Foreign direct investment (fdi) in india

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QUESTION

\nDiscuss the significance of foreign direct investment for a developing country like India? Why India has failed to attract more FDI despite being a democratic country?\n

WHAT IS FOREIGN DIRECT INVESTMENT?

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MEANING:

\nThese three letters stand for direct investment. The simplest explanation of FDI would be a direct investment by a corporation in a commercial venture in another country. A key to escaping this action from investment in other ventures in a foreign country is that the business enterprise operates completely outside the economy of the corporation’s home country. The investing corporation must control 10 percent or more of the voting power of the new venture.\n\nAccording to history the United States was the leader in the FDI activity dating back as far as the end of World War II. Businesses from other nations have taken up the flag of FDI, including many who were not in a financial position to do so just a few years ago.\n\nThe practise has grown significantly in the last couple of decades, to the point that FDI has generated quite a bit of opposition from groups such as labor unions. These organizations have expressed concern that investing at such a level in another country eliminates jobs. Legislation was introduced in the early 1970s that would have put an end to the tax incentives of FDI. But members

of the Nixon administration, Congress and business interests rallied to make sure that this attack on their expansion plans was not successful. One key to introducing FDI is to get a mental picture of the global scale of corporations able to make such investment. A carefully planned FDI can provide a huge new market for the company, perhaps introducing products and services to an area where they have never been available. Not only that, but such an investment may also be more profitable if construction costs and labor costs are less in the host country.\n\nThe definition of FDI originally meant that the investing corporation gained a significant number of shares (10 percent or more) of the new venture. In recent years, however, companies have been able to make a foreign direct investment that is actually long-term management control as opposed to direct investment in buildings and equipment.\n\nForeign Direct Investment (FDI) is a measure of foreign ownership of productive assets, such as factories, mines and land. Increasing foreign investment can be used as one measure of growing economic globalization. The largest flows of foreign investment occur between the industrialized countries (North America, Western Europe and Japan). But flows to non-industrialized countries are increasing sharply. Foreign direct investment (FDI) refers to long-term participation by country A into country B.\n\nIt usually involves participation in management, joint-venture, transfer of technology and expertise. There are two types of FDI: inward foreign direct investment and outward foreign direct investment, resulting in a net FDI inflow(positive or negative). Foreign direct investment reflects the objective of obtaining a lasting interest by a resident entity in one country (‘ direct investor’) in an entity resident in an economy other than that of the investor (‘ direct investment enterprise’).\n

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- Foreign Direct Investment –when a firm invests directly in production or other facilities, over which it has effective control, in a foreign country. \n \t
- Manufacturing FDIrequires the establishment of production facilities. \n \t
- Service FDIrequires building service facilities or an investment foothold via capital contributions or building office facilities. \n \t
- Foreign subsidiaries– overseas units or entities \n \t
- Host country –the country in which a foreign subsidiary operates. \n \t
- Flow of FDI– the amount of FDI undertaken over a given time. \n \t
- Stock of FDI– total accumulated value of foreign-owned assets \n \t
- Differs from FDI, which is the investment in physical assets. \n

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DEFINITION

\nForeign direct investment is that investment, which is made to serve the business interests of the investor in a company, which is in a different nation distinct from the investor's country of origin. A parent business enterprise and its foreign affiliate are the two sides of the FDI relationship. Together they comprise an MNC.\n\nThe parent enterprise through its foreign direct investment effort seeks to exercise substantial control over the foreign affiliate company. ' Control' as defined by the UN, is ownership of greater than or equal to 10% o ordinary shares or access to voting rights in an incorporated firm. For an unincorporated firm one needs to consider an equivalent criterion. Ownership share amounting to less than that stated

above is termed as portfolio investment and is not categorized as FDI.\n\nFDI stands for FOREIGN DIRECT INVESTMENT, a component of a country's national financial accounts. Foreign direct investment is investment of foreign assets into domestic structures, equipment, and organizations. It does not include foreign investment into the stock markets. Foreign direct investment is thought to be more useful to a country than investments in the equity of its companies because equity investments are potentially ' hot money' which can leave at first sign of trouble, whereas FDI is durable and generally useful whether things go well or badly.\n\nFDI or Foreign Direct Investmentis any form of investment that earns interest in enterprises which function outside of the domestic territory of the investor. FDIs require a business relationship between a parent company and its foreign subsidiary. Foreign direct business relationships give rise to multinational corporations. For an investment to be regarded as FDI, the parent firm needs to have at least 10% of the ordinary shares of its foreign affiliates.\n

FOREIGN DIRECT INVESTOR

\nA foreign direct investor is an individual, an incorporated or unincorporated public or private enterprise, a government, a group of related incorporated and unincorporated enterprise – that is, a subsidiary, associate or branch – operating in a country other than the country or countries of residence of the foreign direct investor or investors.\n

TYPES OF FOREIGN DIRECT INVESTMENT

\nFDIs can be broadly classified into two types:\n

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1. Outward FDIs \n \t
2. Inward FDIs \n

\nThis classification is based on the types of restrictions imposed, and the various pre-requisites required for these investments.\n\nOutward FDI: An outward-bound FDI is backed by the government against all types of associated risks. This form of FDI is subject to tax incentives as well as disincentives of various forms. Risk coverage provided to the domestic industries and subsidies granted to local firms stand in the way of outward FDIs, which are also known as ‘ direct investments abroad’.\n\nInward FDI: Different economic factors encourage inward FDIs. These include interest loans, tax breaks, grants, subsidies, and the removal of restrictions and limitations. Factors detrimental to the growth of FDIs include necessities of differential performance and limitations related with ownership patterns.\n

Other categorizations of FDI

\nOther categorizations of FDI exist as well. Vertical Foreign Direct Investment takes place when a multinational corporation owns some shares of a foreign enterprise, which supplies input for it or uses the output produced by the MNC.\n\nHorizontal foreigndirect investments happen when a multinational company carries out a similar business operation in different nations.\n

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- Horizontal FDI – the MNE enters a foreign country to produce the same products at home. \n \t
- Conglomerate FDI – the MNE produces products not manufactured at home. \n \t

- Vertical FDI – the MNE produces intermediate goods either forward or backward in the supply stream. \n \t
- Liability of foreignness – the costs of doing business abroad resulting in a competitive disadvantage. \n

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METHODS OF FOREIGN DIRECT INVESTMENTS

\nThe foreign direct investor may acquire 10% or more of the voting power of an enterprise in an economy through any of the following methods:\n

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- By incorporating a wholly owned subsidiary or company \n \t
- By acquiring shares in an associated enterprise \n \t
- Through a merger or an acquisition of an unrelated enterprise \n \t
- Participating in an equity joint venture with another investor or enterprise \n

\nForeign direct investment incentives may take the following forms:\n\nLow corporate tax and income tax rates\n

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- Tax holidays \n \t
- Other types of tax concessions \n \t
- Preferential tariffs \n \t
- Special economic zones \n \t
- Soft loan or loan guarantees \n \t
- Free land or land subsidies \n \t
- Relocation & expatriation subsidies \n \t

- R&D support \n \t
- Infrastructure subsidies \n

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WHY IS FDI IMPORTANT FOR ANY CONSIDERATION OF GOING GLOBAL?

\nThe simple answer is that making a direct foreign investment allows companies to accomplish several tasks:\n

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1. Avoiding foreign government pressure for local production. \n \t
2. Circumventing trade barriers, hidden and otherwise. \n \t
3. Making the move from domestic export sales to a locally-based national sales office. \n \t
4. Capability to increase total production capacity. \n \t
5. Opportunities for co-production, joint venture with local partners, joint Marketing arrangements, licensing, etc. \n

\nA more complete response might address the issue of global business partnering in very general terms. While it is nice that many business writers like the expression, ‘ think globally, act locally’, this often used cliché does not really mean very much to the average business executive in a small and medium sized company. The phrase does have significant connotations for multinational corporations. But for executives in SME’s, it is still just another buzzword. The simple explanation for tis is the difference in perspective between executives of multinational corporations and small and medium sized companies. Multinational corporations are almost always concerned with worldwide manufacturing capacity and proximity to major markets.

Small and medium sized companies tend to be more concerned with selling their products in overseas markets. The advent of the internet has ushered in a new and very different mindset that tends to focus more on access issues. SME’s in particular are now focusing on access to markets, access to expertise and most of all access to technology.\n

THE STRATEGIC LOGIC BEHIND FDI

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- Resources seeking– looking for resources at a lower real cost. \n \t
- Market seeking– secure market share and sales growth in target foreign market. \n \t
- Efficiency seeking– seeks to establish efficient structure through useful factors, culture, policies or markets. \n

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ENHANCING EFFICIENCY FROM LOCATION ADVANTAGES

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- Location advantages –defined as the benefits arising from a host country’s comparative advantages. \n

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- Lower real cost from operating in a host country \n \t
- Labour cost differentials \n \t
- Transportation costs, tariff and non-tariff barriers \n \t

- Governmental policies \n

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IMPROVING PERFORMANCE FROM STRUCTURAL DISCREPANCIES

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- Structural discrepanciesare the differences in industry structure attributes between home and host countries. Examples include areas where: \n

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- Competition is less intense \n \t
- Products are in different stages of their life cycle \n \t
- Market demand is unsaturated \n \t
- There are differences in market sophistication \n

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INCREASING RETURN FROM OWNERSHIP ADVANTAGES

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- Ownership advantagescome from the application of proprietary tangible and intangible assets in the host country. \n

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- Reputation, brand image, distribution channels \n \t

- Technological expertise, organizational skills, experience \n

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- Core competence –skills within the firm that competitors cannot easily imitate or match. \n

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ENSURING GROWTH FROM ORGANIZATIONAL LEARNING

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- MNEs exposed to multiple stimuli, developing: \n

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- Diversity capabilities \n \t
- Broader learning opportunities \n

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- Exposed to: \n

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- New markets \n \t
- New practices \n \t
- New ideas \n \t
- New cultures \n \t

- New competition \n

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FDI & INDIAN ECONOMY

\nThe economy of India is the third largest in the world as measured by purchasing power parity, with a gross domestic product (GDP) of US $3. 611 trillion. When measured in USD exchange-rate terms, it is the tenth largest in the world, with a GDP of US $800. 8 billion.\n\nThe economy is diverse and encompasses agriculture, handicrafts, textile, manufacturing and a multitude of services. Although two-thirds of the Indian workforce still earn their livelihood directly or indirectly through agriculture, services are growing sector and are playing an increasingly important role of India's economy. The advent of the digital age, and the large number of young and educated populace fluent in English, is gradually transforming India as an important ' back office' destination for global companies or the outsourcing of their customer services and technical support.\n\nIndia is a major exporter of highly-skilled workers in software and financial services, and software engineering. India followed a socialist-inspired approach for most of its independent history, with strict government control over private sector participation, foreign trade, and foreign direct investment. FDI up to 100% is allowed under the automatic route in all activities/sectors except the following which will require approval of the government activities that require an Industrial License.\n

INVESTMENT RISKS IN INDIA

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- Sovereign Risk \n \t
- Political Risk \n \t
- Commercial risk \n \t
- Risk due to terrorism \n

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FDI POLICY IN INDIA

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Foreign Direct Investment policy

\nFDI policy is reviewed on an outgoing basis and measures for its further liberalisation are taken. Change in sectoral policy/sectoral equity cap is notified from time to time through press notes. FDI policy permits FDI up to 100% from foreign investor without prior approval in most of the sectors including the services sector under automatic route. FDI in sectors under automatic route does not require any prior approval either by the government or the RBI.\n\nThe foreign direct investment scheme and strategy depends on the respective FDI norms and policies in India. The FDI policy of India has imposed certain foreign direct investmentregulations as per the FDI theory of the government of India. These include FDI limits in India for example:\n

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- Foreign direct investment in India in infrastructure development projects excluding arms and ammunitions, atomic energy sector, railway system, extraction of coal and lignite and mining industry is

allowed upto 100% equity participation with the capping amount as Rs. 1500 crores. \n \t

- FDI limit of maximum 49% in telecom industry especially in the GSM services. \n \t
- FDI figures in equity contribution I the finance sector cannot exceed more than 40% in banking services including credit card operations. \n

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Foreign direct investment: Indian scenario

\nFDI is permitted as under the following forms of investments –\n

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- Through financial collaborations \n \t
- Through joint ventures and technical collaborations \n \t
- Through capital markets via Euro issues \n \t
- Through private placements or preferential allotments \n

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CONCLUSION

\nA large number of changes that were introduced in the country’s regulatory economic policies heralded the liberalization era of the FDI policy regime in India and brought about a structural breakthrough in the volume of FDI inflows into the economy maintained a fluctuating and unsteady trend during the study period. It might be of interest to note that more than 50% of the total FDI inflows received by India, came from Singapore and the USA.\n\ nAccording to findings and results, we have concluded that FII did have significant impact on Sensex but there is less co-relation with Bank and IT.

One of the reasons for high degree of any linear relation can also be due to the simple data. There are other major factors that influence the bourses in the stock market.