



International Capital Movements: Foreign Direct Investment

Chapter 4 Unit 5

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Types of Foreign Capital

- **Foreign capital includes any inflow of capital into the home country from abroad**

Important components of foreign capital flows

Foreign aid or assistance

- a) Bilateral**
- b) Multilateral aid**
- c) Tied aid and untied aid**
- d) Foreign grants**

Borrowings

- a) Direct inter government loans**
- b) Loans from international institutions (e.g. world bank, IMF, ADB)**
- c) Soft loans for e.g. from affiliates of World Bank such as IDA**
- d) External commercial borrowing, and**
- e) Trade credit facilities**

More

- **Deposits from nonresident Indians (NRI)**
- **Investments in the form of :**
- **Foreign portfolio investment (FPI) in bonds, stocks and securities, and**
- **Foreign direct investment(FDI) in industrial, commercial and similar other enterprises**

Foreign Direct Investment (FDI)

- **The resident of one country (i.e. Home country) acquires ownership of an asset in another country (i.e. The host country)**
- **Involves ownership, control as well as management of the asset in the host country**

Foreign Direct Investment (FDI)

- **Real investments**
- **Exercise control**
- **Long term relationship and lasting interest**
- **acquisition of more than 10 percent of the shares of the target asset.**

Foreign Direct Investment (FDI)

- **Has three components**
- **Equity capital**
- **Reinvested earnings and**
- **Other direct capital**

The main forms of direct investments

- **Opening of overseas companies,**
- **Creation of joint ventures**
- **Joint development of natural resources**

Foreign Portfolio Investment (FPI)

- **‘Financial capital’**
- **Not involve ownership or control**
- **investment in financial stocks, bonds and other financial instruments**

Foreign Portfolio Investment (FPI)

- **Effected largely capital market**
- **Not concerned with manufacture or provision of services.**
- **Search of returns**
- **Total stake in a firm at below 10 percent**
- **Expected to be speculative**
- **Sudden and destabilizing reversals of portfolio investment**

Foreign Direct Investment (FDI)

- **Horizontal direct investment**
- **Vertical investment**
- **Conglomerate type**
- **Reciprocal two- way direct foreign investments**

- **Desire to reap economies of large-scale**
- **Lack of feasibility of licensing agreements**
- **To avoid future competition**

- **Desire to capture large and rapidly growing high potential emerging markets**
- **Ease of penetration getting behind the tariff wall' import restrictions**
- **Lower environmental standards in the host country and saving in costs**

- **Stable political environment**
- **Overall favourable investment climate in the host country**
- **Higher degree of openness to foreign capital exhibited by the recipient country**

- **Prevalence of preferential investment systems**
- **The strategy to obtain control of strategic raw material**
- **Existence of low relative wages in the host country**
- **Lower level of economic efficiency in host countries**

- **Tax differentials**
- **Tax policies of the host country which support direct investment.**
- **Philanthropic objectives**
- **Economic, political, and social stability**

- **Policies on functioning and structure of markets**
- **International agreements on FDI**
- **Privatization policy**
- **Favourable Trade policies**
- **Investment promotion and investment-facilitation services**

- **Investment incentives**
- **Lower ‘hassle costs” (related to corruption and administrative efficiency)**
- **High quality after-investment services**

Factors that discourage FDI

- **Infrastructure lags,**
- **High rates of inflation,**
- **Balance of payment deficits,**
- **Poor literacy and low labour skills,**
- **Rigidity in the labour market**

- **Bureaucracy and corruption,**
- **Unfavourable tax regime,**
- **Cumbersome legal formalities and delays, small size of market and lack of potential for its growth,**
- **Political instability,**
- **Absence of well-defined property rights,**

- **Exchange rate volatility,**
- **poor track-record of investments,**
- **Prevalence of non-tariff barriers,**
- **Stringent regulations,**
- **Lack of openness,**
- **Language barriers,**
- **High rates of industrial disputes,**

- **Lack of security to life and property,**
- **Lack of facilities for immigration and employment of foreign technical and administrative personnel,**
- **Double taxation and**
- **Lack of a general spirit of friendliness towards foreign investors.**

Modes of Foreign Direct Investment (FDI)

- **Opening of a subsidiary or associate**
- **Equity injection**
- **Acquiring a controlling interest**

Modes of Foreign Direct Investment (FDI)

- **Mergers and acquisitions(M&A)**
- **Joint venture**
- **Green field investment**
- **Brownfield investment**

Benefits of Foreign Direct Investment

- **competitive environment in the host country**
- **Cost-reducing and quality-improving innovations**
- **Higher efficiency**
- **wider choice and welfare for consumers**

- **More investment**
- **Enhance the total output**
- **Growth and foster economic development**
- **Employment in the recipient country**
- **Promote the exports of developing countries**

- **Secure scarce foreign exchange**
- **source of new tax revenue**
- **Scale economies**
- **weakening of the market power of domestic monopolies**
- **overall human resources development.**

Potential Problems

- **highly focused on profits , not on development needs**
- **Likely to concentrate on capital-intensive methods**
- **FDI may force local competitors**
- **of outflow of capital can happen**

- **Indigenously developed technology may suffer**
- **Exploitation of local resources**

- **Potential to accentuate regional disparity**
- **Accentuate income inequalities**
- **through ‘crowding-out’ effect.**
- **capital away from crucial investments**

- **Jobs retained in the home country host country is left with routine management jobs**
- **Human resource development may not be realized**
- **advertising and anticompetitive practices which would induce market distortions.**

- **Even drive out domestic firms from the industry**
- **High degree of market power and exist as monopolists**
- **High growth of wages in foreign corporations**

- **Cost Escalation in the domestic corporations**
- **Decreasing competitiveness of domestic companies**
- **Off –shoring’, or shifting jobs and operations abroad in pursuit of lower operating costs**

- **Potential national security considerations**
- **Impact on the host country's commodity terms of trade**

- **Ruthless exploitation of natural resources and the possible environmental damage.**
- **Possibility of emergence of a dual economy**
- **Can exert excessive amount of power in a variety of ways**

- **Loss of control by host country over domestic policies**
- **Less developed host country's sovereignty is put at risk**
- **Corruption issues**
- **Unduly influencing policy making and evasion of corporate social responsibility**

- **100 per cent FDI in Insurance intermediaries in India to give a boost to the sector and attracting more funds.**

9 th largest recipient

- **Foreign direct investment equity inflows to India in financial year 2020, by leading investing country(*in billion Indian rupees*)**
- **See next slide**

Source IBEF

In 2020-21 (between April 2020 and September 2020),

- **India received the maximum FDI equity inflows from**
- **Followed by the US**
- **Cayman islands**
- **Mauritius**
- **The netherlands and**
- **The UK**

In 2020-21 (between April 2020 and September 2020),

- **Gujarat received the maximum FDI equity inflows**
- **followed by Maharashtra at**
- **Karnataka**
- **and Delhi**

OFDI

- **India's outward Foreign Direct Investment (OFDI) in equity, loan and guarantee issue stood at US\$ 1.69 billion in February 2019. (RBI),**

- **The department of industrial policy and promotion (DIPP) has been changed to Department For Promotion of Industry And Internal Trade (DPIIT)**



India Investment Grid (IIG).

- **The department has undertaken an initiative known as India Investment Grid (IIG.) in association with Invest India, India's national investment and facilitation agency.**

Some of the major overseas investments by Indian companies in 2019

- **Infosys to acquire 75 per cent stake in ABN AMRO's subsidiary.**
- **Sun Pharmaceuticals raised its stake Russia's PJSC Biosintez to 96.96 per cent.**

- **Auto components major JBM group has purchased a majority stake in linde-wiemann, a German structural components and assemblies producer.**

- **Hospitality start-up Oyo is planning to invest US\$ 1.2 billion for its expansion.**
- **Ashok Leyland has set up a new facility in Dhaka, Bangladesh in a joint venture with IFAD Autos.**

- **Indian IT major Infosys is going to set up a technology and innovation hub in Texas and hire 500 American workers by 2020.**

- **Tyre Manufacturer Balkrishna Industries is going to set up a US\$ 100 million production facility in US.**
- **Apollo Tyres has commenced commercial production of its truck tyres at its facility in Hungaria.**

- **Pidilite Lanka Pvt Ltd, adhesives manufacturer
Pidilite's joint venture (JV)
company with Macbentan
Pvt Ltd, unveiled a new
world class manufacturing
plant in Sri Lanka.**

- **Government of India's Public Sector Undertakings (PSUs) have invested over US\$ 15 billion in Russia's oil and gas projects**

- **The RBI, encouraged by adequate forex reserves, has relaxed the norms for domestic companies investing abroad**
- **The RBI also liberalised/ rationalised guidelines for foreign investments abroad by Indian companies**

- **It raised the annual overseas investment ceiling to US\$ 125,000 from US\$ 75,000 to establish JV and wholly owned subsidiaries.**

2020

- **ONGC Videsh Ltd invested a total of \$131.85 million in joint ventures and wholly-owned subsidiaries in Myanmar, Russia, Vietnam, Colombia, British Virgin Islands among others.**

Other important firms

- **JSW Steel,**
- **Haldia Petrochemicals,**
- **HCL Technologies, and**
- **Mahindra & Mahindra**

- **Tata Consultancy Services** invested **\$27.77 million** in a **wholly-owned unit in Ireland.**
- **Intas Pharmaceuticals** invested **\$75.22 million** in a **wholly-owned subsidiary in the UK**

2020 Announcements

- **The limits for FPI investment in Government securities (G-secs) and State Development Loans (SDLs)**
- **shall remain unchanged at 6% and 2%, respectively, of outstanding stocks of securities for FY 2020-21.**

March 2020

- **Fully Accessible Route' for Investment by Non-residents in Government Securities**
- **Separate route for investment by non-residents in securities issued by the government of india**