

FOREIGN DIRECT INVESTMENT

Meaning:-

Foreign direct investment (FDI) is direct investment by a company in production located in another country either by buying a company in the country or by expanding operations of an existing business in the country. Foreign direct investment is done for many reasons including to take advantage of cheaper wages in the country, special investment privileges such as tax exemptions offered by the country as an incentive to gain tariff-free access to the markets of the country or the region.

Types:-

1. **Horizontal FDI** arises when a firm duplicates its home country-based activities at the same value chain stage in a host country through FDI.
2. **Platform FDI** Foreign direct investment from a source country into a destination country for the purpose of exporting to a third country.
3. **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:-

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

Advantages: -

- Technology Transfers
- Inflows of foreign stable capital into the country
- Helps in the transition to privatization (when state owned firms are sold to foreign investors)
- Improves the countries' infrastructures

- Brings foreign executives into the country with sufficient knowledge of macroeconomic global and local situations

Asian crises: -

- High levels of short-term debt vs. GDP led to a financial Panic
- Large inflows of Foreign Portfolio Investment led to huge amounts of short-term debt that was feared to never be repaid
- Investors began pulling out their funds from solvent but illiquid banks at the same time in 1997

Traditional Variables in Determining Whether to Invest FDI in an Economy:

- Plant/Firm Level Efficiency:
 - Are labor costs low in this country
 - Is there enough skilled labor in this country, so that there exists a relatively low productivity-adjusted labor cost
 - Are there government policies, such as low corporate tax rates that could reduce production costs
- Transportation Costs:
 - Is there an existing infrastructure that will allow for the flow of both the inputs/outputs of a given investment
 - Are there local suppliers in this economy, or is it necessary to look abroad for necessary inputs
 - Are there tariffs or import/export quotas that prevent a multinational firm from maximizing the effectiveness of its foreign investment

FDI Influencing Factors That Arise in Transition Economies

- Country Risk:
 - The risk of non-payment or non-servicing of payments for goods or services, as well as loans and other finance tools

- The chance of repatriation of capital by the host government
 - The possible loss of rights due to inadequate laws to protect intellectual property (i.e. patents, trademarks, processes, etc.)
- The Level/Method of Privatization:
 - How much has this country actually advanced towards a market economy (How high a share of the GDP is possessed by private businesses)
 - How stable is the market that has been created in this country

FDI 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. After Independence issues relating to foreign capital, operations of MNCs, gained attention of the policy makers. Keeping in mind the national interests the policy makers designed the FDI policy which aims FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resource.

The Ernst & Young's 2012 India Attractiveness Survey says investors view India as an attractive investment destination. In the survey's global ranking, India is the fourth destination for foreign direct investment (FDI) just below the United States, China and Britain. China is the largest competitor of India in terms of attractiveness, according to the survey.

With an eight-fold increase, India attracted foreign direct investment (FDI) of \$8.1 billion in March, the highest ever monthly inflows, despite a brouhaha over Rs 11,000 crore Vodafone tax dispute.

Foreign Direct Investment (FDI) in India is undertaken in accordance with the FDI policy formulated and announced by the Government of India and is governed by the provisions of Foreign Exchange Management Act, 1999.

ENTRY ROUTES FOR INVESTMENT IN INDIA

Under the Foreign Direct Investments (FDI) Scheme, investments can be made in shares, mandatorily fully convertible debentures and mandatorily fully convertible preference shares of an Indian company by non-residents through two routes:

ELIGIBILITY FOR INVESTMENT IN INDIA

Automatic Route: -

FDI up to 100 per cent is allowed under the automatic route in all activities/sectors except where the provisions of the consolidated FDI Policy on 'Entry Routes for Investment' are attracted.

FDI in sectors /activities to the extent permitted under the automatic route does not require any prior approval either of the Government or the Reserve Bank of India.

Government Route: -

FDI in activities not covered under the automatic route requires prior approval of the Government which is considered by the FIPB, Department of Economic Affairs, Ministry of Finance.

Indian companies having foreign investment approval through FIPB route do not require any further clearance from the RBI for receiving inward remittance and for the issue of shares to the non-resident investors.

PROHIBITION ON FDI IN INDIA

Foreign investment in any form is prohibited in a company or a partnership firm or a proprietary concern or any entity, whether incorporated or not (such as, Trusts) which is engaged or proposes to engage in the following activities:

- (a) Business of chit fund, or
- (b) Nidhi company, or
- (c) Agricultural or plantation activities, or
- (d) Real estate business, or construction of farm houses, or
- (e) Trading in Transferable Development Rights (TDRs).

SECTOR SPECIFIC CONDITIONS

Prohibited sectors

- a) Retail trading (Except single brand product)
- b) Atomic Energy
- c) Lottery business
- d) Nidhi company

- e) Gambling and betting
- f) Agriculture
- g) Chit fund business
- h) Manufacture of tobacco
- i) Housing and real estate

Permitted sectors

In the following sectors/activities, FDI up to the limit indicated against each sector/activity is allowed, subject to applicable laws/ regulations; security and other conditionality. In sectors/activities not listed below, FDI is permitted up to 100% on the automatic route, subject to applicable laws/ regulations; security and other conditionalities.

(A) 26% FDI is permitted in

- Defence (In July 2013, there has been no change in FDI limit but higher investment may be considered in state of the art technology production by CCS)
- Newspaper and media
- Pension sector (allowed in October 2012 as per cabinet decision)
- Courier Services (through automatic route)
- Tea Plantation (up to 49% through automatic route; 49-100% through FIPB route)

(B) 49% FDI is permitted in:

- Banking
- Cable network
- DTH
- Infrastructure investment
- Telecom
- Insurance (in July 2013 it was raised to 49% from 26% subject to Parliament approval)
- Petroleum Refining (49% allowed under automatic route)
- Power Exchanges (49% allowed under automatic route)
- Stock Exchanges, Depositories allowed under automatic route upto 49%

- 49% (FDI & FII) in power exchanges registered under the Central Electricity Regulatory Commission (Power Market) Regulations 2010 subject to an FDI limit of 26 per cent and an FII limit of 23 per cent of the paid-up capital is now permissible. [Permitted in September 2012]

(C) 51 % is permitted in

- Multi-Brand Retail (Since September 2012)
- Petro-pipelines

(D) 74% FDI is permitted in

- Atomic minerals
- Science Magazines /Journals
- Petro marketing
- Coal and Lignite mines
- Credit information companies (raised from 49% to 74% in July, 2013)

(E) 100% FDI is permitted in

Single brand retail (100 % FDI is allowed in single brand retail; 49 % through automatic route 49-100 % through FIPB)

- Advertisement
- Airports
- Cold-storage
- BPO/Call centers
- E-Commerce
- Energy (except Atomic)
- Export trading house
- Films
- Hotel, tourism
- Metro train
- Mines (gold, Silver)
- Petroleum exploration
- Pharmaceuticals
- Pollution control
- Postal services
- Roads, highways, ports
- Townships
- Wholesale trading
- Telecom (raised from 74 % to 100% in July 2013 by GOI)
- Asset reconstruction companies (increased from 74 % to 100% in July, 2013)

MODES OF INVESTMENT UNDER FDI

An Indian company issuing shares /convertible debentures under FDI Scheme to a person resident outside India shall receive the amount of consideration required to be paid for such shares /convertible debentures by:

- Inward remittance through normal banking channels.
- Debit to NRE / FCNR account of a person concerned maintained with an AD category I bank.
- Conversion of royalty / lump sum / technical knowhow fee due for payment or conversion of ECB, shall be treated as consideration for issue of shares.

- Conversion of import payables / pre incorporation expenses / share swap can be treated as consideration for issue of shares with the approval of FIPB.
- debit to non-interest bearing Escrow account in Indian Rupees in India which is opened with the approval from AD Category – I bank and is maintained with the AD Category I bank on behalf of residents and non-residents towards payment of share purchase consideration.

If the shares or convertible debentures are not issued within 180 days from the date of receipt of the inward remittance or date of debit to NRE / FCNR (B) / Escrow account, the amount shall be refunded. Further, Reserve Bank may on an application made to it and for sufficient reasons permit an Indian Company to refund / allot shares for the amount of consideration received towards issue of security if such amount is outstanding beyond the period of 180 days from the date of receipt.

RESTRICTIONS ON TRANSFERS

Prior permission of RBI is required in following cases:

- Indian company engaged in financial services sector, Insurance, Infrastructure companies in the securities market.
- Transactions which attract the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997
- Activity of Indian Company falls outside automatic route and FIPB approval is obtained for transfer.
- Pricing guidelines are not adhered
- Payment of consideration by non-resident is proposed to be deferred.
- Transfer by way of gift from resident to non-resident.
- Transfer of shares from NRI to NR.

Approval of Government followed by permission from RBI is required in following cases:

- Activity falls under government route
- Sectoral cap is breached

CALCULATION OF TOTAL FOREIGN INVESTMENT

- Direct Foreign Investment: All investment directly by a non-resident entity into the Indian company would be counted towards foreign investment.
- Indirect Foreign Investment:

(a) The foreign investment through the investing Indian company would not be considered for calculation of the indirect foreign investment in case of Indian companies which are owned and controlled by resident Indian citizens and/or Indian Companies which are owned and controlled by resident Indian citizens.

(b) For cases where condition (a) above is not satisfied or if the investing company is owned or controlled by non-resident entities, the entire investment by the investing company into the subject Indian Company would be considered as indirect foreign investment, provided that, as an exception, the indirect foreign investment in only the 100% owned subsidiaries of operating-cum-investing/investing companies, will be limited to the foreign investment in the operating-cum-investing/ investing company.

REPATRIATION OF INVESTMENT AND PROFITS

All foreign investments are freely repatriable (net of applicable taxes) except in cases where:

- i) the foreign investment is in a sector like Construction and Development Projects and Defence wherein the foreign investment is subject to a lock-in-period; and
- ii) NRIs choose to invest specifically under non-repatriable schemes.

Further, dividends (net of applicable taxes) declared on foreign investments can be remitted freely through an Authorized Dealer bank.

FDI Policy with Regard to Retailing in India

It will be prudent to look into Press Note 4 of 2006 issued by DIPP and consolidated FDI Policy issued in October 2010 which provide the sector specific guidelines for FDI with regard to the conduct of trading activities.

- a) FDI up to 100% for cash and carry wholesale trading and export trading allowed under the automatic route.

- b) FDI up to 51 % with prior Government approval (i.e. FIPB) for retail trade of 'Single Brand' products, subject to Press Note 3 (2006 Series)
- c) FDI is not permitted in Multi Brand Retailing in India.

Benefits of FDI (Foreign Direct Investment): -

1. Farmers will become economically strong, because they will get more money directly from the big retail companies.
2. New employment for the peoples.
3. Consumers will get goods on comparatively low price.
4. Indian government will get approximately US\$ 25-30bn through taxes.
5. Modern technology will come to India.
6. Wastage of agriculture products will go reduce.
7. Rural infrastructure will go improve.
8. Competition in the market will rise.
9. Consumers will get commodities in the same & low rate and will save from the greedy retailers.
10. Consumer will get all the commodities in one roof.
11. Consumers will get the bills for all purchases.

Disadvantage or Drawbacks of FDI:

1. Small retailers will be affected and business of those retailers who are giving service from a long period will be hardly affected.
2. A big amount of money (more than the money which will government get through taxes) will go to the Foreign countries.

3. Big retail companies will buy commodities directly from farmers which will affect the entire supply chain of suppliers and distributors.
4. After some decades it may be the reason of inflation.
5. Local brands will be affected and sale of foreign brands will be increase.
6. Uneducated and semi-educated will have difficulty to get job or earning money because through these big retail shops only smart and educated people will get job.
7. Poor people's will have difficulty in survive because they will not buy a small pack of biscuit from a air conditioned mall.
8. Shopping time of the peoples will increase because they can get commodities from a local retail shop within some minute but in these big retail store it will take big time.
9. Because of FDI, the agriculture products wastage will reduce but the wastage of packed commodities will increase because people will get no.of choices for a single type of commodity and it will be difficult for them while from local retail store they will get trusted products only because of the relation between retailer and consumers.
10. Consumers will not get commodities on credit basis without any extra tax.
11. Consumers will hesitate to buy any single product which will increase the cost of purchase indirectly.

COMPRATIVE STUDY ON FDI BETWEEN INDIA AND CHINA

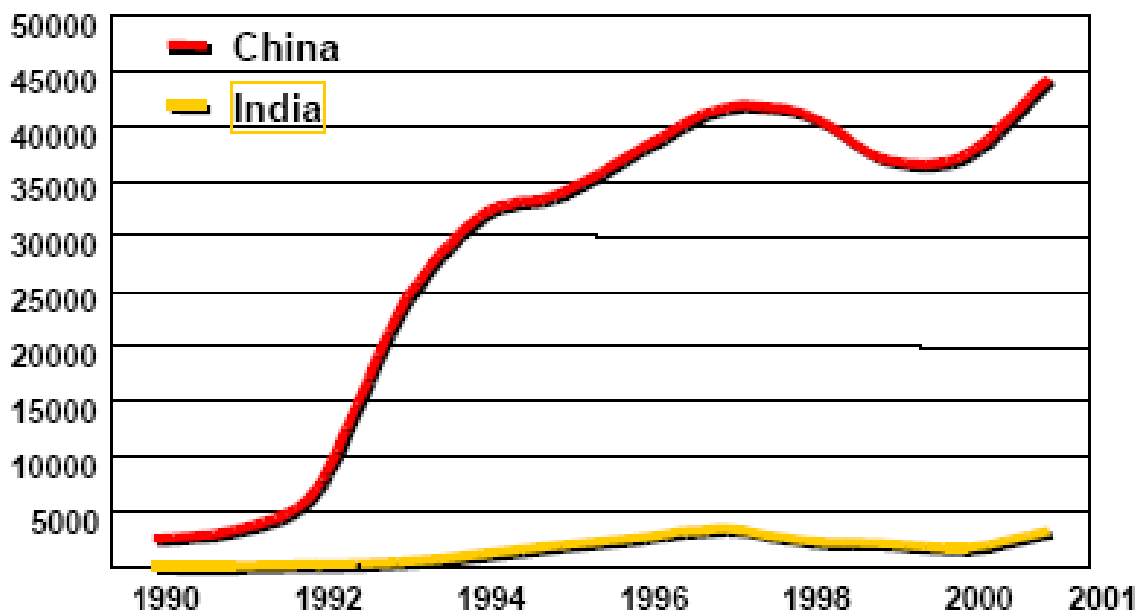
- Ø FDI in china grew from us\$3.5 billion in 1990 to us\$52.5 billion 2002; excluding round-tripping, china's FDI inflows could fall to us\$40 billion. Those to India rose from US\$0.4 billion to US\$3.45 billion during the same time period. Even with these adjustment, china attracted about fifteen times more FDI than India in 2002
- Ø FDI has contributed to the rapid growth of china's merchandise exports, at an annual rate of 15 percent from 1989 to 2001. In 1989, foreign affiliates accounted for less than 9 percent of Chinese export; by 2002 they provided half. In some high-tech industries in 2000, the share of

foreign affiliates in exports was over 90 percent, for example, electronic circuits (91 percent) and mobile phones (96 percent).

- Ø In India, by contrast, FDI has been much less important in driving export growth, except in information technology. FDI in Indian manufacturing has been and remains domestic market-seeking. FDI accounted for only 3 percent of India's exports in the early 1990s (world investment report 2002, pp. 154-163). Even today. FDI is estimated to account for less than 10 percent of India's manufacturing exports.
- Ø On the basic economic determinants of inward FDI, china does better than India. China's total and per capita GDP are higher than India's, making it more attractive for market seeking FDI. China has higher literacy and education rates making it more attractive to efficiency seeking investors. China has large natural resources endowments. In addition, china's physical infrastructure is more competitive, particularly in the costal areas (CUTs 2003, Marubeni corporation economic research institute 2002). But, India may have an advantage in technical manpower, particularly in information technology. It also has better English language skills.
- Ø Some of the differences in competitive advantages of the two countries are illustrated by the composition of their inward FDI flows. In ICT, china has become a key center for hardware design and manufacturing by such companies as Acer, Ericsson, General Electric, Hitachi semiconductors, Hyundai electronics, Intel, LG electronics, Microsoft, Mitac international corporation, Motorola, Nec, Nokia, Philips, Samsung Electronics, Sony. Taiwan semiconductor manufacturing. Toshiba and other major electronic trans-national corporations (TNC's). India, on the other hand, specializes in IT services, call centers, business back –office operations and R&D.
- Ø Rapid growth in china has increased the local demand for customer durables and non durables, such as home appliances, electronics equipment, Automobiles, housing and leisure. This rapid growth in local demand, as well as competitive business environment and infrastructure, has attracted many market seeking investors. It has also encouraged the growth of many local indigenous firms that support manufacturing.
- Ø Other determinants related to FDI attitudes. Policies and procedures also explain why china does better in attracting FDI. China has "more business-oriented" and more FDI-friendly policies than India (AT Kearney 2001). China's FDI procedures are easier, and decisions can be taken rapidly. China has more flexible labour laws, a better labour climate and better entry and exit procedures for business.

- Ø A recent business environment survey indicated that china is more attractive than India in the macroeconomic environment, market opportunities and policy towards FDI. India scored better on the political environment, taxes and financing (EIU 2003a). a confidence tracking survey in 2002 indicated that china was the top FDI destination, displacing the United states for the first time in the investment plans of the TNCs surveyed; India came 15th (AT Kearney 2002).

China and India. Foreign Direct Investment Inflows, 1990-2001 (In millions of US\$)



Source: Pfefferman (2002)

Foreign Direct Investment and its share to GDP in India from 1991-2003

Years FDI	Inflows	Annual Growth Rate [@]	FDI as % of GDP [@]
1991 3,	514.30		0.62
1992 6,	751.80	0.92	1.03
1993 17	,877.10	1.65	2.39
1994 32	,892.80	0.84	3.83
1995 68	,200.30	1.07	6.75
1996 10	3,892.00	0.52	8.79
1997 16	4,253.30	0.58	12.00
1998 13	3,398.40	-0.19	8.76
1999 16	8,677.90	0.26	9.69
2000 19	3,417.40	0.15	9.99
2001 19	2,651.00	0.00	9.16
2002 21	2,859.70	0.10	9.27
2003 14	3,009.40	-0.33	6.36

Share of top investing countries in FDI inflows

(Rupees in crore/ US \$ in million)

Country	1991-1999*	% to the Total FDI	2000	% to the Total FDI	2001	% to the Total FDI	2002	% to the Total FDI	2003	% to the Total FDI
Mauritius	124,659.00	30.12	35,686.50	35.36	75,036.10	47.37	72,844.60	45.18	25,859.30	26.95
USA	83,542.30	20.19	17,993.10	17.83	16,541.30	10.44	13,572.00	8.42	19,040.00	19.84
Japan	29,693.70	7.18	9,856.90	9.77	9,965.40	6.29	19,804.60	12.28	4,343.90	4.53
UK	22,279.00	5.38	2,814.80	2.79	12,840.20	8.11	16,988.10	10.54	8,629.00	8.99
Netherlands	21,743.30	5.25	5,468.00	5.42	10,315.50	6.51	7,475.60	4.64	11,618.80	12.11
Germany	23,510.80	5.68	3,714.70	3.68	5,981.30	3.78	6,629.30	4.11	3,625.00	3.78
Korea (South)	20,920.90	5.06	761.70	0.75	203.00	0.13	1,814.40	1.13	1,128.60	1.18
Singapore	12,393.20	2.99	5,015.20	4.97	1,606.60	1.01	2,262.30	1.40	1,680.50	1.75
France	9,638.10	2.33	3,415.80	3.38	5,951.30	3.76	5,301.50	3.29	1,624.50	1.69
Switzerland	7,951.20	1.92	1,872.20	1.86	1,780.20	1.12	2,516.90	1.56	4,289.60	4.47
Total of all countries (in Indian Rupees)	413,806.40	-	100,923.80	-	158,418.00	-	161,233.60	-	95,960.40	-
Total of all countries (in US\$)	11489.70		2347.00		3520.40		3359.00		2079.10	

Top Sectors attracting highest FDI inflows in India

Prepared By: -CA Yashoda Somani

(Rupees in crore/ US \$ in million)

Sector	FDI stock (1991- 1999)	% of FDI stock (1991- 1999)	2000 - 2003	% of FDI stock (2000- 2003)	FDI stock (1991- 2003)	% of FDI stock (1991- 2003)
Electrical Equipments (including IT and Electronics)	46,424.75	11.22	78,033.98	15.12	124,469.95	13.38
Transportation Industry	51,520.67	12.45	62,376.65	12.08	113,897.32	12.25
Telecommunications	40,376.82	9.76	65,890.19	12.76	106,267.01	11.43
Power and Fuels	36,433.77	8.80	60,747.11	11.77	97,180.88	10.45
Service Sector (financial and non-financial)	40,443.49	9.77	39,398.72	7.63	79,842.21	8.58
Chemicals (other than fertilizers)	39,861.28	9.63	16,981.39	3.29	56,842.67	6.11
Food processing industries	23,676.92	5.72	17,627.75	3.41	41,304.67	4.44
Drugs & Pharmaceuticals	8,221.75	1.99	11,465.47	2.22	19,687.22	2.12
Metallurgical industries	6,333.34	1.53	5,711.86	1.11	12,045.20	1.30
Textiles	8,293.49	2.00	3,323.44	0.64	11,616.93	1.25
Industrial machinery	3,627.90	0.88	2,719.95	0.53	6,347.85	0.68
Total FDI inflows (in Indian Rupees)	413,806.40	73.76	516,215.80	70.57	930,022.20	71.99
Total FDI inflows (in US \$)	11489.70				22795.20	

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