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EMERGING ROLE OF FOREIGN DIRECT INVESTMENTS IN THE DEVELOPING COUNTRIES

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ABSTRACT This paper introduces the conceptual developments with regard to foreign direct investment and multinational enterprises in and from developing countries. The paper contains the detailed overview of the mechanisms of FDI in the developing countries, with recent policy analysis and economic developments like growth and capital flows from some of these countries. Foreign direct investment may be viewed to internalize trade costs and externalities from firm's specific assets. The ownership advantage for foreign direct investments from developing countries originates from technology and management expertise that are suitable or adaptable to local conditions in other developing countries. However the higher productivity of FDI holds only when the host country has a minimum threshold stock of human capital. This paper builds a multi-country model that explains the decision of heterogeneous firms to serve foreign markets through foreign direct investments.

KEYWORDS : FDI, Economic growth, developing countries, technological know-how.

INTRODUCTION:

International capital flows have gained significant momentum since the introduction of globalization in the early 1990's by successfully exploiting foreign investments. This highlighted its role in creating surplus opportunities for developing countries to achieve accelerated economic growth. It tends to supplement national savings, facilitate access to internationally available technologies and raise efficiency and expand output. With globalization, the diversified global market has become united, the investment sector has strengthened and developing economies have been the utmost to liberalize their foreign capital regimes and introduce various policies to attract investment. Foreign investment can be both in the form of foreign direct investment (FDI) and foreign portfolio investment (FPI).

According to OECD,"A direct investment can be defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10% or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise". Foreign direct investment is an investment in company by a company in another country such as setting up of a factory or office in country B by country A. It provides a means for creating direct stable and long lasting links between economies under an attractive policy environment. FDI's can serve as an important driver for the development of local enterprises and it may also help to improve the competitive environment between both the recipient and the investment economies. For example Satyam works in a multinational corporation that provides microchips for smart phones. He is responsible for the opening of branches in other countries to expand the company's global presence. Satyam' s company is interested to open a branch in country B and got him to find out more about the investment opportunities and incentives available in country B. Satyam decides to visit country B to get a clear view of the investment opportunities available. After Satyam's visit to country B, this company decided to setup a factory in country B and employ the locals to work for them. In this way there is transfer of technology and expertise from country A to country B .

Foreign direct investment encourages the development of local enterprise as the increase in competition encourages firms to increase the productivity and improve their goods and services. FDI's brings technology and improves the trade flow and infrastructure and generate employment and thus helps the recipient economy to grow. At the same time it also helps the investing company widen their consumer base by offering products and services in the recipient country which generates more revenue for them. Hence FDI's contributes to the growth of recipient economy as well as allow foreign investments to expand their business in other parts of the globe.

Foreign direct investments also involves establishing operations or acquiring tangible assets including stakes in other business. It is not just transfer of ownership as it usually involves the transfer of factors complimentary the capital including management, technology and organizational skills. The main objective of FDI however is to establish lasting interest. This implies the existence of long term relation between the direct investor and the direct investing enterprise along with the significant degree of influence over the management of the enterprise. The Department of Industrial Policy and Promotion (DIPP) is responsible for facilitating and promoting FDI inflows into the country. It issues the FDI policy in India. India attracts USD 22 billion of FDI flows in the first half of 2018, according to a UN report which states that the global foreign direct investment dropped by 14 percent in the same period due to tax reforms carried out by US government.

Types of FDI:

FDI can be categorized into two main types which are-

1. Greenfield investment
2. Brownfield investment

1. Greenfield investment- It can be defined as the establishment of new operations in the host country. When a country wants to invest in a new country or a new economy, it has two choices, either it can build new facilities or it can invest in existing facilities or country (mergers and acquisitions). The Greenfield investment is foreign direct investment by a parent company to build plants and infrastructure in a foreign country from ground. These investments are made in developing countries and most of the government of developing countries offer tax breaks and subsidies to promote Greenfield investment so that jobs and business opportunities can be created. It also involves building of new distribution hubs, offices, many manufacturing plants, etc. The Greenfield investments in India are coca-cola, Pepsi, P&G, Hyundai, ford, BMW, Yamaha, etc.

Pros and cons of Greenfield investment:

Pros-

1. Maximum flexibility
2. Lower maintenance
3. Greater control
4. Choice of location
5. Long term commitment
6. Tax breaks and other incentives
7. Big press of opportunities
8. Employee training

Cons-
1. High costs
2. High social – political risks
3. Approvals and permissions
4. land acquisitions and environmental changes
5. Labour issues
6. Competition from already established countries

2. Brown field Investment : this is another form of fdi . In this method of fdi, the foreign businesses don't take the pain of building up from scratch in another Country . They expand their businesses by either going for cross-border mergers and acquisitions of leasing existing facilities . This helps the investor co. to start their business in subsidiary company without building anything from zero. The upmost advantage of this investment is that the buildings are already constructed . The cost and time of starting up may thus be greatly reduced. It covers the previously constructed facilities in other country that were once in use for another purpose

Pros –
1. Easily access to new market
2. Lower fixed costs
3. Lower training and manning costs
4. lower setup costs
5. no measure alterations and up gradations required

Cons –
1. up gradations may involves high costs
2. there may be unforeseen taxes
3. expansions issues in already establish units
4. approvals and licenses required

Review of literature

Various studies have been reviewed to the works which are closely to the investment opportunities in different countries . Shiva S.Makki , Agapi somwar Volume 86 august 2004 , American journal of agricultural economics states that FDI is an important vehicle of technology transfer from developed countries to developing countries . FDI also stimulates domestic investment and facilitates improvement in human capital and the institutions in the whole countries .Xueli Wan-International business research 3 (1), 52, 2010 - During the last decades, the relation between FDI and economic growth has been extensively discussed in the economic literature. On the one hand, some scholars argue that foreign direct investment could stimulate technological change through the adoption of foreign technology and Knowhow , thus boosting host country economies . On the other hand, other pessimists believe that FDI may bring about crowding out effect on domestic investment , destructive competition of foreign affiliates with domestic Hymer (1960) showed that firms would prefer to supply the foreign market by way of direct investments when they can compete with the local firms having better knowledge of the local market, due to their compensatory advantage on being multinationals.

Reasons why FDI is better than exporting
1. FDI benefits the global economy as well as the investors and the recipients as it shares technological know-how among the economies.
2. FDI makes easy international trade as it doesnot involve high barriers and taxes as in case of exporting.
3. It also helps the host country in employment generation and training and growth.
4. FDI can be an effective way to enter into a foreign market.
5. Governments of recipients countries invite FDI because they get additional expertise, technology and products.
6. FDI involves transfer of resources.
7. FDI reduces costs of production and cost of sales in host countries.
8. Some markets prefer locally produced goods due to a strong sense of patriotism and nationalism, making it very hard for international expertise to penetrate such a market.FDI helps enterprises enter such markets and gain foothold there.
9. FDI diversifies the holding outside a specific country, legal and political boundaries. Diversification always increases return without increasing risk.
10. It increases government revenue and hence maintains exchange rate stability. It also helps in development of backward areas.
11. Recipient economies receive" best practices management" , accounting or legal guidance from their investors.

Government new FDI policy analysis in India

The government of India has amended FDI policy to increase FDI inflow. It has also launched Make in India initiative in September 2014 under which FDI policy for 25 sectors was liberalized further. Further on April 2015, FDI inflow in India increased in India by 48% since the launch of Modi's initiative Make in India. India ranked 15th in the world in 2013 in terms of FDI inflow. It rose up to 9th position in 2014. While in 2015 India became top destination for FDI. The Department of Promotion of Industry and Internal trade and Invest India has developed the India investment grid (IIG) which provides a pan-India data base of projects from Indian promoters for promoting and facilitating foreign investments. During 2014-16 India received most of its FDI from Mauritius, Singapore, Netherlands, Japan and the US. Furthermore India jumps to 8th place on Global FDI Confidence Index on 2017.Following are some of the major areas for Foreign Direct Investment by India:
1. Infrastructure- 10% of India's GDP is based on infrastructure activity. 100% FDI under automatic route is permitted in construction sector for cities and towns.
2. Service- FDI in service sector was increased by 46% in 2014-15. FDI limit in insurance sector was raised from 26% to 46% in 2014.
3. Pharmaceuticals- Indian pharmaceutical market is 3rd largest in terms of volume and 13th largest in terms of value. 74% of FDI is permitted in this sector.
4. Railways- 100% FDI is allowed under automatic route in most of areas of railway like high speed train, railway electrification, passenger terminal, etc.
5. Chemicals- 100% FDI is allowed in chemical sector under automatic route.
6. Textile- Textile is one of the major contributor to India's export. Nearly 11% of India's total export is textile. 100% FDI is allowed under automatic route.
7. Airlines- Foreign investment in a scheduled or regional air transport or domestic scheduled passenger airline is permitted to 100% with FDI up to 100% permitted under automatic route and beyond 49% through poor existing air route under automatic route.

CONCLUSION:

Hence, the number of policy implications emerge from the study. For instance, results suggests that the country's capacity to progress on economic growth will depend on its policies to promote FDI. The most efficient way to attract FDI is to focus on straighten the deficiencies on the areas like free trade zones, trade regimes, tax incentives and rebates, the human capital base in the host country and economic and political stability. FDI not only allows growth and expansion of investment company but also provides expertise manpower and technological know-how to the host country.FDI brings assets which are crucially scarce in developing countries. These assets are technology and management and marketing skills without which development cannot takes place. This results in wider choice to the customers in the market which leads to higher returns to the economy.

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