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Foreign Direct Investment in India

Abstract

With the initiation of globalization, developing countries, particularly those in Asia, have been witnessing a immense surge of FDI inflows during the past two decades. Even though India has been a latecomer to the FDI scene compared to other East Asian countries, its considerable market potential and a liberalized policy regime has sustained its attraction as a favourable destination for foreign investors.

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Introduction

Definition of Foreign Direct Investment

Foreign direct investment (FDI) is an investment in a business by an investor from another country for which the foreign investor has control over the company purchased. The Organization of Economic Cooperation and Development (OECD) defines control as owning 10% or more of the business. Businesses that make foreign direct investments are often called multinational corporations (MNCs) or multinational enterprises (MNEs). A MNE may make a direct investment by creating a new foreign enterprise, which is called a greenfield investment, or by the acquisition of a foreign firm, either called an acquisition or brown field investment.

There are two types of FDI: inward foreign direct investment and outward foreign direct investment, resulting in a net FDI inflow (positive or negative) and "stock of foreign direct investment", which is the cumulative number for a given period. Direct investment excludes investment through purchase of shares.FDI is one example of international factor movements.

Advantages and Disadvantages of FDI

Trade- Foreign Direct Investments have opened a wide spectrum of opportunities in the trading of goods and services in India both in terms of import and export production. Products of superior quality are manufactured by various industries in India due to greater amount of FDI inflows in the country.

Employment and skill levels- FDI have also ensured a number of employment opportunities by aiding the setting up of industrial units in various corners of India. Technology diffusion and knowledge transfer- FDI apparently helps in the outsourcing of knowledge from India especially in the Information Technology sector. It helps in developing the know-how process in India in terms of enhancing the technological advancement in India.

Linkages and spillovers to domestic firms- Various foreign firms are now occupying a position in the Indian market through Joint Ventures and collaboration concerns. The maximum amount of the profits gained by the foreign firms through these joint ventures is spent on the Indian market.

In the context of foreign direct investment, advantages and disadvantages are often a matter of perspective. An FDI may provide some great advantages for the MNE but not for the foreign country where the investment is made. On the other hand, sometimes the deal can work out better for the foreign country depending upon how the investment pans out. Ideally, there should be numerous advantages for both the MNE and the foreign country, which is often a developing country. We'll examine the advantages and disadvantages from both perspectives.

Advantages of FDI

Access to Markets

FDI can be an effective way for you to enter into a foreign market. Some countries may extremely limit foreign company access to their domestic markets. Acquiring or starting a business in the market is a means for you to gain access.

Access to Resources

FDI is also an effective way for you to acquire important natural resources, such as precious metals and fossil fuels. Oil companies, for example, often make tremendous FDIs to develop oil fields.

Reduces Cost of Production

FDI is a means for you to reduce your cost of production if the labor market is cheaper and the regulations are less restrictive in the target foreign market. For example, it's a well-known fact that the shoe and clothing industries have been able to drastically reduce their costs of production by moving operations to developing countries.

Advantages to Foreign Countries

Source of external capital and increased revenue. FDI can be a tremendous source of external capital for a developing country, which can lead to economic development.

For example, if a large factory is constructed in a small developing country, the country will typically have to utilize at least some local labor, equipment and materials to construct it. This will result in new jobs and foreign money being pumped into the economy. Once the factory is constructed, the factory will have to hire local employees and will probably utilize a least some local materials and services. This will create further jobs and maybe even some new businesses. These new jobs mean that locals have more money to spend, thereby creating even more jobs.

Additionally, tax revenue is generated from the products and activities of the factory, taxes imposed on factory employee income and purchases, and taxes on the income and purchases now possible because of the added economic activity created by the factory. Developing governments can use this capital infusion and revenue from economic growth to create and improve its physical and economic infrastructure such as building roads, communication systems, educational institutions and subsidizing the creation of new domestic industries.

Development of new industries. Remember that a MNE doesn't necessary own all of the foreign entity. Sometimes a local firm can develop a strategic alliance with a foreign investor to help develop a new industry in the developing country. The developing country gets to establish a new industry and market, and the MNE gets access to a new market through its partnership with the local firm.

Learning

This is more of an indirect advantage. FDI exposes national and local governments, local businesses and citizens to new business practices, management techniques, economic concepts, and technology that will help them develop local businesses and industries.

Disadvantages of FDI

FDI has been a booming factor that has bolstered the economic life of India, but on the other hand it is also being blamed for ousting domestic inflows. FDI is also claimed to have lowered few regulatory standards in terms of investment patterns: The disadvantages of foreign direct investment occur mostly in case of matters related to operation, distribution of the profits made on the investment and the personnel. One of the most indirect disadvantages of foreign direct investment is that the economically backward section of the host country is always inconvenienced when the stream of foreign direct investment is negatively affected.

The various disadvantages of foreign direct investment are understood where the host country has some sort of national secret – something that is not meant to be disclosed to the rest of the world. It has been observed that the defense of a country has faced risks as a result of the foreign direct investment in the country. At times it has been observed that certain foreign policies are adopted that are not appreciated by the workers of the recipient country. Foreign direct investment, at times, is also disadvantageous for the ones who are making the investment themselves.

Foreign direct investment may entail high travel and communications expenses. The differences of language and culture that exist between the country of the investor and the host country could also pose problems in case of foreign direct investment. Much of FDI takes place in the developing world, which is just developing its economic systems. The market conditions in the developing world can be quite unstable and unpredictable. A bigger problem may be unstable or underdeveloped political and legal systems. A company may have to deal with a corrupt or unstable political system.

Future Outlook

India is estimated to require around US$ 1 trillion during the 12th Five-Year Plan period (2012–17), to fund infrastructure in sectors such as roads, airports and ports. The government is in the process of liberalizing FDI norms in construction activities and railways, which could bring in investments to meet the target.

The government is also relaxing FDI norms in other sectors for foreign investors to invest. FDI in multi-brand retail has been allowed up to 51 per cent. The minimum requirement for the FDI is US$ 100 million, of which at least 50 per cent must be invested in 'backend infrastructure' within three years following the initiation of the FDI. FDI limit in single-brand retail has been increased to 100 per cent; 49 per cent will be under the automatic route and the rest through the FIPB route.

Conclusion

India’s Foreign Direct Investment (FDI) policy has been gradually liberalised to make the market more investor friendly. The results have been encouraging. These days, the country is consistently ranked among the top three global investment destinations by all international bodies, including the World Bank, according to a United Nations (UN) report. For Indian economy which has tremendous potential, FDI has had a positive impact. FDI inflow supplements domestic capital, as well as technology and skills of existing companies. It also helps to establish new companies. All of these contribute to economic growth of the Indian Economy.

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