International Refereed Journal of Reviews and Research

International Refereed and Indexed Journal for Research Scholars and Practitioners

FDI IN INDIA: A CRITICAL EVALUATION

Dr. Vivek Singla

Assistant Professor in Management Department

Dronacharya Institute of Management and Technology

Kurukshetra, Haryana, India

Abstract:

Foreign Direct investment in India is a crucial factor for the economic growth. The pre economic liberalization period was challenge for the Indian economy to grow because there were many constraints to overcome. The act like FERA causes many companies to withdraw from the India market. Even for the giants like Coca Cola were not able to survive in the market, as the economy was isolated. But the post liberalization period was very fruitful for the India economy to head with a swift pace. The present paper will discuss the meaning of FDI, Arguments in favor of FDI, Arguments against FDI and Measures to remove limitations of FDI.

Keywords: FDI, FPI, MNE.

Introduction:

There has been a tremendous growth in foreign or international investment since 1990s. The underlying reasons for such international flows of capital can be attributed to several factors such as: allows capital to find the highest rate return, helps the owner of capital to diversify his or her lending, development of best practices in corporate governance and accounting rules, and finally it prevents the government from pursuing poor policies. Foreign direct investment (FDI) is a direct investment into production or business in a country by a company in another country, either by buying a company in the target country or by expanding operations of an existing business in that country. Foreign direct investment is in contrast to portfolio investment which is a passive investment in the securities of another country such as stocks and bonds. In other words foreign direct investment (FDI) or foreign investment refers to the net inflows of investment to acquire a lasting management interest (10% or more) in an enterprise operating

International Refereed Journal of Reviews and Research
International Refereed and Indexed Journal for Research Scholars and Practitioners

in an economy other than that of the investor. Foreign direct investment is the sum of equity capital, reinvestment of earnings and other long or short term capital as shown in the balance of payments. It usually involves participation in management, joint venture, transfer of technology and expertise.

Meaning of Foreign Direct Investment - FDI

An investment made by a company or entity based in one country, into a company or entity based in another country. Foreign direct investments differ substantially from indirect investments such as portfolio flows, wherein overseas institutions invest in equities listed on a nation's stock exchange. Entities making direct investments typically have a significant degree of influence and control over the company into which the investment is made. Open economies with skilled workforces and good growth prospects tend to attract larger amounts of foreign direct investment than closed, highly regulated economies.

Characteristics of FDI

1. It is an investment made by a foreign company in a home country.
2. The foreign company may make an investment either by opening its branch or by having a subsidiary or foreign controlled company in home country. It may have wholly owned subsidiary or joint venture or may acquire a stake in the existing Business.
3. Profit is the prime motive of such an investment. It may be in the form a royalty and dividend payments.
4. Investor retains control over investment and management of the firm concerned. In FDI investor may obtain effective voice in the management through other means such as subcontracting, management contracts, turnkey arrangements, franchising, licensing, trade marks and patents and product sharing.
5. On the winding up of the firm, the assets may he repatriated to the country of origin.

Types of FDI

There are two main types of FDI:

1. **Horizontal:** Horizontal FDI arises when a firm duplicates its home country-

International Refereed Journal of Reviews and Research
International Refereed and Indexed Journal for Research Scholars and Practitioners

based activities at the same value chain stage in a host country through FDI. For example, Ford assembles cars in the United States. Through horizontal FDI, it does the same thing in different host countries such as the United Kingdom (UK), France, Taiwan, Saudi Arabia, and Australia. Horizontal FDI therefore refers to producing the same products or offering the same services in a host country as firms do at home.

2. **Vertical:** While a horizontal pattern occurs when MNCs through FDI produce the same product or service in different host countries, vertical FDI takes place when a firm through FDI moves upstream or downstream in different value chains i.e., when firms perform value-adding activities stage by stage in a vertical fashion in a host country. In other words, a vertical FDI arises when a multinational firm fragments the production process internationally, thereby locating each stage of production in the country where it can be done at the least cost.

Factor Attracting FDI

Inflow of Foreign Direct Investments increases with the attractiveness of the country, due to the following factors in different proportions depending on the industry and the country:

- large GDP and market potential;
- advanced know-how;
- skilled work-force;
- low labour cost and wages;
- low taxation;
- lower environmental protection;
- high tariff protection;
- favorable laws and public incentives;
- Intentional and professional territorial marketing;
- EPZ – Export Processing Zones;
- R&D support;
- soft loan or loan guarantees;

Arguments in Favor of FDI

1. FDI improve environmental and social conditions in the host country by, inter alia, transferring "cleaner" technologies, thereby leading to more socially responsible corporate policies.
2. FDI contributes to international trade integration not least because it results in a more competitive business environment for multinational companies
3. FDI helps improve a host country's balance of payments;
4. It can create technology spillovers;

International Refereed Journal of Reviews and Research
International Refereed and Indexed Journal for Research Scholars and Practitioners

5. It creates advanced management know-how;
6. It creates jobs both directly and indirectly.
7. FDI reduces dissemination risk i.e., the risk associated with unauthorized diffusion of firm-specific know-how;
8. FDI results in more direct and tighter managerial control over foreign operations;
9. FDI promotes the transfer of tacit knowledge through "learning by doing."
10. The host country could also benefit from training and development of its workforce as FDI helps human capital formation across different
11. It promotes a healthy competition in the domestic input market.

Arguments against FDI

i. Loss of sovereignty,
ii. Adverse effects on competition,
iii. Capital outflow are the primary costs of FDI to host countries.
iv. Profit distribution, investment ratios are not fixed
v. An economically backward class person suffers from price raise
vi. Retailer faces loss in business
vii. Market places are situated too far which increases traveling expenses
viii. Workers safety and policies are not mentioned clearly
ix. Inflation may be increased
x. Again India become slaves because of FDI in retail sector

Measures to Overcome Limitations of FDI

1. **Admission and Establishment Regulatory Measures**
    i. Quantitative restrictions on numbers of MNEs
    ii. Minimum capital requirements
    iii. Screening, authorization, registration
    iv. Entry conditions – Meeting criteria (environment)
    v. Legal form requirements of FDI
    vi. Restrictions on entry modalities (MAs, IJVs, ISAs)
    vii. Special requirements for non-equity (BOT, IJVs, L/F)
    viii. FDI to specific locations (moderate urban drift)
    ix. Restrictions of imported input factors
    x. Deposit requirements prior to FDI
    xi. Admission to hosts privatization deals restricted

xii. Admission and incorporation fees (taxes)
xiii. Compliances with norms (national security, customs, public morals)

2. Ownership and Control Regulatory Measures

i. Equity limits on foreign ownership (e.g. less than 50 per cent)
ii. Entry modalities limited to IJVs/ISAs, L/F
iii. Nationality limitation on equity held
iv. Restrictions on use of foreign loans (bonds)
v. Restrictions on stocks and share types held by foreign investors (non-voting)
vi. Restrictions on types of share transfers
vii. Restrictions on foreign share holders (dividend, capital)
viii. Restrictions on nationality of directors
ix. Government reserves the right to veto certain decisions
x. Restrictions on land rights transfers

3. Operations Regulatory Measures

i. Employment restrictions on foreign staff
ii. Performance requirements (*local* sourcing, content, mfg, tt, employment, training,
iii. import, export, BOP, Sales, foreign exchange earnings)
iv. Restrictions on public procurement (MNEs excluded)
v. Restricted access to local factors inputs, on OPs relocations within host
vi. Restrictions on diversification, on access to communications, on free flow of government data
vii. Operation restriction on public utilities (price control)
viii. Restrictions on access to local credit, foreign exchange, on capital repatriations
ix. “Cultural” restrictions
x. Information disclosure requirements

xi. Special restrictions on sector operations (banks)

xii. Operational permits and licenses, technical standards, royalty ceilings

xiii. Advertizing restrictions on foreign MNEs

Conclusion:

After studding the need and importance of FDI, it can be concluded that the FDI is imperative for the development of the developing country like India. Government of India should take various measures to attract the FDI. Hence, Indian foreign investment policy makers need to look back and access the impact of FDI on India and on its economic growth. In this connection it seems that government has become more aware and making investment friendly atmosphere in India with adopting new models like Public Private Participation model etc.

References

Agosin, M. and R. Mayer (2000). “Foreign investment in Developing Countries: Does it Crowd in Domestic Investment?” Discussion Paper No.146, UNCTAD, Geneva.

Athreye, S. and S. Kapur (2001) “Private Foreign Investment in India: Pain or Panacea?” *The World Economy*, vol. 34, no.3, pp. 399-424.

Borensztein, E., J. De Gregorio and J. Lee (1995). “How does Foreign Direct Investment Affect Growth”, Journal of International Economics, 45, pp.115-135.

Brewer T. L., 1993, *Government Policies, Market Imperfections, and Foreign Direct Investment*, Journal of International Business Studies, vol. 24, No. 1, 1st Qtr, pp. 101-120.

Dua, P. and A.I. Rasheed (1998). “Foreign Direct Investment and Economic Activity in India”, Indian Economic Review, 33, pp.153-168.

Lall, S. (2002). “Linking FDI and Technology Development for Capacity Building and Strategic Competitiveness, Transnational Corporations, 11, pp.39-88.

Loewendahl H., 2001, “A Framework for FDI Promotion” in *Transnational Corporations*, vol. 10, No. 1 (April 2001).

Oman C., 2000, *Policy Competition and Foreign Direct Investment: A Study of Competition Among Governments to Attract FDI*, Paris: OECD.

Te Velde, D.W. (2001). Policies towards Foreign Direct Investment in Developing Countries: Emerging Issues and Outstanding Issues, London: Overseas Development Institute.