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Foreign Investment in India

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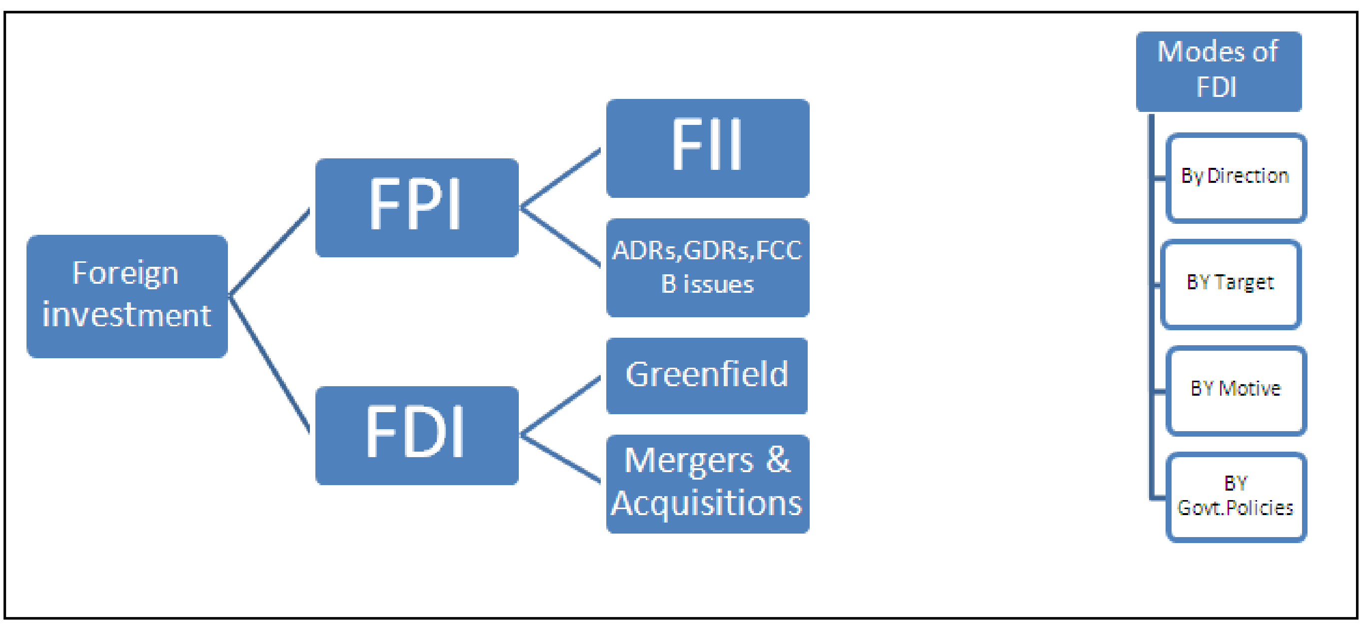
Abstract:
Foreign Investment is considered as an instrument of international economic integration as it brings a package of assets including capital, technology, managerial skills and capacity and access to foreign markets. The early works of FDI theory can be traced in the work by MacDougall (1958) who established his model based on the assumptions of perfectly competitive market. One of the most striking developments during the last two decades is the spectacular growth of FDI in the global economic landscape. Since the beginning of economic reforms in 1991, major reform initiatives have been taken up in the field of investment, trade and financial sector. India is considered as a preferred destination for foreign investment. A substantial portion of foreign direct investment (FDI) has taken place in the form of cross border mergers and acquisitions (M&A)). FDI in India has in a lot of ways enabled India to achieve a certain degree of financial stability, growth and development. India's structural changes have been realized through FDI. Multiplicity of approvals, administrative procedures, labour regulations, legal system, etc. act as hindrances to doing business in India.

Keywords: *Foreign investment, mergers, acquisitions, Indian economy*

1. Introduction

One of the most striking developments during the last two decades is the spectacular growth of FDI in the global economic landscape .Investment provides the base and pre-requisite for economic growth and development. Developing nations looks at foreign investment as a source of filling the savings, foreign exchange reserves, revenue, trade deficit, management and technological gaps. It brings a package of assets including capital, technology, managerial skills and capacity and access to foreign markets. Foreign direct investment has, by some measures, become even more important than international trade.

FDI is generally preferred to FPI, commonly referred to FII since FDI is expected to be long term whereas FII are viewed as good weather friends who can leave the country in the time of trouble. FDI, along with financial investment, brings access to modern technologies and export markets



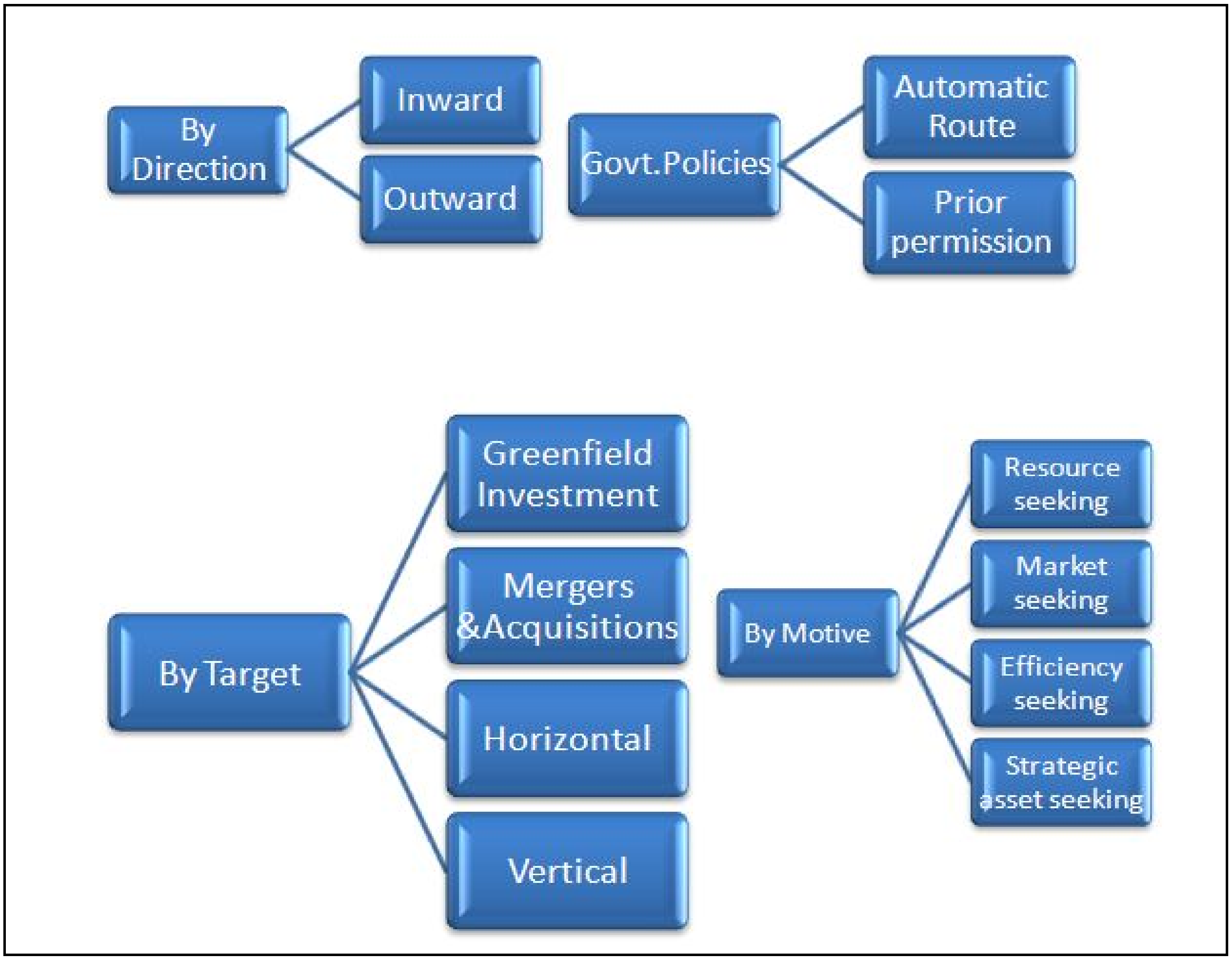


Figure 1: Types and Modes of Foreign Investment

2. Different Modes of Foreign Investment

2.1. By Direction

Inward: when foreign capital is invested in local Resources; Outward: when local capital is invested in foreign resources

2.2. By Target

Greenfield investment: Direct investment in new facilities or the expansion of existing facilities. It creates new production capacity.

Mergers and Acquistions; Transfer of existing assets from local firms to foreign firms takes place ;primary type of FDI, most common way for MNC to do FDI ;Cross border mergers: occur when the assets and operation of firms from different countries are combined to established a new legal entity

Cross –border Acquistions: when the control of assets and operation is transferred from a local to a foreign company, with the local company becoming an affiliate of the foreign company. Also called a takeover or buyout .

Horizontal FDI; When MNC intakes the same production to activities in multiple countries

Vertical FDI; Backward: when an industry abroad provides inputs for a firm's domestic production ; Forward:when an industry abroad seeks the outputs of a firm's domestic production

2.3. By Motive

Resource seeking: Investment which seek to acquire factors of production that are more efficient than those obtainable in the home country of the firm (sometimes do not have in home country like cheap labour , natural resources) .This typifies FDI in developing countries.

Marketing seeking: which aim at either penetrating new markets or maintaining existing ones .It may also be employed as defensive strategy

Efficiency seeking: Which firms hope will increase their efficiency by exploiting the benefits of economies of scale and scope and also those of common ownership

Strategic seeking: A tactical investment to prevent the gain of resource to a competitor. Presently, firms have multiple objectives and they fall under more than one of these categories.

2.4. Other Modes

Automatic Routes; Not permission, but information is to given. Foreign investors only need to inform the RBI within 30 days of bringing in their investment, and again within 30 days of issuing any shares.

Prior Permission: Prior permission is required.

3. Literature Review

In the economic literature a large number of theories exist that explain the reasons for the movement of international capital. The early works of FDI theory can be traced in the work by MacDougall (1958) who established his model based on the assumptions of perfectly competitive market. Hymer (1976) developed the FDI theory approach of industrial organization, in an imperfect market framework. Kindleberger (1969) and Knickerbocker (1973) stated that willingness to increase profits by taking advantage of technological superiority or superior organizational structure were the main reasons for direct investment. Buckley and Casson (1976) provided another explanation of FDI by putting emphasis on intermediate inputs and technology. Investment Development Cycle or Path (IDP) theory proposed a link between a country's level of economic development measured in GDP per capita and its international investment positions –the net outward FDI stock per capita.

Many empirical studies have been undertaken to analyze the trends and determinants of FDI .Ana Mar (1997) concluded that large market size, low labor costs and high return in natural resources are amongst the major determinants in decision to invest in low income. Mien (1999) found FDI has resulted in higher levels of market concentration in the Malaysia .Sahoo and Mathiyazhagan(2003) studied the relationship between economic growth and FDI by examining the enhancement in export promotion by Indian firms .They suggested opening up of export –oriented sectors for FDI .A study by Khawar (2003) concluded that foreign firms are more productive than the domestic firms .

Banga (2005) found an overall positive impact of FDI from Japan and the US on the growth of Indian automobile, electrical, electronics and chemical industries. Kulwinder Singh (2005) concluded the industrial reforms have gone far, though they need to be supplemented by more infrastructure reforms, which are a critical missing link. Tomsaz Mickiewicz, Slavo Rasosevic and Urmas Varblane (2005) examined the role of FDI in job creation and job preservation as well as their role in changing the structure of employment.

Nirupam Bajpai and Jeffrey D. Sachs (2006) concluded that a restricted FDI regime, high import tariffs, exit barriers for firms, stringent labor laws, poor quality infrastructure, centralized decision making processes, and a very limited scale of export processing zones make India an unattractive investment location. Jaya Gupta (2007) in her paper made an attempt to review the change in sectoral trends in India due to FDI Inflows since liberalization. Balasubramanyam V. N Sapsford David (2007) found that India may not require increased FDI because of the structure and composition of India's manufacturing, service sectors and her endowments of human capital. Wang and Li (2007) found positive spillover effects in the initial stage and negative spillover effects at higher levels.

Ray and Venaik (2008) concluded that the contribution of MNCs to growth of exports and royalties in host countries is much lower when compared to the contribution of domestic firms. Kunthuru found a negative impact of foreign ownership on export performance. Akpolar and Inancli (2011) found that FDI is more concentrated in low employment sectors rather than high employment sectors in Turkey. Ramakrishana (2011) concluded that FDI played an important role in higher industrial output and exports by China. Shahina (2011) concluded that higher FDI inflows to China are due to the friendly and business –oriented policies adopted by China. Sapna Hooda (2011) found that foreign Direct Investment (FDI) is a vital and significant factor influencing the level of growth in Indian economy. Anwar and Mughal (2013) found that investment by Indian MNCs have usually gone to countries and regions having sizeable Indian migrant communities

Against this backdrop, the main objective of the study is to analyze the pattern and direction of FDI flows in India. This study is based on secondary data. The required data have been collected from various sources i.e. World Investment Reports, Asian Development Bank's Reports, various Bulletins of Reserve Bank of India, , Economic Survey of India, and from websites of World Bank, IMF, WTO, RBI, UNCTAD, etc.

4. Foreign Investment in India

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. 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. Since the beginning of economic reforms in 1991, major reform initiatives have been taken up in the field of investment, trade and financial sector. Enactment of Competition Act, liberalization of Foreign Exchange Management Act (FEMA), and amendments in Intellectual Property Right (IPR) laws and many other initiatives made India attractive for business.

There are three primary institutions in India that handle FDI-related issues: the Foreign Investment Promotion Board (FIPB), the Secretariat for Industrial Assistance (SIA), and Foreign Investment Implementation Authority (FIIA). FDI in India has –in a lot of ways –enabled India to achieve a certain degree of financial stability, growth and development. India's structural changes have been realized through FDI

China is the major recipient of global FDI flows among the emerging economies of the world. It is also most preferred destination of global FDI flow. A recent United Nations Conference on Trade and Development report shows India's FDI inflow is merely 4.3 percent of its gross fixed capital formation as compared to the global average of 8.3 percent. FDI stocks as a percentage of GDP stand at 12.2 percent in contrast to the ratio for developing economies at 30.4 percent. China still led Asia-Pacific in 2013 with an FDI total value of $64.14 billion and a dominant 34.73 percent market share for FDI. India's FDI market share was only 8.57 percent.

Mauritius is the major investing country in India during 2000-2014, 37 percent of FDI inflows came from Mauritius as shown in Figure 2. The other major investing countries are Singapore, UK, Japan ,USA, Netherlands, Germany, Cyprus, France and UAE. The sector - wise analysis reveals that maximum FDI has taken place in the service sector as shown in Figure 3. High volumes of FDI take place in electronics and hardware, automobiles, pharmaceuticals, cement, metallurgical and hotel industries. The manufacturing sector is still untapped. FDI is not permitted in the arms, nuclear, railways, coal and lignite or mining industries.

A substantial portion of foreign direct investment (FDI) takes place in the form of cross border mergers and acquisitions (M&A). The increased competition in the global market has prompted the Indian companies to go for mergers and acquisitions as an important strategic choice. There has been several multi-billion dollar acquisitions by Indian companies wanting to build global scale and compete in the global markets, notable among them being the takeover of Corus by Tata steel ; Novelis by Hindalco; and Zain telecom by Bharti Airtel.

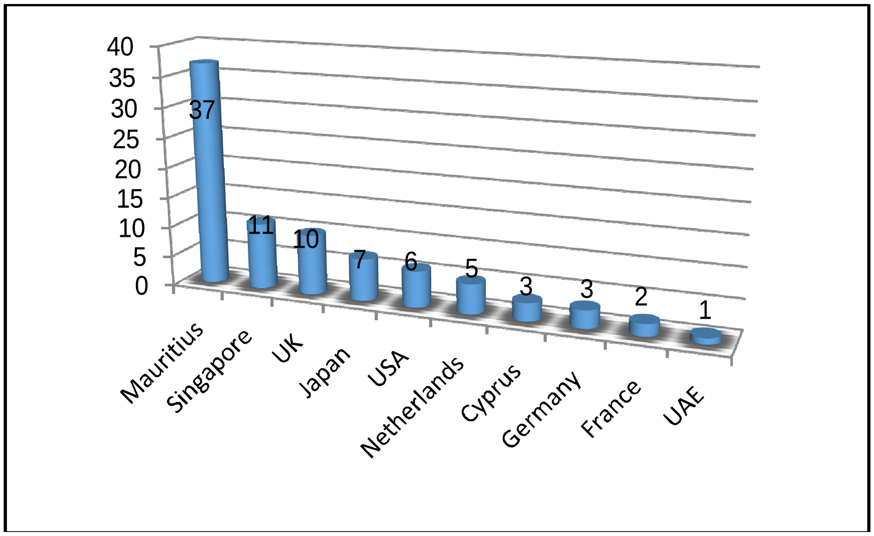


Figure 2: % of Total FDI Inflows (2000-14)

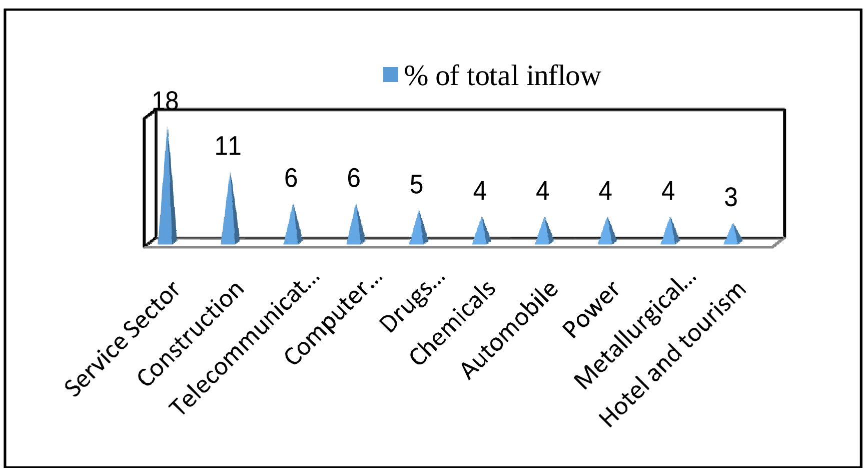


Figure 3

Mergers of Brook Bond, Lipton, Tea Estates and Doom Dooma Tea with Hindustan Lever saw the company taking a dominant position in tea. Tea Tea' takeover of Tetley, one of U.K' leading tea companies for $207 million was the most notable cross border deal. Ajay Piramal's group also shored up its holdings in the pharmaceutical sector through a series of takeovers in the 90's. Ranbaxy took over Crosslands in 1997. Reliance Industries 'takeover of IPCL in 2002 is a classic case .Mahindra was drawn to Ssangyong because of the South Korean company's line of premium and higher-priced sport utility vehicles, which complements the Indian company's more modestly priced, rugged S.U.V.'s built for India's more cost-conscious consumers. Countries that are seeking mergers in India for enhancing the trade scenario are Canada, Holland, Belgium, Italy, Sweden, Norway, Poland, Germany, Spain and the United Kingdom.

4.1. Outward FDI

The faster growth of outward FDI indicates that their enterprises are building ownership advantages rapidly and/or are increasingly choosing to exploit their advantages by establishing operations in foreign locations. Outward FDI during 2012 was $ 11097 million as shown in Figure 4. Indian outward FDI has three components viz., equity, loans and guarantees as shown in Figure 5. The leading destinations for India's outward FDI are Netherlands, Singapore, Mauritius, the United States and UAE as shown in Figure 6. Figure 7 displays the sector wise outward FDI pattern from which it is evident that transport and manufacturing sector constitute lion's share of India's outward FDI.

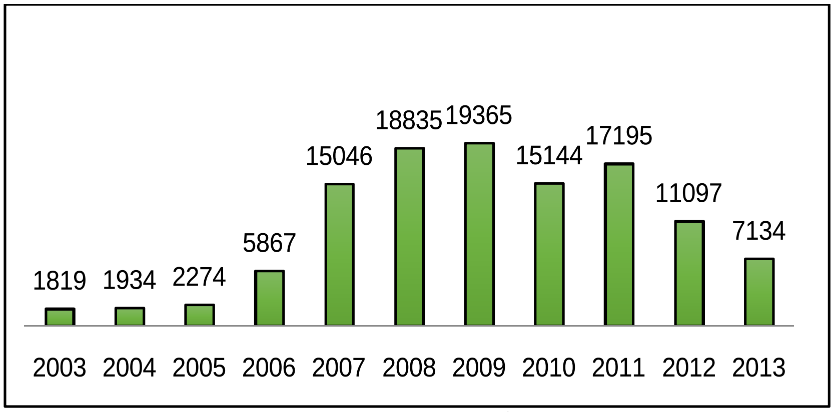


Figure 4: Outward FDI ($ million)

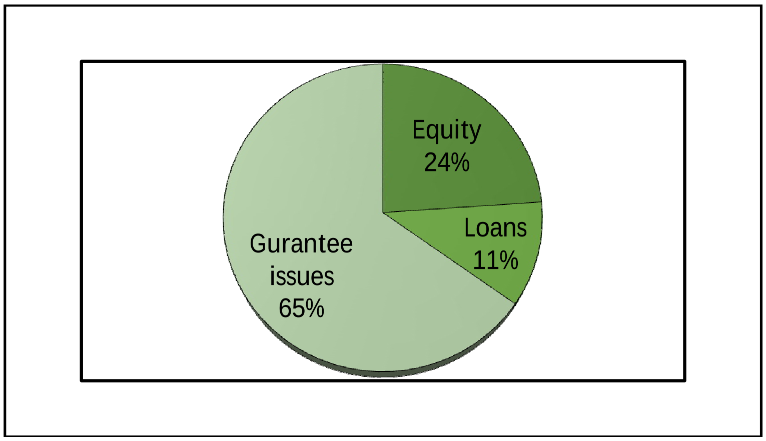


Figure 5: % of components of Outward FDI

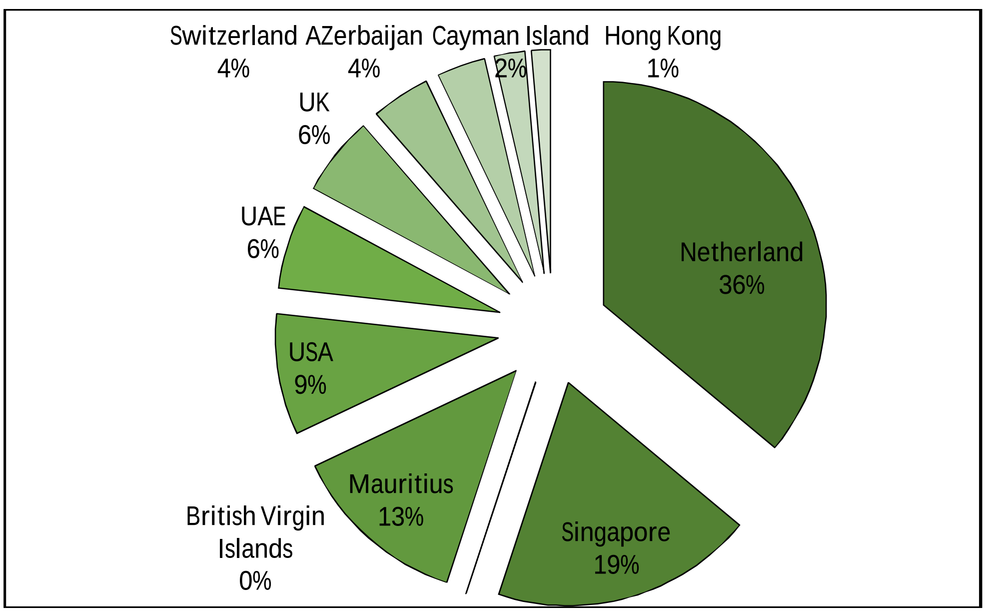


Figure 6: Leading destinations for India's outward FDI

Indian companies were growing more confident in making cross-border acquisitions. The largest outbound deal from India was Bharti Airtel's $10.7 billion acquisition of Zain, a wireless phone company that operated in 15 African countries including Kenya and Nigeria — markets that it had long hoped to expand into but which it would have been difficult to enter without an acquisition. Other big deals have included the Adani Group's $2 billion acquisition of the Abbott Point port in Australia that Adani intends to use to ship coal to its power plants in India. Essar, an Indian energy and steel conglomerate, bought a British oil refinery from Shell for $350 million. With the advent of global credit crisis, Indian M&A activity slowed down.

5. Conclusion

The economic reforms made India not only favourable FDI destination in the world but also set an example to the rest of the world by achieving what is predicted. Large Growing Economy, Largely untapped domestic market Availability of Domestic Skill sets and Technology access make India a preferred destination for FDI but multiplicity of approvals, administrative procedures, labour regulations, legal system, etc. act as hindrances to doing business in India. Therefore Govt should do; Permit "automatic route" for all investments within the sector cap; Provide long term visibility and consistency of policy; Improve business environment – reduce number of procedures and approvals; make all approvals time bound and non-discretionary; and facilitate upgradation of urban infrastructure in cities.

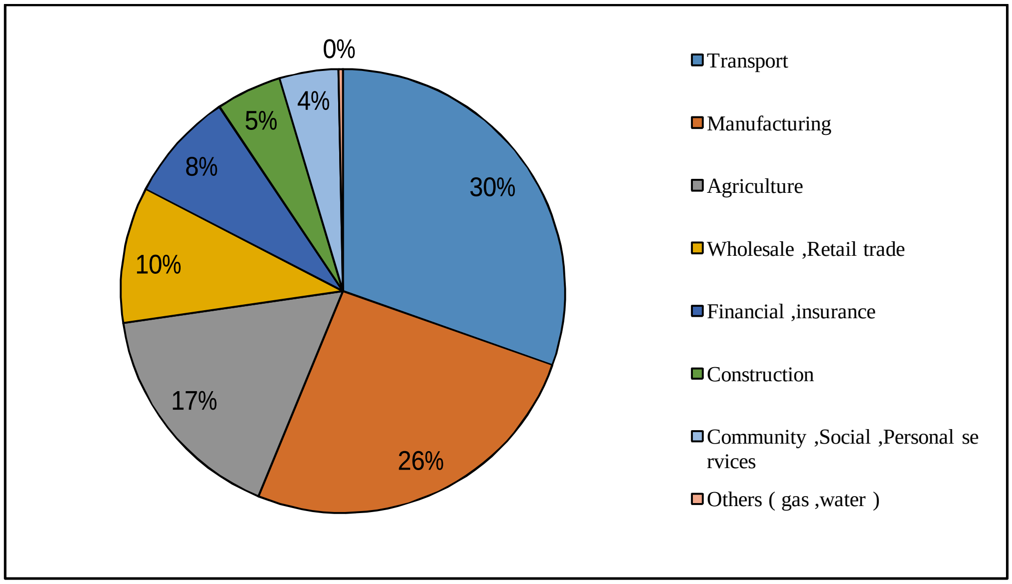


Figure 7: Sector -wise %of outward FDI

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