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FOREIGN DIRECT INVESTMENT

INTRODUCTION

Foreign direct investment (FDI) is an ownership stake in a foreign company or project made by an investor, company, or government from another country. Generally, the term is used to describe a business decision to acquire a substantial stake in a foreign business or to buy it outright to expand operations to a new region. FDI is a key element in international economic integration because it creates stable and long-lasting links between economies

Companies or governments considering a foreign direct investment (FDI) generally consider target firms or projects in open economies that offer a skilled workforce and above-average growth prospects for the investor. A key feature of foreign direct investment is that it establishes effective control of the foreign business or at least substantial influence over its decision making.

WHEN FDI IS ALLOWED IN INDIA

- The government began liberalising FDI during 1980-91 with the Industrial Policy Statements of 1980 and 1982 followed by the Technology Policy Statement in 1983.

- This period also witnessed a considerable degree of trade liberalisation in terms of reductions in tariffs and the shifting of many import items from licensing to open general license (OGL) category. During the first half of the 1990s, FDI emerged, for the first time, as a preferred route for mobilising financial resources over loans and other forms of financial channels.

- Foreign equity up to 51 per cent was permitted under the automatic approval route by the RBI in specified industries producing intermediate and capital goods.

- FDI was considered as an instrument to bring in foreign technology not available domestically and which subsequently replaced the phrase 'indigenous' by 'sophisticated and high technology'.

ADVANTAGES OF FOREIGN DIRECT INVESTMENT

1. Economic growth: The creation of jobs is the most obvious advantage of FDI, one of the most important reasons why a nation (especially a developing one) will look to attract foreign direct investment. FDI boosts the manufacturing and services sector which results in the creation of jobs and helps to reduce unemployment rates in the country. Increased employment translates to higher incomes and equips the population with more buying powers, boosting the overall economy of a country.

2. Human capital development: Human capital involved the knowledge and competence of a workforce. Skills that employees gain through training and experience can boost the education and human capital of a specific country. Through a ripple effect, it can train human resources in other sectors and companies.

3. Technology: Targeted countries and businesses receive access to the latest financing tools, technologies, and operational practices from all across the world. The introduction of newer and enhanced technologies results in company's distribution into the local economy, resulting in enhanced efficiency and effectiveness of the industry.

4. Increase in exports: Many goods produced by FDI have global markets, not solely domestic consumption. The creation of 100% export oriented units help to assist FDI investors in boosting exports from other countries.

5. Exchange rate stability: The flow of FDI into a country translates into a continuous flow of foreign exchange, helping a country's Central Bank maintain a prosperous reserve of foreign exchange which results in stable exchange rates.

6. 6. Improved Capital Flow: Inflow of capital is particularly beneficial for countries with limited domestic resources, as well as for nations with restricted opportunities to raise funds in global capital markets.

7. 7. Creation of a Competitive Market: By facilitating the entry of foreign organizations into the domestic marketplace, FDI helps create a competitive environment, as well as break domestic monopolies. A healthy competitive environment pushes firms to continuously enhance their processes and product offerings, thereby fostering innovation. Consumers also gain access to a wider range of competitively priced products.

DISADVANTAGES OF FOREIGN DIRECT INVESTMENT

1. Hindrance of domestic investment: Sometimes FDI can hinder domestic investment. Because of FDI, countries' local companies start losing interest to invest in their domestic products.

2. The risk from political changes: Other countries' political movements can be changed constantly which could hamper the investors.

3. Negative exchange rates: Foreign direct investments can sometimes affect exchange rates to the advantage of one country and the detriment of another.

4. Higher costs: When investors invest in foreign counties, they might notice that it is more expensive than when goods are exported. Often times, more money is invested into machinery and intellectual property than in wages for local employees.

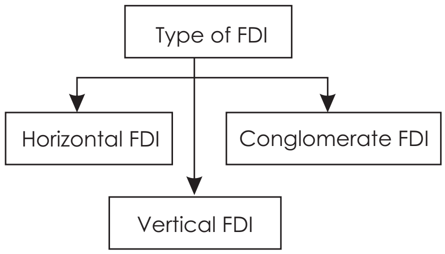
5. Economic non-viability: Considering that foreign direct investments may be capital-intensive from the point of view of the investor, it can sometimes be very risky or economically non-viable.

6. Expropriation: Constant political changes can lead to expropriation. In this case, those countries' governments will have control over investors' property and assets.

7. Modern-day economic colonialism: Many third-world countries, or at least those with history of colonialism, worry that foreign direct investment would result in some kind of modern-day economic colonialism, which exposes host countries and leave them vulnerable to foreign companies' exploitation.

TYPES OF FOREIGN DIRECT INVESTMENT [FDI]

Foreign direct investment can be classified into horizontal, vertical, and conglomerate. The types of FDIs are segregated on the basis of the companies that the investors are investing in. Walk through the illustrated points to get complete details of the types of FDI.



1. Horizontal FDI: It is a type of investment in which the company makes investment only in the company running their type of business in foreign. Example – If any sportswear company wants to make investments, they will only invest in any other sportswear company in another country rather than in any other sector. It's called horizontal investment.

2. Vertical FDI: In this type of investment, the company