Impact of Foreign Direct Investment in India

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ABSTRACT

Foreign Direct Investment plays an important role in any country’s economical activities. Large scale Companies or small scale companies cannot solely depend on the conventional source of finance all together. Although India has substantially liberalized its foreign investment policy, the FDI inflows have been much below the targets. India has not been getting even one-tenth size of FDI flow to China. Not only that the FDI inflow has been disappointing, but it is also feared that there are signs of capital flight from India. Bureaucratic problems, certain unfavorable government attitudes, poor infrastructure, labour factors, high input costs etc. are regarded as the major reasons. For financial and technological support they have to depend on foreign resources. For big companies getting FDI is not difficult issue because of financial security, reach in global market and business experience. The paper is concerned with the various ways of contributing to strengthening the indigenous small and medium enterprise sector in a situation of resource scarcity. Specifically, the paper is concerned with the potential impact of foreign direct investment (FDI) in relation to the long term competitive development and inter-nationalization of the small and medium enterprise sector in transition and developing countries.

Key words: Foreign Direct Investment, Small Scale Industries, Globalization, Small and Medium Enterprises, Multi-National Corporations.

1. INTRODUCTION

Capital is stated as the engine of economic growth. Foreign direct investment (FDI) plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development. Foreign direct investment, in its classic definition, is defined as a company from one country making a physical investment into building a factory in another country. In other word FDI is an investment involving a long term relationship and reflecting a lasting interest and control of a resident entity in one economy in an enterprise resident in an economy other than that of the foreign direct investor. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment which is considered an indirect investment. In recent years, given rapid growth and change in global investment patterns, the definition has been broadened to include the acquisition of lasting management interest in a company or enterprise outside the investing firm’s home country. As such, it may take many forms, such as a direct acquisition of a foreign firm, construction of a facility, or investment in a joint venture or strategic alliance with a local firm with attendant input of technology, licensing of intellectual property.

In the past decade, FDI has come to play a major role in the internationalization of business. Reacting to changes in technology, growing liberalization of the national regulatory framework governing investment in enterprises, and changes in capital markets
profound changes have occurred in the size, scope and methods of FDI. New information technology systems, decline in global communication costs have made management of foreign investments far easier than in the past. The sea change in trade and investment policies and the regulatory environment globally in the past decade, including trade policy and tariff liberalization, easing of restrictions on foreign investment and acquisition in many nations, and the deregulation and privatization of many industries, has probably been then most significant catalyst for FDI’s expanded role.

2. THE CURRENT TREND OF FOREIGN DIRECT INVESTMENT

The vast majority of FDI originates from the developed world, with the countries in the developed economies making up 83.0% of the world’s total in 2005. Similarly, it is developed countries that remain the main destinations for FDI, accounting for 59.2% of the world's total, although the proportion destined for transition and developing countries has been growing: by six times between 1990-98, and from 18% of global FDI flows in the mid-1980s to 42% in 1998 (World Bank, 1999); fluctuating between 27% and 37% during the 2001-5 period. Moreover, FDI inflows can represent significant sums for developing countries, several of which record levels of FDI that are large, when considered in relation to the size of the domestic economy. However, the distribution of FDI between developing and transition economies is very uneven. For example, despite an increase in volume, FDI to Africa and Latin America represents a smaller proportion of the world’s total in 2001 than it did in the mid-1990s (Morisset, 2000; World Investment Report, 2001. In recent years, MNEs have been increasing their level of outsourcing, although this often involves subcontracting out parts, components and services to a smaller number of key suppliers with whom they develop collaborative arrangements. Whilst this process of Consolidation can result in MNEs taking first tier multinational suppliers with them into transition and developing countries, opportunities for local SMEs can exist at the second or third tier supplier level.

Traditionally, FDI has been seen to be the preserve of large firms, both in developed and developing countries. However, there is growing evidence of changes in patterns of foreign direct investment, involving a wider range of source and destination countries and the increasing involvement of SMEs as foreign investors, as well as larger firms and MNEs. Unfortunately, most official investment reports do not separately identify FDI activity by the size of the investing firm. Nevertheless, there is evidence that a growing number of medium sized firms, in particular, are internationalising their operations as a strategic response to increasing competitive pressure. In this context, internationalization represents a means of reducing costs, as well as of opening up new market opportunities, thereby enabling them to combine greater flexibility with cost reduction.

3. THE IMPORTANCE OF FDI IN GLOBAL APPEARANCE

The simple answer is that making direct foreign investment allows companies to accomplish several tasks:

1. Avoiding foreign government pressure for local production.
2. Circumventing trade barriers, hidden and otherwise.
3. Making the move from domestic export sales to a locally-based national sales office.
4. Capability to increase total production capacity.
5. Opportunities for co-production, joint ventures with local partners, joint marketing arrangements, licensing etc.
A 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 medium and small size companies. MNCs almost always concerned with
worldwide manufacturing capacity and proximity to major markets. SMEs tends to be more
concerned with selling their products in overseas markets. Traditionally, FDI has been seen to
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reduction.

4. THE BASIC REQUIREMENTS TO GO FOR FOREIGN DIRECT INVESTMENT

Depending on the industry sector and type of business, a foreign direct investment may be
an attractive and viable option. With rapid globalization of many industries and vertical
integration rapidly taking place on a global level, at a minimum a firm needs to keep abreast
of global trends in their industry. From a competitive standpoint, it is important to be aware
of whether a company’s competitors are expanding into a foreign market and how they are
doing that. At the same time, it also becomes important to monitor how globalization is
affecting domestic clients. Often it becomes imperative to follow the expansion of key clients
overseas if an active relationship is to be maintained. New market access is another major
reason to invest in foreign country. At some stage export of product or service reaches a
critical mass of amount and cost where foreign production or location begins to be more cost
effective. Any decision on investing is thus a combination of a number of key factors
including: a) Assessment of internal resources b) Competitiveness c) Market analysis d) Market expectation.

5. KEY STATISTICS OF FDI INFLOWS

FDI inflows rose by 36 per cent to US$ 23.69 billion during January-October 2011, while
the cumulative amount of FDI equity inflows from April 2000 to October 2011 stood at US$ 226.05 billion, according to the latest data released by the Department of Industrial Policy
and Promotion (DIPP). The services (including financial and non-financial) sectors attracted
highest FDI equity inflows during April-October 2011-12 at US$ 3.43 billion. India received
maximum FDI from countries like Mauritius, Singapore, and the US at US$ 61.2 billion, US$ 15.2 billion and US$ 10 billion, respectively, during April 2000-October 2011.

6. THE FDI SOLVEFINANCIAL PROBLEM OF SMALL AND MEDIUM SCALE
ENTERPRISES

The current FDI norms impose a ceiling of 24 per cent FDI for companies in the SSI
sector i.e. small scale units having capital investment in plant and machinery not exceeding
Rs. 50,000,000 (USD 1,250,000). Further, SSI units with foreign investment exceeding the
notified sectorial cap are liable to lose their status as SSI units. With a view to liberalizing the
SSI sector and augmenting economic activity in the country, it is announced that FDI norms
governing SSIs would be relaxed and a notification is likely to be tabled before Parliament,
enabling an increase in the limits of FDI in the SSI sector. If such notification is passed, SSI
units would be eligible to raise foreign equity in accordance with caps governing the sectors
in which they operate, thereby improving their access to technology and capital and assisting
in the growth and modernization of the sector.

7. CONCLUSION:

The SMEs the world over have been undergoing crucial changes in response to the
manifold imperatives of globalization. The potential of neo-localism having been much
emphasized, the SMEs in developing countries have often been split between national
strategies and objectives of promoting this vital and most promising sector and the demands
of a globalizing business environment. In India, the historical role of SMEs in creating ample
opportunities for employment for the teeming millions has come to occupy secondary status
in the face of novel strategies to ensure external orientation, achieving manufacturing
competitiveness and emerge notable global player. While there is much merit in recognizing
the relative advantages and disadvantages of participating in a fervent global market, it is
equally important to take stock of the ground realities that indicates a poor and inadequate
infrastructure base for SMEs; this situation is particularly worse in rural areas as even in
small towns, where a major proportion of MSMEs function. Of the most vital infrastructure
bottlenecks, access to adequate, reliable and reasonably priced power remains a challenge for
SMEs progress and competitiveness. Further, poor transport network (whether roads,
railways or ports) have emerged as important constraints to the development of SMEs in a
dynamic fashion. Despite decades of small industry policy making, even during the reforms
period, there has been a definite decline in the access to credit by the small (and within it the
so-called tiny sector) enterprises. It is clear that there is no dearth of capital available but
there remain serious implementation snags, including complex and unhelpful procedural
requirements, which, ultimately result in dwindling access to loan finance. The situation is
similar when it comes to the intractable product reservation policy Given the large scale
attempts to promote industrial clusters in the SME sector, it needs to be underscored that,
despite the potential of neo-localism, cluster promotion in the Indian context must move
beyond the „sectorial bind; a comprehensive regional development strategy needs to be
woven into the cluster development policy. External orientation and a global outlook for the
SME sector must first address persisting basic constraints facing the sector. In fact, as a
Indian SMEs are looking forward to a newer and larger market space with its numerous
advantages of skills, raw materials and large domestic market as well, networking with
various stakeholders both within and outside the countries.

8. REFERENCES :

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