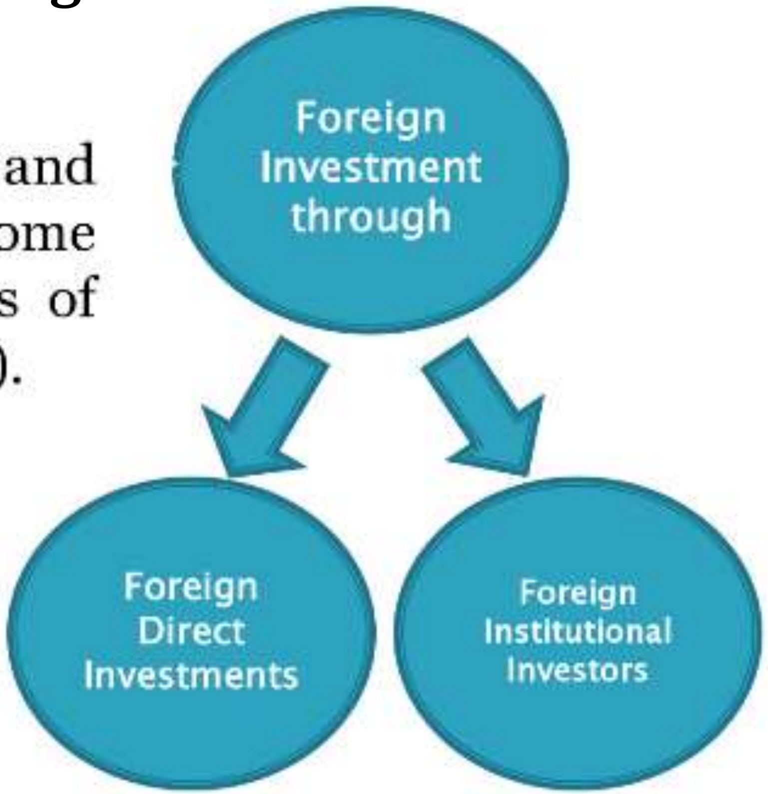
MODULE:V
FOREIGN DIRECT INVESTMENT

An Investment is..

The commitment of money or capital to purchase financial instruments or assets in order to gain profitable returns.

An Investment becomes foreign investment when

Investment done by citizens and government of one country (home country) invest in industries of another country (host country).



What is foreign direct investment?

An **indirect investment** is one where the investor does not gain control of the entity he or she invests in

- ✓ I can buy stock in Toyota, but Toyota’s management won’t pay much attention to my opinions.

A **direct investment** is one where the investing company creates a new business or gains control

- ✓ When BP bought the whole of Amoco (a U.S. oil company), it took control of the firm

Taking control of the business your firm will work with may:

- ✓ decrease operating costs
  - because it results in better coordination
- ✓ increase rate of technology transfer
  - because businesses are willing to transfer tech to units they control

Foreign direct investment (FDI) refers to long term participation by a country into another country. It usually involves participation in management, joint-venture, transfer of technology, managing supply chain, distributing and expertise etc.

FDIs around here – Hitachi, Fujitsu, Sony from Japan, BP from Britain, Volkswagen owns its own dealers.

You can enter foreign markets without control by…

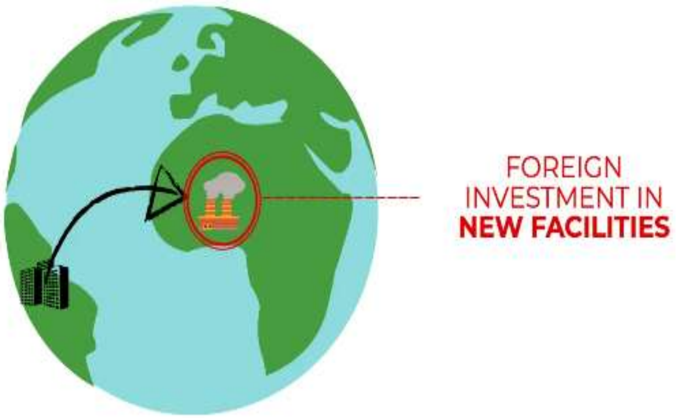
- Exporting – selling your goods overseas without setting up a unit abroad that you control
- Licensing – selling others the permission to use your knowhow
- Franchising – where you provide a complete package to allow others to set up a business like yours – is a kind of licensing

How companies make foreign direct investments

Acquisition: buying an existing company

- ✓ Easy to execute
- ✓ Gain brand identification and goodwill
- ✓ Best if your company is attempting to acquire knowledge

Building a **new unit** from scratch (‘Greenfield’ investment):



- ✓ hire or buy local resources
- ✓ construct or buy
- ✓ buildings build own labor force
  - ➢Foreign personnel may be difficult to hire
  - ➢You control the results

When Sony set up a network to sell its TVs in the US, it set up a company and hired people here.

The Investor’s Advantage

Foreign direct investment is correlated with profitability.

- Companies that do more foreign direct investment are, on average, more profitable

Why?

Create supremacy over other companies in countries of interest (monopoly)

- Sell more efficiently
- Get to know markets, resource sources better
- Foreign currency may have a high buying power
- May be able to borrow capital at a lower interest rate than companies from other countries

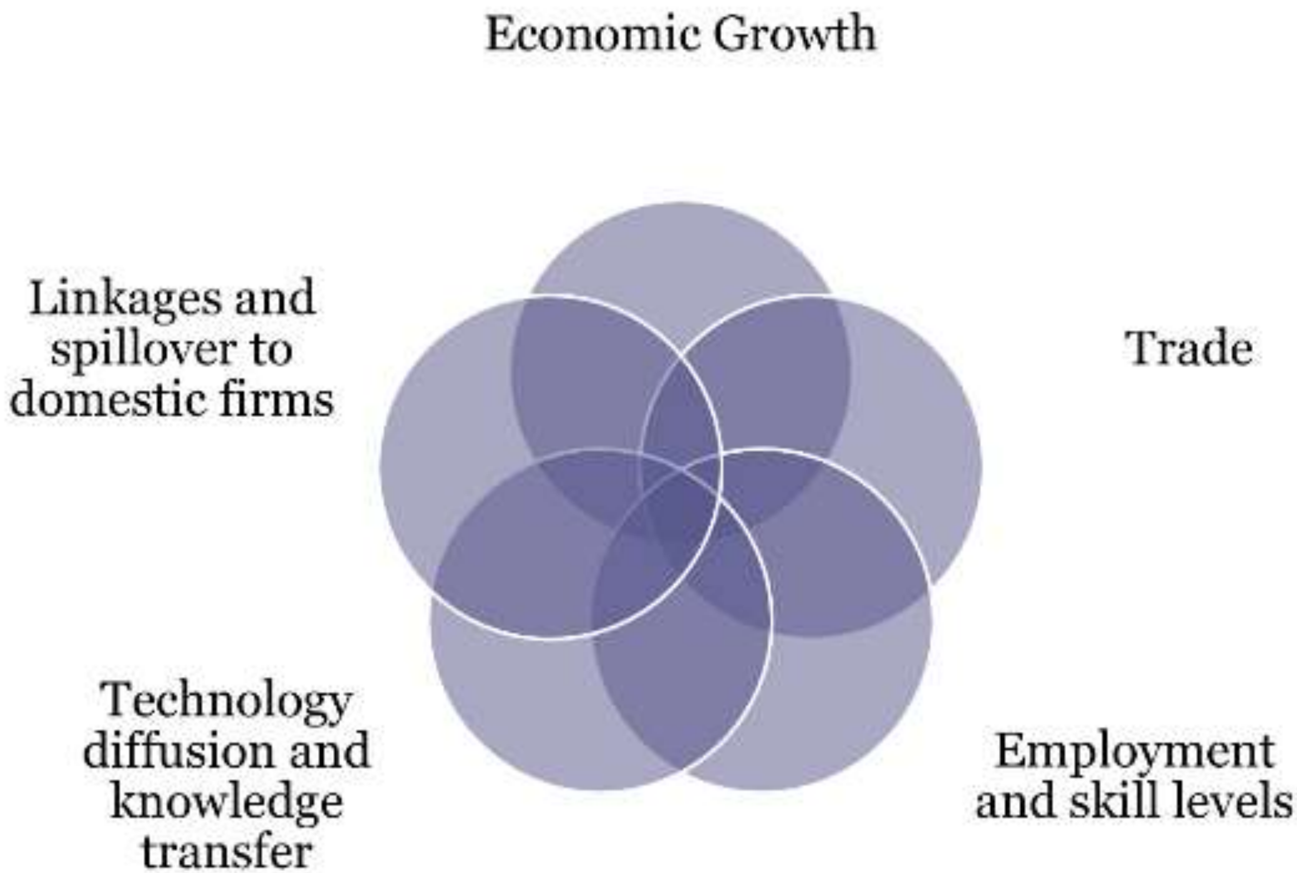
Factors Required to Attract FDI

- Low cost BUT Qualified, Educated/Skilled Labor Pool.
- Long-term Market Potential OR Yields greater than can be achieved Domestically.
- Access to Natural Resources.
- Geography
- Stability of the economic and Political Environment.

- Mining of iron, manganese, chrome, gypsum, sulphur, gold, diamonds, copper, zinc.
- Lottery Business
- Agricultural or plantation activities
- Housing and Real Estate Business (except development of townships, construction of residen-tial/commercial premises, roads or bridges to the extent specified in NotificationNo. FEMA 136/2005-RB dated July 19, 2005)

Advantages of FDI

- Employment and Economic Boost-
- Increased Productivity-
- Increment in Income-
- Quality of products and flow of technology-
- Increase in government revenue-
- Increased Capital Investment
- New Technology and “Know How” Transfer.


Economic Growth
Trade
Employment and skill levels
Technology diffusion and knowledge transfer
Linkages and spillover to domestic firms

Disadvantages of FDI

- Bad deal for the small entrepreneurs
- Inflation
- Limited employment generation
- Cultural erosion
- Corruption
- Technological Dependence on Foreign Technology Sources

Flow of FDI in India

Currently FDI is permitted in India

- Through financial collaborations.
- Through joint ventures and technical collaborations.
- Through capital markets via Euro issues.
- Through private placements or preferential allotments.

Major Sector for FDI in India are

- Infrastructure
- Automotive
- Pharmaceuticals
- Defense
- Retails
- Railways Infrastructure
- Chemicals
- Textiles
- Airlines

Sector for which FDI is NOT permitted in India are

- Arms and ammunition
- Atomic Energy
- Railway Transport
- Coal and lignite
- Agriculture
- Housing and Real Estate business

Major MNC's under FDI in India are

- ✓ Apple
- ✓ Vodafone
- ✓ Ford Motors
- ✓ LG
- ✓ Samsung
- ✓ Hyundai
- ✓ Accenture
- ✓ Reebok
- ✓ Skoda Motors

Impact of FDI on Indian Economy

- ✓ Investment provides the base and pre-requisite for economic growth and development.
- ✓ Apart from a nation's foreign exchange reserves, exports, government's revenue, financial position, available supply of domestic savings, magnitude and quality of foreign investment are necessary for the well being of a country.

- ✓ FDI is the safest type of international capital flows out of all the available sources of external finance available.
- ✓ FDI provides a win — win situation to the host and the home countries. Both countries are directly interested in inviting FDI because they benefit a lot from such type of investment.
- ✓ FDI can help to raise the output, production and export at the sectoral level of the Indian economy

It is advisable to open up the export oriented sectors and higher growth of economy could be achieved through the growth of these sectors. FDI affects the GDP of a country directly and hence they are positively correlated.

THANK YOU