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Problems and Prospects of Foreign Direct Investment in India

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KEYWORDS :

One of the distinguishing features of the ongoing transition of the Indian economy towards market driven economic system has been the metamorphic change in our Capital markets. Not only has there been a spurt in the volume of Capital raising activity, but also in terms of depth and composition there has been a sea-change. Indeed opening-up of capital market to the world of Foreign Institutional Investors (FIIs) has given a new remarkable dimension.

It needs to the mentioned that foreign institutional investment is not recent phenomenon. Way back 1868; foreign colonial was floated as a close-ended investment trust in Britain and by 1994 the British investors owned 27 per cent of the equity in the US market which was then emerging market. Along with their economic progress, developed countries like UK, France, Italy, Germany, USA and Japan have over the year matured from the status of emerging to developed markets. Till the last eight, he FIIs investment at the global level was restricted. The third world countries were not attractive but they have knowledge about it. Hens FIIs was now hear in the picture in the big way in the third world countries because there capital markets were: (i) offering lower rate of returns, (ii) there was lake of liquidity, transparency, depth and stability. Afterwards FIIs included the foreign investments under financial collaboration (foreign direct investment) and investment by FIIs through the alternative routes, (a) offshore single/regional funds, (b) global depository receipts, and (c) Euro-convertibles

The importance of foreign direct investment (FDI) inflow for an economy in transition like India can never be ignored as the FDI inflow not only integrates the host country close to the world economy, but also act as a developmental resources in the form of capital, technology managerial and marketing knowhow and market access required for sustained economic growth and development. Besides a large and quality inward FDI can make the relationship between the domestic and foreign enterprises more dynamics in terms of both technology and environment, which is very urgent particularly in the present era of globalization and competition.

Compare to the earlier restrictive FDI policy regimes, in India, the New Industrial Policy (NIP) of 1991 accords a much liberal attitude towards FDI to exploit the opportunities for promoting foreign investment in the country. The industrial policy changes in the nineties especially in the form of simplification of procedural rules and regulations and removal of entry barriers have created a favourable environment for the foreign investors. The new policy framework not only permits the firms t have higher equity participation in their venture in India, but also opens up many new sector to them that were earlier reserved f the domestics firms.

After introducing a number of liberals measures in this direction ever since the initiation of the liberalisation process the amount of FDI is yet to reach a satisfactory level. Although 11874 numbers of FDI proposal have been received with proposed investment of Rs 2,42,602.00 crore during 1991-2000. A. T Kearney FDI confidence index upgraded India from rank 15th to 6th in 2003.interestingly manufacturing investor rank India among top six most preferred destinations in 2003. In service India ranked 4th in 2003 whereas in previous year it stood at 14th position. However FDI flow into India received only 2 percent of the Total FDI flow to the developing countries. China received 28 percent, Brazil 9 percent and Mexico 7 percent.

The Indian investment mood in changed. Now margins are growing, demand is picking up and corporate India swears by prosperous future. The investment scenario, which looked bleak recently, is looking brighter once again because index of industrial production has grown by 6.9 percent in 2003-04 compared to 5.8percent in the previous year. But more than the rise in growth rate of industrial production r corporate bottom line, what significant is that the larger part of this rise has come through higher growth in capital production up by 13.1 percent in 200304 against 10.5 percent in the previous year. This has been reflected in the higher implementation rate of Industrial Entrepreneurs Memorandum (IEM) in 2004. In this year corporate India has filled large number of new IEMs and committed substantially higher funds in them. The implementation of IEMs has been highly concentrated in few pockets. States like Gujrat, Maharashtra, Tamil Nadu, Andra Pradesh and Punjab. Accounted for the lion's share in the number of IEMs implemented. Gujrat alone has accounted for about 18 percent of the total implemented IEMs between 1992-04.Maharashtra accounted for another 15.8 percent of IMEs implement, in Tamil Nadu this percentage is 7.3 during this period. In contrast some east states of Indian territory like WestBengal, Orissa , Bihar and Assam have failed to take benefits of this investment. Orissa accounted for about 0.9 percent of the aggregate investment made in the country between 1992 April 2004. While Assam and Jharkhand accounted for meagre 0.6 percent and 0.8 percent respectively. This percentage with Bihar is 0.03.Even Rajasthan, Haryana and Madhya Pradesh industrially backward stes during this period. Rajasthan accounted for 6 percent of the total investment between 1992 to April 2004. While Haryana 5.7 percent and Madhya Pradesh 4.9 percent during the same period. In this period some small states like Arunachal Pradesh, Manipur, Mizoram, Nagaland, Sikkim, Andaman and Nicobar, Lakshawdeep have not add nothing to the states. This institution is very bad for the economic sight because it tends towards regional imbalance in the investment sector.

The very low volume of the quality of FDI inflow was not as per expectation. The distributions of FDI are not even across industries. It is skewed towards the basic goods and services sector, which together received more that 75 percent of the total amount during August 1991 to February 2001.

Merger Motives

With the liberal FDI policy measures of nineties and abolition of FERA facilitating across boarder mergers and acquisition (M&A), most of the recent FDI inflows seems to be for taking over of the existing Indian companies rather than to invest for capacity expansion or new venture in the host country. While until almost 1990 almost all the FDI inflows in the country took the form of green filed investment, about 40 % f that was through M&As during 1997-9, in 2000-1 around 43% of the inflows were for take over purpose. This tendency of the FDI inflows in the form of M&As might have the limited the economy from its very objective of attracting of quality of FDI inflows that have domestic capital augmentation potential spill over benefits along with competition employment and efficiency generating competencies. The magnitude of FDI inflow into the economy is largely driven by the factor like market size, the extent of urbanization, geographical and culttral proximity with the source countries and quality of infrastructure.

Lack of Economic Environment

The recent economic slowdown seems to be one of major factors for the sorry FDI situation in India. The erratic economy growth since the latter half of the nineties in general and industrial recession in particulars have undoubtedly limited the market for industrial product and thereby the confidence of potential foreign investor to invest in the country. With the recession domestic as well as global economy continuing and the rate of inflation being very low, it s very unlikely that the situation will reverse in the near future unless appropriate measures are taken n this regard with immediate effect. In other side the declining corporate profitability in the nineties, especially since mid-nineties seems to be another important factor responsible for the low investment. The declining state of corporate profitability especially that of foreign firms might have undermined their confidence as well as risk-taking attitude of the foreign investor. These firms have also reduced their ability to expand capacity of the existing units or opening up new one and forced them to take the relatively safe route of M&As to entry into and increase presence in Indian Industry.

Poor Infrastructure

Indian economy cannot attract more FDI without fast development and provision of adequate industrial infrastructure facilities. It seems to be absent creating service obstacle in the way of rapid investment inflow even in the current situation. It was very shocking report of world investment report, 2000 that among 47 industrialist countries worldwide, India stands at the bottom most terms of infrastructure competitiveness. Very latté progress has been made in respect f roads, railway, port, power, etc. during the last ten years. While the major ports are still over utilised and hence cost is efficient compared to others Asian prts like Singapore, Hong Kong and Colombo; the growth rate of power generating capacity id gradually decreasing.

Imperfect policies

The policies prevailing in these countries are not in position influence the magnitude of FDI, especially after the harmonisation of policies across the world. But what is more important perhaps is that while the liberal policies measures may not necessarily guarantee a bigger and quality inflow of FDI for many economies the imperfection and in consistence's therein can surely pose a pose a threat on way in. Besides, with the development impact of FDI being influenced to the large extent by the initial conditions prevailing in the host country, investment strategies of the foreign firm and polices and performance of the host government in channelizing FDI inflows in tune with the objective o it development policy, development of a comprehensive policy framework is a quite imperative. A comprehensive should also include reforms of the infrastructure and trade related policies, the measure on these fronts are not only inconsistent and unclear, they have also failed in their respective field, creating a greater deal of confusion in the mind of potential investor. Even after the decade since the New Industrial policy was introduced, India had failed to appear as one of the hot destination for the foreign investor particularly for green field investment.

Not only policies are imperfect but they are confusing in nature. By and large, a FDI policy in developing countries would seek to promote exports, technology or employment. All these subjects to the consideration of national security. If motives are to export promotion, the FDI should be encouraged in areas, which are presently reserved for the small scale industries (SSIs). India is major export are garments, gems and jewellery and agriculture products, which is largely produced by SSIs. These sectors are low cost of labour and have highly employment intensive.

Despite of problem the FDI is essential for the development of Indian economy. Problems are curable and adequate amount of FDI may be attracted in the economy after solving the problem. In India the current FDI facilitation structure is quite complex. The Indian investment centres which was originally mandated to pursue these objectives, it almost defunct till 1991. The department that dealt with foreign investment and regulated the flow of FDI. But the secretariat of Industrial approvals, which accepted and approved foreign investment application, functioned in the ministry of investment policy has been with the Department of Industrial policy and promotion (DIPP) but the secretariat if Industrial Assistance (SIA), as it's known, is no longer the secretariat for the FIPB (Foreign Investment Promotion Board) the finance secretary chair the FIPB and all foreign investment cases are processed in the Finance Ministry. Quick transition of FDI approvals into implementation, provide a proactive one stop after care services to foreign investor.

An Investment Promotion Agency (IPA) work to promote the contry as an investment destination, target investor and provide after care service in a hostile manner currently these function are disperse but different government, bodies. It advocacy, (b) image- making , (c) Investment promotion including investor targeting, (d) after care of investor and (e) net working both globally and within the country with state level IPAS.

India is seen as a rule bound and highly bureaucratic. Good governance is investment promotion in the new buzzword. It is necessary t analyze all polices and process in the light of principals of good governance such s fro transparency, predictability and accountability. On the other hand, Chinese policies are less liberal than those in India; the perception of the investor has been more favourable. This is on account of the keenness shown by its leader and bureaucracy at every level and ease of entry and implementation process.

Investment promotion function is about marketing with the competition for FDI is becoming fiercer by the day. India must be seen and heard above all the competing location by investor as the investment destination. The IPA must undertake image building activities, such as the use of media, public relations, etc. Participation in international investment promotion events organising events can be effective china international investment trade Fair organised annually in September in Xiamen promotion platform for that country.

The new IPA must identify TNCs that are seeking new market or production base and targets them. Foreign investors go through several stage of decision making before finalising upon a location. At every level the new IPA must provide full support to the investors. Once he decision to invest in the country is taken, the aftercare functions, requiring effective coordination with line ministries and the state IPAs become important. Net working both globally and within the country would be an important position for investment. Outward Investment Promotion Agencies (OIPAs) promote outward investment, often in combination with the promotion of inward investment and export. The primary objective of these agencies is to help domestic enterprises to develop business links abroad and to pursue overseas business opportunities. Japan bank for international Co-operations, Common Wealth Development Corporation (CDC)< UK and Overseas Private Investment Corporation (OPIC), USA is very active in promoting outward investment, development finance, Institution Investment guarantee schemes, bilateral and multilateral institutions private constancy firms and private banks and insurance companies also assist in investment of firms in other countries. Information about firms intending to invest in other countries at a very early stage can be sourced from these agencies at an early stage. Organisation like World Association of Investment Promotion Agencies (WAIPA) has more than 160 with other IPAs and bodies like UNCTAD, UNDO, MIGA, OECD & FIAs which are cosponsors of WAIPA. There is a need to short our weakness in India Investment System that has kept FDI flows below their potential. After removal of these weaknesses, India could emerge as one of the top FDI recipients in developing world.