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CHALLENGES TO FDI IN INDIA

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Abstract
The investment scenario has been buoyant and moving upwards since the initiation of economic reforms. This has become inevitable due to radical as well as structural changes which have taken place world over. So, in order to globalize an economy, four vital facets, namely, resources, sophisticated technology, managerial skills, and innovative marketing techniques are required which ultimately ask for liberalization. One of the most striking developments during the last two decades is the spectacular growth of FDI in the global economic landscape. This unprecedented growth of global FDI in1990 around the world makes FDI an important and vital component of development strategy in both developed and developing nations and policies are designed in order to stimulate inward flows. Infact, FDI provides a win –win situation to the host and the home countries. Both countries are directly interested in inviting FDI because they benefit a lot from such type of investment. The 'home' countries want to take the advantage of the vast markets opened by industrial growth On the other hand, the 'host' countries want to acquire technological and managerial skills and supplement domestic savings and foreign exchange. Moreover, the paucity of all types of resources viz, financial, capital, entrepreneurship, technological, know-how, skills and practices, access to markets abroad in their economic development, developing nations accepted FDI as a sole visible panacea for all their scarcities.Further,the integration of global financial markets paves ways to this explosive growth of FDI around the globe. However, this concept has taken ground very late in India. It was necessary to encourage Indian companies to become global with a view to integrate India with the global market. Since the introduction of economic reforms programme in 1990, India has emerged as a principal host and source in the region. There is a remarkable change in the GDP and Global Distribution System. The capital market has become very active and FIIs, Foreign Investment Banks and asset management companies have shown increasing interest in investing in India. This paper aims at studying the trends and patterns of flow of FDI in India, assesses the determinants of FDI inflows, its implications on the Indian economy and barriers and major challenges and strategy to promote FDI in India.

Key Words: Foreign Direct Investment, FDI Inflows, Economic Determinants, Economic Growth, Economic Implications.

Introduction

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. However, researchers could not portray the complete history of FDI pouring in India due to lack of abundant and authentic data. Before independence, major amount of FDI came from the British companies. British companies set up their units in miming sector and in those sectors that suits their own economic and business interests. 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 reserves. With time and as per economic and political regimes, there have been changes in the FDI policy too.

Infact, in the early 90's, Indian economy faced severe Balance of payment crisis. Exports began to experience serious difficulties. There was a marked increase in petroleum prices due to Gulf War. The crippling external debts were debilitating the economy. India was left with that much amount of foreign exchange reserves which can finance its three weeks of imports. The out flowing of foreign currency which was deposited by the Indian

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NRI's gave a further jolt to Indian economy. The overall Balance of Payment reached at Rs.(-) 4471 crores. Inflation reached at its highest level of 13%. Foreign reserves of the country stood at Rs.11416 crores. The continued political uncertainty in the country during this period adds further to worsen the situation. As a result, India's credit rating fell in the international market for both short-term and long term borrowing All these developments put the economy at that time on the verge of default in respect of external payments liability In this critical face of Indian economy, reforms were brought in. As a result of these reforms, India opened its door to FDI inflows and adopted a more liberal foreign policy in order to restore the confidence of investors.

Conceptual Framework

FDI refers to investment in a foreign country where the investor retains control over the investment. It typically takes the form of starting a subsidiary, acquiring a stake in the existing firm or starting a joint venture in the foreign country. Direct investment and management of the firms concerned go together. In other words, FDI is fund flow between the countries in the form of inflow or outflow by which one can gain some benefit from their investment, whereas another can exploit the opportunity to enhance the productivity and find out better position through performance.

Review of Literature

Arshad, 2008, the role of Foreign Direct Investment has been widely recognized as economic growth enhancing factor in the developing countries. The effects of FDI in the host economy are normally believed to be increase in the employment, increase in productivity and increase in exports and of course, increased pace of transfer of technology.

Basu.P.,Nayak .N.C.,Vani Achana, (2007) in their paper "Foreign Direct Investment in India: Emerging Horizon", intends to study the qualitative shift in the FDI inflows in India in- depth in the last fourteen odd years as the bold new policy on economic front makes the country progress in both quantity and the way country attracted FDI.It reveals that the country is not only cost effective but also hot destination for R&D activities. The study also finds out that R&D as a significant determining factor for FDI inflows for most of the industries in India. The software industry intensive R&D activity, which has to be channelized in the form of export promotion for penetration in the new markets. The study also reveals strong negative influence of corporate tax on FDI inflows.

Nirupam Bajpai and Jeffrey D Sachs (2006) in their paper 'Foreign Direct Investment in India: Issues and Problems ",attempted to identify the issues and problems associated with India's current FDI regimes and more importantly the other associated factors responsible for India's unattractiveness as an investment location. Despite India offering a large domestic market, rule of law, low labour costs and a well working democracy, her performance in attracting FDI flows have been far from satisfactory. The study concludes that a restricted FDI regime, high import tariffs, exit barriers for firms, stringent labour laws, poor quality infrastructure, centralized decision making processes and a very limited scale of export processing zones make India an unattractive investment location.

Kulwinder Singh (2005) in his study "Foreign Direct Investment in India: A critical analysis of FDI FROM 1991-2005" explores the uneven beginnings of FDI in India and examines the developments (economic and political) relating to the trends in two sectors: Industry and Infrastructure. The study concludes that the impact of the reforms in India on the policy environment for FDI presents a mixed picture. The industrial reforms have gone far, though they need to be supplemented by more infrastructure reforms which are critical missing link.

Nayak D.N.(2004) in his paper "Canadian Foreign Direct Investment in India. Some Observations", analyses the patterns and trends of Canadian FDI in India. He finds out that India does not figures very much in the investment plans of Canadian firms. The reasons for the same is the indifferent attitude of Canadian towards India and lack of information of investment opportunities in India are the important contributing factors for such an unhealthy

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trends in economic relations between India and Canada. He suggested some measures such as publishing of regular documents like newsletter that would highlight opportunities in India and a detailed focus on India's area of strength so that Canadian firms could come forward and discuss their areas of expertise would go a long way in enhancing Canadian FDI in India.

Naga Raj R (2003) in his article "Foreign Direct Investment in India in the 1990s: Trends and Issues" discusses the trends in FDI in India in the 1990s and compare them in China. The study raises some issues on the recent investments on the domestic economy. Based on the analytical discussion and comparative experience, the study concludes by suggesting a realistic foreign investment policy.

Sahoo and Mathiyazhagan, 2003, there were also a few evidences which demonstrate that there is a long-run relationship between Gross Domestic Product, FDI and export in India.

Basu (2002) tried to find out the short run dynamics of FDI and growth. The study reveals that GDP in India is not Granger caused by FDI: the causality runs more from GDP to FDI and trade liberalization policy of the Indian government had some positive short run impact on the FDI flow.

Hanson (2001) argues that FDI generates positive spillovers for host countries is weak

Kumar and pradhan, 2001, FDI has emerged as the most important source of external financial resource for developing countries and has become a significant part of economy in the developing.

Alam (2000) in his comparative study of FDI and economic growth for Indian and Bangladesh economy stressed that though the impact of FDI on growth is more in case of Indian economy yet it is not satisfactory.

Barro and Martin, 1999: Helpman and Grossman, 1991,The studies that used the endogenous growth theory challenged this view in explaining the long run growth rate of the economy by using endogenous variables like technology and human capital.

Bhawati, 1994, the local enterprises are able to learn by watching FDI initiative if the economic framework is appropriate.

Singer, 1990: Griffin, 1970: Weisskof, 1972: The main argument of these studies was that FDI flows to Less Developing Countries were mainly directed towards the primary sector which basically promoted the less market value of this sector. Since these primary products are exported to the developed countries and are processed for import, it receives a lower price for its primary product. This could create a base for the negative impact of FDI flows in the economy

Need for the Study

It is apparent from the above discussion that FDI is a predominant and vital factor in influencing the contemporary process of global economic development. The study attempts to analyze the important dimensions of FDI in India. The study works out the trends and patterns, main determinants and investment flows to India. The study also examines the role of FDI on economic growth in India for the period 1991-2011. The period under study is important for a variety of reasons. First of all, it was during July 1991 India opened its doors to private sector and liberalized its economy. Secondly, the experiences of South-East Asian countries by liberalizing their economics in 1980s. Thirdly, India's experience with its first generation economic reforms and the country's economic growth performance were considered safe havens for FDI which led to second generation of economic reforms in India in first decade of this century. Fourthly, there is a considerable change in the attitude of both the developing and developed countries towards FDI. They both consider FDI as the most suitable form of external finance. Fifthly, increase in competition for FDI inflows particularly among the developing nations.

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The shift of the power center from the western countries to the Asia sub-continent is yet another reason to take up this study. FDI incentives, removal of restrictions, bilateral and regional investment agreements among the Asian countries and emergence of Asia as an economic powerhouse (with China and India emerging as the two most promising economies of the world) develops new economics in the world of industrialized nations. The study is important from the view point of the macroeconomic variables included in the study as no other study has included the explanatory variables which are included in this study. The study is appropriate in understanding inflows during 1991-2011

Objectives of the Study

The following objectives are covered in this study.

1. To study the trends and patterns of flow of FDI.
2. To study the factors influencing foreign direct investment.
3. To study implications of FDI on the Indian economy
4. To find out the barriers and challenges associated with FDI and strategies to promote FDI.

Methodology

The study is descriptive in nature and therefore the information presented is based on secondary data. Secondary information has been collected from various documents such as books, newsletters, reports, magazines, journals, daily newspaper, WWW related to foreign direct Investment

Limitations of the Study

All economic / scientific studies are faced with various limitations and this study is no exception to this phenomena. The various limitations of the study are:

1. The study is confined to the period 1991-2011 FDI initiative in Indian context based on secondary data.
2. The research was faced with the problem of various resources like time and money

Analysis and Interpretation

1. Trends and Patterns of Flow of FDI in India

India's economic reforms way back in 1991 has generated strong interest in foreign investors and turning India into one of the favorite destinations for global FDI flows. According to A.T.Kearney, India ranks second in the World in terms of attractiveness for FDI. A.T.Kearney's 2007 Global Services Locations Index ranks India as the most preferred destination in terms of financial attractiveness, people and skills availability and business environment. Similarly UNCTAD's World Investment Report, 2005 considers India the 2^{nd} most attractive destination among the TNCS. The positive perceptions among investors as a result of strong economic fundamentals driven by 18 years of reforms have helped FDI inflows grow significantly in India. The FDI inflows grow at about 20 times since the opening up of the economy to foreign investment

The following table depicts the data relating to the status of FDI in India for the period of 1991-2011.

FOREIGN DIRECT INVESTMENT IN INDIA
FINANCIAL YEARWISE FDI EQUITY INFLOWS

YEARS	FDI INFLOWS (IN CRIRES)
1991-1992	408
1992-1993	1094
1993-1994	2018
1994-1995	4312
1995-1996	6916
1996-1997	9654
1997-1998	13548
1998-1999	12343

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1999-2000	10311
2000-2001	12646
2001-2002	19361
2002-2003	14932
2003-2004	12117
2004-2005	17138
2005-2006	24613
2006-2007	70630
2007-2008	98664
2008-2009	123025
2009-2010	123378
2010-2011	88520

(Source: DIPP'S FDI data 1991-2011)

2. Factors Influencing FDI Inflows/Determinants of FDI

Foreign Direct Investment is influenced by a number of factors

1. **Stables predictable macro-economic policy**: Companies must have the confidence that the economy in which they make an investment will be managed in a competent and predictable way.
2. **An effective and honest government**: An investor must be able to rely upon the integrity of the host government and its ability to maintain law and order.
3. **A large and growing market**: The size and potential for growth of a country's domestic market, especially the purchasing power of its customers ,are key.
4. **Freedom of activity in the market**: The freer the market, the more attractive it becomes as an investment site for international investors.
5. **Minimal governmental regulation**: The cost of government regulation and intervention in the affairs and profits of private companies must be kept to a minimum.
6. **Property rights and protection**: Private property must be protected. The likelihood that a company's real or intangible property will be stolen must be avoided.
7. **Reliable Infrastructure:** The ability to consummate transactions and get products and services to market is also critical. Investments cannot yield a sufficient or reliable financial return reliable infrastructure.
8. **Availability of high quality factors of production**: While the investor brings capital, technology and management to the table, the quality of the indigenous work force and the availability of local raw materials are also key ingredients in the recipe for success.
9. **A strong local currency**. The local currency must retain its value.
10. **Ability to remit profits, dividends and interest**: If you cannot get your money out of the Country, why invest?
11. **A favorable tax climate**: A company's final investment decision is usually based on how a country's taxation will affect the normal operating environment once the venture is off the ground.
12. **Freedom to operate between markets**: A company must be able to source goods and services from its operating unit in one market in order to serve other markets. Or to maximize the global efficiency by trading operating entities in different countries to "round out" its product lines.

3. Implications of FDI on the Indian Economy

There are two types of implications i.e. positive and negative as under,

Positive Implications

1. FDI provides capital which is usually missing in the target country.
2. Foreign Investors are able to finance their investments projects better and often cheaper.
3. Foreign corporations create workplaces.

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4. FDI bring new technologies that are usually not available in the target country.
5. Foreign corporations provide better access to foreign markets.
6. Foreign corporations bring new know-how and managerial skills into the target country.
7. Foreign corporations can help to change the economic structure of the target country.
8. "Crowding in" effect- The foreign corporations often bring additional investors into the target country.
9. Foreign corporations improve the business environment of the target country.
10. Foreign corporations bring new "clean" technologies that help to improve the environmental conditions.
11. Foreign corporations usually help increase the level of wages in the target economy.
12. Foreign corporations usually have positive effects on the trade balance.

Negative Implications

1. Foreign corporations may buy a local company in order to shut it down.
2. "Crowding out "effect can be seen if the foreign corporations target the domestic market and domestic corporations are not able to compete with these corporations.
3. Foreign corporations may cut working positions.
4. Foreign corporations have a tendency to use their usual suppliers which can lead to increased imports.
5. Repatriation of the profits can be stressful on the balance of payments.
6. The high growth of wages in foreign corporations can influence a similar growth in the domestic corporations which are not able to cover this growth with the growth of productivity. The result is the decreasing competitiveness of domestic companies.
7. Missing Tax Revenues if the foreign corporations receive tax holidays/similar provisions.
8. The emergence of a dual economy.
9. Possible environmental change.
10. Inventive tourism.

4 .Barriers for FDI in Indian Market and Major Challenges and Strategy to Promote FDI

Tariffs and tax structure

MNCs are frustrated by the complicated tax and tariff structure followed in India. This is not just a concern for MNCs only but also for the Indian businessmen. The complicated tax structure contributes to hassles and this makes the image of India bad in terms of foreign investors.

Bureaucracy

The attitude of government personnel and bureaucrats is one of the major hurdles on the path of FDI coming over to India. Many a times, due to this attitude, there is delay in decision making. Many MNCs due to their hassles and not cooperation hosts are not ready to come down to India for setting up their business.

Corruption

One of the major issues in India is corruption. This is one of the biggest drawbacks as MNCs never favor to carry on business in countries where the entire systems are corrupt.

Infrastructure

This is one of the greatest drawbacks in India. In India, the condition of communication, transportation and power supply is in a poor state. When the major infrastructure in the country is in a bad shape, the operation of business houses is greatly affected.
Due to these reasons, the foreign companies are not attracted to India.

Major Challenges and Strategy to Promote FDI

Major Challenges

India has failed to attract huge external inflows into the infrastructure sector. The lack of proper business-quality infrastructural facilities in India is cited to be one of the main reasons for India's inability to attract huge FDI

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inflows. The overall political instability at the centre is another deterrent for FDI. Import substitution acted as a major disincentive for export promotion which requires a degree of mental openness towards foreign investment and foreign technology. This is also another reason that foreign investment did not develop in the country. FDI companies are basically catering to the domestic markets due to high protection and profitability of domestic sales. Highly profitable domestic market is also one of the reasons for the lack of competition in the economy and thus results in the inertia on the part of FDI companies to actively formulate an export promotion strategy.

Strategy to promote FDI

To promote FDI flows to the country and to enhance their intensity, India needs a consistent, coherent and comprehensive long term export promotion strategy. It is essential that FDI companies create brand image for the goods produced in India by improving the quality of goods as well as the quality of labeling and packaging. These measures would not only improve the quality of Indian products but also reduce the outflow of foreign exchange from the country. Foreign Investors are interested to enter such ventures which have export potential. So the development of proper transport facilities and modernization of ports is paramount. It is essential that India adopts and implements concepts like EPZs, free trade Zones and special economic zones which provide free market environment to achieve export promotion objective. The Government should identify highly competitive sectors of the economy to ascertain export growth areas in the continuously evolving dynamic world.

Conclusion

It can be concluded that there has been substantial improvement in the inflows of FDI to India. However, keeping in view the parameters of the global FDI supply position and the need of India in terms of further FDI, there are certain aspects need to be considered for sustaining the flow of FDI to India. The current institutional system does not provide a mechanism for aggressive marketing of India as a FDI location. The Indian investment center, due to the lack of overseas offices, is not in a position to promote India abroad. It is now desirable to develop a mechanism that will have the private sector as an integral partner. Several alternative models may be analyzed and developed to identify the best mechanism suited to India’s needs. Therefore a conducive business environment is required to attract FDI flow by providing better infrastructure, hassle free government procedures and most importantly, a degree of autonomy and freedom in various decision making processes.

Encouraged by the favorable business environment fostered by the global liberalization, the international private capital flows have been increasing rapidly. Cross- border M&As has been the major driver of the recent surge in the FDI. Foreign capital now contributes a significant share of the domestic investment, industrial production and exports in a number of economies. The presence of any or even all the determinants of FDI alone need not attract it. Several other factors like the political environment, government policies, bureaucratic culture, social climate, infrastructural facilities etc. are also important determinants of FDI.

Although India has substantially liberalized its foreign investment policy, the FDI inflows have been much below the targets. India has not been getting even one-tenth the size of FDI flow to China. Not only that the FDI inflow has been disappointing, but it is also feared that there signs of capital flight from India. Bureaucratic problems, certain unfavorable government attitudes, poor infrastructure, labour factors, high input costs etc. are regarded as the major reasons.

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