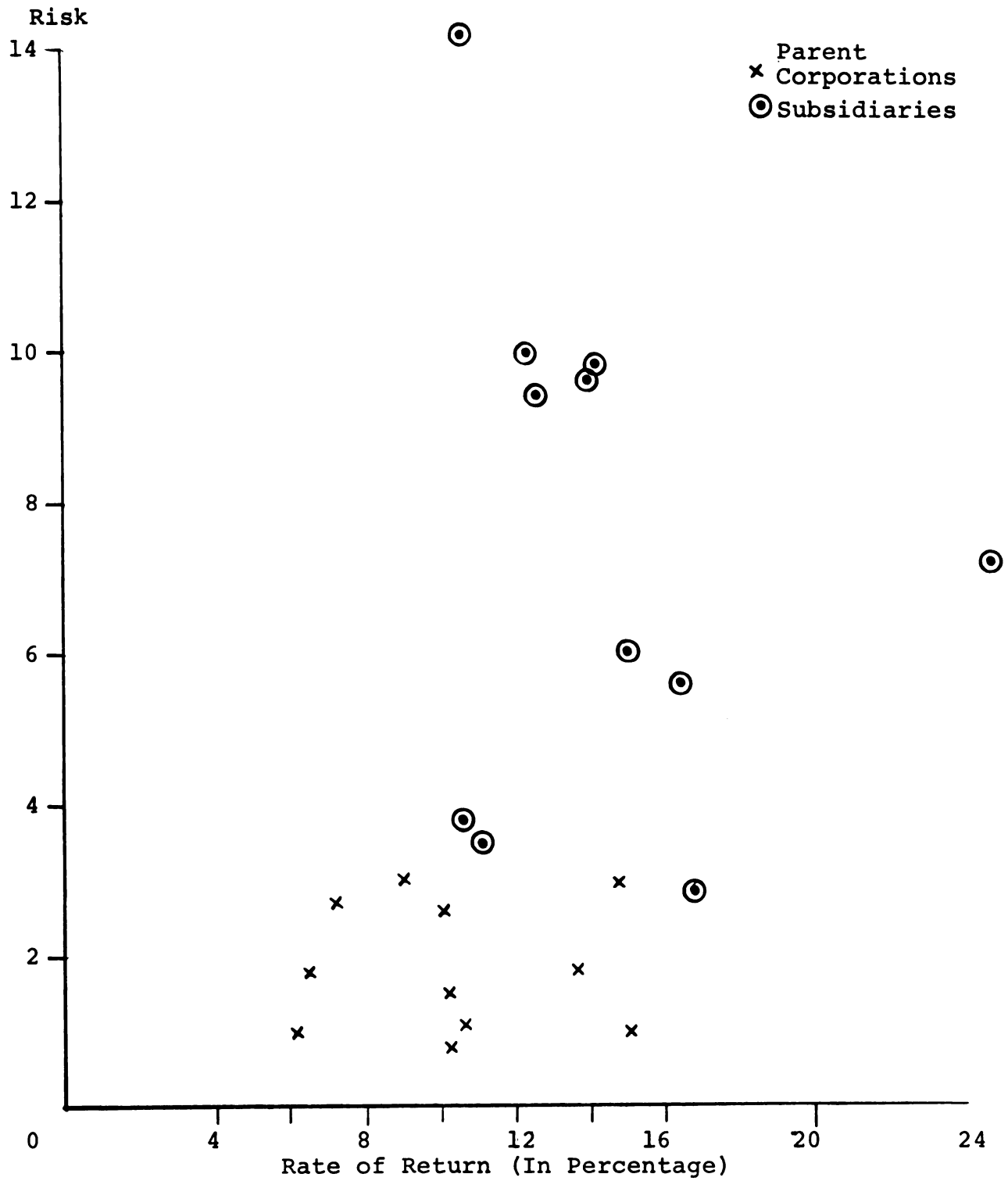

Figure 6.3.--Risk and return on net worth of subsidiaries (higher) and parent corporations.

Source: Based on Table 6:27.

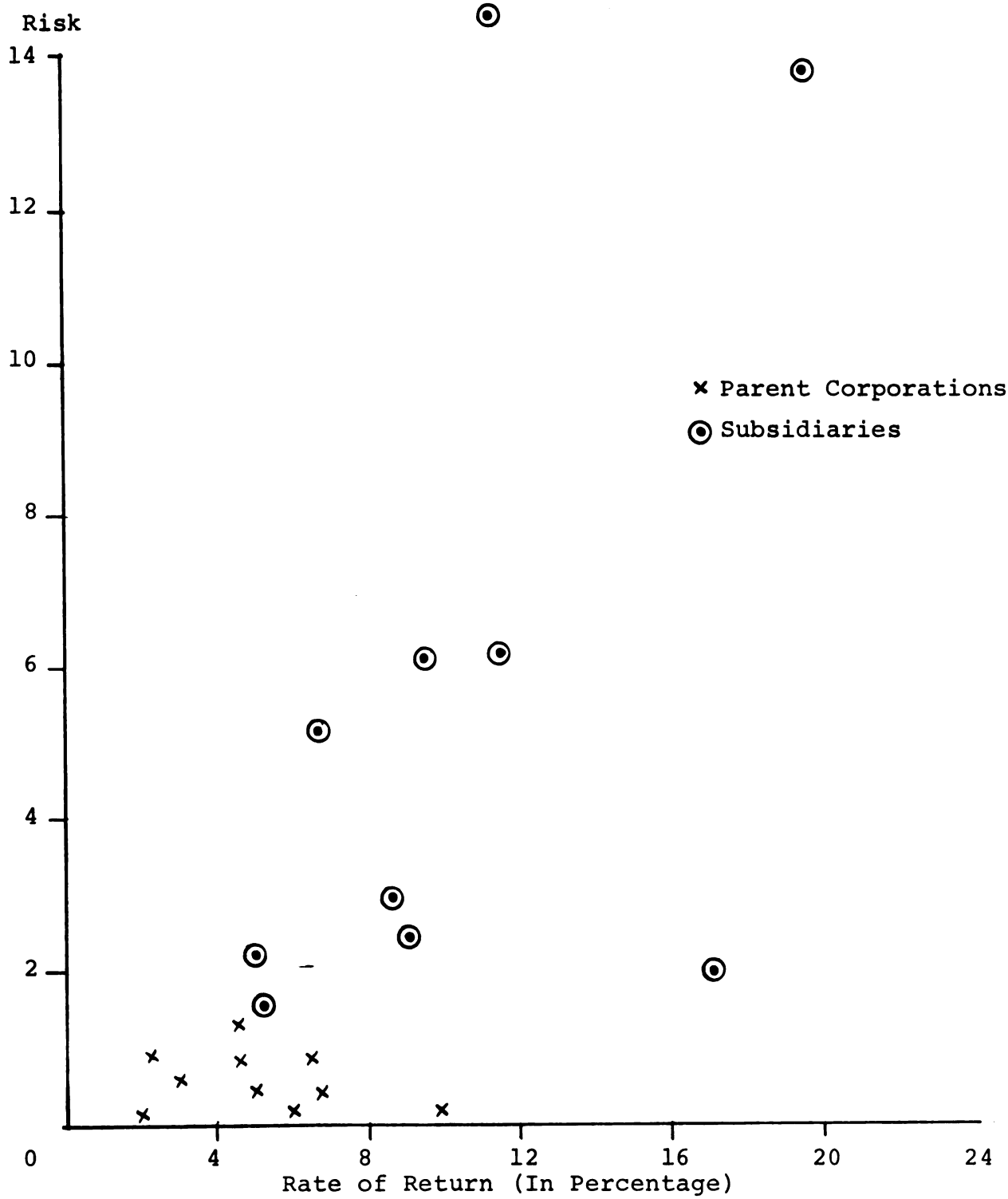

Figure 6.4.--Risk and return on total sales of subsidiaries (higher) and parent corporations.

Source: Based on Table 6:28.

Table 6:28.--Higher mean rate of return on total sales and standard deviation of subsidiaries and their parent corporations.

Parent/ Subsidiary*	Mean Rate of Return[a]		Standard Deviation	
	Parent	Subsidiary	Parent	Subsidiary
1. X3	6.3	9.6	0.2	6.1
2. X10	6.4	19.4	0.9	13.9
3. X11	4.7	11.7	1.4	6.2
4. X13	2.1	5.1	0.5	3.1
5. X18	9.0	9.4	0.5	2.5
6. X19	4.5	6.9	0.9	5.2
7. X20	2.2	5.2	0.9	1.6
8. X21	3.3	17.3	0.6	2.0
9. X22	6.9	8.5	0.4	3.0
10. X24	5.3	11.3	0.4	14.6

*These are the number of subsidiaries (10) paired with their parent corporations, having higher rates of return on total sales than their parent corporations.

[a]In percentage.

Table 6:29.--Lower mean rate of return on total assets and standard deviation of subsidiaries and their parent corporations.

Parent/ Subsidiary*	Mean Rate of Return[a]		Standard Deviation	
	Parent	Subsidiary	Parent	Subsidiary
1. X1	11.2	1.4	2.7	2.9
2. X3	7.2	4.6	1.0	2.8
3. X4	11.0	5.4	1.4	1.2
4. X5	9.6	6.6	1.2	1.9
5. X6	8.4	4.0	1.2	2.6
6. X7	8.1	5.3	0.3	3.2
7. X8	6.1	2.3	1.6	3.2
8. X9	6.5	4.7	0.3	3.7
9. X11	6.9	5.0	1.8	3.1
10. X12	7.6	-0.6	3.7	7.0
11. X14	17.1	7.5	2.8	2.1
12. X15	6.8	1.9	0.9	7.6
13. X16	9.6	7.3	0.5	2.0
14. X18	7.2	5.4	0.3	1.6
15. X19	6.1	0.4	1.7	3.5
16. X22	7.9	7.1	0.4	2.3
17. X23	9.7	2.9	2.0	1.0
18. X24	6.8	2.9	0.3	2.8
19. X25	8.5	7.7	1.9	3.2
20. X26	11.2	3.6	1.5	2.0
21. X27	13.1	8.9	1.7	4.7

*These are the number of subsidiaries (21) paired with their parent corporations, having lower rates of return on total assets than their parent corporations.

[a]In percentage.

Table 6:30.--Lower mean rate of return on net worth, and standard deviation of subsidiaries and their parent corporations.

Parent/ Subsidiary*	Mean Rate on Return[a]		Standard Deviation	
	Parent	Subsidiary	Parent	Subsidiary
1. X1	12.3	2.4	3.4	6.6
2. X2	10.0	6.9	0.5	14.5
3. X4	13.8	10.7	2.2	3.3
4. X6	10.3	6.4	1.8	4.6
5. X7	12.4	8.3	0.4	5.8
6. X8	9.1	4.8	2.7	4.5
7. X9	11.8	7.1	0.5	7.8
8. X12	14.3	-1.5	6.2	17.2
9. X14	22.5	11.6	4.0	1.9
10. X15	11.5	3.5	1.5	18.4
11. X18	13.0	11.0	1.3	2.9
12. X19	9.1	2.8	2.8	7.0
13. X23	15.0	8.9	0.5	3.4
14. X24	10.9	6.8	1.0	7.6
15. X26	15.2	9.7	1.5	4.2
16. X27	19.1	14.0	1.6	9.0

*These are the number of subsidiaries (16) paired with their parent corporations, having lower rates of return on net worth than their parent corporations.

[a]In percentage.

Table 6:31.--Lower mean rate of return on total sales and standard deviation of subsidiaries and their parent corporations.

Parent/ Subsidiary*	Mean Rate of Return[a]		Standard Deviation	
	Parent	Subsidiary	Parent	Subsidiary
1. X1	13.1	1.6	2.1	11.9
2. X2	5.9	5.9	0.2	18.5
3. X4	11.0	7.7	0.9	1.5
4. X5	9.6	7.4	1.2	1.4
5. X6	5.9	5.6	0.2	4.6
6. X7	9.6	3.7	0.4	1.8
7. X8	4.5	2.4	0.9	7.6
8. X9	4.8	2.8	0.1	2.9
9. X12	5.0	1.8	2.4	17.2
10. X14	16.0	10.4	1.7	2.0
11. X15	9.9	4.8	1.0	31.4
12. X16	9.6	7.3	0.3	2.3
13. X17	8.7	6.1	0.3	22.3
14. X23	5.5	5.2	1.0	1.5
15. X25	9.6	8.8	1.6	4.2
16. X26	7.0	6.6	0.7	4.6
17. X27	9.4	6.9	1.0	2.5

*These are the number of subsidiaries (17) paired with their parent corporations, having lower rates of return on total sales than their parent corporations.

[a]In percentage.

Table 6:29 indicates that the standard deviations of subsidiaries were varying between 1.0 and 7.6 as against a variation between 0.26 and 3.7 for the parent corporation. The lower rates of return were associated with higher variability. Fig. No. 6.5 shows this picture.

Table 6:30 indicates that the standard deviations of subsidiaries varied between 1.9 and 18.4 as against a variation between 0.4 and 6.2 for the parent corporations. Out of 19 subsidiaries earning lower rates of return on net worth, only one subsidiary had lower variability than the parent corporation. In other words, the lower rates of return were associated with higher business risk. Fig. No. 6.6 depicts this picture.

Table 6:31 shows that the standard deviations of subsidiaries varied between 1.4 and 31.4 as compared to a variation between 0.1 and 2.4 for the parent corporations. Moreover, in each case the business risk of subsidiary was relatively greater than their parent corporation. Fig. No. 6.7 shows this picture.

The above analysis indicates that the higher rates of return of subsidiaries were associated with the higher business risk and the lower rates of return were also associated with higher business risk.

Limitation of Business Risk

From the above analysis, it is evident that the subsidiaries with higher rates of return have relatively

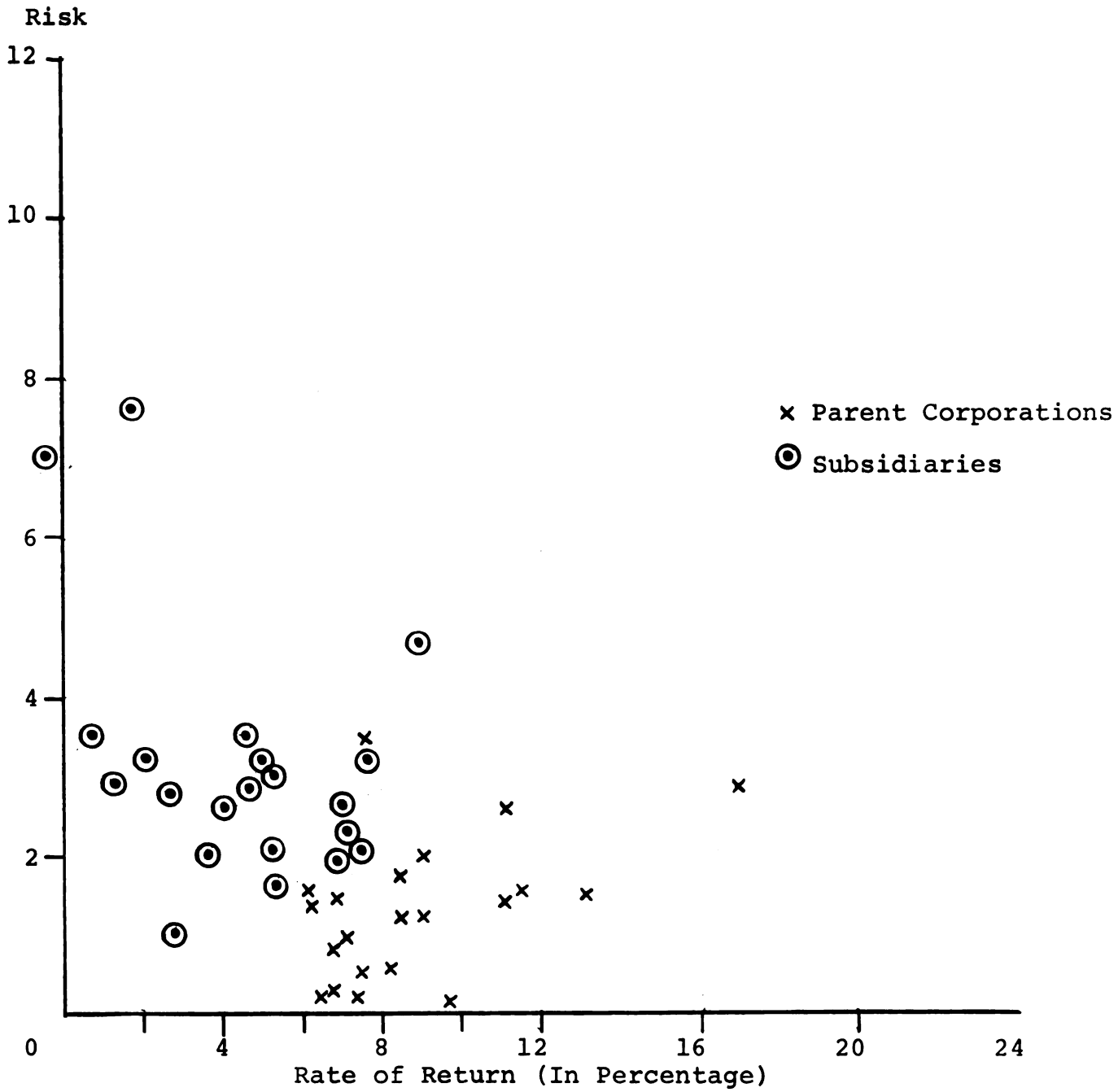

Figure 6.5.--Risk and return on total assets of subsidiaries (lower) and parent corporations.

Source: Based on Table 6:29.

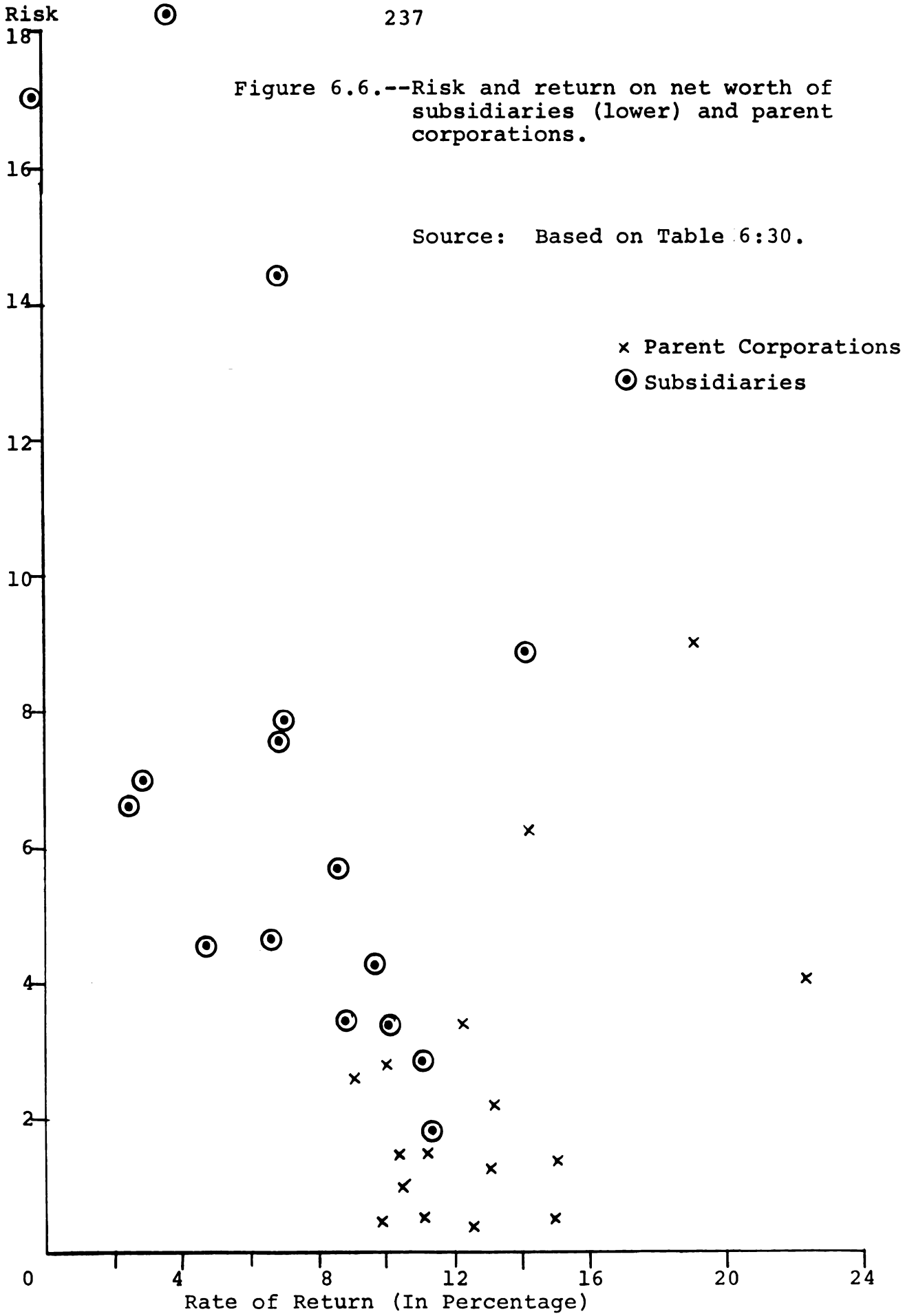

Figure 6.6.--Risk and return on net worth of subsidiaries (lower) and parent corporations.

Source: Based on Table 6:30.

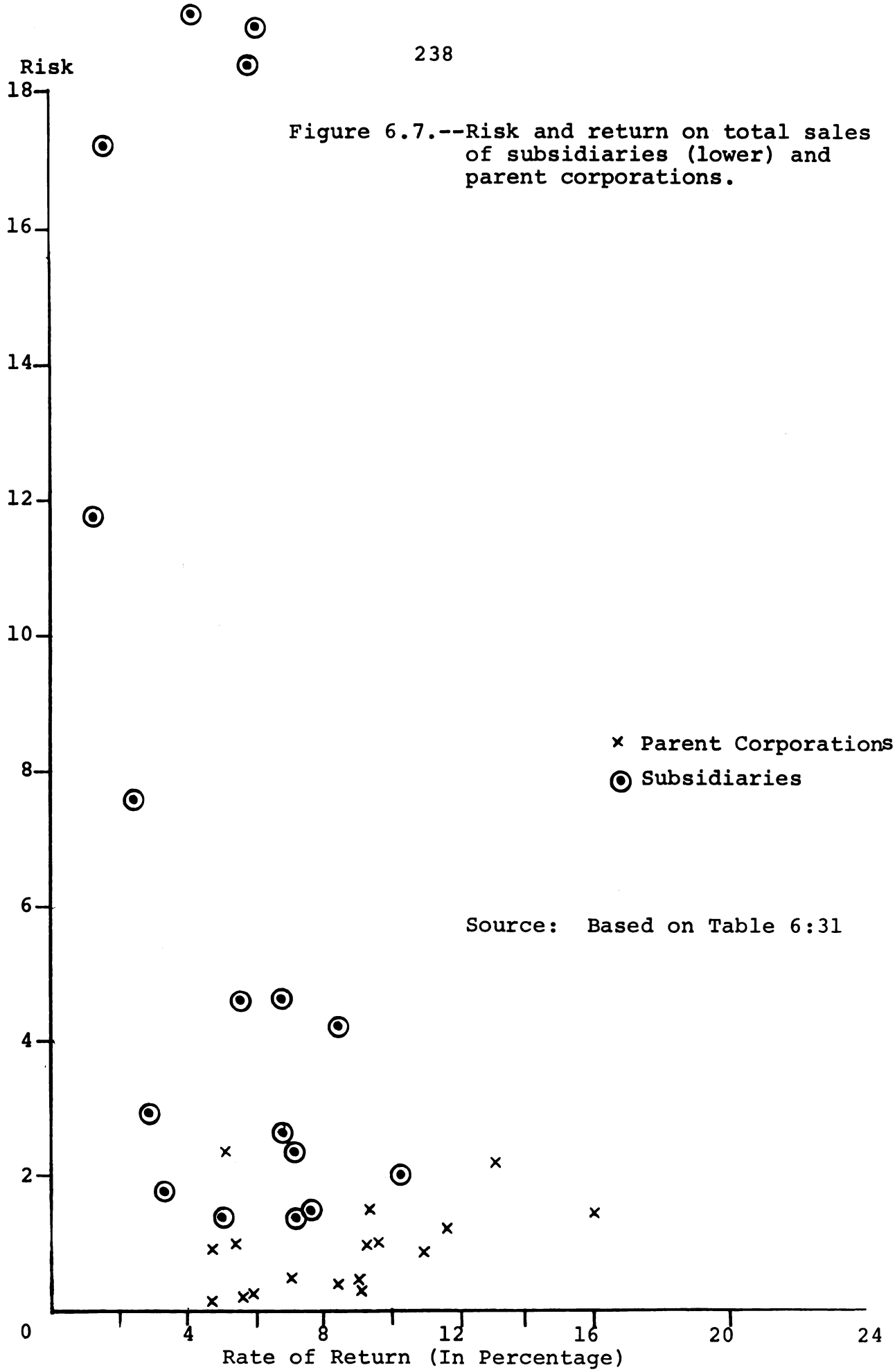

Figure 6.7.--Risk and return on total sales of subsidiaries (lower) and parent corporations.

Source: Based on Table 6:31

higher business risk than their parent corporations. Moreover, the lower rates of return of subsidiaries were associated with relatively higher business risk than their parent corporations. The analysis of business risk should be interpreted in the context of the following limitations;

(1) The period for the analysis of the business risk is five-year period. The analysis of business risk is valid only in this period. With the change of period, the nature of business risk may change.

(2) The U.S. parent corporations take a long term view regarding their goals and hence the analysis of business risk based on these five years may not fit into their long-term goals of the firm.

(3) The 1963-67 period was atypical for India (on the bad side) and it was also probably atypical (on the good side) for the U.S.A. This has affected the business risk.

(4) The "return-risk" concept uses the expected rate of return and its risk associated with this return. In the present study the past rate of return is used as the proxy for the expected rate of return. The past rate of return may not reflect the expected rate of return. The change in the future economic situation of the country may not reflect the nature of risk associated with past rate of return.

(5) Many investors may not be concerned with the variance of returns but may be concerned with the risk of losing money. For instance, the U.S. parent corporations are more concerned regarding the environmental or non-business risks present in the foreign country than the business risk of investing in these countries.

PART III

Environmental Risk

The above analysis shows that the U.S. subsidiaries were experiencing higher business risk in India during 1963-67 than their parent corporations in the U.S.A. The higher business risk in India was mainly due to the wide variations in the economic situation of the country in these years. Under more stable economic conditions, the business risk may be significantly less. No doubt, the U.S. corporations going abroad consider business risk but they are more concerned with the environmental or non-business risk than business risk.[9] The environmental risk arises mainly due to factors in the foreign environments not experienced by U.S. corporations in their domestic operations.

The environmental risk may broadly be divided into three parts; foreign exchange risk, political risk and

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[9]During the course of the personal interviews, the U.S. corporations emphasize the environmental risk more than business risk.

economic risk. The categorization of the environmental risk is not exclusive. Some variables discussed in one part may be related to another part.

The main purpose of discussing the environmental risk is not to suggest techniques for measuring these risks,[10] but to provide an idea regarding the various types of environmental risks present in India.

Foreign Exchange Risk

The U.S. corporations going abroad expect to earn profits and to remit the foreign profit to the U.S.A. in dollars. They also expect to repatriate their capital on the close or sale of their foreign operations. To convert profit or capital into dollars, they expect that the rate of exchange should be fairly stable so that the amount of dollars realizable from the foreign country may be certain. Moreover, these corporations also desire that the foreign currency should be converted into dollars without much difficulty. If there are many restrictions or uncertainties regarding the above aspects of the foreign exchange or if

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[10] "Few U.S. companies have developed formal tools to measure foreign risk. . . .Though some are using computer techniques for the analysis of domestic risk, few use them in foreign operation." Recently Du Pont is making a stab in the direction of formally measuring environmental uncertainties (of foreign countries). See, Sanford Rose, "The Rewarding Strategies of Multinationalism," Fortune, September 15, 1968, Vol. LXXVIII, No. 4, p. 105.

they think that the foreign government may introduce various restrictions, the foreign investors feel that the foreign exchange risk has increased in such country. The attitude of the U.S. corporations (Question No. 9 of Appendix 1) regarding repatriation of capital, foreign exchange policy and remittance of profit in India, is presented in Table 6:32.

Table 6:32.--Attitude of U.S. corporations regarding foreign exchange risk in India.

	Number of Companies		
	Repatriation of Capital	Foreign Exchange Policy	Remittance of Profit
Very Favorable	3	-	1
Favorable	2	2	5
Reasonable	6	4	4
Restrictive	3	2	3
Very Restrictive	-	6	1
Total	14	14	14

The table shows that repatriation of capital and remittance of profit are considered quite reasonable whereas foreign exchange policy is viewed as fairly restrictive. During the course of the personal interviews, the executives pointed out that "the procedure for the conversion of Indian currency into dollars is time-consuming and hence the

U.S. corporations consider the foreign exchange policy either restrictive or very restrictive." Besides these, the rate of exchange in India has been quite stable up to June 6, 1966 when the Indian currency was devalued. The post-devaluation rate is also stable.

On the basis of the above description, it may be concluded that the foreign exchange risk in India has been minimal. During the course of personal interviews, the executives also expressed the same view. One executive pointed out that "few countries in the developing world could match the commitment of Indian Government in the foreign exchange matter." He further emphasized that "despite the acute foreign exchange shortage in India, the Government of India had always allowed the remittance of profit to the foreign countries."

Political Risk

Political risk is considered more important, because of the involvement of more potential loss, than other types of risk and hence the U.S. corporations going abroad give significant weight for the presence of this risk in their foreign investment decision. Despite its importance, no study has been conducted regarding the systematic evaluation of political risk involving their identification, their likely incidence and their specific consequences for company

operations.[11] There are a number of variables influencing political situations in a foreign country. Table 6:33 gives the attitudes of U.S. corporations (Question No. 9 of Appendix 1) regarding the following political situations in India.

Table 6:33.--Attitude of U.S. corporations regarding political risk in India.

	Number of Companies				
	Labor Situation	Price Control	Red Tape in India	Industrial Policy	Foreign Investment Policy
Very Favorable	-	-	-	-	-
Favorable	3	-	-	-	2
Reasonable	7	7	1	6	6
Restrictive	3	4	1	2	2
Very Restrictive	1	3	12	6	4
Total	14	14	14	14	14

The table indicates that U.S. corporations consider labor situation in India as fairly reasonable. Twelve out

[11] Franklin R. Root, "U.S. Business Abroad and the Political Risks," MSU Business Topics, Winter 1968, Vol. 16, No. I , p. 75.

of fourteen U.S. corporations feel that red tape in government machinery is quite prevalent and is very restrictive for foreign investment; and two corporations think it either reasonable or restrictive. During the course of personal interviews, executives pointed out that the government machinery took a long time in taking decisions for foreign investment. This time-consuming process generates frustration among the U.S. investors. Moreover, many prospective investors interpret this delay in the sense that they are not welcomed in India.

Fifty percent of U.S. corporations view price control as reasonable; whereas other 50% think as quite restrictive. The U.S. corporations feel that the increase in price control will reduce the profitability of their Indian subsidiaries.

Six U.S. corporations consider industrial policy[12] of the Government of India as reasonable; another six corporations think as very restrictive; and two corporations view as restrictive. During the course of personal interviews, executives emphasized that the classification of industries into three categories and broad demarcation of future ownership in each category gave the impression that the Government of India intends to start her own enterprises

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[12]For details, refer to Chapter II, p. 41.

or to nationalize the existing industries considered to be important for the Indian economy.

Two out of fourteen corporations consider the foreign investment policy[13] of the Government of India as favorable; six corporations think it reasonable; and another six corporations feel this policy as restrictive or very restrictive.

Besides the above political variables, the executives were also concerned regarding the political instability, increasing influence of communism in the country, border conflicts with neighboring countries; etc. Their views regarding these problems have been summarized in the following paragraph.

Due to the thin majority of the ruling party in the Indian parliament and the absence of one strong opposition party in the county, the executives feel that the political instability in the country has increased significantly. Under such circumstances, the U.S. investors are not in a position to evaluate the future political trend in the country. They fear that there is greater possibility of the nationalization or expropriation of the foreign property by the next government in India. Moreover, the increasing influence of communism in India, as demonstrated by Communist ruling governments in two states is viewed by many executives that India is going to become communist. This situation

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[13]For details, refer to Chapter II, p. 43.

would lead to the nationalization or expropriation of U.S. property. Some executives also feel that the border conflict with Pakistan and China may lead the country to the major war and this will endanger the U.S. property in India.

The above discussion indicates that the political risks have recently increased in India. Many executives view the uncertainty of political situation and its consequence on the foreign investment. This situation may have frightened many prospective U.S. investors. But the existing U.S. investors would try to adjust with the political situation of the country. One executive emphasized that his corporation does not become very concerned about political risks unless the foreign government is hostile to the American firms.

Economic Risk

The attitude of the U.S. corporations (Question No. 9 of Appendix 1) regarding two key economic factors of India are given in Table 6:34.

The table indicates that seven out of fourteen U.S. corporations view the access to the Indian capital market by their Indian subsidiaries as favorable; six corporations think as reasonable; and one corporation considers as restrictive. No parent thinks that the access to Indian capital market by the subsidiaries is very restrictive. During the course of personal interviews, the executives

Table 6:34.--Attitude of U.S. corporations regarding economic risk in India.

	Number of Companies	
	Corporate Taxes	Access to Indian Capital Market
Very Favorable	-	-
Favorable	-	7
Reasonable	7	6
Restrictive	3	1
Very Restrictive	4	-
Total	14	14

emphasized that their Indian subsidiaries had received favorable treatment in the Indian capital market.

Seven U.S. corporations consider the Indian corporate taxes as reasonable; three corporations think as restrictive; and four corporations feel as very restrictive. During the course of personal interviews the executives emphasized the uncertainties of the frequent changes in the corporate tax rates in India.

Besides the above variables, the uncertainties of production and raw materials, changes in the priorities of Indian Plans, and rate of inflation were also viewed by the executives as important factors affecting the attitude of U.S. corporations regarding the economic risks of the country. Among these variables, the executives considered

uncertainty of production and non-availability of raw materials as quite significant. Due to the import restrictions on raw materials and difficulties of domestic procurement of materials and semi-finished parts, uncertainty in the manufacturing operation has been created. The situation has been described by Jack Baranson[14] in the following words:

> First, the Indian economy does not provide anywhere near the range of procurement sources provided by the American economy. Secondly, limited demands for all types of industrial materials and goods throughout the Indian economy restrict most industrial activities to small-scale, high cost production.

The executives also pointed out that changes in the priority of Indian Planning from industry in Second Plan to agriculture in Third Plan had also shifted the demands for the products of many industries. The increasing expenditures on defense in the recent years have affected many industries in different ways. The increasing inflationary pressure on the Indian economy was also pointed out by some executives as the element of economic uncertainty. But other executives were not worried about the rate of inflation in India.

Steps to Minimize Various Risks

American corporations take various measures to minimize the risks present in India (Question No. 5(ii) of

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[14]Jack Baranson, Manufacturing Problems in India, The Cummins Diesel Experience, (Syracuse, New York: Syracuse University Press, 1967) p. 71.

Appendix 1). Table 6:35 gives the details of these measures.

Table 6:35.--Steps to minimize various types of risks in India.

	Number of Companies
(1) Insure risks where possible	8
(2) Guarantee of risks by U.S. Government	8
(3) Keep a minimum of equity investment in subsidiary	8
(4) Admission of Indian partner	6
(5) Borrow private funds in India	6
(6) Borrow less dollars from U.S.A.	3
(7) Cooley Fund (P.L. 480)	3
(8) Borrow funds from Indian Government Agencies	2
Total*	44

*The response of 14 U.S. corporations surveyed by Questionnaire shows that many corporations employ more than one method.

From the above response it is evident that the insurance of risk, guarantee of risks by the U.S. Government and minimum equity investment are the most popular methods of minimizing the risks. Moreover, joint ventures between the U.S. corporations and Indian investors are also viewed as an effective means to minimize the various kinds of risk

in India. The above views of the U.S. corporations regarding the minimum equity investment and the joint venture may be substantiated with their preference for the U.S. ownership in India (Question No. 11 of Appendix 1). Table 6:36 gives the details of their preference.

Table 6:36.--Percentage of U.S. equity preferred by parent corporations.

	Number of Companies
(1) 100% U.S. capital	2
(2) Majority U.S. capital	5
(3) 50% U.S. capital	1
(4) Minority U.S. capital (25%-49%)	1
(5) Nominal U.S. capital (below 25%)	5
Total	14

Two out of fourteen U.S. corporations prefer 100% U.S. capital; five corporations like majority U.S. capital; another five prefer nominal U.S. capital (below 25%) and the remaining two corporations prefer U.S. capital between 25% and 50%. The data though not an extensive sample, do not support the general feeling among the Indian people that the U.S. corporations always prefer 100% U.S. ownership of their Indian subsidiaries.

To minimize the serious political risks leading to the expropriation or nationalization of U.S. property, nearly all U.S. subsidiaries have taken the guarantee under the U.S. Guarantee Program.[15] Some U.S. corporations have already started joint ventures with Government of India or state governments. During the course of personal interviews, one executive pointed out that his corporation had collaborated with Government of India to minimize the chances of expropriation.

To find out the over-all impression of the U.S. corporations regarding the environmental risks in India, the questionnaire survey asked the question (Question No. 12 of Appendix 1) about the parent corporations' attitude toward future investment in India. The response of the parent corporations indicates that the one-half of the corporations are anxious to expand their operation in India; three corporations want to maintain the present level; and four corporations are uncertain about their future plan in India (See Table 6:25).

Summary

The performance of the subsidiaries and their parent corporations is measured on the basis of "return-risk" concept. The five-year average rates of return of U.S.

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[15]For details, refer to Chapter II, pp. 58-59.

subsidiaries, on the whole, on total assets and net worth were smaller than their parent corporations. On the other hand, the subsidiaries earned higher rate of return on total sales than their parent corporations.

The group-wise comparison indicates that the subsidiaries engaged in metal and metal products had higher five-year average earnings on total assets and net worth than their parent corporations. The well established subsidiaries were earning higher rate of return on net worth than their parent corporations. A striking feature of the average rates of return was that with the increase in the maturity of subsidiaries, the earnings showed an increasing trend. There was no evidence to show that the nationality of directors or ownership is of great influence on the rate of return of the subsidiaries.

No doubt, the subsidiaries, on the whole, could not earn higher rate of return on investment than their parent corporations but it should not be interpreted that they could not meet the expectation of their parent corporations. The subsidiaries while earning lower rates of return on total assets and net worth, at the same time, earned higher rates of return on total sales than their parent corporations. This indicates that the subsidiaries were able to expand their product market in India and earn higher rate of return on total sales. Moreover, the higher rate of return on net worth of the well established subsidiaries

suggests that with the passage of time the subsidiaries would start earning higher rates of return on investment.

The business risk of all subsidiaries with higher rates of return was greater than their parent corporations. At the same time, the lower rates of return of the subsidiaries were also associated with the higher business risk. Despite the higher business risk, the parent corporations were more concerned with the environmental or non-business risks such as exchange risk, political risk and economic risk.

The U.S. corporations feel that the foreign exchange risk in India has been minimal and few countries in the developing world could match to the commitment of the Indian government in the foreign exchange matter. The parent corporations view that the political risks have recently increased in India due to the political instability, increasing influence of communism, border conflicts with neighboring countries, etc. Many U.S. executives view the uncertainties of political situation and its consequences on the foreign investment. The uncertainties of procuring raw materials, changes in priorities of Indian plans and rate of inflation were viewed as important factors affecting the attitudes of U.S. corporations regarding the economic risk of the country. To minimize the environmental risks, the American corporations take various measures such as guarantee of risk by the U.S. Government, minimum equity

investment, joint ventures between U.S. corporations and Indian partner, etc.

CHAPTER VII

SUMMARY AND CONCLUSIONS

The primary purpose of this chapter is to present the main findings of this research and to examine their implications. The chapter begins with a brief summary of the purpose of the research and research methodology. The next section presents the main hypotheses and findings. The final section examines the implications of these findings.

Brief Summary of Purpose and Research Methodology

The main purpose of the present research is to examine and evaluate the investment policies and performance of U.S. (manufacturing and petroleum) subsidiaries in India. The basic approach, based on published financial data, questionnaires and interviews, is to compare the investment policies and performance (profitability and risk) of the U.S. subsidiaries with their parent corporations.

From a total population of 37 U.S. subsidiaries eligible (widely-held corporate subsidiaries, with at least 10% American equity investment, operating throughout the 1963-67 period) for the present study, the annual reports

of 27 U.S. subsidiaries were made available for the years 1963 to 1967. These participating subsidiaries accounted for about 90% of the total assets, net worth and total sales of total population and constituted a reasonable cross-section view in terms of nature of products, age, ownership, management and size. To get more information regarding the objective of investment, the application of capital budgeting approach in international investment, etc., all of these 27 parent corporations were contacted through questionnaires. Fourteen returned the completed questionnaire. Personal interviews were conducted in the case of eight U.S. corporations. Moreover, two Indian officials of Indian Investment Centre, New York, were also interviewed.

Before comparing the investment policy and performance of the subsidiaries with their parent corporations, the financial statements of the participating subsidiaries were adjusted for the price level changes in India. The U.S.A. also experienced some inflation during the period under study and the adjustment process followed for the U.S. subsidiaries allowed for this also in the approximate way described in Chapter IV. The adjusted financial statements of the subsidiaries were used as the basis for the present study.

Main Hypotheses and Findings

The first hypothesis asked whether the investment policy of the U.S. subsidiaries in India is similar to or different from that of their parent corporations. Study of comparative financial ratios indicated that the subsidiaries' policies differed in the following ways. Subsidiaries had relatively more investment in net fixed assets and inventories than their parent corporations while the parents, of course, had invested relatively more in cash and marketable securities and accounts receivable (see Table 5:8). Moreover, the subsidiaries had not followed similar financial structure as that of their parent corporations (see Table 5:14). The subsidiaries relied more on the short and long term debts and common stock than their parent corporations. The parent corporations depended more on the retained earnings which accounted for more than one-half of their total financing whereas retained earnings, on the whole, were not the major source of finance in the case of the U.S. subsidiaries operating in India. This is mainly due to the differences in the relative age and the dividend payment policies of the parent and the subsidiaries. Preferred stock played an insignificant role as a source of capital in the case of both subsidiaries and parent corporations but the share of parent corporations was greater than their Indian subsidiaries.

The group-wise comparison indicates, as expected, that the proportion of common stock of the newer subsidiaries was much greater than their parent corporations and even greater than the old subsidiaries. The degree of American versus Indian management (Board of Directors) and ownership of these subsidiaries do not seem to influence the financial structure of the subsidiaries.

The U.S. subsidiaries, on the whole, have paid higher percentage of their earnings as dividend than their parent corporations. (See Table 5:20.) There were greater fluctuations in the high and low dividend payout ratios of the subsidiaries than their parent corporations. The dividend payout ratios of the U.S. subsidiaries were noted to be similar to those of other Indian public limited companies.

The second hypothesis of the present research was that the performance (rate of return, considering risk) of the U.S. subsidiaries in India is better than their parent corporations. The findings of the research indicate that the five-year average rates of return on total assets and net worth of U.S. subsidiaries, on the whole, were smaller than their parent corporations. On the other hand, the U.S. subsidiaries' return on total sales generally exceeded those of their parent corporations (see Table 6:1).

The group-wise comparison indicates that the subsidiaries engaged in the metal and metal products had a higher five-year average rate of return on total assets and

net worth than their parent corporations. However, the well established U.S. subsidiaries were earning higher rates of return on net worth than their parent corporation. Moreover, with the increasing maturity of the U.S. subsidiaries, the subsidiaries started earning greater rates of return on net worth. There is no evidence to show that the nationality of the directors or ownership or size of subsidiaries had great influence on the rate of return of the U.S. subsidiaries.

The above findings may give the impression that the U.S. subsidiaries in India could not even earn the rate of return available on their domestic investment. Such a conclusion would not be realistic because the parent corporations are not overly concerned with the lower rate of return on investment in the short-term so long as the subsidiaries are able to expand their market. The empirical evidence indicates that the subsidiaries, while earning lower rates of return on total assets and net worth than their parent corporations, at the same time earned higher rates of return on total sales than their parent corporations. Moreover, the well established subsidiaries were earning higher rates of return on net worth than their parent corporations. It indicates that the subsidiaries' performance is not inconsistent with the long-range policies of the parent corporations. The optimistic attitude of parent corporations, as revealed by the questionnaire

survey and personal interviews, regarding their future plan in India also supports the above findings.

The business risk (variability of returns as measured by the standard deviation) of all subsidiaries, with either higher or lower average rates of return, was greater than their parent corporations. Despite higher variability of earnings, the parent corporations were more concerned, as revealed by the questionnaire survey and personal interviews, with the environmental or non-business risks, i.e., foreign exchange risks, political risks and economic risks. The parent corporations feel that the foreign exchange risks are minimal in India few countries in the developing world being able to match the commitment of Indian Government in the foreign exchange matters. The parent corporations pointed out, though,that the political risks had increased in India due to political instability, increasing influence of communism in the country, border conflict with neighboring countries, etc. Many executives believed that the uncertainties of the political situation would have adverse consequences on the foreign private investment in India. The uncertainties of production and raw materials, changes in the priorities of Indian Plans, and rate of inflation were viewed as important factors affecting the attitude of U.S. corporations regarding economic risks of the country. To minimize the various environmental risks, the parent corporations indicated that they took

various measures such as guarantees of risk by the U.S. Government, minimum equity investment, joint ventures between U.S. corporations and Indian investors, etc.

Implications of the Study

(1) The present study confirms that the U.S. corporations going to India and presumably to other foreign countries, do not adopt their domestic investment policy for their foreign subsidiaries. Economic, political and other factors may have an important impact on the investment policy of the subsidiaries.

(2) The findings of the present research indicate that the performance of the U.S. subsidiaries in India was not better than their parent corporations. The rates of return on total assets and net worth of the subsidiaries were smaller and the business risks greater than their parent corporations. On the basis of these findings one may argue that the parent corporations either should not expand or discontinue their investment in India. Such a generalization would not be justified, however. When the parent corporations invested in India, their objectives were long-range earnings. The data, questionnaire survey and personal interviews make it appear that this objective is generally being reached. The rate of return on sales suggests that the U.S. subsidiaries were earning higher rates of return than their parent corporations indicating

their efficiency of operation in India. Moreover, the well established U.S. subsidiaries were earning higher rates of return on net worth than their parent corporations. These two empirical evidences suggest that the U.S. subsidiaries were operating efficiently and were able to earn higher profit in the long run. The optimistic attitude of the parent corporations regarding their future plans in India also supports the above generalization.

(3) The empirical evidence of the present research indicates that the U.S. subsidiaries were paying higher percentage of their earnings as dividend than their parent corporations and were not reinvesting their earnings like their parent corporations. This policy of the U.S. subsidiaries may be interpreted as a sort of 'exploitation.' But such a conclusion would not be justified. A comparison between the dividend payout ratios of Indian public limited companies and the U.S. subsidiaries indicates that the U.S. subsidiaries had paid similar percentage of their earnings as dividend as other Indian companies.

(4) While evaluating the various kinds of risks, the U.S. corporations were more concerned with the environmental risks than the business risks. It suggests that in analyzing the international investment decisions, more emphasis should be given to the environmental risks than the business risks.

(5) The period of the present study (1963-67) was marked with various stresses and strains, one after another, on the Indian economy. The economy experienced stagnation in agricultural production and acute food shortage due to the severe drought for the two successive years (1965 and 1966), Chinese aggression in 1962 and border conflict with Pakistan in 1965, substantial increase in government expenditure on defense, recessionary trend in industrial production, postponement of Fourth Plan, devaluation of Indian currency, etc. Due to these factors, the earning capacity of the subsidiaries reduced significantly. On the other hand, 1963-67 was unusually good period for the U.S. economy. With the normal situation in India there is greater possibilities for the better performance of the subsidiaries.

The present study is limited by the inability to incorporate transfer pricing, management fee, royalties, etc., in studying the performance of the U.S. subsidiaries. However, the evidence did seem substantial that in general the subsidiaries' earnings were less than the parents', this in addition to greater risks. Yet many of the U.S. subsidiaries are fairly new. There seemed to be evidence that with the maturity of the subsidiaries (and assuming an improvement in the economic situation of India and continuation of a reasonable foreign investment climate) the performance of the U.S. subsidiaries in the long run will improve, becoming consistent with the parents' risk-return expectations.

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APPENDIX 1

COVER LETTER TO QUESTIONNAIRE

April 3, 1969

Dear Mr.

In connection with my doctoral dissertation entitled 'Investment Policy and Performance of U.S. Subsidiaries in India' I have prepared the enclosed questionnaire. The form of the questionnaire requires to put an 'X' in the ( ) following the answer preferred. The questionnaire has been pretested and the total time to complete it should not exceed fifteen minutes.

Needless to say, the information will be kept in strict confidence and no firm or person will be identified in the published result.

I intend to provide a summary of the results of this questionnaire to the respondent and therefore would appreciate your cooperation.

Yours truly,

(Daya R. Singh)

Enc.

QUESTIONNAIRE

(1) Why was the original investment undertaken in India? For example, was it undertaken for:

(a) Expectation of profit	( )
(b) Supply of raw materials	( )
(c) Tariff or other import restrictions	( )
(d) Expansion of market for your products	( )
(e) Lower cost of production	( )
(f) Take advantage of future growth of Indian economy	( )
(g) Any other factors: (please specify)	( )

(2) Who is the final authority to decide the following policy decisions regarding your subsidiary in India?

	Parent Corp.	Subsidiary
(a) Major capital expenditures (greater than 5% of the equity investment)	( )	( )
(b) Minor capital expenditure (below 5% of the equity investment)	( )	( )
(c) Choosing sources of financing of capital expenditure	( )	( )
(d) Production planning	( )	( )
(e) Marketing planning	( )	( )
(f) Purchasing of raw materials, equipment	( )	( )
(g) Day to day operation	( )	( )
(h) Employment of top executives	( )	( )

(3) Do you conduct a detailed economic calculation of the most likely investment cases and then consider the alternative cases and the consequences.

Yes ( ) No ( )

(4) For the evaluation of foreign investment alternatives, which technique do you use and how much emphasis do you give in your corporation?

	Very Much	Somewhat	None
(a) Formalized quantitative models	( )	( )	( )
(b) Subjective evaluation	( )	( )	( )

(A) If you put weight on the formalized quantitative models, which of the following techniques do you use in your corporation?

(a) Payback method ( ) (b) Average rate of return on book value ( )
(c) Internal rate of return ( ) (d) Net present method ( )
(e) Any other method ( )

(5) While making investment decisions for foreign country, do you consider risk explicitly in the decision making process?

(a) Yes ( ) (b) No ( )

(i) If your answer is yes, which of the following techniques (i.e., (1) or (2) or both) do you use for this purpose?

(1) Formalized techniques:

(a) Vary required rate of return on investment ( )
(b) Vary payback period ( )
(c) Adjust cost of capital in the present value method ( )
(d) Higher discounting rate ( )
(e) Sensitivity analysis ( )
(f) Simulation by model ( )

(2) Subjective evaluation ( )

(ii) What step(s) do you prefer to take to minimize the risks of your subsidiary in India?

(a) Borrow funds from Indian Government Agencies ( )
(b) Borrow less dollar from U.S.A. ( )
(c) Insure risks where possible ( )
(d) Admission of Indian partners ( )
(e) Guarantee of risks by U.S. Government ( )
(f) Keep a minimum of equity investment in subsidiary ( )
(g) Borrow private funds in India ( )

(6) While evaluating your investment decisions do you use different cost of capital for domestic and foreign investment?

(a) Yes ( ) (b) No ( )

If Yes, how do you determine the cost of capital in these cases?

(a) Do not vary cost of capital	( )
(b) Vary cost of capital subjectively	( )
(c) Use parent corp.'s cost of capital	( )
(d) Use prime interest rate of U.S.A.	( )
(e) Use cost of capital of foreign subsidiary	( )
(f) Any other	( )

(7) What minimum rate of return (excluding royalties, transfer price, management fees) on net worth (equity plus retained earnings) on your investment in India must be in order to attract your company's capital?

(a) Above 5%	( )	(b) Above 10%	( )
(c) Above 15%	( )	(d) Above 20%	( )
(e) Any other rate (Please specify)	( )		

(8) While deciding about your foreign investment policy in general, how much emphasis do you give to the following factors in foreign countries?

	Major	Minor	None
(a) Repatriation of capital	( )	( )	( )
(b) Convertibility of currency	( )	( )	( )
(c) Stability of exchange rate	( )	( )	( )
(d) Remittance of profit, etc.	( )	( )	( )
(e) Tax consideration	( )	( )	( )
(f) Inflation	( )	( )	( )
(g) Political stability	( )	( )	( )
(h) Rapid economic growth	( )	( )	( )
(i) Encouragement by U.S. Government	( )	( )	( )
(j) Any other	( )	( )	( )

(9) Please indicate your attitudes regarding the following Indian situations:

	Very Fav.*	Fav.*	Reasonable	Rest.*	Very Rest.*
(a) Repatriation of capital policy	( )	( )	( )	( )	( )

	Very Fav.*	Fav.*	Reasonable	Rest.*	Very Rest.*
(b) Foreign exchange policy	( )	( )	( )	( )	( )
(c) Foreign investment policy	( )	( )	( )	( )	( )
(d) Corporate taxes policy	( )	( )	( )	( )	( )
(e) Remittance of profit, etc. policy	( )	( )	( )	( )	( )
(f) Industrial policy of Indian Government	( )	( )	( )	( )	( )
(g) Labor situation	( )	( )	( )	( )	( )
(h) Price control	( )	( )	( )	( )	( )
(i) Access to Indian Capital Market	( )	( )	( )	( )	( )
(j) Red tape in government machinery	( )	( )	( )	( )	( )

(10) Please indicate the reason for the retention of earnings of your subsidiary in India?

(a) Better return on reinvestment in India ( )
(b) Majority ownership by Indian partner ( )
(c) Restriction on remittance of profit ( )
(d) Don't retain ( )
(e) Any other reason (Please specify) ( )

(11) What percent of U.S. equity capital would you prefer to invest in your subsidiary in India?

(a) 100% U.S. Capital ( ) (b) Majority U.S. Capital ( )
(c) 50% U.S. Capital ( ) (d) Minority (25%-49%) ( )
(e) Nominal (below 25%) ( )

(12) What is your corporation's attitude toward future investment in India?

(a) To expand the operation ( ) (b) To maintain present level ( )
(c) To reduce present level ( ) (d) Uncertain ( )

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*Fav. = Favorable; Rest. = Restrictive.

(13) Do you think that the performance of your subsidiary in India lived up to the expectation of your corporation?

(a) Early to judge ( ) (b) Exceeded ( )
(c) Reasonable in early period ( ) (d) Disappointed today ( )
(e) Very disappointed ( )

APPENDIX 2

APPENDIX 2

GUIDE TO PERSONAL INTERVIEWS

A. Investment and Financial Policies

(1) What procedure does your corporation follow for making decision for foreign investment? Is it different from that of the local investment?

(2) Before making your decision for investment in a particular country, do you consider a number of countries and then decide for a particular country?

(3) What factors or policies have to be changed or improved for attracting your corporation to invest in the new projects in India?

(4) Do you think that your Indian subsidiary has been able to meet the short term requirements of funds from Indian capital market?

(5) Does your Indian subsidiary raise enough funds for long-term financing of the project from the Indian capital market?

Risk Criteria

(1) How do you make provision for the various elements of risk in foreign investment decision?

(2) Do you think that the political risk has increased in India recently? If yes, how would you protect your interest in India?

(3) Do you think that the business risk is greater in India than in the U.S.A.?

(4) To protect the interest of the U.S. corporations, there are two guaranty programs (i.e. Specific Risk Guaranty Program and Extended Risk Guaranty Program). Do you think that they are sufficient protection against the various types of risks?

Performance Criteria

(1) For the evaluation of the performance of your Indian subsidiary, do you take a short term view and/or a long-term view or both?

   (a) What criteria do you take to evaluate the performance of your Indian subsidiary?

(2) Which of the following methods are taken into consideration for the evaluation of the performance of your Indian subsidiary?

   (a) Net profit to stockholders' equity.

   (b) Net profit to total sales.

   (c) Net profit to total assets.

   (d) Other method.

(3) During the period 1963 through 1967 the Indian economy experienced various stresses and strains. Do you think that these conditions have influenced the profitability of your Indian subsidiary?

(4) Do you expect that the performance of your Indian subsidiary will be improved in the near future?