FOREIGN DIRECT INVESTMENT – IS INDIA STILL THE PREFERRED DESTINATION IN THE CURRENT GLOBAL SCENARIO?

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Abstract *India is known to be one of the world's most promising markets today. Being the third largest world economy in Asia and eleventh largest in the world along with a well developed infrastructure and industrial base, the world's third largest pool of scientific and engineering personnel and a relatively stable political environment, India is a potentially attractive location for foreign investment. Foreign direct investment (FDI) gives opportunities to Indian industry for technological upgradation, reducing dependency on aid, gaining access to global managerial skills and practices, optimizing utilization of human and natural resources, and competing internationally with higher efficiency. While making a comparison of the foreign direct investment levels between India and other nations, it is found that, India is one of the preferred destinations among them. This paper compares the opportunities of FDI in India with other nations and finds that India should improve on growth and expansion of Indian economy, which will maintain the same upward trend in the forthcoming years.*

Key Words:
FDI; foreign direct investment ; China: India; Global Financial Crisis

INTRODUCTION

The developed nations were the most affected ones by the current global recession. Among the developed nations, USA has been hit drastically with "for closure" boards displayed in front of the corporate houses. General Motors, the World's largest automobile manufacturer is about to be declared bankrupt. There are a number of similar cases from all sectors. Although Barak Obama could freeze the recession to some extent, it will still take couple of years for USA to come out of it. The cases of other developed countries are not different.

However the emerging nations like Brazil, Russia, India and China better known as BRIC Countries were less affected by the global economic recession. This resulted in the FDI flow world over to be streamlined towards the BRIC Countries, and among the BRIC Countries India has started attracting a reasonably good share, which is said to be almost one billion USD every week.

Foreign Direct Investment in India – The scenario before the recession

'Is India still a sought after destination for FDI?'- This is the question deliberation. At the outset, let us try to look at the pre-recession scenario. India ranked, as the world's third best FDI destination after China and the USA has been one of the most favored investment destinations in the world. In 2003, India was ranked sixth on the list. The Goldman Sachs Global Economic Paper of October 2003 'Dreaming with BRICS: The Path to 2050 had predicted that over the next 50 years, Brazil, Russia, India and China could become a much larger force in the world economy. There were several initiatives from the policy makers to facilitate increased FDI inflows.

Along with the liberalization policies of the 1990s initiated by the government of

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India, there was enough effort in policy measures with respect to foreign direct investment (FDI). Till 1990s as far as India was concerned, FDI was something like an unworthy proposition or something that was meant for developed nations. This period was quite promising for many of the world countries in terms of attracting FDI. Emerging nations in general and China in particular have done well. The Indian performance has been worth noticing since 1990s till the recent global slowdown, deflation and recession. Of course, economic slowdown is the reduction of the commercial activities adversely affecting the growth of the economy. Deflation is the reduction of money in an economy resulting in stagnation or fall in prices. Recession is the mixture of both economic slowdown and deflation with an end result of reduction and negative growth of economy. Countries like USA and UK have already declared entering the cycle of negative economic growth. However, the Indian economy has so far not been directly affected although some signs of recession are very much visible. The World Bank and IMF reports dated 10th March 09 revealed that recession has hit the global economy. It has also hit developing economies like India and the effects of recession will last for a longer period.

In the good old days, India with all its strengths like huge domestic market, low-cost skilled and unskilled labour, good legal system, strong regulatory mechanism etc did not attract FDI at least like emerging nations like China, Brazil, Mexico etc. However, today we can see a positive change in the investment scenario far more favorable than that of the past. The only drawback faced by India is the spread of destinations and type of sectors, which might affect the overall economic growth of the nation. The investment destinations are limited to a few states and a few types of investment sectors. Although it is not a major problem, one can always be happy about the achievement of our nation in general.

FDI Challenges Ahead

Although India could achieve commendable progress in the area of FDI, there is still a pressing need for continuous improvements in providing a more attractive policy environment to attract foreign investment. Whilst India is said to have one of the most transparent and liberal FDI regimes amongst developing countries, there still exist several hurdles and red tapes which need to be addressed.

Economic slowdown is the reduction of the commercial activities adversely affecting the growth of the economy.

Profile of India's FDI locations

Main investment destinations

	Investment strengths	Investment weaknesses	Priority areas
Maharashtra	Well-developed, fast improving physical and social infrastructure, excellent financial infrastructure, largest market for goods and services, high purchasing power	Power deficient; deterioratiog state government image due to weakening in state finances in the last 5 years; poor irrigation resulting in high variability in agricultural output	Softwate, electronics, textiles, auto-ancillaries, food processing
Delhi	Advanced physical infrastructure, richest market in the nation and high rate of urbanisation; developed services sector	Local administration still perceived as not business friendly and corrupt; high transmission and distribution losses; high costs of labour	Hotels, tourism, IT, transportation, power
Karnataka	Conservative fiscal policies of the state administration; relatively healthy state finances, well-developed and adequately maintained telecom infrastructure; easy availability of highly-skilled workers; few industrial disputes	Shortage of power, frequent rationing and high tariffs; relatively slow rate of growth in the rail and road networks in the state; low irrigation coverage resulting in high dependence on rainfall	IT, electronics, auto components, leather, textiles, pharmaceuticals
Other investment locations			
Gujarat	Business-friendly state policies, responsive local administration, extensive network of roads, ports, railways and telecoms in most parts; well-developed financial structure	High power tariffs, high cost of labour and frequent disputes	IT, gems and jewellery; electronics, garments, food processing, leather
Andhra Pradesh	Reform-oriented state, improved governance and administration; fourth largest market in the nation; relatively high purchasing power	State finances under pressure, deficient power supply, high power tariffs, low literacy and poor healthcare coverage	Food processing, software, financial services, electronics power
Tamil Nadu	Business-savvy state government; responsive local administration; good railways, ports and telecom network; adequate road connectivity; availability of low-cost labour throughout the state	Large power deficits; high power tariffs for industry; lowest purchasing power among southern states, over-strained and poor coverage of public healthcare	Electronics, software, auto-ancillaries, pharmaceuticals, leather
West Bengal	Large market with considerable rural purchasing power; national and international connectivity; power availability with low tariffs and distribution losses	Active and often adversarial trade unions; inadequate infrastructure outside the metro area; slow but responsive state government policies toward industry	IT, petrochemicals, food processing, leather

[Source:http://economictimes.indiatimes.com/News/Economy/Investment/India-beats-recession-blues-attracts-27-billion-FDI-in-January/articleshow/4271870.cms]

Table 1 : The usually stated factors for improving FDI

Usual Suspects	
1. Improve infrastructure	5. Concentrated effort to build the "India" brand
2. Corruption and Bureaucracy	6. Curb on labor militancy
3. Cumbersome taxing Regulations	7. Reduce Inflation
4. Lengthy approval procedures	8. Setting up special zones

[**Source :** ASSOCHAM Eco Pulse Study, Annual FDI Report 2008-09]

How did India appeal to Investors? – Illustrations from Australian Firms

The identification of the location-specific factors critical for improving a host country's appeal to potential investors can assist in developing the country's resource allocation strategies. This helps to maximize its natural and created location characteristics which in turn influences a firm's decision to invest in that country. The attractiveness of a country may also vary from one firm to another depending on its organizational context. The eclectic paradigm includes the likely interaction among ownership advantages, internalization and location advantages in guiding a firm's FDI decisions (Dunning, 1979, 1981). Gunslinger and Associates (1985, p. 40) argue: 'Each firm may evaluate a country's attractiveness as a possible investment site according to criteria specific to the firm'.

A study on this issue was done by Peter K. John conducted among senior managers of 25 Australian firms that considered FDI in India between 1993 and 1998, and constructed an indicator, and evaluated whether a firm's previous FDI experience has any influence on this indicator. The study reveals that Location-specific Factor influences a firm's FDI Decision. Natural and created location characteristics of a country can have a major influence on a firm's decision to invest in the country (Mallampally and Sauvant, 1999). Based on a literature review, this research incorporates six groups of location-specific factors which may influence FDI attractiveness of a country.

1. Economic/Financial Factors (eg. Anderson, 1991; UNCTAD, 1998): The country's GDP growth rate; Conditions for FDI resulting from the country's economic policies; Infrastructure facilities; Economic incentives for FDI; Stability of its currency; and Expected returns on investment.

2. Political/Legal Factors (Gastanaga et al., 1998; Seyoum, 1996): Political stability; Integrity of its legal system; and Ease of protecting intellectual property rights in the country.

3. Cultural Factor (eg. Erramilli, 1991; Luo, 1999): Cultural similarity of the country to a firm's home country.

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4. Market Factors (eg. Porcano, 1993; Billington, 1999): Current market size; Expected market growth rate; and Proximity to other countries to facilitate exports from the FDI venture.

5. Resource Factors (eg. Porcano, 1993; Maskus, & Webster, 1995): Availability of skilled workers; Lower labour costs (after including the effect of labour productivity); Availability of competent management staff; and Availability of raw materials.

6. Factors relating to IJV Formation (eg. Thoreli, 1990; Lorenz, 1988): Ease in finding suitable IJV partners; and Trustworthiness of IJV partners in maintaining long-term relationship.

[**Source:**http://findarticles.com/p/articles/mi_qa3674/is_200004/ai_n8891022/]

FDI in India in the light of current global financial crisis and the liquidity crunch could push down global foreign direct investment (FDI) flows by about 10 per cent, but the developing world, including India, would still remain a favored FDI destination as opposed to the more advanced economies.

FDI in India in the light of current global financial crisis

FDI in India in the light of current global financial crisis and the liquidity crunch could push down global foreign direct investment (FDI) flows by about 10 per cent, but the developing world, including India, would still remain a favored FDI destination as opposed to the more advanced economies, according to the World Investment Report 2008 released by United Nations Conference on Trade and Development (UNCTAD). In fact, India emerged as one of the most favored FDI destinations second only to China. Analyzing the above factors with respect to India, we may conclude that except the infrastructure facilities, all other factors stand well in favor of India in comparison to many other emerging world economies. Also the GDP per capita is expected to double within the next decade.

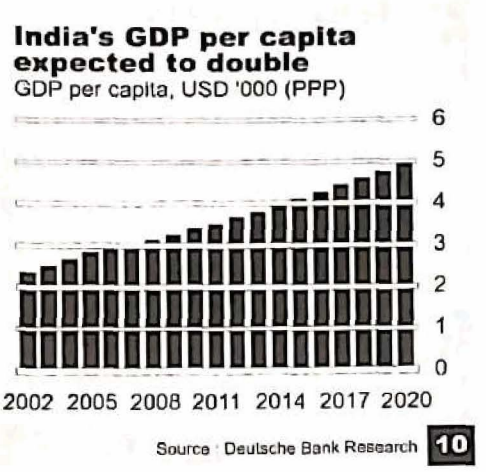


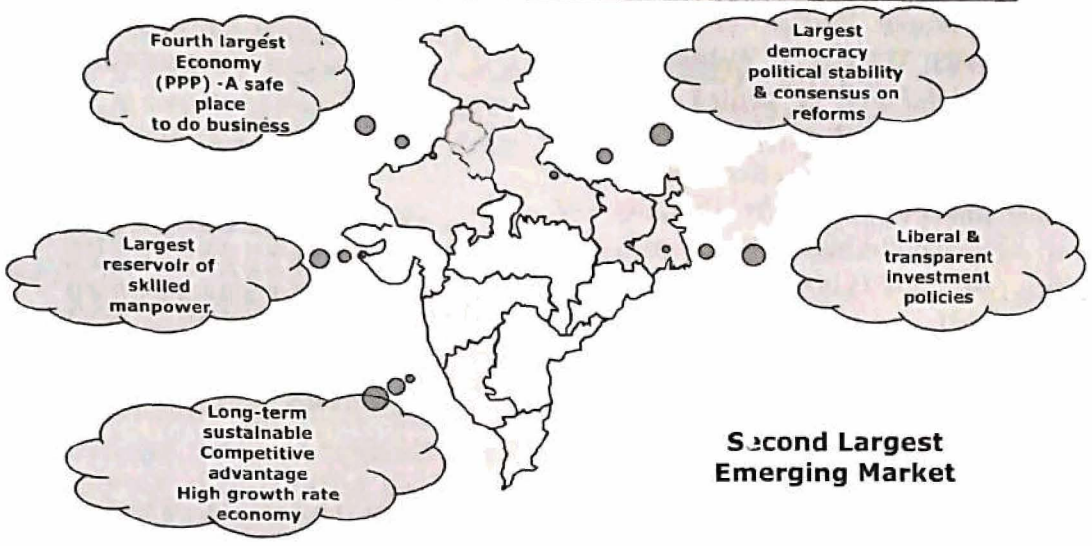
Fig 1

"China is the most preferred investment location, followed by India and the United States," said the report. It went on to add that the two countries would be the top two preferred destinations not only for the current year but for the next three years (2008-2010) as well. FDI inflow is bolstered by large scale investment by transnational corporations like Oracle, Holcim and Matsushita, it said. India registered 17 per cent increase in FDI inflows last year on the back of robust economic growth, improved investment environment and further opening up of telecommunication and other sectors, said the report. India witnessed a total FDI inflow of $23 billion in 2007. In the medium term, the UNCTAD report said, global FDI outlook is not impressive and the flows may be affected by continued slow growth and difficult market conditions in developed countries.

The World Investment Report 2007 pointed to the interest shown by foreign

retailers in India as a possible sector for inflows. A 153% rise in FDI inflows during 2006 to 17 dollar billion helped India overtake Thailand, Indonesia and South Korea and emerge as the fourth biggest recipient in Asia, behind China, Hong Kong and Singapore.

India –A Good Place to Put Your Money



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[Source: Investment Opportunities in India , Department of Industrial Policy & Promotion, Ministry of Commerce and Industry, Government of India Feb6,2006]

Though the report appeared bullish on India due to the interest shown by the likes of Wal-Mart, which is entering the country and also expansions by auto giants, it also warned of possible hurdles which would make it tough for India to reach the annual inflow target of $50 billion by 2010.

The report said poor infrastructure could be a roadblock, while pointing out that FDI projects "are not necessarily welcomed by local communities". The statement was probably a reference to the resistance being faced by investors like Posco which intends to invest $12 billion in setting up a steel plant in Orissa.

But it is not FDI inflows alone which found a mention; Tata's $11 billion acquisition of Corus has helped India emerge as the third biggest source of outflows from Asia, after Hong and China, overtaking Singapore, Taiwan, South Korea and Malaysia. If it was oil companies which led the Chinese and Russian overseas hunt, Indian companies were undertaking cross-border M&A to gain access to new technologies, competencies and to build stronger positions in global markets, says the report.

UNCTAD Survey 2008 – 2010: the most attractive locations for FDI in the next three years

Economies	2007 -2009 survey
China	56
India	45
United States	38
Russian Federation	23
Brazil	14
Viet Nam	10
United Kingdom	10
Australia	10
Germany	7
Mexico	7
Poland	7

Economies	2008 -2010 survey
China	55
India	41
United States	33
Russian Federation	28
Brazil	22
Viet Nam	12
Germany	9
Indonesia	8
Australia	7
Canada	6
Mexico	6
United Kingdom	6

Source : UNACTAD, 2008b.

In comparison to 1990-2000 session, the years 2004-2007 had been very profitable for India as far as the inflows and outflows of foreign direct investment are concerned, claimed the report. From an average annual inflow of $1,705 billion in 1990-2000, it reached a whopping $22,950 billion in 2007.

Conclusion

The findings of a survey conducted by, Premila Nazareth Satyanand, an independent consultant and research contributor, to the UNCTAD, clearly placed India as one of the leading economic power and a key player in both outward and inward foreign direct investment. The reports of the UNCTAD also claimed that East, South and South-East Asia are the most preferred regions when it comes to foreign direct investment.

In comparison to 1990-2000 session, the years 2004-2007 had been very profitable for India as far as the inflows and outflows of foreign direct investment are concerned, claimed the report. From an average annual inflow of $1,705 billion in 1990-2000, it reached a whopping $22,950 billion in 2007. The above statistics clearly reveal the growth and expansion of the Indian economy which will maintain the same upward trend in the forthcoming years.

All the macro fundamentals determining FDI flows, except fiscal deficit, are going good for India. For instance, India has a huge market, excellent economic prospects, good balance of payments situation, low external vulnerabilities, stable price levels, a progressive tax regime, a high degree of openness, and a large English-speaking population.

Also, the right host-country policies, such as promotion of private ownership and financial market regulation, have been pursued. Yet, FDI flows to India have lagged behind those of China, Brazil or Singapore. This indicates that India lacks in some of the crucial factors determining FDI flows, mainly infrastructure, labor reforms, and quality of governance.

India should improve on the above aspects to make it more attractive especially looking at issues like infrastructure, flexible labor laws, improved governance and overall accountability in public office and so forth. It will not only help attract more FDI but also increase domestic investments.

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