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FOREIGN DIRECT INVESTMENT IN INDIA

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Abstract: *It is nowadays accepted that FDI plays a crucial role in industrial development of the developed and developing countries alike and can help in boosting economic growth through, for example, total factor productivity growth. FDI increasing comprises sets of inter-connected operationalized business decisions by multinational enterprises (MNEs) in response to changing global and regional competitive, strategic considerations and factor conditions. As such, FDI Policy Instruments, which have analytical and regulatory dimensions, are required to manage the landscape of MNEs' FDI operations in order to maximize positive externalities accruing to the host location, as well as optimizing the allocative efficiencies involved in FDI. According to UNIDO (2003), the policy framework for FDI is a crucial part of the overall national strategy for industrialization. As the ratio of inward FDI to GDP is, in general, relatively high for developing countries in comparison to industrialized countries, the role of well-designed FDI Policy Instruments in economic development cannot be over estimated. From the out set, one needs to appreciate that when reference is made to the advantages and disadvantages of FDI Policy Instruments, it is in terms of the relative merits of the policy tools. It is also important to indicate that, from a policy perspective, the pros and cons of Policy Instruments are framed by considerations of who gains or loses. This is not a trival issue, depending not only on the demographic structure of employment distribution of the labour force in the economy, but also on the changing nature of the relative balance of competitive advantage.*

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INTRODUCTION

Foreign investment was introduced in 1991 as Foreign Exchange Management Act (FEMA), driven by Finance Minister Manmohan Singh. As Singh subsequently became a prime minister, this has been one of his top political problems, even in the current (2012) election. India disallowed overseas corporate bodies (OCB) to invest in India. Starting from a baseline of less than $1 billion in 1990, a recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010–2012. As per the data, the sectors that attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, US and UK were among the leading sources of FDI. Based on UNCTAD data FDI flows were $10.4 billion, a drop of 43% from the first half of the last year.

Foreign direct investment (FDI) is a direct investment into production or business in a country by a company in another country, either by buying a company in the target country or by expanding operations of an existing business in that country. Foreign direct investment is in contrast to portfolio investment which is a passive investment in the securities of another country such as stocks and bonds.

The above pictures show that the meaning of the term Foreign Direct Investment.

DEFINITIONS

Foreign direct investment has many forms. Broadly, foreign direct investment includes "mergers and acquisitions, building new facilities, reinvesting profits earned from overseas operations and intra company loans".

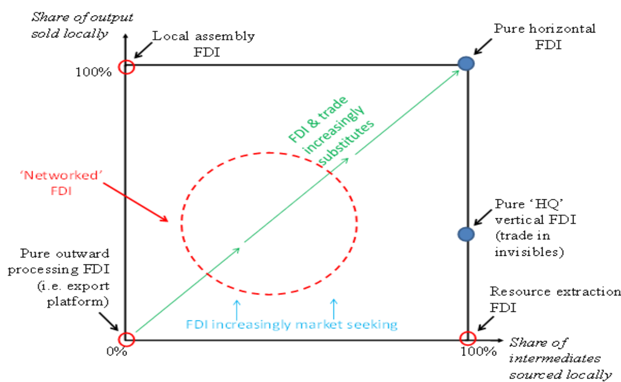
In a narrow sense, foreign direct investment refers just to build new facilities. The numerical FDI figures based on varied definitions are not easily comparable.

As a part of the national accounts of a country, and in regard to the national income equation Y=C+I+G+(X-M), I is investment plus foreign investment, FDI is defined as the net inflows of investment (inflow minus outflow) to acquire a lasting management interest (10

percent or more of voting stock) in an enterprise operating in an economy other than that of the investor.

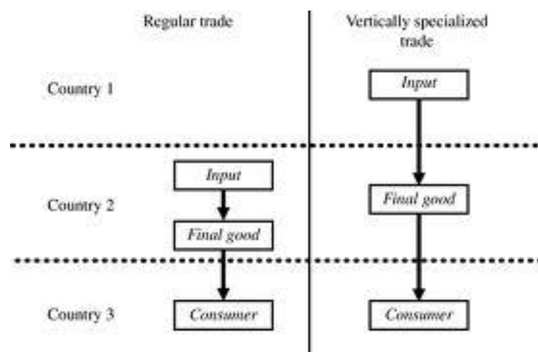
TYPES OF FOREIGN DIRECT INVESTMENT

- **Horizontal FDI** arises when a firm duplicates its home country-based activities at the same value chain stage in a host country through FDI.



- **Platform FDI**

- **Vertical FDI** takes place when a firm through FDI moves upstream or downstream in different value chains i.e., when firms perform value-adding activities stage by stage in a vertical fashion in a host country.



Horizontal FDI decreases international trade as the product of them is usually aimed at host country; the two other types generally act as a stimulus for it.

METHODS OF FOREIGN DIRECT INVESTMENT

The foreign direct investor may acquire voting power of an enterprise in an economy through any of the following methods:

- by incorporating a wholly owned subsidiary or company anywhere
- by acquiring shares in an associated enterprise
- through a merger or an acquisition of an unrelated enterprise
- participating in an equity joint venture with another investor or enterprise

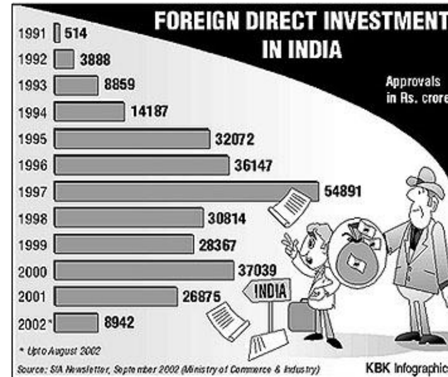
Foreign direct investment incentives may take the following forms

- low corporate tax and individual income tax rates
- tax holidays
- other types of tax concessions
- preferential tariffs
- special economic zones
- EPZ – Export Processing Zones
- Bonded Warehouses
- Maquiladoras
- investment financial subsidies
- soft loan or loan guarantees
- free land or land subsidies
- relocation & expatriation
- infrastructure subsidies
- R&D support
- derogation from regulations (usually for very large projects)

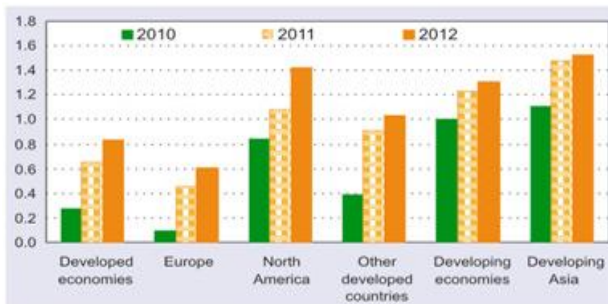
FOREIGN TECHNOLOGY COLLABORATION AGREEMENT

RBI has delegated the powers, to make payments for royalty, lump sum fee for transfer of technology and payment for use of trademark/brand name in terms of the foreign technology collaboration agreement entered by the Indian company with its foreign partners, to the AD banks subject to compliance with the provisions of Foreign Exchange

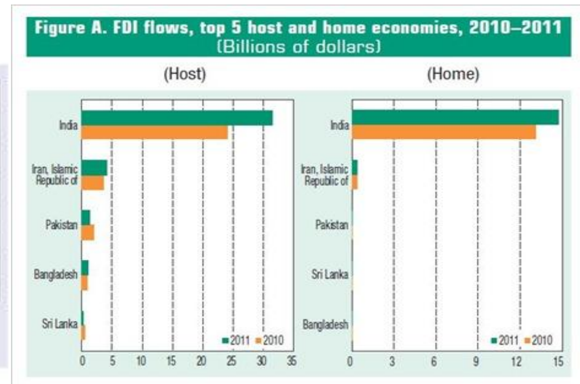
Management (Current Account Transactions) Rules, 2000. Further, the requirement of registration of the agreement with the Regional Office of Reserve Bank of India has also been done away with.



In the above the Wal*Mart Company is willing to trade with India and make the agreements also. And It shows the FDI in India from the starting year 1991 to 2002. The developed world also receives its fair share of cross-border investment, but of a different nature. Most of this is mergers and acquisitions between mature companies.



Source: UNCTAD survey.



Foreign direct investment is of growing importance to global economic growth. This is especially for developing and emerging market countries. FDI from investors in developed areas like the EU and the U.S. provide funding and expertise to help smaller companies in these emerging markets to expand and increase international sales. Until recently, Southeast Asia was the greatest beneficiary of FDI. However, as of 2011, Latin America and the Caribbean pulled ahead, receiving a 35% increase in FDI. These already-global corporations are engaged in restructuring or refocusing on core businesses. However, it gets recorded as FDI. This type of investment is more about maintenance, and less about making great stride in economic growth. (Source: UNCTAD, Annual FDI Report)

ADVANTAGES OF FOREIGN DIRECT INVESTMENT

Foreign direct investment has many advantages for both the investor and the recipient. One of the primary benefits is that it allows money to freely go to whatever business has the best prospects for growth anywhere in the world. That's because investors aggressively seek the best return for their money with the least risk. This motive is color-blind, doesn't care about religion or form of government.

This gives well-run businesses -- regardless of race, color or creed -- a competitive advantage. It reduces (but, of course, doesn't eliminate) the effects of politics, cronyism and bribery. As a result, the smartest money goes to the best businesses all over the world, bringing these goods and services to market faster than if unrestricted FDI weren't available.

Investors receive additional benefits. Their risk is reduced because they can diversify their holdings outside of a specific country, industry or political system. Diversification always increases return without increasing risk.

Businesses benefit by receiving management, accounting or legal guidance in keeping with the best practices practiced by their lenders. They can also incorporate the latest technology, innovations in operational practices, and new financing tools that they might not otherwise be aware of. By adopting these practices, they enhance their employees' lifestyles, helping to create a better standard of living for the recipient country. In addition, since the best companies get rewarded with these benefits, local governments have less influence, and aren't as able to pursue poor economic policies.

The standard of living in the recipient country is also improved by higher tax revenue from the company that received the foreign direct investment. However, sometimes countries neutralize that increased revenue by offering tax incentives to attract the FDI in the first place.

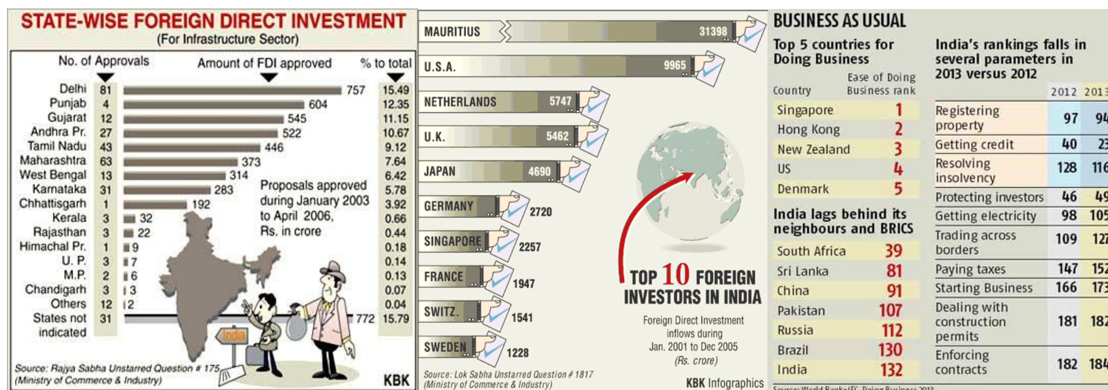
Another advantage of FDI is that it can offset the volatility created by "hot money." Short-term lenders and currency traders can create an asset bubble in a country by investing lots of money in a short period of time, then selling their investments just as quickly. This can create a boom-bust cycle that can wreak economies and political regimes. Foreign direct investment takes longer to set up, and has a more permanent footprint in a country.

DISADVANTAGES OF FOREIGN DIRECT INVESTMENT

Too much foreign ownership of companies can be a concern, especially in industries that are strategically important. Second, sophisticated foreign investors can use their skills to strip the company of its value without adding any. They can sell off unprofitable portions of the company to local, less sophisticated investors. Or, they can borrow against the company's collateral locally, and lend the funds back to the parent company. (Source: IMF, Finance and Development Magazine, Prakash Loungani and Assaf Razin)

FOREIGN DIRECT INVESTMENT STATISTICS

The Following Charts clearly gives the FDIs Statistical Data like State-Wise FDI, Top 10 FDI in India and also the business rating parameters in 2003 Vs 2012.



Apparently, everyone guide to the most important agencies.

- United Nations - The United Nations Conference on Trade and Development (UNCTAD) publishes the Global Investment Trends Monitor. This summarizes FDI trends around the world. For example, UNCTAD reported that FDI in 2011 was $1.5 trillion, a 17% increase and a new record. It forecast that FDI would reach $1.6 trillion in 2012.
- OECD - These FDI statistics are released quarterly for the developed countries within the OECD. It reports on both inflows and outflows, so the only statistics it doesn't capture are those between the emerging markets themselves.
- IMF - In 2010, the IMF published its first Worldwide Survey of Foreign Direct Investment Positions. This annual worldwide survey is available as an online database. It covers investment positions from 2009 on for 72 countries. The IMF assembled this information with the help of the European Central Bank, Eurostat, OECD, and UNCTAD.
- BEA - This agency reports on the FDI activities of foreign affiliates of U.S. companies. This provides the financial and operating data of these affiliates, as well as which U.S.

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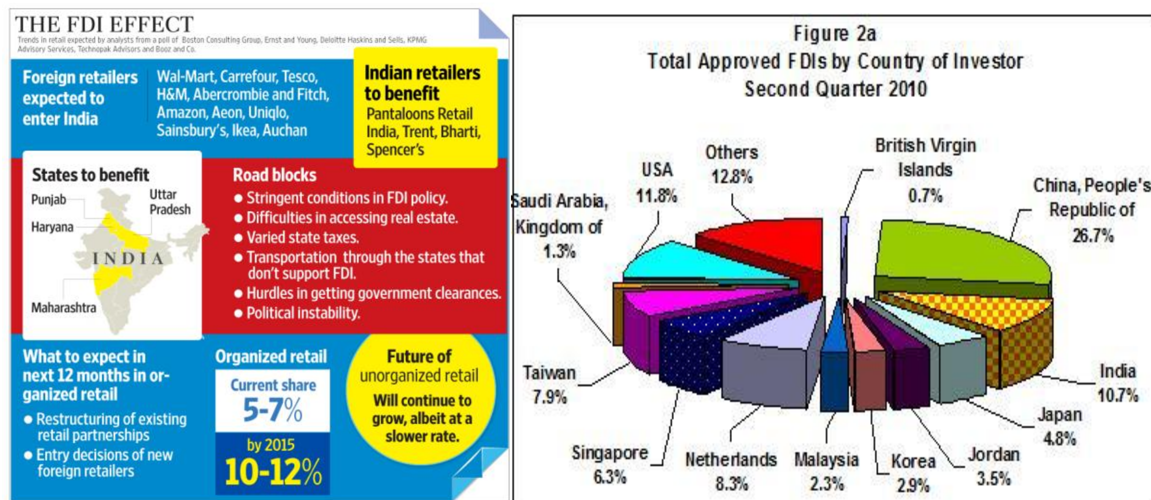
companies were acquired or created by foreign companies. It also describes how much investment U.S. companies have made overseas.

THE FORMS OF BUSINESS BY A FOREIGN COMPANY IN INDIA

A foreign company planning to set up business operations in India may:

- Incorporate a company under the Companies Act, 1956, as a Joint Venture or a Wholly Owned Subsidiary.
- Set up a Liaison Office / Representative Office or a Project Office or a Branch Office of the foreign company which can undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office or Other Place of Business) Regulations, 2000.



The above charts depict that how the Foreign retailers expected to enter India and the benefited Institutions and States and what is the future expectation, and also the total approved FDI by country wise in the year 2010.

THE PROCEDURE FOR RECEIVING FOREIGN DIRECT INVESTMENT IN AN INDIAN COMPANY

An Indian company may receive Foreign Direct Investment under the two routes as given under:

i. **Automatic Route**

FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.

ii. **Government Route**

FDI in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance. Application can be made in Form FC-IL, which can be downloaded from http://www.dipp.gov.in. Plain paper applications carrying all relevant details are also accepted. No fee is payable.

The Indian company having received FDI either under the Automatic route or the Government route is required to comply with provisions of the FDI policy including reporting the FDI to the Reserve Bank. FDI is prohibited under the Government Route as well as the Automatic Route in the following sectors:

i) Atomic Energy

ii) Lottery Business

iii) Gambling and Betting

iv) Business of Chit Fund

v) Nidhi Company

vi) Agricultural (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisci culture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors) and Plantations activities (other than Tea Plantations) (c.f. Notification No. FEMA 94/2003-RB dated June 18, 2003).

vii) Housing and Real Estate business (except development of townships, construction of residential/commercial premises, roads or bridges to the extent specified in Notification No. FEMA 136/2005-RB dated July 19, 2005).

viii) Trading in Transferable Development Rights (TDRs).

ix) Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

FDI IN BANKING SECTOR

This is in continuance of our series on Consolidated FDI Policy of India 2012 by DIPP. In this article Perry4Law and Perry4Law Techno Legal Base (PTLB) would discuss the FDI in banking sector of India under the consolidated FDI policy of India 2012. FDI in private banking sector of India is allowed up to 74% where FDI up to 49% is allowed through automatic route and FDI beyond 49% but up to 74% is allowed through government approval route.

These conditions must also be satisfied in this regard:

(1) This 74% limit will include investment under the Portfolio Investment Scheme (PIS) by FIIs, NRIs and shares acquired prior to September 16, 2003 by erstwhile OCBs, and continue to include IPOs, Private placements, GDR/ADRs and acquisition of shares from existing shareholders.

(2) The aggregate foreign investment in a private bank from all sources will be allowed up to a maximum of 74 per cent of the paid up capital of the Bank. At all times, at least 26 per cent of the paid up capital will have to be held by residents, except in regard to a wholly-owned subsidiary of a foreign bank.

(3) The stipulations as above will be applicable to all investments in existing private sector banks also.

(4) The permissible limits under portfolio investment schemes through stock exchanges for FIIs and NRIs will be as follows:

(i) In the case of FIIs, as hitherto, individual FII holding is restricted to 10 per cent of the total paid-up capital, aggregate limit for all FIIs cannot exceed 24 per cent of the total paid-up capital, which can be raised to 49 per cent of the total paid-up capital by the bank concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body.

(a) Thus, the FII investment limit will continue to be within 49 per cent of the total paid-up capital.

(b) In the case of NRIs, as hitherto, individual holding is restricted to 5 per cent of the total paid-up capital both on repatriation and non-repatriation basis and aggregate limit cannot exceed 10 per cent of the total paid-up capital both on repatriation and non-repatriation basis. However, NRI holding can be allowed up to 24 per cent of the total paid-up capital both on repatriation and non-repatriation basis provided the banking company passes a special resolution to that effect in the General Body.

(c) Applications for foreign direct investment in private banks having joint venture/subsidiary in insurance sector may be addressed to the Reserve Bank of India (RBI) for consideration in consultation with the Insurance Regulatory and Development Authority (IRDA) in order to ensure that the 26 per cent limit of foreign shareholding applicable for the insurance sector is not being breached.

(d) Transfer of shares under FDI from residents to non-residents will continue to require approval of RBI and Government as per para 3.6.2 above as applicable.

(e) The policies and procedures prescribed from time to time by RBI and other institutions such as SEBI, D/o Company Affairs and IRDA on these matters will continue to apply.

(f) RBI guidelines relating to acquisition by purchase or otherwise of shares of a private bank, if such acquisition results in any person owning or controlling 5 per cent or more of the paid up capital of the private bank will apply to non-resident investors as well.

(ii) Setting up of a subsidiary by foreign banks

(a) Foreign banks will be permitted to either have branches or subsidiaries but not both.

(b) Foreign banks regulated by banking supervisory authority in the home country and meeting Reserve Bank‘s licensing criteria will be allowed to hold 100 per cent paid up capital to enable them to set up a wholly-owned subsidiary in India.

(c) A foreign bank may operate in India through only one of the three channels viz., (i) branches (ii) a wholly-owned subsidiary and (iii) a subsidiary with aggregate foreign investment up to a maximum of 74 per cent in a private bank.

(d) A foreign bank will be permitted to establish a wholly-owned subsidiary either through conversion of existing branches into a subsidiary or through a fresh banking license. A foreign bank will be permitted to establish a subsidiary through acquisition of shares of an existing private sector bank provided at least 26 per cent of the paid capital of the private sector bank is held by residents at all times consistent with para (i) (b) above.

(e) A subsidiary of a foreign bank will be subject to the licensing requirements and conditions broadly consistent with those for new private sector banks.

(f) Guidelines for setting up a wholly-owned subsidiary of a foreign bank will be issued separately by RBI.

(g) All applications by a foreign bank for setting up a subsidiary or for conversion of their existing branches to subsidiary in India will have to be made to the RBI.

(iii) At present there is a limit of ten per cent on voting rights in respect of banking companies, and this should be noted by potential investor. Any change in the ceiling can be brought about only after final policy decisions and appropriate Parliamentary approvals.

FDI in public banking sector of India is allowed up to 20% (FDI and Portfolio Investment) through government approval route subject to Banking Companies (Acquisition and Transfer of Undertakings) Acts 1970/80. This ceiling (20%) is also applicable to the State Bank of India and its associate Banks.

FDI IN THE RETAIL SECTOR:

Retailing is one of the world's largest private industry. Liberalizations in FDI have caused a massive restructuring in retail industry. The benefit of FDI in retail industry superimposes its cost factors. Opening the retail industry to FDI will bring forth benefits in terms of advance employment, organized retail stores, availability of quality products at a better and cheaper price. It enables a country's product or service to enter into the global market.

Cheaper production facilities:

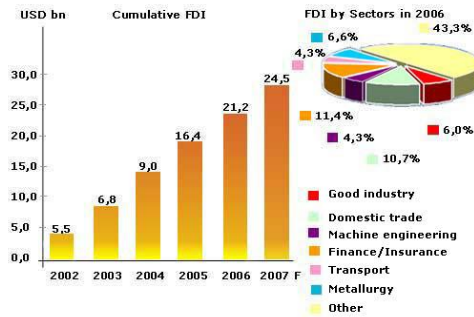
FDI will ensure better operations in production cycle and distribution. Due to economies of operation, production facilities will be available at a cheaper rate thereby resulting in availability of variety products to the ultimate consumers at a reasonable and lesser price.

Availability of new technology:

FDI enables transfer of skills and technology from overseas and develops the infrastructure of the domestic country. Greater managerial talent inflow from other countries is made possible. Domestic consumers will benefit getting great variety and quality products at all price points.

Long term cash liquidity:

FDI will provide necessary capital for setting up organized retail chain stores. It is a long term investment because unlike equity capital, the physical capital invested in the domestic company is not easily liquidated.



The above chats shows that the Cumulative FDI from the year 2002 – 2007 and also FDI by Sectors like Insurance Machine engineering, Transport, Good Industry, Domestic trade, Metallurgy and others in 2006.

CONCLUSION

Thus from the above we conclude that FDI can be a cross border investment, where foreign assets are invested into the organizations of the domestic market excluding the investment in stock. It brings private funds from overseas into products or services. The domestic company in which foreign currency is invested is usually being controlled by the investing foreign company. Eg. An American company taking major stake in a company in India. Their ROI is based on the performance of the project. In the past decades, FDI was concerned only with highly industrialized countries. US was the world's largest recipient of FDI during 2006 with an investment of 184 million from OECD (Organization for Economic Co-operation and Development) countries. France, Greece, Iceland, Poland, Slovak Republic, Switzerland and Turkey also have a positive record in FDI investments. Now, during the course of time, FDI has become a vital part in every country more particularly with the developing countries. Availability of cheap labor, Uninterrupted availability of raw material, Less production cost compared with other developed countries, Quick and easy market penetration are the reasons for that.

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LIST OF ABBREVIATIONS

FDI foreign direct investment

FPI foreign portfolio investment

FTZs free trade zones

GATS General Agreement on Trade in Services

IP Investment promotion

IPAs Investment promotion agencies

IPPRs Intellectual property protection rights

MNCs Multinational corporations

MNEs Multinational enterprises

TNCs Transnational corporations

UNIDO United Nations Industrial Development Organization

WTO World Trade Organization