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The pros and cons of foreign direct investment in India

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Abstract
India has continually sought to attract FDI from the world's major investors. FDI has played a important role in development of Indian economy. India has today become a budding target for FDI. With high purchasing power of Indian men, India now offers more lucrative and profitable market for investors. Its growing economy and growth is becoming an eye treat for foreign companies to expand their business and operations overseas. FDI in India has in a lot of ways enabled India to achieve a certain degree of financial stability, growth and development. FDI no doubt is creating innovation in retail sector but simultaneously it may pull down the local and domestic retailers of India which is surely a concern to worry about for Indian government. In this research we have just tried to bring down maximum thoughts in lieu of FDI and form a constructive view over it.

Keywords: FDI, economic growth, trade deficit, cultural erosion

Introduction

In this 21ST century globalization makes this planet as a global village and people of different countries are getting closer and closer (Dunning, 2002). Due to immense development of technologies investors of different countries are looking forward to find business opportunities beyond the conventional territory and as a result one of the most popular and highlighted terms in modern business-"FDI" is evolving at a greater pace than ever before (Birkin Shaw, 2000; Alfaro *et al*., 2004). In this era of globalization and intense competition, foreign direct investment (FDI) has become a very common and immensely important phenomenon for consumers, producers and different governments (Balasubramanian *et al.*, 1996; Bornstein *et al.*, 1995). In this 21ST century, business and trade become more competitive and diversified than ever before. As traditional market is shrinking down in a faster pace, operators are looking for options for expansion and international trade is getting accelerated. As a result, FDI is getting accelerated at a faster rate and different countries of the world are trying their best to attract more and more FDI as it proves to be a great force for triggering the domestic economic development. (Chang & Rosenzweig, 2001; Chung, 2001; Daisuke, 2008). While the large Multi-National Corporations of the West are getting advantages of market expansion from FDI, the host countries are also utilizing it as a major mechanism and source for accelerating their domestic economic growth. Several research works are taking place over the years in the field of FDI and the suitability and attractiveness of various destinations. There is little doubt on the fact that while a large company from the US or Europe consider about going into diversified operation across the globe-first thing came into their market is the size of the market.

Conceptual Framework

Foreign direct investment (FDI) plays an extraordinary and growing role in global business. It can provide an organisation new markets and marketing channels, cheaper production facilities, access to new technology, product skills and financing. For a host country or the foreign firm that receives the investment, it can provide a source of new technologies, capital, processes, products, organisational 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 in one country making a physical investment into building a factory in another country. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment, which is considered an indirect investment.

FDI Flows to India

India slipped a rank to end at tenth place in the latest ranking of top foreign direct investment receiving countries for the year 2018, according to the latest edition of the World Investment Report of the United Nations Conference on Trade and Development (UNCTAD). According the report, India received $42 billion in FDI in 2018, a growth of 6%.China, which retained the number two position, received the highest foreign inflows among the developing countries at all-time high of $139 billion, a growth of 4%.Manufacturing, communication and financial services – were the top three recipients of inflows in India. Growth in cross-border M & As to $33 billion in 2018 from $23 billion in 2017 was primarily due to transactions in retail trade, which includes e-commerce, and telecommunication. The report mentioned the acquisition of Flipkart, country's biggest e-commerce platform, by Walmart and telecommunication deals involving Vodafone and American Tower amounting to $2 billion. It highlighted the changes to the FDI policy introduced for the ecommerce sector terming the changes restrictive. In February 2019, India introduced several restrictive changes in its FDI policy for e-commerce in order to safeguard the interests of domestic offline retailers. Global FDI slipped by 13% in 2018, to US$1.3 trillion from $1.5 trillion the previous year – the third consecutive annual decline, according to UNCTAD's World Investment Report 2019. "FDI continues to be trapped, confined to post-crisis lows. This does not bode well for the international community's promise to tackle urgent global challenges, such as abject poverty and the climate crisis.

Benefits of FDI to emerging markets

Much modern economic research highlights the benefits FDI may have on a host nation's economy. FDI can be undertaken essentially by three means: joint-venture (JV), greenfield, and acquisition. FDI itself can provide four important economic gains for the host nation. First, FDI increases the ability of firms to undertake intra-firm trade, which can alleviate market imperfections. Second, the recipients of FDI may experience increase in productivity often through the introduction of new technology and expertise and by engaging dormant or underutilized domestic economic sectors. Third, FDI generates positive externalities, including increases in global trade, new goods and services, improved quality of labour, and increased social welfare such as health, housing, and education. Fourth, and perhaps most important, FDI provides financial capital, which in many emerging economies is an underprovided resource. FDI's role in providing capital is growing larger as an increasing percentage of private capital flowing to emerging economies comes in the form of FDI.

Positive impact of FDI

It causes a flow of money into the economy which stimulates economic activity. It increases the employment. Long run aggregate supply will shift outwards and aggregate demand will also shift outwards as investment is a component of aggregate demand. It may give domestic producers an incentive to become more efficient the government of the country experiencing increasing levels of FDI will have a greater voice at international summits as their country will have more stakeholders in it.

Importantly, increased FDI is likely linked to increased economic growth. Empirical studies disagree, however, as to the degree of linkage and when and where such linkage is most prominent. Recent studies show that, for FDI to be effective, certain threshold requirements must be met, including nominal GDP, a degree of financial market development, institutional maturity, educational level, and a functioning property rights regime. The investment's source can also have an important impact on the effect of specific FDI investments. For example, U.S. firms tend to have both higher returns on foreign investments and lower debt-to-equity ratios than Japanese and Korean firms, despite a tendency for U.S. firms to be less likely to develop long-term relationships with host nation firms. The source of investments may matter more as FDI is coming from more diverse sources, such as Western Europe and Asia.

The benefits of M&A activity are widely documented, especially those involving benefits to shareholders of target companies. Takeovers, and even the threat of takeovers, are believed to improve market efficiency by allocating resources to higher yielding activities. Takeovers help to put assets in the hands of those who can put them best to work. In nations with particularly bad corporate governance this may be especially beneficial. Additionally, for some firms, acquisition of a domestic company is the best, if not the only, means for entering a new market.

Demerits of FDI

The disadvantage of a foreign direct investment is the risks that are involved. There is no guarantee that an investment will offer dividends in the future. The global political climate is inherently unstable as well, which means a company could lose its investment as soon as it is made should a seizure or takeover take place.

It stops domestic investments from happening: A 10% minimum investment into a foreign company is money that isn't going into domestic companies. Although money comes back into local communities with FDI, a local investment's value is almost another $1 for every dollar spent. That means a $10,000 domestic investment could be worth $20,000 or more in the future.

It isn't without risk: Political instability around the world means that the business environment can change at a moment's notice. Although companies and individuals choose foreign organizations that have little risk, there can never be a complete elimination of risk from the transaction. In some countries, the political risk factors could be so high that a foreign direct investment doesn't make sense.

It can be more expensive: In the United States, the dollar is one of the strongest currencies in the world. For an investment into the developing world, the value of the currency can be stretched further than it would be domestically. That isn't always the case, however, because the euro and the pound trade higher than the dollar. Investing into one of those markets through FDI would actually have higher costs for the individual or business compared to a domestic investment.

It can affect currency exchange rates: A developing country with a struggling currency may see a surge of popularity after a foreign direct investment. People and companies see an investment as a sign of stability, creating additional interest in the market being examined. That higher level of interest can lead to a better monetary value for the foreign nation, which may destabilize exchange rates.

It can lead to exploitation: Exploitation of FDI can happen on a number of levels. A foreign government might choose to seize the investment. Assets or proprietary information might be seized for political purposes. The foreign company might take the investment and squander it. Even if there is a well-constructed contract governing the terms and conditions of the investment, some foreign companies may decide to take the money and run. That can leave an investor with few, if any, options to recover their funds.

Risk from Political Changes: Because political issues in other countries can instantly change, foreign direct investment is very risky. Plus, most of the risk factors that you are going to experience are extremely high.

Negative Impact on the Country's Investment: The rules that govern foreign exchange rates and direct investments might negatively have an impact on the investing country. Investment may be banned in some foreign markets, which means that it is impossible to pursue an inviting opportunity.

Modern-Day Economic Colonialism: Many third-world countries, or at least those with history of colonialism, worry that foreign direct investment would result in some kind of modern day economic colonialism, which exposes host countries and leave them vulnerable to foreign companies' exploitations.

Positive Impact of FDI on India's Economy

Attracting foreign direct investment has become an integral part of the economic development strategies for India. FDI ensures a huge amount of domestic capital, production level, and employment opportunities in the developing countries, which is a major step towards the economic growth of the country. The effects of FDI are by and large transformative. The incorporation of a range of well-composed and relevant policies will boost up the profit ratio from Foreign Direct Investment higher. Some of the biggest advantages of FDI enjoyed by India have been listed as under:

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.

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

Technology diffusion and knowledge transfer: FDI apparently helps in the outsourcing of knowledge from India especially in the Information Technology sector. It helps in developing the know-how process in India in terms of enhancing the technological advancement in India.

Linkages and spillovers 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.

Negative Impact of FDI on India's Economy

FDI has been a booming factor that has bolstered the economic life of India, but on the other hand it is also being blamed for ousting domestic inflows. FDI is also claimed to have lowered few regulatory standards in terms of investment patterns. The major disadvantages of FDI are mentioned below:

Disappearance of cottage and small scale industries: Some of the products produced in cottage and village industries and also under small scale industries had to disappear from the market due to the onslaught of the products coming from FDIs. Example: Multinational soft drinks.

Contribution to the pollution: Foreign direct investments contribute to pollution problem in the country. The developed countries have shifted some of their pollution-borne industries to the developing countries. The major victim is automobile industries. Most of these are shifted to developing countries and thus they have escaped pollution.

Exchange crisis: Foreign Direct Investments are one of the reasons for exchange crisis at times. During the year 2000, the Southeast Asian countries experienced currency crisis because of the presence of FDls. With inflation contributed by them, exports have dwindled resulting in heavy fall in the value of domestic currency. As a result of this, the FDIs started withdrawing their capital leading to an exchange crisis. Thus, too much dependence on FDls will create exchange crisis.

Cultural erosion: In all the countries where the FDls have made an inroad, there has been a cultural shock experienced by the local people, adopting a different culture alien to the country. The domestic culture either disappears or suffers a setback. This is felt in the family structure, social setup and erosion in the value system of the people. Importance given to human relations, hither to suffers a setback with the hi-fi style of living.

Political corruption: In order to capture the foreign market, the FDIs have gone to the extent of even corrupting the high officials or the political bosses in various countries. Lockheed scandal of Japan is an example. In certain countries, the FDIs influence the political setup for achieving their personal gains. Most of the Latin American countries have experienced such a problem. Example: Drug trafficking, laundering of money, etc.

Inflation in the Economy: The presence of FDIs has also contributed to the inflation in the country. They spend lot of money on advertisement and on consumer promotion. This is done at the cost of the consumers and the price is increased. They also form cartels to control the market and exploit the consumer. The biggest world cartel, OPEC is an example of FDI exploiting the consumers.

Trade Deficit: The introduction of TRIPs (Trade Related Intellectual Property Rights) and TRIMs (Trade Related Investment Measures) has restricted the production of certain products in other countries. For example, India cannot manufacture certain medicines without paying royalties to the country which has originally invented the medicine. The same thing applies to seeds which are used in agriculture. Thus, the developing countries are made to either import the products or produce them through FDIs at a higher cost. WTO (World Trade Organization) is in favour of FDIs.

World Bank and lMF Aid: Some of the developing countries have criticized the World Bank and IMF (International Monetary Fund) in extending assistance. There is a discrimination shown by these international agencies. Only those countries which accommodate FDIs will receive more assistance from these international institutions.

Convertibility of Currency: FDIs are insisting on total convertibility of currencies in under-developed countries as a prerequisite for investment. This may not be possible in many countries as there may not be sufficient foreign currency reserve to accommodate convertibility. In the absence of such a facility, it is dangerous to allow the FDIs as they may withdraw their investments the moment they find their investments unprofitable.

Conclusion

On the basis of above research and discussion FDI has both positive and negative impact on India Economy. Government should promote FDI and in order to lower down its negative impact it should have redesigned framework for the local players. Government should encourage FDI on gradual basis depending on products from one area to other. Product category wise clauses should be developed to allow FDI. To keep pace with growing GDP government should encourage foreign investments. India needs inflows to drive investment in infrastructure, a lack of which is often cited as restricting the country's economic growth. Investment is also needed to expand capacity and technology in sectors such as autos and steel, as well as to offset a big current account deficit. In a nutshell, FDI should be encouraged with strict feasible and mutually beneficial regulations. “Better Investment Climate” Need of the Hour.

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