International Research Journal of Management and Commerce
ISSN: (2348-9766)
Impact Factor 3.007 Volume 2, Issue 8 August 2015
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FORIGN DIRECT INVERSTMENT IN INDIA (FDI) PROBLEMS AND PROSPECTS

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Abstract: With a view to bringing the present FDI reporting system of RBI in alignment with the international reporting system Government, in consultation with RBI, had Constituted a Committee comprising officials from RBI and the Department of Industrial Policy and Promotion (DIPP), in May 2002 to study the conceptual and methodological issues, including data gaps involved and make necessary recommendations to strengthen the collection, compilation and reporting of FDI data. Some firms establish the manufacturing; distribution and servicing facilities in foreign countries when exporting and licensing strategic alternatives are available. Exporting and licensing strategies are explained. in detail in an at a Seminar in Washington D.C. in international Strategic Management. Companies produce goods at home and transport them to foreign countries for sale under exporting strategy. Firms grant the right to produce and sell the firm's products for a royalty fee to the foreign companies under licensing.

INTRODUCTION

With a view to bringing the present FDI reporting system of RBI in alignment with the international reporting system Government, in consultation with RBI, had Constituted a Committee comprising officials from RBI and the Department of Industrial Policy and Promotion (DIPP), in May 2002 to study the conceptual and methodological issues, including data gaps involved and make necessary recommendations to strengthen the collection, compilation and reporting of FDI data.

The committee was constituted with the following purpose:

1. To study the International definition of FDI;

2. To analyse current practices prevailing in different countries;
3. To analyse current data compilation and reporting practices in India and identify gaps in collection and compilation of FDI data; to make appropriate recommendations to put the FDI reporting system in alignment with international reporting practices.

The Committee had several rounds of deliberations on the subject, 'including consultation with technical experts from RBI. The committee also referred to available published material on the subject. The following definition emerged. FDI is the process whereby residents of one country
(The home country) acquire ownership of assets for the Purpose of controlling the production, distribution and other activities of a firm in another country (the host country),
Foreign direct investment is the category of 'International investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise resident in another economy. The lasting interest' implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the
Management of the enterprise."

UNCTAD DEFINITION

The WIR-02 defines FDI as an investment involving a long relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor of parent enterprise) in an enterprise resident in and economy other than that of the FDI enterprise affiliate enterprise of foreign affiliate.' FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. Such investment
Involves both the entail transaction between and_ all Subsequent transaction between them and amount foreign affiliates both incorporated and unincorporated, individuals as well as business entities May undertake FDI Flow of FDI comprise capital provided (either directly or through other related enterprises) by a foreign direct investor to an FDI enterprise, or capital received from an FDI enterprise by a foreign" direct investor. FDI has three components viz, equity capital, reinvested earnings and intra-company loans.

« Equity capital is the foreign direct investor's purchase of share of an enterprise in a country other than its own.
"Reinvested earnings comprise the direct investor, share (in proportion of direct equity participation) of earnings not distributed as dividends by affiliated, or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested.
Intra company loans or intra- company debt transactions refer to short - or long - term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises
OECD Benchmark' definition of Foreign Direct 'Investment is "FDI reflects the objective of obtaining a lasting interest by a resident entity in one economy (direct investor) in- an entity resident in an economy other than that of the investor (direct investment enterprise)". The lasting interest implies the existence of a long – term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated. as is evident from the above definitions that there is a large degree of commonality between the IMF, UNCTAD and OECD definitions of FDI. Since the IMF definition is followed internationally the Committee is in favour of following the IMF definition. IMF has defined FDI as" Direct investment position data are also divided into four categories
Organization for Economic Cooperation & development, such as, (1) equity capital (ii) reinvested earnings (iii) other capital and (iv financial derivatives. One distinguishing feature of FDI from the viewpoint of direct investors is that direct investment enterprises often represent units in a multinational operation the overall profitability of which depends on the advantage to be gained by deploying the various resources available to the investors in units located in different economies. Direct investors are thereby in a position to derive benefits in addition to the investment income than may accrue on the capital that they invest (e.g. the opportunity to earn management fees or other sorts on income) Such extra benefits are likely to be derived from the investors associations with the enterprises over considerable period of time.

COMPARATIVE ADVANTAGE OF FDI OVER DOMESTIC CAPITAL

Some firms establish the manufacturing; distribution and servicing facilities in foreign countries when exporting and licensing strategic alternatives are available. Exporting and

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licensing strategies are explained. in detail in an at a Seminar in Washington D.C. in international Strategic Management. Companies produce goods at home and transport them to foreign countries for
sale under exporting strategy. Firms grant the right to produce and sell the firm's products for a royalty fee to the foreign companies under licensing. However, both these strategies suffer from limitation.
(i) Constraints to Exports: Though the companies find it easy to export goods, there are certain limitations of exporting. They are (a) High costs of transportation, shipment and transshipment (b) High cost of tariffs and other forms of trade barriers. (c) Low value of weight products like soft drinks and cement can be produced at any place. Similarly, some of the costlier goods can also be produced easily at any place.
(ii) Limitations of Licensing: Internationalization theory explains the advantages of FDI over licensing. According to this theory the limitations of licensing are:
Under licensing, firms give away valuable technical knowhow to the foreign collaborator, who would turn into a potential competitor in the future.
The licensor firm cannot have tight control over the licensee's manufacturing, marketing, other strategies and profitability in a foreign country.
The firms with competitive advantage in products and technology only can go for licensing. It does mean that the firms with the competitive advantage in marketing, management etc. cannot go for licensing strategy.
For example Toyota's competitive advantage is mostly due to its superior ability in product designing, engineering, manufacturing and marketing automobiles. Thus, it has management and organization capabilities which are not amenable for licensing. As such Toyota prefers to enter
Foreign markets through FDI rather than licensing.’

ADVANTAGES OF FDI

Most of the limitations of exporting and licensing are turned to be advantages of licensing.
The significant among them are:

1. Trade barriers like tariffs and quotas can be overcome through FDI.
2. Foreign Direct Investment in India: How can $ 10 billion of Annual Inflows be Firm's competitive strengths like management and organization can be exported through FDI only.
3. FDI creates employment opportunities in the host country.

4. FDI enlarges business activity in the host country.

BENEFITS TO HOME COUNTRY

- Inflow of foreign currencies in the form of dividend, interests etc. Nissan's profits repatriated to Japan are form it's FDI in UK. They helped Japan for positive balance of payments.
- FDI increases export of machinery, equipment, technology etc. from the home country to the host country. This in turn enhances the industrial activity of the home country.
- The increased industrial activity in the home country enhances employment opportunities.
- The firm and other home country firms can learn skills from its exposure to the host country and transfer those Skills to the industry in the home country.

COSTS TO THE HOME COUNTRY

There are some costs to the home country, in addition to benefits from the FDI, They include.

- Home country's industry and employment position are at stake when the firms enter foreign markets due to low cost labour. US textiles moved to Central America. This resulted in retrenchment in USA.
- Current account position of the home country suffers, as FDI is a substitute for direct exports. Let us now discuss the benefits and costs of FDI to the host country.

HOST COUNTRY BENEFITS

Transfer Effects: The resources which are scarce in host country are transferred from the foreign country. These resources include foreign capital, technology, machinery and = equipment, management — and Organization. Transfer of these resources develops the host country economically and socially, Indian government has been encouraging the FDI after 1991 to develop the Indian industry, infrastructure and service sectors.

Employment Effects The FDI contributes for the establishment of new industries and business directly and for the employment of existing economic activity. Further, FDI helps for the developing of ancillary industries. These developments invariably increase the employment opportunities for the people of the host country.

Balance of Payment Effects Balance of payments position and foreign exchange resources are very crucial from the view point of external situation of a country. India faced severe foreign exchange resource crunch and thereby unfavorable balance of payments position

before July 1991. In fact this adverse position, forced the Indian government to announce economic liberalization in July 1991.
FDI provides for the production of number of goods and ice services domestically. This in turn reduces the imports and thereby improves the current account position of the host country's balance of payment.

Further, the foreign companies export the goods, produced in the host country to a number of other countries. This activity helps the host country to have foreign exchange earnings e.g. Nissan established its plants in UK and exports 80% of its automobiles to other countries and improved Britain's balance of payments.

PROBLEMS OF FDI IN INDIA:

The major obstacles to inflow of FDI in India are unfavour was unfavorable Government Policies, poor Infrastructure, state obstacles, lengthy legal procedures, political turmoil, terrorism, rigid labour law, low rate of GDP growth etc, To mention a few more weak credibility of regulatory system, The urban Land Ceiling Act and the Rent Control Acts in states and high taxation, different types of tax policies by different state, the menace of terrorism, the rigid labour laws, low: literacy ratio and outdated Food Price Order, are yet some other irritants to FDI inflow.

FDI flows into India have risen since the 1990s but remain low, compared to other emerging markets, while India has sought to increase inflows of FDI with a much liberal policy since 1991 after decades of cautions attitudes. They have grown from a rather small figure of attitudes.
US$ 129 million in 1991-92 to US $ 4673 million in 2003-04 in actual terms. India climbs to become the third most attractive FDI location up from sixth place last year, reaching its highest ranking ever is accompanied by an improved outlook with 38% of global investors taking a more positive view on India compared to a year ago. No other country, except China, received such high marks in terms of investor optimism. The country's service oriented development path is helping it by pass obstacles like weak infrastructure. A "wired" India has played to its strong suit is a well educated IT savvy workforce with English language proficiency.

FDI is the process whereby residents of one country (the home country) acquire ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country (the host country).

SUGGESTIONS FOR BETTER MANAGEMENT OF FDI

(1) Enactment of Foreign Investment Law

(2) State Laws on Infrastructure

(3) Institutional Changes

(4) Plan for FDI Sector Targets

(5) Fund for Assistance to states

(6) Non-Governmental Facilitation Services

(7) Ratsing FDI Sectoral Caps

(8) Freeing Dual use Goods From FDI

(9) FDI in Cultural and Media

(10) Regulation of Natural Monopolies

(11) Competition Law should take care of Foreign Competition

(12) Encourage FDI in Retail Sector

(13) Allowing 100% Equity in the Manufacturing Sector

(14) Mining

(15) Increase in Foreign Equity in the Infrastructure Sector

(16) Raising of FDI Limit in Services Sector

(17) Attitude change is required to FDI

(18) Marketing strategy for Promoting FDI

(19) Policy for special Economic Zones

(20) State SEZ Laws

(21) SEZ Infrastructure Policy

(22) SEZ Administrative Structure

(23) Disinvestments

(24) Power Sector Reforms

(25) Monitoring the MNC entry

(26) Promoting India as an Attractive Investment Destination

(27) Encouragement to Technology base

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