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# Foreign Direct Investment In India And Its Impact

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***Abstract:***
*Foreign Direct Investment is a cross border investment into manufacturing or business in one country by a company in another country either by expanding existing business or by buying a new business in the host country. This occurs when one foreign company purchases another business or establishes new operations for an existing business in a country other than own country. Duos to fast population growth in developing countries, good opportunities have been created for foreign companies to invest in these countries and enjoy the low cost of manufacturing. India as the second largest destination for FDI after China has became more important economically for foreign companies. In addition, FDI is one of the most significant pillars of the Indian economy accounting for 14 to 15 percent of its GDP. The question that arises here is, whether foreign investment improves a developing economy or is it only beneficial for foreign investors. In this article we will see the impact of FDI in different domain and how it improves the economy of the host country.*

***Key words:*** *FDI, GDP*

## 1.Introduction

FDI in India is one of the sunrise sectors with huge potential growth. According to the Investment Commission of India, the retail sector is expected to grow almost three times its current level to $660 billion by 2015. Despite the recent developments in the retail sector and its huge contribution to the economy , the growth in this sector has been much slower compared to the rest of the world. There is no qualm that the dismal condition of the retail sector stems from the absence of encouraging policies in the Indian retail sector.

It is significant to note that the developing countries eased restrictions on FDI inflows and operations of Multinational Enterprises (MNEs) in the early 1980s and this trend became more common during the 1990s, which brought a considerable FDI inflows into the developing countries such as India.

India opened up its economy and allowed MNEs in the core sectors as a part of an amendment process in the beginning of 1990s. Since then a big share of FDI inflows has been attracted to India. As a result, India became one of the most lucrative investment locations for the foreign investors.

### *1.1.FDI In The Retail Sector*

Until 2011, FDI in multiband retail was forbidden to any retail outlets. Even single brand retail was allowed up to 51% ownership. In November 2011, India’s federal government announced retail amendments for both multi-brand and single-brand stores. These modifications paved the way for retail innovation and competition with multi- brand retailers such as Wal-Mart, Carrefour and Tesco as well as single- brand majors such as IKEA, Nike, and Apple.

In January 2012, government approved amendments for single brand stores allowing anyone in the world to invest in India’s retail sector with 100% ownership, but with the requirement that the single brand retailers should get 30% of its goods from India.

In December2012, the government allowed 51% FDI in multiband retail in India such as Wal-Mart, Tesco, etc. So retail sector became one of the pillars of Indian economy and accounts for 14 to 15% of its GDP.

### *1.2.FDI In The Insurance Sector*

The insurance sector is also one of the most important pillars of the Indian economy. In recent years a proposal for raising FDI to 49% from 26% in this sector has been submitted to the cabinet for approval and both domestic and foreign companies will benefit from this amendment.

Based on statistical information, India has occupied the fifth position of the largest and booming insurance market in the world but still only 0.2% of its population has been covered under any such insurance as medical which is around 2 million Indians. So Insurance sector is an area with extensive potential scope for growth.

*1.3.FDI In The Aviation Sector*

India's aviation sector and its domestic market have been growing rapidly Duo to growing national and international tourism. Currently, India has the ninth position of the largest aviation market in the world and is expected to be one of the five largest aviation markets in 2012. As a result the Department of Industrial Policy and Promotion (DIPP) is planning to increase the FDI capital for foreign investors from 24% to 26%.

*1.4.FDI In The Power Trading*

In the power trading sector, the decision taken by the Indian Cabinet Committee on Economic Affairs (CCEA) regarding FDI, which allows FDI up to 49% in power exchanges or power trading in India. All power sectors of the country and foreign investors also are benefited by this decision.

*1.5.Retailing In India*

Retailing in India is a main segment of the economy accounting for 15%of its GDP. The Indian Retail sector is rapidly growing with approximately 1.2 billion people. In 2012, only 4% of the retailing industry used to belong to large supermarkets and shops and these shops were located in big urban areas and only 3.3% of Indian population was employed in this sector. Over 40 million outlets operate in the country and only 4% of them are larger than 500 sq. Most of the unorganized retail shops are managed by family members and they buy their products from middlemen. These unorganized retail shops typically have no after-sale service and most of their transactions are done with cash.

Until 1990s, rules and regulations did not support entrepreneurship in Indian retailing. After the market liberalization in 1990, the Indian government reformed the market rules, soon after people started to experience the benefits of organized retail sector.

*1.6.FDI Can Take Place In The Following Ways*

- Mergers and acquisitions
- Building new facilities
- Expanding the existing businesses
- Reinvesting profits earned from other operations

**2.The Structure Of The Indian Retail Sector**

The retail sector is one of the fastest growing sectors in India. This sector has gone through an evolution from traditional shops to glamorous shopping malls. In fact, retailing is a process of distribution. In this process, retailers provide many benefits for suppliers and consumers as well. For example, a small quantity of products becomes available for customers at a reasonable price and manufacturers can easily reach the market and sell their products.

*2.1.The Indian Retail Market Is Divided Into Two Sectors*

- Organized
- Unorganized

The organized sector refers to those companies that are registered for tax. Hypermarkets, large retail businesses, and retail chains are examples of the organized sector.

On the other hand, unorganized retailing refers to traditional shops and low- cost retailing that is not registered for tax. Convenience stores, hand carts are a few examples of the unorganized sector. The unorganized sector includes the biggest portion of the retailing in India which accounts for 95% of its total market, but as time passes, the organized sector will grow more rapidly due to globalization, economic growth, alteration of lifestyle, and high disposable income. Even small towns have experienced the change in their lifestyle, and preferences which have accelerated the growth of organized sector.

Generally, Indian retailing has a long way to overcome various barriers. The lack of adequate infrastructure facilities, professional workforce and inexperienced managers makes the process more complicated. Further the retail industry is affected by external factors such as government rules and regulations and polices, real state prices.

*2.2.Challenges And Attractions For Global Retailers*

Due to the entry of big global retailers, India faces several challenges. For example, the entry of Wal-Mart could destroy domestic markets and eliminate a huge number of jobs because millions of Indian population are employed in the unorganized retailing sector. In addition to this point, big foreign retailers through the destruction of local shops, can create monopolistic power which allows them to increase prices and enjoy higher profit.

On the other hand, there are many attractions. Organized retailing in India is considered as a beginner and it is seen as an appealing sector for foreign investors. Indian retailing in India is one of the sunrise sectors and an enormous potential profit is expected. In addition, India is considered as one of the opportunity lands for foreign investors due to its huge population. Retailing sector is the second largest sector in India after agriculture, so there are plenty of job opportunities in this sector.

The lack of competition and big players in India, has created a better scenario for foreign players but in recent years, some big Indian investors have entered the market and created more opportunities for companies and investors. These events have some other effects as well, for instance, higher living standards, higher economic growth, higher purchasing power, higher level of information available for customers, etc.

*2.3.Effects Of FDI*

There are various implications on the domestic economy due to FDI inflows. These implications can be divided into two categories, quantitative and qualitative. The impacts of the FDI on domestic investment, income, employment, productivity, price levels and export growth are quantifiable as they are static in nature. The effects on the technology growth, spillover, and structural change of the economy are more qualitative and dynamic in nature.

Generally the impact of FDI on domestic investment indicates that the impact of foreign direct investment is twofold as outlined here:

- Crowding-in
- Crowding-out.

The impact of FDI on the economy is measurable and it changes the domestic investment. During this alteration in domestic investment, FDI can change the growth of the host country and it brings new goods and technologies to the host economy. When the presence of the foreign direct investment stimulates the domestic economy that would not have occurred in its absence, it is called "crowding in". When this happens in the host country's domestic investment, the national income of the host country will increase.

If FDI enters various sectors in the host country, where the level of competition is high among domestic firms or firms already producing for export markets, it may diminish investment opportunities for domestic investors. In this case, the domestic investment may not come down in the near future but it will eventually. This is called "crowding out". Briefly, when the FDI crowds out, the domestic investment and national income of the host country will shrink. In such a situation, FDI can be considered as a substitute for domestic investment. But when the domestic investment is in an under-developed level, the relationship between foreign direct investment and domestic investment is complimentary. As FDI brings direct capital and technology to the host country, the FDI- receiving firms are expected to perform better.

In addition, FDI has significant effects on technology and know-how which is known as spillover effects. In reality, the flow of capital and technology into the domestic firms enhances competition among local firms, if the difference between domestic and foreign firms are huge. Furthermore, FDI can increase the level of employment in the host country, if the foreign investors need to use the local resources in their manufacturing process. In some countries, the foreign firms are compelled by the government to use the local resources, as a result, the total employment level of the host country will rise.

<u>2.3.1.Qualitative Effects</u>

There are some qualitative effects of FDI which are dynamic in nature and complicated to measure. These issues are strategically important and needs to be considered. The technology of domestic firms, the spillover effects and the impacts on the structure of the economy are some areas affected by FDI. In this regarding, it is important to note that the conventional method of importing foreign technologies by paying royalty or so-called license fees has become rejected because the technology owners are charging extremely high royalty fees. As a result, most of the developing countries, which don't have enough original technologies, are more interested in the foreign direct investment method in order to access the leading technologies. The transfer of new technologies either by the conventional method or through the help of FDI, improves the quality of techniques of production and domestic technologies. This technology transfer has crucial effects on the host economy. Positive spillover effect to domestic industries in the process of production by utilizing purchased intermediate goods, implanted with valuable technology, from foreign invested firms is one of these effects.

There is another effect of FDI which can be considered as the pivotal point of the whole process. This important effect of FDI on the domestic economy is the structural change of the economy due to the integration of the economy with the global economy.

<u>2.3.2.Financial Effects</u>

Apart from qualitative effects, FDI affects the balance of payment (BOP) of the domestic economy. The balance of payment of the host country is affected by FDI. When the BOP of the domestic country is facing a deficit in their current account FDI helps to improve the BOP position. The fluctuation of BOP made by FDI can be either positive or negative which pertains to the FDI inflows of the domestic economy.

FDI has another financial impact which affects the domestic saving of the host country. FDI is a channel that allows the foreign savings to come to the domestic investors. In the case of current account deficit, FDI can play a crucial role by increasing foreign savings. In such a situation, FDI is considered a financial flow and its impacts are also financial effects on the host country.

*2.4.Entry Options For Foreign Players*

There are various methods of entry for foreign players which are briefly outlined below:

- Franchise Agreements:
  This entrance route is the simplest way to enter into the Indian market. Foreign investors are allowed to enter the Indian market with the approval of the Reserve Bank of India (RBI) under the Exchange Management Act. Some of these foreign investors entered the Indian marketplace which come under this category are, Pizza Hut, KFC, McDonald, Lacoste, Mango,……
- Cash And Carry Wholesale Trading:
  100% FDI is possible in this sector and wholesaler is involved with the process of distribution to small retailers and not to individual customers. Metro AG of Germany is an example of the global player that entered into India through this route.

- Strategic Licensing Agreements:
  In this method, Indian companies get exclusive licenses from foreign brands and they can either sell it through their own stores or enter into shop-in-shop arrangements. Mango is one of these foreign brands that entered into India through this route.
- Manufacturing and wholly owned subsidiaries:
  Some foreign brands that have wholly-owned subsidiaries are considered Indian companies. These companies are allowed to manufacture, distribute, and have their own outlets. Nike and Reebok, and etc. are some examples that came to India through this route.

**3.SWOT Analysis**

*3.1.Strengths*

- The emergence of FDI provides a greater variety of international quality branded goods.
- Employment opportunities both direct and indirect have been going up. A large young working population, along with increasing working women population and emerging opportunities in the service sector are the key growth factor of the organized retail sector.
- It has a key contribution to large scale investments in the real state sector.
- Increase in domestic market, middle class and potential customers with higher purchasing power and disposal income.
- Increase in consumer’s value of money due to better products at cheaper prices.

*3.2.Weaknesses*

- Will mainly cater to high-end consumers placed in metros and will not deliver mass consumption goods for customers in villages and small towns.
- Retail chains are yet to be settled down with proper merchandise mix for the mall outlets.
- Another weakness in the Indian retailing is small size outlets , 96% of the outlets are less than 500 sq.ft.
- Property prices, retail real estate rentals have mounted significantly, which may render a few retailing business houses unavailable. Retail companies have to pay high rent which is blocked in the turn of profits.
- The sales average in Indian retailing is also a very low due to low disposable income.

*3.3.Opportunities*

- FDI in retail will boost the Indian economy.
- Create more job opportunities in forthcoming years. The Indian retail sector is currently growing rapidly and is expected to create 54000 jobs by 2017, which create jobs for different levels of organization, from entry level to senior management level, for fresher’s as well as professionals. The job scope is extremely huge, jobs will not be generated only in the mainstream areas such as retail, but also in areas such as front end sales, facility management, human resource management, financial management, inventory management, merchandising, customer relationship, and etc.
- Duo to increasing disposable income and purchasing power retail sector has become one of the fastest growing sectors.
- FDI brings modern technology to the country which improves the quantity and quality of products and also reduces spoilage of raw materials.
- The biggest beneficiary of FDI in retail sector is small farmers who would be able to improve productivity and earn higher income by selling their products directly to the large organized player and shorten the chain from farm to consumers.
- Another opportunity pertains to capital infusion. This would help domestic retailers to bridge the gap between the capital required and raised. In fact FDI is one of the major sources of investment for a developing country like India.
- One more opportunity is relevant to health competition. The entry of the many foreign corporations will obviously increase competition among different companies offering their brands in a particular market and this will lead in the availability of many varieties, reduced prices, and convenient distribution of the marketing offers.

*3.4.Threats*

- Supply chain management issues are one of the greatest barriers to the growth of modern retail formats. For perishables, the system is complicated. Government rules and regulations, lack of adequate infrastructure and inadequate investment are bottlenecks for retail companies.
- Targeting all segments of society is difficult.
- Heavy initial investment is required to break even with other companies and compete with them.
- Lack of Labor rules and regulation in the organized retails.
- Another barrier is the lack of the uniform tax system for organizing retailing.
- The unorganized sector has dominance over the organized sector because of low investment needs.

**4.Recommendations And Suggestions**

- By the advent of FDI in India, government revenues have risen substantially on account of more foreign investment.
- The adverse impact on small retailers and traders can be mitigated by innovative policies.
- Farmers make a larger profit by shortening the supply chain but this requires a creative and effective actions and policies.
- Due to enhanced competition, consumers will get more benefit and better quality.

The lesson for developing countries such as India is that the more increase in FDI, the more development in infrastructure. This development will reinforce the Indian economy in a long span of time.

Also in SWOT analysis it is evident that FDI is going to attract more foreign investments. In the retail sector, more protection must be given to small retailers and theses retailers should not be crowded out.

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