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REVIEW ARTICLE

THE ROLE OF FOREIGN DIRECT INVESTMENT IN INDIA

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ABSTRACT

Foreign direct investment (FDI) plays a very important role in the economic development of our country. Many development countries like India are facing the deficit of saving. This problem can be solved with the help of foreign direct investment. In this article an analysis is made to find out the merits and demerits of foreign direct investment in India. Oppositions have raised concerns about employment losses, promotion of unhealthy competition among organized small domestic retailers from the market and distortion of culture development. It also Covers brief determinants of foreign direct investment and emphasizes the area of challenges of foreign investors. The growth of FDI inflows and sectoral growth is also analysed.

INTRODUCTION

FDI has helped India to attain a financial stability and economic growth with the help of investments in different sectors. FDI has boosted the economic life of India. After liberalization of Trade policies in India, there has been a positive GDP growth rate in Indian economy. Foreign direct investments helps in developing the economy by generating employment to the unemployed, Generating revenues in the form of tax and incomes, Financial stability to the government, development of infrastructure, backward and forward linkages to the domestic firms for the requirements of raw materials, tools, business infrastructure, and act as support for financial system. There are legal and financial consultants who also guide in the early stage of establishment of firm. The objective behind allowing FDI is to complement and supplement domestic investment, for achieving a higher level of economic development and providing opportunities for technological up gradation, as well as access to global managerial skills and practices. Need of FDI is depends on saving and investment rate in any country.

Foreign Direct Investment

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.

Further, after Independence issues relating to foreign capital, operations of MNCs, gained attention of the policy makers. Keeping in mind the national interests the policy makers designed the FDI policy which aims FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resources. The first Prime Minister of India considered foreign investment as "necessary" not only to supplement domestic capital but also to secure scientific, technical, and industrial knowledge and capital equipments. With time and as per economic and political regimes there have been changes in the FDI policy too. The industrial policy of 1965, allowed MNCs to venture through technical collaboration in India. However, the country faced two severe crisis in the form of foreign exchange and financial resource mobilization during the second five year plan (1956-61). Therefore, the government adopted a liberal attitude by allowing more frequent equity participation to foreign enterprises, and to accept equity capital in technical collaborations. The government also provides many incentives such as tax concessions, simplification of licensing procedures and de- reserving some industries such as drugs, aluminium, heavy electrical equipments, fertilizers, etc in order to further

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boost the FDI inflows in the country. This liberal attitude of government towards foreign capital lures investors from other advanced countries like USA, Japan, and Germany, etc. But due to significant outflow of foreign reserves in the form of remittances of dividends, profits, royalties etc, the government has to adopt stringent foreign policy in 1970s. During this period the government adopted a selective and highly restrictive foreign policy as far as foreign capital, type of FDI and ownerships of foreign companies was concerned. Government setup Foreign Investment Board and enacted Foreign Exchange Regulation Act in order to regulate flow of foreign capital and FDI flow to India. The soaring oil prices continued low exports and deterioration in Balance of Payment position during 1980s forced the government to make necessary changes in the foreign policy. It is during this period the government encourages FDI, allow MNCs to operate in India. Thus, resulting in the partial liberalization of Indian Economy. The government introduces reforms in the industrial sector, aimed at increasing competency, efficiency and growth in industry through a stable, pragmatic and non-discriminatory policy for FDI flow.

In fact, in the early nineties, Indian economy faced severe Balance of payment crisis. Exports began to experience serious difficulties. There was a marked increase in petroleum prices because of the gulf war. The crippling external debts were debilitating the economy. India was left with that much amount of foreign exchange reserves which can finance its three weeks of imports. The out flowing of foreign currency which was deposited by the Indian NRI’s gave a further jolt to Indian economy. The overall Balance of Payment reached at Rs.(-) 4471 crores. Inflation reached at its highest level of 13%. Foreign reserves of the country stood at Rs.11416 crores. The continued political uncertainty in the country during this period adds further to worsen the situation. As a result, India’s credit rating fell in the international market for both short-term and long- term borrowing. All these developments put the economy at that time on the verge of default in respect of external payments liability. In this critical face of Indian economy the then finance Minister of India Dr. Manmohan Singh with the help of World Bank and IMF introduced the macro – economic stabilization and structural adjustment programm. As a result of these reforms India open its door to FDI inflows and adopted a more liberal

foreign policy in order to restore the confidence of foreign investors. Further, under the new foreign investment policy Government of India constituted FIPB (Foreign Investment Promotion Board) whose main function was to invite and facilitate foreign investment through single window system from the Prime Minister’s Office. The foreign equity cap was raised to 51 percent for the existing companies. Government had allowed the use of foreign brand names for domestically produced products which was restricted earlier. India also became the member of MIGA (Multilateral Investment Guarantee Agency) for protection of foreign investments. Government lifted restrictions on the operations of MNCs by revising the FERA Act 1973. New sectors such as mining, banking, telecommunications, highway construction and management were open to foreign investors as well as to private sector.

Review of Literature

Mete Feridun (2002) This study examines the relationship between economic growth as measured by GDP per capita and foreign direct investment for Singapore, using the methodology of Granger causality and vector auto regression (VAR). Evidence shows that there is a unidirectional Granger causation from foreign direct investment to economic growth. Anitha (2012) This study discussed about FDI inflow during pre and post liberalization period in India, determinants of FDI inflow to India, problems for low FDI flow to India, suggestions for increased flow of FDI into the country. Dr. Jasbir Singh (2012) In this paper recommends that we should welcome the inflow of foreign investment because it enable us to achieve our cherished goal like making favorable the balance of payment, rapid economic development, removal of poverty, and internal personal disparity in the development and also it is very much convenient and favorable for Indian economy. Mahanta Devajit (2012) The study tries to find out how FDI seen as an important economic catalyst of Indian economic growth by stimulating domestic investment, increasing human capital formation and by facilitating the technology transfers. The main purpose of the study is to investigate the impact of FDI on economic growth in India.

Shalini Aggarwal (2012) These paper tries to study the need of FDI in India, to exhibit the sector-wise & year-wise analysis of FDI’s in India, to rank the sectors based upon the highest FDI inflows. Kali Ram Gola (2013) This paper is discussed about capital inflows from abroad that are invested in or to enhance the production capacity of the economy. Despite, globalization is the essential role of foreign direct investment (FDI) in economic development has not changed. In many mechanisms and dynamics of FDI-assisted developments have changed: there is greater variation in the kinds of FDI, the benefits each offers, and the manner in which each interacts with the host economy. The main purpose of the study is to investigate the impact of FDI on economic growth in India, from the period of 1990 to 2011. Sourangsu Banerji (2013) In this paper we study the effects of Foreign Direct Investment (FDI) with respect to India and its economy. The study analyze the merits and demerits of FDI upon implementation in the Indian domestic market.

Objectives of the Study

- To explain the advantages and disadvantages of foreign direct investment
- To study about the in challenges in FDI.
- To discuss about determinants of foreign direct investment inflows
- To analyze about the trends of foreign direct investment in India.
- To analyze about the Sectoral Trends in FDI Inflows

Advantages of FDI

Integration into global economy: Developing countries, which invite FDI, can gain access to a wider global and better platform in the world economy.

Economic growth: This is one of the major sectors, which is enormously benefited from foreign direct investment. A remarkable inflow of FDI in various industrial units in India has boosted the economic life of country.

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.

Technology diffusion and knowledge transfer: FDI apparently helps in the outsourcing of knowledge from India especially in the Information Technology sector. Developing countries by inviting FDI can introduce world-class technology and technical expertise and processes to their existing working process. Foreign expertise can be an important factor in upgrading the existing technical processes. For example, the civilian nuclear deal led to transfer of nuclear energy know-how between the USA and India.

Increased competition: FDI increases the level of competition in the host country. Other companies will also have to improve on their processes and services in order to stay in the market. FDI enhanced the quality of products, services and regulates a particular sector. Linkages and spillover 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.

Human Resources Development: Employees of the country which is open to FDI get acquaint with globally valued skills.

Employment: FDI has also ensured a number of employment opportunities by aiding the setting up of industrial units in various corners of India.

Demerits of Foreign Direct Investment

Domination of Organized Retailers: FDI in retail definitely strengthens organized retail in the country. These organized retailers will tend to dominate the entire consumer market. It leads to unfair competition and ultimately results in large-scale exit of domestic retailers, especially the small family managed outlets. When FDI hit Thailand, 60000 small shops closed. It may all look good on paper now but eventually, big businesses will monopolize their respective markets in India by destroying all small competitors, and then they will be in complete control of prices, so it will ultimately come at a cost. Also, after monopolizing, product quality will stop mattering, since all small businesses whose products competed in quality would be destroyed. Also, vegetables and fruits that will be imported from outside India will be not fresh and stale due to long distance transportation and constant refrigeration.

Loss of jobs: Retail in India has tremendous growth potential and it is the second largest employer in India. Any changes by bringing major foreign retailers who will be directly procuring from the main supplier will not only create unemployment on the front end retail but also the middleman who have been working in this industry will be thrown out of their jobs. Jobs in the manufacturing sector will be lost because foreign giants will purchase their goods from the international market and not from domestic sources. This has been the experience of most countries which have allowed FDI in retail. Although, our country had made a condition that they must source a minimum of 30% of their goods from Indian micro and small industries, we can't stop them from purchasing goods from international markets as per WTO law. So after coming to India, they can reduce this 30% by litigating at the WTO.

Loss of Self Competitive Strength: The Indian retail sector, particularly organized retail, is still underdeveloped and in a nascent stage and that, therefore the companies may not be able to compete with big global giants. If the existing firms collaborate with the global biggies they might have to give up at the global front by losing their self-competitive strength.

Distortion of Culture: Though FDI in Indian retail will indirectly or directly contribute for the enhancement of Tourism, Hospitality and few other Industries, the culture of the people in India will slowly be changed. The youth will easily imbibe certain negative aspects of foreign culture and lifestyles and develop inappropriate consumption patterns, not suited to our cultural environment.

Farmers' woes: Because of FDI, there is a negative impact on farming, since large corporations will push farmers to work for them and get involved in single-crop farming and the use of artificial means of farming. Due to monopolization, farmers will have to sell their products to corporations at the offered price, whatever it may be. The farmers will have to bear the cost of reduced MRPs eventually.

Rise in unethical practices: Due to lack of transparency and proper regulation norms in our country, FDI would act as another source of increasing corruption and red tape in the country. In fact, Unethical behaviours like corruption, red-tapism and selfishness is increasing day by day because of huge potential of money making, which is their ultimate aim and not quality or providing jobs or reviving the economy. Example include Walmart, which in October 2013 had to break the alliance with Bharati due to continuing US investigation of fraud in Mexico, Brazil, China and India. Even the Indian government is investigating whether a loan made by Walmart to Bharti broke foreign investment rules. This is a very good example how substandard law and regulation mechanism in India can be exploited by the foreign players, negating all good things that FDI provide.

Challenges of FDI

The challenges facing larger FDI in India are in spite of the fact that more than 100 of Fortune 500 companies are already investing in India. These FDIs are already generating employment opportunities, income, technology transfer and economic stability. India is focusing on maximizing political and social stability along with a regulatory environment. In spite of the obvious advantages of FDIs, there are quite a few challenges facing larger FDIs in India, 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.

India must also focus on areas of poverty reduction, trade liberalization, and banking and insurance liberalization. Challenges facing larger FDI are not just restricted to the ones mentioned above, because trade relations with foreign investors will always bring in new challenges in investments.

The Factors Determining the Foreign Investors to India

According to an Ernst & Young survey, while India has been one of the leading destinations for shared services, it is rapidly emerging as a manufacturing location for many foreign corporations. By 2020, 25 per cent of survey respondents see India among the world's leading three destinations for manufacturing. Ernst & Young has found factors that foreign investors find most attractive while deciding to invest in India.

High potential of domestic market: The recent FDI data mirrors the emergence of manufacturing for FDI. In 2011, 78 per cent of investment in terms of value went to the manufacturing sector in comparison to 14 per cent for shared services.

Cost competitiveness: This is despite the fact that in terms of number of projects, 54 per cent of FDI projects were related to services and 34 per cent were manufacturing-led.

Access to highly qualified workforce: Underscoring the potential in the domestic market, 35 per cent of the companies surveyed nominated India as an attractive destination for domestic manufacturing and 21 per cent as an attractive base for manufacturing for the global market.

Demand-driven growth model: When investing in manufacturing projects in India, investors tend to target the industrial machinery, equipment and tools (115 projects) and the automotive (76 projects) sectors.

High productivity: About 65 per cent of the respondents believe that an improvement in quality of logistics and transportation will accelerate India's attractiveness as a destination for manufacturing.

Leading location for manufacturing facilities: Investors show strong confidence in India to maintain this performance in the long term. Only 11 per cent of the survey respondents see India being surpassed by more dynamic countries.

Support for innovation: Twenty-nine per cent believe that India will continue to experience rapid growth in the coming years.

Political stability: Investors are also more demanding. They want to secure their investments in easily accessible (63 per cent) and predictable business climates with FDI-friendly regulatory environments (62 per cent).

Ease of doing business: Indian business conditions raise concerns among global leaders. The survey respondents believe that improving infrastructure network (76 per cent) and better governance and transparency system (60 per cent) will have a high impact on India's attractiveness.

Importance of CSR initiatives: In the long term, investors highlight innovation as a challenge for India. Forty-three per cent of investors think that it needs to improve the quality of its labs and research institutions.

Natural Resources: Availability of natural resources in the host country is a major determinant of FDI. Most foreign investors seek an adequate, reliable and economical source of minerals and other materials. FDI tends to flow in countries which are rich in resources but lack capital, technical skills and infrastructure required for the exploitation of natural resources.

Government Policies: Policy towards foreign investment, foreign collaborations, foreign exchange control, remittances, and incentives – both monetary and fiscal offered to foreign investors exercise a significant influence on FDI in a country. For example, Export Processing Zones (EPZs) have been developed in India.

More specifically, 38 per cent of investors cite distance between research institutions and corporations as a roadblock to developing new products in the country.

Growth of Foreign Direct Investment Inflows to India

Table 1 gives details of year-wise net inflows of FDI in India for the period 1990-2010. In 1990, this increased to $ 0.24

billion or by 3 times. During the post reform period, it increased by 99 times from $ 0.25 billion in 1992 to $ 24.64 billion in 2010.

Table 1. Trends in Net FDI Inflows to India: 1990-2010 (values in US$ billion)

Year	FDI Inflows (net)	% change over preceding year
1990	0.24	0
1991	0.08	-67
1992	0.25	213
1993	0.53	112
1994	0.97	83
1995	2.15	122
1996	2.53	18
1997	3.62	43
1998	2.63	-27
1999	2.17	-17
2000	3.59	65
2001	5.48	53
2002	5.63	3
2003	4.32	-23
2004	5.78	34
2005	7.62	32
2006	20.33	167
2007	25.35	25
2008	42.55	68
2009	35.65	-16
2010	24.64	-31

Source: UNCTADSTAT, World Development Indicators, World Bank, Last updated on 23 May 2012.

Sectoral Trends in FDI Inflows

The flow of FDI into different sectors in India reveals interesting pattern. At the time of economic reform it was perceived that FDI inflows would be more concentrated towards manufacturing sector thereby raising domestic productivity, production and revenues because this sector has strong linkage effect. But over the period of time reverse trend was observed. The FDI inflows were directed towards services sector (Table 2).

Table 2. Sectors Attracting Largest FDI in India

Sectors/Periods	1991-1999	2000-2010
Services Sector	40443.82 (11.08)	1184053 (20.84)
Computer Software and Hardware*	0	472744.15 (8.32)
Telecommunication	40376.82 (11.06)	467377.15 (8.22)
Housing and Real estate	0	420517.27 (7.40)
Construction Activities	0	398019.90 (7.00)
Automobile Services	0	263024.82 (4.63)
Power	36433.77 (9.98)	258793.34 (4.55)
Metallurgical Industries	6333.77 (1.73)	179598.95 (3.16)
Petroleum and Natural Gas	0	135859.10 (2.39)
Chemical other than Fertilizer	39861.28 (10.92)	129259.10 (2.27)

Source: Calculated on the basis of data given in various issues of SIA Newsletter, Government of India, New Delhi.
Note: Figures in parenthesis are percentage to total.
*Included in Electrical equipments till 2003.

Global Competitiveness Index Ranks of India

Table 3. Global Competitiveness Index Ranks of India

Country/Year	2009-2010	2010-2011	2011-2012
India	49	51	56

Source: Global Competitiveness Report, World Economic Forum, Various issues.

The World Economic Forum prepares an annual index to measure competitiveness of different countries. It "assesses the abilities of countries to provide high levels of prosperity to their citizens. This in turn depends on how productively a country uses available resources. Therefore, Global Competitiveness Index measures the set of institutions, policies, and factors that set sustainable current and long term of economic prosperity. According to 2010-2011 ranking of the Global Competitiveness Index (GCI) by World Economic Forum, India slipped from 49th rank in 2009-2010 to 51st in 2010- 2011 and further fell down to 56th in 2011-2012 indicating low competitiveness of the Indian economy in global context (Table 3).

Conclusion

Foreign direct investment as a strategic component of investment is needed by India for its sustained economic growth and development. The advantages of foreign direct investment in India through creations of employment opportunities and also develop the economic development. So, we can conclude that FDI is always helps to create employment in the country and helps country to put an impression on the world wide level through liberalization and globalization. A number of concerns have been raised about opening up the retail sector to FDI in India.

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