Foreign Direct Investment

[UPSC Notes]

What is FDI?

Foreign Direct Investment or FDI is when a foreign company invests their money in a company of another country. When a company or individual invests money in a company of another country, then the nation of the investment company is called the home country, and the country where the investment takes place is called the host country.

The term Foreign Direct Investment [FDI] refers to an investment made through capital instruments by a person not a resident of India.

- In an unlisted Indian firm or
- Ten percent or more of a listed Indian company's post-issue paid-up equity capital is fully diluted.

Through these FDI, the company can take ownership and stakes in more than one company in different fields. As a result, it can help to increase and expand the business. In addition, through this act, investors become capable of being part of the daily discussion and decision process of the company in which they have invested.

Not Capital Intensive: FDI is how one business supports the other in various ways.

- For example, foreign investors fund business and bring new technology to companies with the required resources to boost business growth.
- Most of cases, foreign direct investments are made when they find the potential in the business and the market in which they are investing,

FDI is the best way to get investment from foreign companies without debt to improve and boost the business model.

Types of FDI

Foreign direct investment can be classified into horizontal, vertical, and conglomerate.

- 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.

- Vertical FDI

In this type of investment, the company makes the investment in another company dealing with a complementary type of business. For example, Suppose company X wants to invest in any company in the form of FDI. In that case, they will invest in a company selling raw materials required by company X, called a vertical investment.

- Conglomerate FDI

In this type of investment, the company could invest in any firm, business, or startup, even if it is not from the same industry. FDI investment will make a huge opportunity for the business to explore the new area and gain experience in different fields.

Components of FDI

The three FDI components and their brief description is mentioned below

- **Equity capital** happens when the company owns a share to profit from the multiple-business. The purchase of shares in a company in a country other than one's own by a foreign direct investor is known as equity capital.
- **Reinvested earnings:** The direct investor reinvests profit in the company for further profits. Profits not dispersed as dividends by affiliates or earnings not remitted to the direct investor are referred to as "reinvested earnings." Affiliates reinvest their reserved gains.
- **Intra company loans** include investing by any investor for a brief period for further gains. Intra-company loans are short- and long-term borrowing and lending transactions between direct investors (or firms) and affiliate enterprises.

Method of FDI in India

Foreign Direct Investment [FDI] in India is mainly made through two channels:

Automatic Method of FDI

In this method, when investors are investing, they do not need the government's permission to invest in the country and can make investments easily without any approval.

- In India, automatic FDI investments are made only in no critical sectors like medical, thermal power insurance, petroleum, and aviation.
- The Automatic Route eliminates the need for a non-resident investor or an Indian corporation to seek Government of India clearance for their investment.
- The Reserve Bank of India manages the Automatic Route of FDI.

Government Method of FDI

The Government Approval Route necessitates approval from the Indian government before investment. In this method, the company needs to take the government's permission before making an investment in the country; such investments are made for critical sectors like defense, telecommunication, satellite, and private security agencies only after the government's permission.

- The foreign investment facilitation department must approve investment permission before making it.
- The administrative ministry/department in question reviews proposals for Foreign Direct Investment [FDI] through the government route are reviewed by the administrative ministry/department in question.

Foreign Direct Investment In India

India opened its door to FDI in 1991 when the government invited companies to invest in India by initiating strategies like liberation, globalization, and privatization.

- The government of India made the FDI easy by easing the investment policies in India. Invest India's national investment promotion and facilitation agency was established in 2009. This is a non-profit venture run by the Ministry of Commerce and Industry's Department for Promotion of Industry and Internal Trade. Invest India focuses on sector-specific investor targeting and the formation of new partnerships to facilitate long-term investment in India.
- All the sectors welcome investment from all foreign countries, which increases the chances to expand their business, and gives them vast opportunities.
    - India is also on the list of 100 countries in the index of ease of doing business.
- India has shown an improvement in Foreign direct investment in the past years. According to a UN report, investment has increased by 16% from 2018 to 2019.
- According to the new policy from the department of promotion of industry and Trade, a company in a country that shares a border with India or investors in India can invest only through the government method.
- The Make in India initiative was launched with FDI in liberalized manufacturing norms.

FDI Boost in India

There have been several efforts by the government to increase FDI in India in the form of amendments and changes in government policies.

Amendments: Production linked incentive scheme by the government for electronic manufacturing has been connected and attracted foreign direct investment from all over the world.
Amendment in the policy of investment to allow automatic investment in various sectors has further influenced the investors to invest more funds in Indian companies.

Government Change In Policy
The government also allows FDI in the digital industry, which opens the opportunity for the company because of excellent internet penetration and surge in connection and demands, which will give huge profits to investors.

- The government makes the permission process easier for foreign investors by providing a portal to take approval through online modes.

Foreign direct investment will increase because the investors seem influenced by the government's new investment policy.

Role of FDI in Indian Economy

The advantages and Disadvantages of FDI in India are listed below

Advantages of FDI in India

- It helps to enhance the business and the economy by supporting the local company which can do their own business and contributes considerably to the economy.
- It will help in the development of big business and the expansion of local business. All of these will help to enhance the economy and reduce poverty.

Disadvantage of FDI in India

- Foreign direct investment or exchange rate limits may be harmful to the investors.
- When a company invests in other countries, it can affect the investment in the companies in the domestic market.
- Often, exchange rates are limited to benefit one company and derogate the benefit of another company.
- Foreign direct investment is a capital-intensive deal, which makes it risky for the company to invest in a new start-up and business in the market due to the higher risk of failure.

Impact of FDI on Indian Economy

- Foreign direct investment can help increase the economy by transferring the resources, skills, and technology to businesses that expand and grow.
- FDI also increases the company's assets by expanding the company's profit by improving cash flow by making an investment. This increases the productivity of the business & workers.
- It makes the rupee strong compared to dollars due to an increase in foreign countries' exports.
- As consumption increases, which leads to an increase in the companies' income and a rise in tax revenue and government spending.

Every investment has a gestation period, and the return increases after a few years.

New FDI Policy in India

1. To change the ownership in Foreign direct investment made by the company in an agreement, permission is required from the government in the agreement form.

2. Investors not covered under the policy must notify the government after making a capital transaction rather than before the trade.
3. According to the new law, China, along with Afghanistan and Bangladesh, have to invest through government methods, which means they have to take government permission, which was earlier limited to Afghanistan and Bangladesh.

Future of FDI in India

Foreign direct investment became the primary source of growing economy which cannot be removed in the future, as it has become the prime economic regulation source. India's economic recovery after covid and market growth also increased the chances of more investment and attracted investors to the market soon.

Foreign direct investment contributes to the economy through money, skills, and technology, and these investments help the company gain higher profits and increase its experience in various businesses. This is also the best way to build good relations with foreign countries, which can help future trade and industry. Furthermore, FDI helps to know about other countries business and their technology which can help do business in own country.