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An Article on Foreign Capital and Foreign Investment (Foreign Direct Investment)

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Abstract: Recently world economy is passing through the global crisis. India is not free from its effect. India is also suffering from inflection and economic crisis. To overcome this situation and make to economy speedy, Indian Govt. has decided to do economic reforms, as a result, Indian Govt. has taken steps in this direction and make free Foreign Direct Investment in some sectors like Retail, Broad Casting, Air – line etc. Indian Govt. has increased limits of Foreign Direct Investment in such sectors.

So, we inspired to write this article which will throw light on this concept Foreign Direct Investment. This consists the meaning, nature, types and advantages – disadvantages of Foreign Direct Investment. We have tried our best to give enough explanation about Foreign Direct Investment.

The objective of this Research paper is to understand the conceptual background, its necessity and its impact on Indian economy. The design of the study is descriptive in nature. This is a secondary database research. The relevant information is collected from various sources like internet, books, magazines, news papers etc.

Keywords: Economic Reforms, New Economic Policy, Liberalization, Privatization, Globalization, FDI and its advantages - disadvantages.

I. Introduction

India's first planning was done in 1951. From that time to 1991, the economic policies, which have been applied, have changed in big view in 1991. These reforms are divided in three parts.

- 1. Liberalization
- 2. Privatization
- 3. Globalization

The term globalization refers to the opening up of the economy in the world market by attaining international competitiveness. Globalization of the simply indicates interaction of the country relating to production, trading and financial transactions with the developed industrialized countries of the world.

It refers to relative softening up of economic and trade barriers across the countries, to facilitate a free interflow of capital, technology, labour, goods and service. It can be said to be the cost effectiveness of being able to manufacture anywhere in the world.

Thus, Globalization is a process to join more and more economy of the country with the world economy. This process needs the following constitutes which are called parameters of globalization.

1. Promotion of free trade

- 2. Free flow of capital
- 3. Free flow of technology
- 4. Free movement of labour

With the introduction of the new economic policy, Indian economy has accepted the challenges of facing globalization of the economy. This new economic policy included many changes related to Foreign Direct Investment, export-import, which were as follows:

- 1. The new economic policy 1991 has prepare a specified list of high technology and high investment priority industries in which automatic permission will be available for Foreign Direct Investment up to 51 % of foreign equity.
- 2. Under foreign technology agreements, automatic permission is provided in high priority industry up to a sum of Rs. 1 crore.

Thus, Foreign Direct Investment is an important part of Globalization. Generally in developing country like India, the level of national income and per head income is low, the ratio of savings is low, because of it, the rate of capital formation is low and it is realizing the scarcity of capital. Scarcity of capital has been a big barrier in the economic development of India. In this situation, it is necessary to invite foreign capital as supplementary capital in economic development. Every undeveloped or developing country requires foreign capital in the initial stages of development due to deficiency of domestic savings and inadequate capital formation.

Nearly every developed state has had the assistance of foreign finance to supplement its own merge savings during the initial stages of its development. This foreign capital mostly from the developed countries has played a significant role in the development of Indian economy.

II. Meaning of Foreign Capital (Foreign Direct Investment)

- Foreign capital refers to the investment of capital by a foreign government, institution, private individual and international organization in the productive activities of a country.
- Foreign Direct Investment is a direct investment into production in a country by a company located in another country, either by buying a company in the target country or by expanding operation of an existing business in that country.

Thus, putting the money of your country in a company which in functioning in some other country is Foreign Direct Investment, if we invest this way then we are a foreign direct investor. Foreign Direct Investment plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing for a host country, which receives the investment. It can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development.

As a part of the national accounts of the country, the national income equation is Y = C + I + G + x - m. I is investment plus foreign investment. Foreign Direct Investment refers to the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, other long term capital and short term capital as shown the balance of payment. It usually involves participation in management, joint ventures, transfer of technology and expertise. There are two types of Foreign Direct Investment, which is the cumulative number for a given period. Direct investment excludes investment through purchase of shares. Foreign Direct Investment is the one example of international factor movements.

III. Need for Foreign Direct Investment

Foreign Direct Investment is necessary for developing country like India for the following reasons:

1) Inadequate Domestic Capital

Since, in India the domestic capital is inadequate for the purposes of economic growth, it becomes necessary to invite foreign capital for investment. Developing countries are not in a position to mobilize adequate savings for their development. Thus, foreign capital becomes indispensable to fill the gap between actual capital formation out of domestic sources and the amount of capital necessary for accelerating the process of development.

2) To Decrease Deficit in Balance of Payment

A developing country has to import of plant, machinery, equipments, raw material, technology, etc. in large amount, to balance it, it cannot do export in equivalent amounts. So there is arising a deficit in the balance of payment. Foreign capitals help to decrease such deficit.

3) Development of Basic infrastructure

Increment in infrastructure facility is necessary for economic development. But there is a lack of capital for infrastructure development in developing country. By receiving foreign capital investment such country can build-up such facility and can push up economic development.

4) Inflow of Technical know-how

The underdeveloped or developing countries have a low level of technology, which create a need of import of technology from the developed countries. Such technology comes with a foreign capital investment.

5) Exploitation of Natural Resources

In a developing country, it cannot make optimum use of natural resources due to lack of knowledge and capital. With the assistance of foreign capital investment, the maximum use and speedy economic development can be possible.

6) Speeding up Economic Activity

In a developing country like India, there may be potential saved but this may come forward only with a higher level of economic activity, where foreign capital can prove to be quite helpful.

7) Stimulant to Domestic Saving

It may be difficult to mobilize domestic savings for the financing of projects that are badly needed for economic development. In the initial stages of development, the capital market is itself underdeveloped. During this period in which the capital market is in the process of development, foreign capital is essential as a temporary measure.

8) Controlling inflationary Pressures

With the help of foreign capital investment and foreign aid, it can possible the speedy growth in production in various economic sectors. It increases the quantity of goods of consumption, which results in stability of price level which controls the inflationary pressures.

9) Risk Factor in New Business

The larger risk is lying in new business. When the industrialization process starts, then no entrepreneurs come forward to face risk and uncertainty lying in new business. But with the help of foreign aid, many new businesses have established and developed, which have given their valuable contribution in economic development, by facing risk factor successfully.

10) Vicious Circle of Poverty

Developing countries suffer from the vicious circle of poverty due to low level of income savings and investment foreign help to increase the production of wealth and income. This results in increase of savings and investment. The cumulative process follows towards development.

11) Total Economic Development

For totally economic development and to maintain balance in the development of various sectors of country, foreign direct investment and foreign aid is necessary. Due to inadequate development excluding agricultural sector, population was fully depended on agriculture. But due to foreign investment and aid, it has been possible development in industry and service sector and India has been able to be overall developed.

IV. Types of Foreign Capital

Foreign Direct investment: Foreign capital can enter India in the form of direct investment role in helping economic development. Private foreign capital can result in the inflow of new and up to date techniques and the latest ideas.

Foreign Collaboration: In the recent years there has been joint participation of foreign and domestic capital. India has been encouraging this form of important of foreign capital. There are three types of foreign collaborations.

- Joint participation: between private parties
- · Between foreign firms and Indian Govt.
- Between Foreign Govt. and Indian Govt.

Though the inflow from this type of foreign capital depends on the healthy attitude of their domestic collaborator and government in giving them due share in the decision making of the enterprise, appointing of directors, personnel, day to day control, etc.

Inter Government Loan: Since the Second World War, there has been a growing tendency toward direct inter government loans and grants, other advanced countries to provide grants and loans to government of less developed countries. Government participation in borrowing and lending activities also creates greater confidence in the minds of private investors as regard to investments abroad. Government lending is meant to supplement the flow of private foreign capital and not to supplant it.

Though to this type of foreign capital often comes with political strings attached. There is also the risk by the donor Govt. as to borrowing Govt. not making the best use of the funds.

Loans from International Institution: On account of dissatisfaction with inter – government loans, international lending institutions are regarded the best source to distribute foreign capital among borrowing and needy developing countries. The World Bank, IMF, ADB, the Aid India Consortium has been the major sources of external assistance of India recent years.

External Commercial Borrowing: India has also been tapping export credit agencies like the Us Exim Bank, Japan Exim Bank, etc. to obtain a major option of the commercial borrowing from the capital market. With the world economy becoming more and more globalized and liberalized this form of foreign capital is acquiring importance. The formalities and restrictions on such type of capital are less when compared with the other types of foreign capital.

V. Shortcoming of Foreign Capital

1) Unbalanced Growth

Foreign capital tends to lopsided rather than balanced growth. In many cases it was observed that the foreign investment was in these sectors and areas not in the priority list consequently the basic and key industries could not develop.

2) Political Strings

Many times the foreign capital has certain restrictive strings attached to it, with a motive to earn profits the borrowing country's monetary fiscal, industrial and commercial policies must be conformed to the requirement and conditions of the donor country.

3) Obsolete Technology

There are instances of obsolete machines and technology being passed on to the Indian partners by the foreign collaborators. In some cases technologies have been imported not quite appropriate to the Indian situation.

4) Adverts Effect on Balance of Payment

The foreign collaborations' effect on India's balance of payments has been negative. The main reason for this was high re maintenance abroad, high level of imports and low level of exports.

5) Decline in Domestic Production in the Economy

Domestic producers suffer because of the established by industries financed by foreign capital. They are unable to compete with foreign enterprises.

6) Increase in Foreign Dependency

Yearning for foreign capital and through its foreign technology and technicians increases our dependency on external sources. It also increases the vulnerability of the borrowing country towards the instability of the donor country.

7) Setback to Indigenous Development of Technology

Foreign technology accompanies foreign capital. It has an adverse effect on the development of Indian technology and research.

8) Uncertainty

It is often observed that foreign capital becomes scarce when it is needed the most. This happens because foreign capital can be repatriated at any time. Thus an element of uncertainty looms large in respect of foreign capital.

9) Favoritism

It is often observed that in developed countries, foreign companies reserve higher managerial and technical posts for their own national thus denying adequate opportunities of training to people in developing countries. Usually, these foreign companies avoid revealing important technical and trade secrets to the people or government of the developing country.

Thus, there are so many disadvantages of foreign capital investment. But it is also facing that to develop the country to take aid from foreign is also necessary. There are main 5 types of foreign capital aid. Out of which Foreign Direct Investment in India has played an important role in economic development.

VI. Foreign Direct Investment in India

The fast and steadily growing economy of India with the majority of its sectors has made India one of the most famous and popular destinations in the whole world for foreign direct investment. According to a recent survey by the UNCTAD India has conspicuously immerged out as the second most popular and preferable destination in the entire world, after china for highly profitable direct investment.

In recent years, the bulk of the foreign direct investment sectors of infrastructure, telecommunication, IT, computer hardware and software and hospitality services; have been made by investors of countries like US, Mauritius, Singapore and many others. According to Earnest and Young, Foreign Direct Investment in India in 2010 was \$ 44.8 billion, and in 2011 experienced an increase of 13% to \$ 50.8 billion. India has seen an eightfold increase in its Foreign Direct Investment in March 2012, on 14 Sep, 2012 Govt. of India allowed Foreign Direct Investment aviation up to 74 %, in multi – brand retail up to 100%.

VII. Foreign Direct Investment in Retail India

The retail sector of India is vast and has potential for growth and development as the majority of its, constituents are unorganized. The retail sector of India handles about \$530 billion every year and is expected by veteran economist to reach to \$660 billion by the year 2015. The business in the organized retail sector in India is to grow most and faster at a rate of 15 - 20% every year, and can reach the level of \$100 billion by the year 2015. Here, it is noteworthy that the retail sector of India contributes 15% to the national GDP and employs a massive workforce to it, after the agriculture sector. India's growing economy with a rate of approximately 8 % per year makes its retail sector highly fertile and profitable for the foreign investors of all sectors of commerce and economy of all over the world.

AT Keamey, a globally famous international management consultancy recognized India as second most alluring and developing retail growing and emerging markets. And liberalization of trade policy and loosening of barriers and restrictions to the Foreign Direct Investment in the retail sector of India have made the Foreign Direct Investment in retail sector quite easy and smooth. Our services are easily and economically available in the following way of Foreign Direct Investment in Indian retail can be made through any of following ways:-

- 1. Joint ventures
- 2. Franchising
- 3. Security of supplies from small scale sector
- 4. Cash and carry operations
- 5. Non store formats

Foreign Direct Investment in retail will be beneficial to agriculture sector. Due to lack of cold storage facility 40% vegetable is wastage. By Foreign Direct Investment such risk overcomes. By adequate transportation and cold chain facility, agriculture sector will get benefits due to purchase of agriculture product by reasonable price from farmers and storage at the ideal level.

Foreign direct investment will create new employment opportunities for young.

Foreign direct investment in the retail sector is also beneficial for customers. Because of it the agriculture product will be reached directly to the distributor and quality of product will be maintained and price will be decreased.

VIII. Conclusion

Thus, FDI has some good factors and also bad factors. So, FDI may be good for the economy, if it used optimally. So the Government has to make use of FDI in various sectors by considering its advantages-disadvantages optimally.

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