ISSN: 2321-7782 (Online)
Volume 2, Issue 2, February 2014
International Journal of Advance Research in Computer Science and Management Studies
Research Article / Paper / Case Study
Available online at: www.ijarcsms.com

Foreign Direct Investment- An Overview

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I. INTRODUCTION

Foreign Direct Investment (FDI) is defined as a long-term investment by a foreign direct investor in an enterprise resident in an economy other than that in which the foreign direct investor is based. Foreign direct investment (FDI) is also defined as "investment made to acquire lasting interest in enterprises operating outside of the economy of the investor. The FDI relationship consists of a parent enterprise and a foreign affiliate which together form a Multinational corporation (MNC). In order to qualify as FDI the investment must afford the parent enterprise control over its foreign affiliate. The UN defines control in this case as owning 10% or more of the ordinary shares or voting power of an incorporated firm or its equivalent for an unincorporated firm; lower ownership shares are known as portfolio investment.

Foreign Direct Investment (FDI) flows have increased dramatically in last few decades. As developing countries, particularly in Asia, remove restrictions and implement policies to attract FDI inflows, trade and investment have become increasingly intertwined. As such, there have been growing calls for a multilateral framework of foreign investment rules to be negotiated under the auspices of the World Trade Organization (WTO). This paper reviews developments in FDI flows, forms of incentives in FDI and their factors affecting in FDI flows in India and FDI in India.

II. OBJECTIVE OF THE STUDY

The following are the objectives focused in the study

- To study about FDI in detail.
- To know about the forms of incentives in FDI.
- To analyse about the factors affecting FDI in flow.
- To understand FDI in India.

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.

In the years after the Second World War global FDI was dominated by the United States, as much of the world recovered from the destruction brought by the conflict. The US accounted for around three-quarters of new FDI (including reinvested profits) between 1945 and 1960. Since that time FDI has spread to become a truly global phenomenon. FDI has grown in importance in the global economy with FDI stocks now constituting over 20 percent of global GDP.

In the US, in the late 1960s and early 1970s, foreign direct investment became increasingly politicized. Organized labor, convinced that foreign investment exported jobs, undertook a major campaign to reform the tax provisions which affected foreign direct investment. The Foreign Trade and Investment Act of 1973 (or the Burke-Hartke Bill) would have eliminated both the tax credit and tax deferral. The Nixon Administration, influential members of Congress of both parties and well-financed lobbying organizations came to the defense of the multinational. The massive counterattack of the multinational corporations and their allies defeated this first major challenge to their interests.

Foreign Direct Investment has many forms. Broadly, Foreign Direct Investment includes "mergers and acquisitions, building new facilities, reinvesting profits earned from overseas operations and intercompany loans". In a narrow sense, foreign direct investment refers just to building 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. FDI is the sum of equity capital, other long-term capital, and short-term capital as shown the balance of payments. FDI usually involves participation in management, joint-venture, transfer of technology and expertise. There are two types of FDI: inward and outward, resulting in a *net* FDI *inflow* (positive or negative) and "stock of foreign direct investment", which is the cumulative number for a given period. Direct investment excludes investment through purchase of shares. FDI is one example of international factor movements.

TYPES

1. Horizon 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
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

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)

III. Importance and Barriers to FDI

The rapid growth of world population since 1950 has occurred mostly in developing countries. This growth has not been matched by similar increases in per-capita income and access to the basics of modern life, like education, health care, or - for too many - even sanitary water and waste disposal.

FDI has proven — when skillfully applied — to be one of the fastest means of, with the highest impact on, development. However, given its many benefits for both investing firms and hosting countries, and the large jumps in development were best practices followed, eking out advances with even moderate long-term impacts often has been a struggle. Recently, research and practice are finding ways to make FDI more assured and beneficial by continually engaging with local realities, adjusting contracts and reconfiguring policies as blockages and openings emerge.

IV. Factors Affecting FDI Inflow in India

- Domestic market potentials
- Low wage rates
- Low transactions costs
- High rates of return
- Labour mobility
- Matured capital market
- Modern financial system
- Efficient infrastructure
- Established legal and institutional set-up
- Transparent rules and regulations
- Administrative speed and efficiency
- Special economic zones, EPZs etc.
- Fourth largest economy in terms of PPP adjusted GDP after USA, China and Japan

- One of ten fastest economies of the world
- Largest pool of technical manpower
- Demographic dividend- youngest workforce
- Rich in mineral and natural resources
- Major country in agrl and industrial products
- Fiscal incentives and investment environment
- Low wage rates and low production costs
- High Return and Huge domestic market
- Well developed banking and capital market.
- Dynamic private sector
- National treatment to foreign investors
- Most favored nation treatment (MFN)
- Free transfer of profits and dividends
- International standards for laws
- International arbitration in the case of disputes
- Protection of intellectual property rights (IPR)
- Right to employ management of its choice
- The formation of regional trading blocks such as NAFTA, ASEAN, APEC, SAARC etc. had also an important impact on the FDI pattern
- In future, countries outside the regional blocks might have disadvantages in attracting FDI.

V. Foreign Direct Investment in India

Foreign investment was introduced in 1991 as Foreign Exchange Management Act (FEMA), driven by 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.

VI. Conclusion

Foreign direct investment (FDI) is an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate). FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates, both incorporated and unincorporated. FDI may be undertaken by individuals as well as business entities.

Foreign direct investment (FDI) continues to gain in importance as a form of international economic transactions and as an instrument of international economic integration. The rate of growth of worldwide FDI inflows in the past two decades has substantially exceeded that of worldwide gross domestic product (GDP), exports and domestic investment. Transnational corporations (TNCs) account for an increasing share and, in some cases, a substantial part of the assets, employment, domestic capital formation, research and development, sales and trade of many countries and have become one of the driving forces of integration in the world economy.

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