Effects of Foreign Direct Investment (FDI) in the Indian Economy

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Abstract:
In this paper we study the effects of Foreign Direct Investment (FDI) with respect to India and its economy. We try to analyze the merits and demerits of FDI upon implementation in the Indian domestic market.

Introduction:
Foreign direct investment (FDI) refers to the net inflows of investment 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. It is the sum of equity capital, other long-term capital, and short term capital as shown in the balance of payments. It usually involves participation in management, joint venture, transfer of technology and expertise.
There are two types of FDI: inward foreign direct investment and outward foreign direct investment, 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.

For FDI:

- causes a flow of money into the economy which stimulates economic activity
- Employment will increase
- Long run aggregate supply will shift outwards
-Aggregate demand will also shift outwards as investment is a component of aggregate demand
- it may give domestic producers an incentive to become more efficient
- the government of the country experiencing increasing levels of FDI will have a greater voice at international summits as their country will have more stakeholders in it .

Against FDI:

- Inflation may increase slightly.
- Domestic firms may suffer if they are relatively uncompetitive.
- if there is a lot of FDI into one industry e.g. the automotive industry then a country can become too dependent on it and it may turn into a risk that is why countries like the Czech Republic are "seeking to attract high value-added services such as research and development (e.g. biotechnology)"

FDI in India: A virtual Debate!!!

For:

I think to start with, FDI (foreign direct investment) multi-brand retail policy should be adopted as there is not any issue about the fact that this will affect the fellow shopkeeper's .Instead it will give ample opportunities to the unemployed (lower class) and also improve the quality of the product. I don't know that why Indian govt. has completely postponed the idea of passing the bill.

Against:

"Instead it will give ample opportunities to the unemployed (lower class)"
Corporations predict that a total of 2 million jobs will be created when they infiltrate India's economy. There are 200 million people in India, however, whose jobs depend on the retail sector, which intervention of big business will destroy through forcing small businesses to close and killing local economies.

"Improve quality of product"
Big businesses will monopolize their respective markets in India by destroying all small competitors, and then they will be in complete control of prices, so it will ultimately come at a cost. Also, after monopolizing, product quality will stop mattering, since all small businesses whose products competed in quality would be destroyed. Also, vegetables and fruits that will be imported from outside India will be not fresh and stale due to long distance transportation and constant refrigeration.
My argument is that FDI of major corporations in India will lead to detrimental effects, such as unemployment, destruction of local economies, and the consumers of India will not benefit.

Letting India's economy be hijacked by large foreign corporations is a bad idea.

For:

"Intervention of big business will destroy through forcing small businesses to close and killing local economies."

How can intervention of big businesses destroy and kill local economies India most of the local areas and villages already have the local retail shops. They won't be affected as the foreign retail investments would be only establishing themselves in metropolitan and centralized cities like Delhi, Mumbai etc. plus PM also said that each and every city can decide whether to have FDI policy in their area or not.

"Product quality will stop mattering"

Product quality can't stop mattering at all because every day there is numerous cases of fake dairy products. You may not be familiar with that fact but I am.

"Destroying all small competitors"

Entering of multi-retail brands such as Wal-Mart to India would have no effect on local shops. It will give a good competition to companies like reliance fresh (which is also similar to Wal-Mart and yet it has not at all had any significant effect on local retail shops.).plus brands like reliance can also learn so much from these foreign brands.

Against:

"How can intervention of big businesses destroy and kill local economies India most of the local areas and villages?"

Big businesses will destroy local economies by displacing many people affiliated with small businesses, including shopkeepers, hawkers, vendors, and workers.

"They won't be affected as the foreign retail investments would be only establishing themselves in metropolitan and centralized cities."

Who said that they are restricted to metropolitan and centralized cities? Also, establishment of large foreign businesses in metropolitan cities would have to affect neighboring villages and towns, since products will be branched off to them. When FDI hit Thailand, 60,000 small shops closed. Through market saturation, large corporations are able to create widespread impact in an economy.

"Fake dairy products"

The opponent is correct that I am unfamiliar with this claim... and I cannot find any information about it. I'm still not sure, though, how it is relevant to my argument that, through monopolization, large corporations can lower product quality due to a huge decrease in competition.

According to a study, when two malls were established next to 82 small shops and 29 hawkers, these were the effects on them:

"-71% of small businesses sampled reported falling sales.

-Sales decline is evenly distributed by value of inventory up to 25 lakhs. It has most frequently impacted larger shops in the size range of 400-500 sq ft and 300-400 sq ft and those less than 100 sq. ft.

-Highest concentration in declining sales by business type was experienced in grocery stores who, of those sampled, 87% reported a decline in sales.

-63 % of the sample said that they felt threatened by the Malls. 50% of the sample was expecting serious trouble. 92% said that their children would not continue with the business.

-Hawkers are facing increasing eviction drives and harassment around the Malls. 41% reported an increase in eviction drives, 24% in harassment by agents of the Malls, 17% increase in bribes and hafta.

-72% of hawkers experienced a fall in sales and all reported falling profits, which means falling income for them."

Moreover, there is a negative impact on farming, since large corporations will push farmers to work for them and get involved in single-crop farming and the use of artificial means of farming. Due to monopolization, farmers will have to sell their products to corporations at the offered price, whatever it may be. This is already starting to happen in India.

Is FDI in retail bane or boon?

The government's decision to open up Foreign Direct Investment (FDI) in the retail sector has created uproar of opposition in the political arena. However there seems to be a greater diversity of opinion among our readers at least. On Sunday 27 November, Firstpost Published an article titled, Manmohan Singh's big retail risk which has received a number of comments arguing both for and against FDI in the retail sector. We found these comments extremely interesting and thought provoking in terms of the points they raised, and have therefore decided to publish a cross section of them here.

The FDI issue has points both for and against it:

Some readers such as Arul Prakash feel that the measures will put farmers at a disadvantage and also result in a situation where consumers are not given the freshest produce. He writes, "Once they come the farmers who now have several middleman to sell their goods..will have only a few retail stores to sell in future.

Usually that means price he gets will not be as competitive as it is today. Second! the same supermarkets may not actually give the best products grown in India to Indians..third! they can alter the food habits of the nation. Instead of eating fresh foods we will all be eating canned foods soon!"

"Guest", an anonymous commenter on the article also feels that FDI will be more bane than boon.

He says, "Manmohan Singh and his team may believe that Wal-Mart, Carrefour etc. are coming to India to uplift the condition of agricultural sector and will improve supply chain efficiency. We believe they are coming for sheer profit motives and if that means squeezing the billion+ Indians, selling Chinese goods, killing indigenous ventures - they will do that. Today's independent entrepreneur and businessmen will become their salaried employees."

On the other side of the debate, Shiva Kakkar does not believe that the entry of foreign players such as Wal-Mart will necessarily kill off the kirana stores, and says that India's bad supply chain management could do with some propping up. He says, "Opening up of foreign store does guarantee one thing – stiffer competition and aggressive pricing and better quality of service. But that doesn't mean that Kirana store guys would die of hunger. They have their own clientele and I have seen that when competition stiffens they tend to adapt to it. I come from a tier 2 city. When Reliance and Big Bazaar first entered, there was the same opposition but after that I have seen many small Kirana store owners turn their stores into departmental format and they seem to have maintained their clientele. Secondly, I have noted that they tend to have a better hold of tastes of the local public, for e.g. shich variety of rice or wheat sells more than others etc. The one good thing was that it was only after the onslaught of retail chains, the kirana guys started valuing customers. I have seen men who wouldn't give a damn if you stomped out of their shops change their attitude and give better service. Still, the return policies and complaints department happens to be a problematic affair for local stores. Truly speaking, I am thrilled how foreign retailers would handle the Indian retail scenario.

Secondly, people arguing on supply lines being 'hijacked' by Wal-Mart need to see the footage rolling on Rice and Wheat rotting in rains that was flashing on every channel barely a month ago. Had efficient supply chain management been there, thousands of tonnes of those grains could have been saved. Accept it - India is BAD at supply chain management, be it PDS or private. We need expertise of foreign retailers. Maybe, it has a lesson or two for us too."

Meanwhile another reader, "Catamaran" says that the government decision is a brave one, and the opposition to the move should be ignored in the interest of India's future. In his own words, "Good Move…by Government..Every good thing has opposition in this world before the actual fools start to see the benefits of it….same happened when India was opened to foreign companies in 1992..now see where is INDIA..at least the world recognize us today…Wait n Watch..INDIA will do much well by these kind of brave decisions.."

Yet other readers such as Sai, see both the positives and negatives of the FDI move. On the positive side he cites "Infrastructure build up, more cold storage's, less food rotting, for urban and semi urban's its very good in terms of creating new jobs for those who wanted to work but not finding it and also encourage for part time jobs, introduction of new brands, its will be only allowed to 50-60 cities i.e. only 20% of total population, 80% people still go for kirana's…"

However he sees negatives too. "Wal-Mart especially has very bad track record in handling its own employees, developed countries US and Euros have negative statement that Multi Brand retailers cut the jobs and give less returns to the farmers from what they were getting before they enter their market, might hamper Kirana's where they will open store, may in coming years will lead to cane foods in India and at higher prices so will lead to higher inflation…. The biggest concern is that may change people's mentality, India is country where people saves more, but after these multi brands enter, people will spend more and save less(as we all know how we behave when we enter a shopping mall).. that's the reason why US and Euro went through 2008 meltdown and still wont be able to recover and might in 2-3 years will be declared bankrupt's."

Merits/Demerits of Foreign Direct Investment:

Merits:

Merits-Attracting foreign direct investment has become an integral part of the economic development strategies for India. FDI ensures a huge amount of domestic capital, production level, and employment opportunities in the developing countries, which is a major step towards the economic growth of the country. The effects of FDI are by and large transformative. The incorporation of a range of well-composed and relevant policies will boost up the profit ratio from Foreign Direct Investment higher. Some of the biggest advantages of FDI enjoyed by India have been listed as under:

Economic growth- This is one of the major sectors, which is enormously benefited from foreign direct investment. A remarkable inflow of FDI in various industrial units in India has boosted the economic life of country.

Trade- Foreign Direct Investments have opened a wide spectrum of opportunities in the trading of goods and services in India both in terms of import and export production. Products of superior quality are manufactured by various industries in India due to greater amount of FDI inflows in the country.

Employment and skill levels- FDI have also ensured a number of employment opportunities by aiding the setting up of industrial units in various corners of India.

Technology diffusion and knowledge transfer- FDI apparently helps in the outsourcing of knowledge from India especially in the Information Technology sector. It helps in developing the know-how process in India in terms of enhancing the technological advancement in India.

Linkages and spillovers to domestic firms- Various foreign firms are now occupying a position in the Indian market through Joint Ventures and collaboration concerns. The maximum amount of the profits gained by the foreign firms through these joint ventures is spent on the Indian market.

<u>Demerits:</u>

Demerits of FDI in India: FDI has been a booming factor that has bolstered the economic life of India, but on the other hand it is also being blamed for ousting domestic inflows. FDI is also claimed to have lowered few regulatory standards in terms of investment patterns:

The disadvantages of foreign direct investment occur mostly in case of matters related to operation, distribution of the profits made on the investment and the personnel. One of the most indirect disadvantages of foreign direct investment is that the economically backward section of the host country is always inconvenienced when the stream of foreign direct investment is negatively affected.

The various disadvantages of foreign direct investment are understood where the host country has some sort of national secret – something that is not meant to be disclosed to the rest of the world. It has been observed that the defense of a country has faced risks as a result of the foreign direct investment in the country.

At times it has been observed that certain foreign policies are adopted that are not appreciated by the workers of the recipient country. Foreign direct investment, at times, is also disadvantageous for the ones who are making the investment themselves.

Foreign direct investment may entail high travel and communications expenses. The differences of language and culture that exist between the country of the investor and the host country could also pose problems in case of foreign direct investment.

Another major disadvantage of foreign direct investment is that there is a chance that a company may lose out on its ownership to an overseas company. This has often caused many companies to approach foreign direct investment with a certain amount of caution.

To Sum up!!!

Positives:

Foreign direct investment would allow India to secure foreign infrastructure into India, which would increase India's capital base rapidly. If anything if India can attract FDI in the big picture it's nothing but positive things. China has grown tremendously because of FDI. So, the benefits can be listed as:

- Employments opportunities
- reduce spoilage and
- enable the delivery of affordable products to customers.

Negatives:

The negatives are that it can affect local communities, when larger projects come in. It also means subjecting domestic firms to foreign competition which can harm domestic firms, and this isn't necessarily due to incompetence of the domestic firm. Foreign firms may have technology that India has not acquired. On the other hand FDI brings those technologies to India much quicker. The negative impacts:

-improper time of allowing FDI in Retail in India because of lack of infrastructure and

-taking of revenue and market share by the big foreign giants.

Conclusion

The primary source of information on a boring Sunday evening came when a friend of mine actually called me up to help him with some of his college work. Guess what he had to prepare for his college debate the very next day!!!The topic was "FDI in India". I quickly glanced through the ever so dependent Wikipedia article on FDI and began my information search quest through the fascinating world of the internet. I chanced upon one video on YouTube where the language of the same content coming from a financial broadcast drifts drastically to optimism in hopes to play the bull and the bear game. The broadcast had roped in some top management gurus to tarot card the future. "India is an idea that will take off this year". In this thirty minutes program, the gentleman devoted twenty-eight minutes to ideate an optimistic view for the leap year while the ad agencies squeezed out two minutes to sell a million things possible. Two topics that strongly emerged from this discussion were the introduction of FDI in India and the impact of new products on the growth rate in these recessionary times. Following are my views on these issues.

I have been reading many articles on the impact of FDI in India. I am happy for giants like Starbucks and IKEA entering the Indian market. I hope Starbucks does influence the Indian political system in some way but IKEA is going to be a game changer in the interior industry. Apart from this, how does FDI revolutionize everyday buying?

The first thing I recall reading FDI is the famous retail chain- More. More was the first place where my father learnt about the discounts being offered on the MRP. What he thought was a fascinating concept is actually a headache to the local ‘Mudir Dokan’ stores. A few months later when the local More store started winding up, the local ‘Mudir Dokan’ stores saw every Tom, Dick and Harry ask for a bargain. But if more was such a fascinating place, why did the retail chain shut down? Let me take you on a demographic ride around my residential area

Let’s fix the ‘zero mile’ at the entrance of my residence. Travel some miles and you see an Infosys like campus called ‘Big Bazaar’, take the second right and a sober looking ‘Bazaar Kolkata’ welcomes you. A few blocks down the road you see a place crowded with everyday vegetables and everyday people; that’s Reliance fresh. After all the hustle and bustle when you finally return home, keep an eye to the left; you will probably stop at the wine selling ‘Godrej Natura’. I am not sure what exactly will FDI do in the retail sector. There may be some kind of revolution in everyday buying but I am sure my father will not dump his local ration card for some loyalty cards program.

Another subject interesting about this century is the rise of Africa. Slowly and steadily, the ‘first world’ has realized the direct connection of the population with customers. Now what do I mean by the rise of Africa? Let’s take an Indian example. I was born in 1992 and by mid 2012 I had a simple idea to be a millionaire. Thanks to engineering text books, crazy ideas came to me effortlessly. So what was the idea? To collect one rupee from every Indian that would make me rich by a million dollars. Now what seems like a simple plan is actually a complicated business with competition coming from places as far as America. One billion plus population with nearly 700 million customers ready to buy an affordable, feature rich product, and that’s a market twice as large as U.S.

Bottom of the pyramid is a term long used in business and currently being reinforced with design thinking for the BRICs (Brazil, Russia, India and China). We have seen giant companies like GE and Philips come up with affordable products sold with low margins and a strategy relying heavily on the foundations of scalability. These products are designed for the emerging markets and compete with similar products launched by the ‘local entrepreneurs’ that specialize in catching up with the competition. The only way a product can survive and/or maintain its market share is by incorporation the right ‘looks’ and the ‘desired’ features. This is when Design Research powered by Product Design will slowly make way into the boardroom.

Way back in 2009, I was shopping at an Electronic outlet and found myself staring at a brightly lit glass cube with some four-grand, two-inch gizmo inside. This was a Sony USM 2 (GB) SE pen drive that sounded more like an American sergeant on mission. Three years down the line, prices for a pen drive have reduced by a factor of eight and are usually stacked in plastic buckets and sold around the cash counter. Growth can either be achieved by improving your products and services or by introducing new products and services. Now some ‘curve’ in the management theory will stop you from launching new products under such volatile conditions and respecting this theory, the only option remains is refinement. So how much growth do you expect by selling the same old products with new brochure? In years from now, targeting the mass market with refined products will not define growth. Growth will be achieved by platform based innovations that would make a feature rich product affordable in the mass market.