POSITIVE AND NEGATIVE IMPACT OF FOREIGN DIRECT INVESTMENT ON INDIAN ECONOMY- AN OVERVIEW

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ABSTRACT

FDI gives a win – win situation to the host and the home countries. In fact, both the countries are directly concerned in inviting more and more FDI, as they benefit a lot from these type of investments. The 'home' countries have the advantage of the vast markets opened by industrial growth. On the other side, the 'host' countries are having the advantage to acquire technological and managerial skills and aid domestic savings and foreign exchange. As a result, Foreign Direct Investment (FDI) is now been a vital driver of growth. Many Emerging Market Economies (EMEs) are looking upon FDI as one of the easiest means to satisfy and fulfil their financial, technical, employment generation and competitive efficiency requirements. Gradually they also realized that substantial economic growth is inevitable without global integration of business process. This created opportunities for locational advantages and thus facilitated strategic alliances, joint ventures and collaborations over R & D.

Keywords: Determining factors, Foreign Direct Investment, Pre & Post Liberalization period, SWOT.

INTRODUCTION

Foreign Direct Investment (FDI) plays a very important role in the development of the nation. It is very much vital in the case of underdeveloped and developing countries. A typical characteristic of these developing and underdeveloped economies is the fact that these economies do not have the needed level of savings and income in order to meet the required level of investment needed to sustain the growth of the economy. In such cases, foreign direct investment plays an important role of bridging the gap between the available resources or funds and the required resources or funds. It plays an important role in the long-term development of a country not only as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities.

In India, FDI is considered as a developmental tool, which helps in achieving self-reliance in various sectors and in overall development of the economy. India after liberalizing and globalizing the economy to the outside world in 1991, there was a massive increase in the flow of foreign direct investment. In India FDI inflow made its entry during the year 1991-92 with the aim to bring together the intended investment and the actual savings of the country. To pursue a growth of around 7 percent in the Gross Domestic Product of India, the net capital flows should increase by at least 28 to 30 percent on the whole. But the savings of the country stood only at 24 percent. The gap formed between intended investment and the actual savings of the country was lifted up by portfolio investments by Foreign Institutional Investors, loans by foreign banks and other places, and foreign direct investments. Among these three forms of financial assistance, India prefers as well as possesses the maximum amount of Foreign Direct Investments. Hence FDI is considered as a developmental tool for growth and development of the country. Therefore, this study is undertaken to analyze the flow of FDI into the country identifying the various set of factors which determine the flow of FDI.

NEEDS OF FDI

- Low Capital Formation:
- Need for high level of investment:
- Development of Basic Economic Infrastructure
- Exploitation of Productive Resources:
- Backwardness in Technology
- Making Balance of Payment favourable:

MAJOR SECTORS ATTRACTING FDI IN INDIA

- **Infrastructure:** The number of FDI projects in the Infrastructure sector grew by 90 percent in 2011 in India.
- **Automotive: The** automotive sector in India attracted 78 FDI deals during 2011, an increase of 28 percent in comparison to the same period in 2010.
- **Retail and Consumer Products:** The number of projects in the consumer products sector grew by 31 percent in 2011.
- **Technology:** The industry has grown from US$4 billion in 1998 to more than US$80 billion in 2011, employing directly and indirectly more than 10 million people.
- **Financial Services:** In 2011, the number of projects in the Indian financial services sector increased by 21 percent, whereas the value of FDI projects increased by 75 percent.
- **Life Sciences:** Government permits 100 percent FDI for health and medical services under the automatic route.

INDIAN PROSPECTIVE

The historical background of FDI in India can be traced back with the establishment of East India Company of Britain. British capital came to India during the colonial era of Britain in India. However, researchers could not portray the complete history of FDI pouring in India due to lack of abundant and authentic data. Before independence major amount of FDI came from the British companies. British companies setup their units in mining sector and in those sectors that suits their own economic and business interest. After Second World War, Japanese companies entered Indian market and enhanced their trade with India, yet U.K. remained the most dominant investor in India. According to UNCTAD (2007), India has emerged as the second most attractive destination for FDI after China and ahead of the US, Russia and Brazil. While India has experienced a marked rise in FDI inflows in the last few years

FLOWS OF FDI IN INDIA

Flows of FDI comprise capital provided by a foreign direct investor to an FDI enterprise, or vice versa by a foreign direct investor. FDI has three components, viz., equity capital, reinvested earnings, and intra company loans:

i. Equity capital is the foreign director investor's purchase of share of an enterprise in a country other than its own

ii. Reinvested earning compromise the direct investor's share of earning not distributed as dividends by affiliates, or earning not remitted to the direct investor. Such retained profits by affiliates are reinvested.

iii. Intra company loans or intra company debts transactions refer to short or long term borrowing and lending of funds between direct investor and affiliate enterprise.

FDI POLICY FRAMEWORK IN INDIA

Policy regime is one of the key factors driving investment flows to a country. Apart from underlying overall fundamentals, ability of a nation to attract foreign investment essentially depends upon its policy regime - whether it promotes or restrains the foreign investment flows. This section undertakes a review of India's FDI policy framework. There has been a sea change in India's approach to foreign investment from the early 1990s when it began structural economic reforms about almost all the sectors of the economy.

Pre-Liberalization Period:

The announcements of Industrial Policy (1980 and 1982) and Technology Policy (1983) provided for a liberal attitude towards foreign investments in terms of changes in policy directions. The policy was characterized by de-licensing of some of the industrial rules and promotion of Indian manufacturing exports as well as emphasizing on modernisation of industries through liberalised imports of capital goods and technology. This was supported by trade liberalisation measures in the form of tariff reduction and shifting of large number of items from import licensing to Open General Licensing (OGL).

Post-Liberalisation Period:

A major shift occurred when India embarked upon economic liberalisation and reforms program in 1991 aiming to raise its growth potential and integrating with the world economy. Industrial policy reforms slowly but surely removed restrictions on investment projects and business expansion on the one hand and allowed increased access to foreign technology and funding on the other.

SWOT Analysis of Foreign Direct Investment

SWOT analysis is one of the primary steps in strategic management. It contains an analysis of strengths, weaknesses, opportunities and threats. The strength and weaknesses of the FDI shows the present.

Strength

- Fast growing economy.
- Young and dynamic manpower. A large young working population with median age of 25 years, nuclear families in urban areas, along with increasing working women population and emerging opportunities in the service sector are going to be the key growth drivers of the organized sectors.
- Highest shop density in the world. Customers will have access to greater variety of international quality branded goods

Weaknesses

- Low capital investment

- ❖ Will mainly cater to high-end consumers placed in metros and will not deliver mass consumption goods for customers in villages and small towns.
- ❖ Retail chain is yet too settled down with proper merchandise mix for the mall outlets.
- ❖ Small size outlets are also one of the weaknesses in the India, 96% of the outlets are lesser than 500 sq. ft.
- ❖ Lack of trained & educated force.
- ❖ Lack of competition.
- ❖ More prices as compared to specialized shops.

Opportunities

i. Global strategy giant takes India as key market.

ii. FDI can become one of the largest industries in terms of numbers of employees and establishments.

iii. Rural marketing is still unexploited Indian market. It will enhance the financial condition of farmers.

Threats

- Jobs in the manufacturing sector will be lost.
- Started roadside bargains.
- Work will be done by Indians and profits will go to foreigners.

Challenges of FDI in India

- ➢ Promote cartels and will create monopoly.
- ➢ Increase in the real estate prices.
- ➢ Marginalize domestic entrepreneurs.
- ➢ The financial strength of foreign players would displace the unorganized players.

Absence of proper regulatory provisions and guidelines would induce unfair trade practices like Predatory pricing despite the above challenges there are certain other problem relating to foreign direct investment (FDI) in India is that it does not provide a level playing field to other players of the domestic and small sort.

IMPACT OF LIBERALIZATION ON FDI IN INDIA

FDI reforms

In India Rated among the top emerging nations, India's liberalization policies are paying rich dividends to the economy as a whole. India, post liberalization, has not only opened it's doors to foreign investors but also made investing easier for them by implementing the following measures:

1. FDI in the Retail sector: Retailing is one of the worlds largest private industry. Liberalizations in FDI have caused a massive restructuring in retail industry. The benefit of FDI in retail industry superimposes its cost factors. Opening the retail industry to FDI will bring forth benefits in terms of advance employment, organized retail stores, availability of quality products at a better and cheaper price. It enables a countrys product or service to enter into the global market.

a) **Cheaper production facilities:** FDI will ensure better operations in production cycle and distribution. Due to economies of operation, production facilities will be available at a cheaper rate thereby resulting in availability of variety products to the ultimate consumers at a reasonable and lesser price.

b) **Availability of new technology:** FDI enables transfer of skills and technology from overseas and develops the infrastructure of the domestic country. Greater managerial talent inflow from other countries is made possible. Domestic consumers will benefit getting great variety and quality products at all price points.

c) **Long term cash liquidity:** FDI will provide necessary capital for setting up organized retail chain stores. It is a long term investment because unlike equity capital, the physical capital invested in the domestic company is not easily liquidated.

2. Make in India Initiation and FDI in Manufacturing Sector Foreign direct investment (FDI) in India has received a dramatic boost from the launch of the Make in India initiative, according to the latest Economic Survey. After the September 2014 launch of the initiative, which seeks to promote manufacturing and attract foreign investment, there was an almost 40% increase in FDI inflows from October 2014 to June 2015 over the year-ago period. Under the programme, the government has awarded 56 defence manufacturing permits to private sector entities in the past one year, after allowing 49% FDI in the defence sector in August 2014, compared with 47 granted in the preceding three years.

3. FDI in Services Sectors Services, telecommunications, construction, computers (software and hardware), real estate and housing, chemicals, drugs and pharmaceuticals, power, automobiles and metallurgical industries received the highest FDI inflows across India. Assocham has also called for a time-bound, nondiscretionary, simplified and less number of procedures and approvals to help uplift overseas investors' confidence and foster more investments in India. In terms of sectors, services attracted the maximum investment this fiscal as per Department of Industrial Policy and Promotion (DIPP) data. However, in terms of growth, it was drugs and pharmaceuticals that saw the maximum jump, with an over 15-fold increase

DETERMINANTS OF FDI

There are various factors that influence the FDI inflows into a country. The investors consider and evaluate various aspects of a country before investing in it. The relative importance of these determinants of FDI varies not only between countries but also between different types of FDI. Traditionally, the determinants of FDI include the following:

1. Size of the Market: The developing countries possess substantial markets where the consumers demand for certain goods far exceed the available supplies. This demand potential is a big draw for many foreign enterprises. In many cases, the establishment of a low cost marketing operation represents the first step by a multinational company into the market of the country. This establishes a presence in the market and provides important insights into the ways of doing business and possible opportunities in the country.

2. Political Stability: In many countries, the institutions of government are still evolving and there are unsettled political questions. Companies will generally be unwilling to contribute large amounts of capital into an environment where some of the basics political questions have not yet been resolved.

3. Macro-Economic Environment: Instability in the level of prices and exchange rate enhance the level of uncertainty, making business planning difficult. This increases the perceived risk of making investments and therefore adversely affects the inflow of FDI.

4. Legal Regulatory Framework: the relevant areas in this field include protection of property rights, ability to repatriate profits, and a free market for currency exchange. It is important that these rules and their administrative procedures are transparent and easily comprehensive.

5. Access to Basic Inputs: Many developing countries have large reserves of skilled and semi-skilled workers that are available for employment at wages significantly lower than in developed countries. This provides an opportunity for foreign firms to make investments in these countries to cater to the export market. Availability of natural resources such as oil and gas, minerals and forestry products also determine the extent of FDI.

POSITIVE AND NEGATIVE IMPACT OF FDI

Positive Effect

Competitive economy - FDI makes the economy of a country more competitive. Multinationals Corporations while setting up offices or manufacturing units brings with them cutting edge technology that helps to boost the business and provides employment to the people of the country.

Elemination of Monopoly - Through FDI, government can eliminate monopoly of the local companies so that consumer can get quality products at a cheaper rate. Also it helps in increase of the revenue of exchequer in the form of taxes and duties.

Human Resources Development - Foreign Corporation's trains the local human resources so that they can be made productive and employable.

Revenue to the host country - By FDI, Multinational Corporations brings in new technology to the host country and sets offices and manufacturing units which in turn helps the government to increase their revenue in the form of taxes. Also corporations export the product they made in the host country to the other country and increase the foreign reserve to the host country.

NEGATIVE EFFECT

Exploitation of local resources - Many a times corporation pursue the local government to amend the labour laws as per their needs and due to which they exploit the labour by forcing them to work for long hours and doesn't get fair remunerations. Also they exploit the natural resources such as minerals by extracting them in larger quantities and sending them back to their home country at a cheaper rate, thus causing harm to the environment also.

Loss of business of local enterprises - multinational corporations too much money as compared to local ones and have big belly with them, thus the local ones cannot compete with them in terms of technology and most important capital thus many wipe out from the race or becomes niche player.

Problems

In spite of the obvious advantages of FDIs, there are quite a few challenges/problems facing larger FDIs in India. So in order to solve these, few root cause of the problems along with the feasible solutions are given below, such as:

Resource challenge: India is known to have huge amounts of resources. There is manpower and significant availability of fixed and working capital. At the same time, there are some underexploited or unexploited resources. The resources are well available in the rural as well as the urban areas. The focus is to increase infrastructure 10 years down the line, for which the requirement will be an amount of about US$ 150 billion. This is the first step to overcome challenges facing larger FDI.

Equity challenge: India is definitely developing in a much faster pace now than before but in spite of that it can be identified that developments have taken place unevenly. This means that while the more urban areas have been tapped, the poorer sections are inadequately exploited. To get the complete picture of growth, it is essential to make sure that the rural section has more or less the same amount of development as the urbanized ones. Thus, fostering social equality and at the same time, a balanced economic growth.

Political Challenge: The support of the political structure has to be there towards the investing countries abroad. This can be worked out when foreign investors put forward their persuasion for increasing FDI capital in various sectors like banking, and insurance. So, there has to be a common ground between the Parliament and the Foreign countries investing in India. This would increase the reforms in the FDI area of the country.

Federal Challenge: Very important among the major challenges facing larger FDI, is the need to speed up the implementation of policies, rules, and regulations. The vital part is to keep the implementation of policies in all the states of India at par. Thus, asking for equal speed in policy implementation among the states in India is important.

CONCLUSION

Foreign capital has been assigned a significant role. Indian Foreign Investment policy has been formulated with a view to inviting and encouraging FDI into India. Equity capital and Reinvested Earning and other capital consisting short term and long term borrowing are three main categories of FDI. The role of Foreign Direct Investment in the up gradation of technology, skills and managerial capabilities is now acknowledged. Under the automatic route with some exception FDI up to 100 is allowed in most sectors/areas and some sectors there is no permission of FDI.

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