Outside Direct Investment Strategies in India

Suman
Research Scholar, Deptt of Economics , MDU Rohtak, Haryana (India)
Email : sumanghanghas246@gmail.com

ABSTRACT: In India, ODI is considered as a developmental tool, which helps in achieving self-reliance in various sectors and in overall development of the economy. India after liberalizing and globalizing the economy to the outside world in 1991, there was a massive increase in the flow of Outside direct investment. This study analyses ODI inflow into the country during the Post Liberalization period. Further, the trends of ODI inflow into the country are projected for a period of five years from 2010-11 to 2014-15 using Autoregressive Integrated Moving Average (ARIMA) forecasting technique. The study tries to examine the various set of factors which influence the flow of ODI Identifying the causes for low inflow and suggestive remedial measures to increase the flow of ODI in India with that of other developing nations in the world. Outside Direct Investment (ODI) plays a very important role in the development of the nation. It is very much vital in the case of underdeveloped and developing countries. A typical characteristic of these developing and underdeveloped economies is the fact that these economies do not have the needed level of savings and income in order to meet the required level of investment needed to sustain the growth of the economy. In such cases, outside direct investment plays an important role of bridging the gap between the available resources or funds and the required resources or funds. It plays an important role in the long-term development of a country not only as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities.

KEYWORDS: development, income, economy, growth, country, technology, Outside Direct Investment, important, infrastructure, India.

INTRODUCTION: India is a country with one of the oldest civilization in the world. It is a country where religions, languages and customs different from one another CO-exist. It appears to be a place of contrast with strong reactions and conflicting feelings, adding to the value and identity of the country. An Indian business man, Jagdish Parekh once observed that 'The Indian economy is like a coconut - it is hard on the outside, but once broken one can enjoy the taste of sweet liqueur. It is a favoured fruit for one who has patience'.

The World Bank has identified India as one of the powerful economic giants. With nearly a billion people, India is not only the world's largest democracy but a country of enormous economic and political potential. India has a long history of wide and specific economic Strategies swinging between regulation and Liberalization, based on the prevailing social, political and economic environment. Now India is changing faster than at any time as a result of new economic reforms oriented towards Privatization, Liberalization and globalization of the economy. All the regulated and liberal Strategy changes have proved to be significant in their own way resulting in the transformation of the Indian economy.

One of the most striking developments during the last two decades is the spectacular growth of ODI in the global economic landscape. This unprecedented growth of global ODI in 1990 around the world make ODI an important and vital component of development strategy in both developed and developing nations and Strategies are designed in order to stimulate inward flows. Infect, ODI provides a win – win situation to the host and the home countries. Both countries are directly interested in inviting ODI, because they benefit a lot from such type of investment. The 'home' countries want to take the advantage of the vast markets opened by industrial growth. On the other hand the 'host' countries want to acquire technological and managerial skills and supplement domestic savings and Outside exchange. Moreover, the paucity of all types of resources viz. financial, capital, entrepreneurship, technological know- how, skills and practices, access to markets- abroad- in their economic development, developing nations accepted ODI as a sole visible panacea for all their scarcities. Further, the integration of global financial markets paves ways to this explosive growth of ODI around the globe.

The historical background of ODI in India can be traced back with the establishment of East India Company of Britain. British capital came to India during the colonial era of Britain in India. However, researchers could not portray the complete history of ODI pouring in India due to lack of abundant and authentic data. Before independence major amount of ODI came from the British companies. British companies setup their units in mining sector and in those sectors that suits their own economic and business interest. After Second World War, Japanese companies entered Indian market and enhanced their trade with India, yet U.K. remained the most dominant investor in India.

Table-1ODI Inflows in India (From 1948-2010)

Amount of FDI	Mid 1948	March 1964	March 1974	March 1980	March 1990	March 2000	March 2010
In crores	256	565.5	916	933.2	2705	18486	1,23,378

There is a considerable decrease in the tariff rates on various importable goods. Table –1 shows ODI inflows in India from 1948 – 2010.ODI inflows during 1991-92 to March 2010 in India increased manifold as compared to during mid-1948 to march 1990 (Figure-1). The measures introduced by the government to liberalize provisions relating to ODI in 1991 lure investors from every corner of the world. There were just few (U.K, USA, Japan, Germany, etc.) major countries investing in India during the period mid-1948 to march 1990 and this number has increased to fifteen in 1991. India emerged as a strong economic player on the global front after its first generation of economic reforms. As a result of this, the list of investing countries to India reached to maximum number of 120 in 2008. Although, India is receiving ODI inflows from a number of sources but large percentage of ODI inflows is vested with few major countries. Mauritius, USA, UK, Japan, Singapore, Netherlands constitute 66 percent of the entire ODI inflows to India. ODI inflows are welcomed in 63 sectors in 2008 as compared to 16 sectors in 1991.

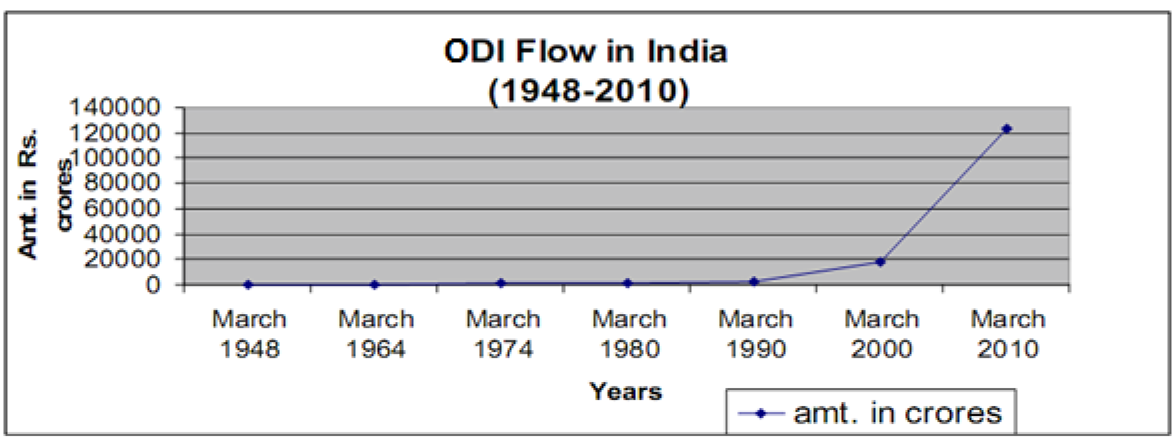

Figure – 1 ODI Inflows in India (From 1948-2010)

The ODI inflows in India during mid-1948 were Rs, 256 crores. It is almost double in March 1964 and increases further to Rs. 916 crores. India received a cumulative ODI inflow of Rs. 5,384.7 crores during mid-1948 to march 1990 as compared to Rs.1,41,864 crores during August 1991 to march 2010 (Table-1). It is observed from the (Figure –1) that there has been a steady flow of ODI in India after its independence. But there is a sharp rise in ODI inflows from 1998 onwards. U.K. the prominent investor during the pre and post independent era stands nowhere today as it holds a share of 6.1 percent of the total ODI inflows to India.

Further, after Independence issues relating to Outside capital, operations of MNCs, gained attention of the Strategy makers. Keeping in mind the national interests the Strategy makers designed the ODI Strategy which aims ODI as a medium for acquiring advanced technology and to mobilize outside exchange resources. The first Prime Minister of India considered outside investment as "necessary" not only to supplement domestic capital but also to secure scientific, technical, and industrial knowledge and capital equipment. With time and as per economic and political regimes there have been changes in the ODI Strategy too. The industrial Strategy of 1965, allowed MNCs to venture through technical collaboration in India. However, the country faced two severe crisis in the form of Outside exchange and financial resource mobilization during the second five year plan (1956 -61). Therefore, the government adopted a liberal attitude by allowing more frequent equity participation to Outside enterprises, and to accept equity capital in technical collaborations. The government also provides many incentives such as tax concessions, simplification of licensing procedures and de- reserving some industries such as drugs, aluminum, heavy electrical equipment, fertilizers, etc. in order to further boost the ODI inflows in the country. This liberal attitude of government towards Outside capital lures investors from other advanced countries like USA, Japan, and Germany, etc. But due to significant outflow of Outside reserves in the form of remittances of dividends, profits, royalties etc., the government has to adopt stringent outside Strategy in 1970s. During this period the government adopted a selective and highly restrictive outside Strategy as far as Outside capital, type of ODI and ownerships of Outside companies was concerned. Government setup Outside Investment Board and enacted Outside Exchange Regulation Act in order to regulate flow of Outside capital and ODI flow to India. The soaring oil prices continued low exports and deterioration in Balance of Payment position during 1980s forced the government to make necessary changes in the Outside Strategy. It is during this period the government encourages ODI, allow MNCs to operate in India. Thus, resulting in the partial liberalization of Indian Economy. The government introduces reforms in the industrial sector, aimed at increasing competency, efficiency and growth in industry through a stable, pragmatic and non-discriminatory Strategy for ODI flow.

REVIEW OF LITERATURE: The comprehensive literature centered on economies pertaining to empirical findings and theoretical rationale tends to demonstrate that ODI is necessary for sustained economic growth and development of any economy in this era of globalization.

Yew Siew Youg (2007) in his study, "Economic Integration, Outside Direct Investment and Growth in ASEAN five members" examines the effects of economic integration on ODI flows and the effects of ODI flows on economic growth in ASEAN 5 countries. The study found that market size, economic integration, human capital, infrastructure and existing ODI stock are the important determinants of ODI for ASEAN countries. The study also found that ODI, economic integration and human capital are robustly significant to economic growth, manufacturing sector growth and high technology sector growth for ASEAN countries. The ODI flow into ASEAN countries was found to be inversely proportional to the per capita income of the five countries.

It is concluded that the effect of ODI on economic growth of ASEANS countries was found to be higher for countries with higher per capita income. Coupled with strong intra – industry trade in the manufacturing sector of ASEAN countries an integrated approach to draw in ODI and promote manufacturing and high technology growth should be accelerated. The machinery and electrical appliances industry contributes the highest trade in the region and is highly integrated in intra – industry trade within the region. The key hubs of the industry within the region are Malaysia and Singapore.

Sasidharan Subash and Ramanathan A. (2007), study on "Outside Direct Investment and Spillovers: Evidence from Indian Manufacturing". It is an attempt to empirically examine the spillover effects from the entry of Outside firms using a firm level data of Indian manufacturing industries. Firm – level data of Indian manufacturing industries are used for the period 1994-2002. They consider both horizontal and vertical spillover effects of ODI. Consistent with the results of the previous studies, the study finds no evidence of horizontal spillover effects. However, the study finds negative vertical spillover effects.

Diana Viorela Matei (2007) in her study, "Outside Direct Investment location determinants in Central and Eastern European Countries" focuses on central and Eastern European former state – planned economies and investigates why multinationals chose to locate their investments in these countries. The main findings of the study are that market potential, privatization and agglomeration factors have significant effects upon ODI location choice, helping to explain the attractiveness for ODI of these host countries.

Dunning John H. (2004) in his study "Institutional Reform, ODI and European Transition Economics" studied the significance of institutional infrastructure and development as a determinant of ODI inflows into the European Transition Economies. The study examines the critical role of the institutional environment (comprising both institutions and the strategies and Strategies of organizations relating to these institutions) in reducing the transaction costs of both domestic and cross border business activity. By setting up an analytical framework the study identifies the determinants of ODI, and how these had changed over recent years.

Tomsaz Mickiewicz, Slavo Rasosevic and Urmas Varblane (2005), in their study, "The Value of Diversity: Outside Direct Investment and Employment in Central Europe during Economic Recovery", examine the role of ODI in job creation and job preservation as well as their role in changing the structure of employment. Their analysis refers to Czech Republic, Hungary, Slovakia and Estonia. They present descriptive stage model of ODI progression into Transition economy. They analyzed the employment aspects of the model. The study concluded that the role of ODI in employment creation/ preservation has been most successful in Hungary than in Estonia. The study also find out that the increasing differences in sectoral distribution of ODI employment across countries are closely relates to ODI inflows per capita. The bigger diversity of types of ODI is more favorable for the host economy. There is higher likelihood that it will lead to more diverse types of spillovers and skill transfers. If Strategy is unable to maximize the scale of ODI inflows then Strategy makers should focus much more on attracting diverse types of ODI.

Swapna S. Sinha (2007) in his thesis," Comparative Analysis of ODI in China and India: Can Laggards Learn from Leaders?" focuses on what lessons emerging markets that are laggards in attracting ODI, such as India, can learn from leader countries in attracting ODI, such as China in global economy. The study compares ODI inflows in China and India. It is found that India has grown due to its human capital, size of market, rate of growth of the market and political stability. For china, congenial business climate factors comprising of making structural changes, creating strategic infrastructure at SEZs and taking strategic Strategy initiatives of providing economic freedom, opening up its economy, attracting diasporas and creating flexible labour law were identified as drivers for attracting ODI.

Samuel Adams5 (2009) in his study, "Can Outside Direct Investment help to promote growth in Africa" provides a review of Outside Direct Investment and economic growth literature in the context of developing countries and particularly Sub- Saharan Africa. The main findings of the study are as follows, first, ODI contribution to economic development of the host country in two main ways, augmentation of domestic capital and enhancement of efficiency through the transfer of new technology, marketing and managerial skills, innovation and best practices. Secondly, ODI has both benefits and costs and its impact is determined by the country specific conditions in general and the Strategy environment in particular in terms of the ability to diversify, the level of absorption capacity, targeting of ODI and opportunities for linkages between ODI and domestic investment.

Basu P., Nayak N.C, Vani Archana (2007) in their study "Outside Direct Investment in India: Emerging Horizon", intends to study the qualitative shift in the ODI inflows in India in – depth in the last fourteen odd years as the bold new Strategy on economic front makes the country progress in both quantity and the way country attracted ODI. It reveals that the country is not only cost – effective but also hot destination for R&D activities. The study also finds out that R&D as a significant determining factor for ODI inflows for most of the industries in India. The software industry is showing intensive R&D activity, which has to be channelized in the form of export promotion for penetration in the new markets. The study also reveals strong negative influence of corporate tax on ODI inflows.

Kostevc Crt, Tjasa Redek, Andrej Susjan (2007) in their study "Outside Direct Investment and institutional Environment in Transition Economies" analysed the relation between ODI and the quality of the institutional environment in transition economies. The analysis confirmed a significant impact of various institutional aspects on the inflow of Outside capital. To isolate the importance of the institutional environment from the impact of other factors, a panel data analysis was performed using the data of 24 transition economies in the period 1995-2002. The findings showed that in the observed period the quality of the institutional environment significantly influenced the level of ODI in transition economies. Other variables that proved to have a statistically significant influence were budget deficit, insider privatization and labour cost per hour.

Rudi Beijnen (2007) in his study, "ODI in China: Effects on Regional Exports" investigates the existence of a significant ODI – Export linkage in China, using panel data at the provincial level over the 1995 to 2003. The theory of ODI proposes the possibility of an export creating effect. However, the results show that if the model is correctly specified, there is no evidence for the existence of a significant ODI-export linkage. The study concluded that the claims of the reference studies concerning the presence of a ODI – export linkage are not valid.

ODI Strategies in India: The Strategy of our government towards ODI has undergone rapid changes since independence. Viewed in a historical perspective, the Indian Strategy on ODI could be seen as ambivalent and swinging between regulation and Liberalization. These Strategy changes can be explained under four distinct phases, viz (Subramanian, 1996).

1. 'Cautious Welcome Strategy (1948 - 67)

2. Selective and Restrictive Strategy (1968- 1979)

3. Partial Liberalization Strategy During 1980s

4. Liberalization and Open door Strategy since 1991.

Each of the phases marks different degrees of freedom or regulation on the entry of outside investment and technology transfer in India.

ODI Strategies in Developing Economies: An Overview ODI means an investment in an Outside country where the investor retains control over the investment. It constitutes a relatively stable element of international private capital flows that is insulated from short term and cyclical pressures, since it primarily reflects the long term strategies of international investors. In the present global economy ODI is not only a source of capital funds and Outside exchange, but also a dynamic and efficient vehicle to secure the much needed industrial technology, managerial expertise and marketing knowledge and networks to improve on growth, employment, export and productivity of an economy. Obviously it has become the single largest source of net capital inflows for the developing countries.

Factors that influence the effectiveness of ODI flows are not uniform across developing countries. So different Strategy initiatives by governments and strategies by multinational corporations are required in different nations. Most of the developing economies use a complex set of direct and indirect incentives to attract ODI. In some countries repatriation of earnings is unrestricted and profits and dividends are freely convertible into the currency of home country and some have specific laws regarding transfer of technology, ownership rights etc. Thus laws and Strategies regarding the ownership and entry, transfer of technology, repatriation of profits, fiscal incentives all vary across countries.

During 1960s and 1970s the developing economies followed restrictive Strategies towards ODI fearing outside economic domination. So they regulated the entry and operations of ODI. The decade of 1980s saw a marked shift in the attitudes of less developed countries towards ODI. Recently with increasing globalization and integration of markets, developing countries have started taking definite Strategy steps to facilitate an increased role for ODI in their economies. Consequently to attract ODI, now they have changed their developing strategies giving greater stress on competitiveness, Privatization and outward orientation.

ODI Inflows in India in Post Reform Era: India's economic reforms way back in 1991 has generated strong interest in Outside investors and turning India into one of the favorite destinations for global ODI flows. According to A.T. Kearney, India ranks second in the World in terms of attractiveness for ODI. A.T. Kearney's 2007 Global Services Locations Index ranks India as the most preferred destination in terms of financial attractiveness, people and skills availability and business environment. Similarly, UNCTAD's76 World Investment Report, 2005 considers India the 2nd most attractive destination among the TNCS. The positive perceptions among investors as a result of strong economic fundamentals driven by 18 years of reforms have helped ODI inflows grow significantly in India. The ODI inflows grow at about 20 times since the opening up of the economy to Outside investment. India received maximum amount of ODI from developing economies (Figure –2). Net ODI flow in India was valued at US$ 33029.32 million in 2008. It is found that there is a huge gap in ODI approved and ODI realized (Figure - 3). It is observed that the realization of approved ODI into actual disbursements has been quite slow. The reason of this slow realization may be the nature and type of investment projects involved. Beside this increased ODI has stimulated both exports and imports, contributing to rising levels of international trade. India's merchandise trade turnover increased from US$ 95 bn in FY02 to US$391 bn in FY08 (CAGR of 27.8%).

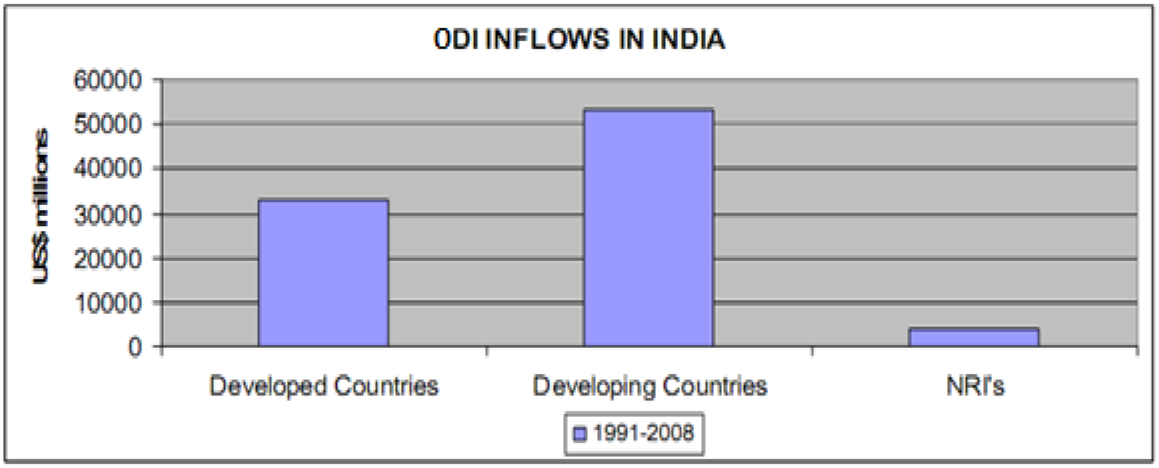

Figure- 2 ODI inflows in India

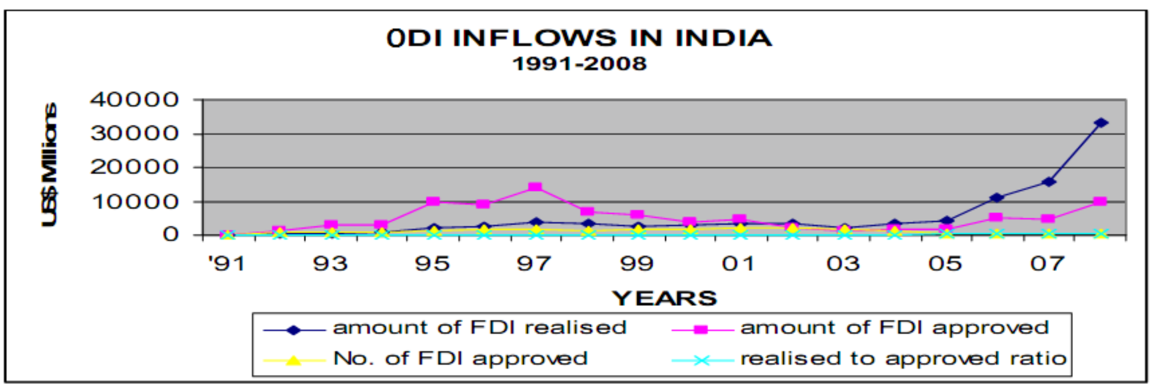

Figure- 3 ODI inflows in India (1991-2008)

India's exports increased from US$ 44 bn in FY02 to US$ 163 bn in FY08 (CAGR of 24.5%). India's imports increased from US$ 51 bn in FY02 to US$ 251 bn in FY08 (CAGR of 30.3%). India ranked at 26th in world merchandise exports in 2007 with a share of 1.04 percent. Further, the explosive growth of ODI gives opportunities to Indian industry for technological up gradation, gaining access to global managerial skills and practices, optimizing utilization of human and natural resources and competing internationally with higher efficiency. Most importantly ODI is central for India's integration into global production chains which involves production by MNCs spread across locations all over the world.

ODI Strategy in India: An Evaluation: India had been following selective Strategy towards ODI, swinging between regulation and Liberalization, since independence. Outside investment was permitted only in high technology and export oriented industries I\ here it was felt very essential. During 1980s the Strategy was partially liberalized so as to encourage outside capital and technology with a view to promote exports and competition. Since 1991 with the inception of economic reforms the ODI Strategy has been liberalized further and made it more open and transparent. It is an undisputable fact that the ODI Strategy has provided a better environment for more ODI inflows skilled management and sophisticated technology resulting in the modernization of the Indian economy to a certain extent. But it appears that the approach towards ODI has yet to become powerful and pragmatic. In this context we summaries the views expressed by eminent scholars and economists regarding the attitude, approach and Strategies towards ODI in India in the background of Liberalization. Subramanian (1996) has explicitly stated that the sectors which are opened to ODI now are much larger as compared to the earlier protected regime. According to him the most striking feature of the new liberal ODI Strategy is the freedom provided to the level of Outside equity participation coupled with the simplification of the procedures. He further says that ODI Strategy of our government is more open and liberal in comparison to that of China and Malaysia to the extent that in a large number of manufacturing industries outside majority ownership is freely allowed without any restriction. He emphasizes that India's automatic approval of equity up to 51 percent is a unique process which goes a long way in making Indian Strategy on ODI transparent.

Strategy regime is one of the key factors driving investment flows to a country. Apart from underlying overall fundamentals, ability of a nation to attract Outside investment essentially depends upon its Strategy regime - whether it promotes or restrains the Outside investment flows. This section undertakes a review of India's ODI Strategy framework. There has been a sea change in India's approach to Outside investment from the early 1990s when it began structural economic reforms about almost all the sectors of the economy.

Economic Strategy Changes in India: The poor economic conditions in the first phase led to rethinking of + the entire economic Strategy during 1977-84. This has resulted in the formulation of several committees to review the Strategy framework in general. They recommended a shift from physical to fiscal controls, Liberalization in industrial licensing and trade regime, export promotion in the place of import substitution, greater role for private sector, and measures to improve the performance and efficiency of public sector enterprises. All these recommendations had been taken into account by the government for further Strategy improvement. The economic reforms initiated in India really aimed at restoring macroeconomic balance and economic growth, regaining external credit worthiness and preparing the Indian economy to respond effectively to emerging global challenges and opportunities.

A Brief Review Indian economy had undergone several significant Strategy changes before the inception of economic reforms. The past economic Strategies can be broadly explained under four distinct phases namely physical control Regime (1951-76);.Rethinking on Economic Strategy (1977-84); Liberalized Regime (1985 - mid 1991); Current Economic Reform (mid 1991 onwards) (Sharma, 1998).

The first phase (1951-76) pursued the planned objectives under physical control regime. Apart from direct resource allocation in the public sector, four major physical control instruments- Industrial licensing, Outside exchange regulations, controls and regulations of monopoly and Restrictive trade practices and Import Controls were evolved to direct private investment in conformity with planned objectives and targets. Human resource development, food self-sufficiency, diversified industrial structure etc. have been cited as some of the achievements of these Strategy changes. Still the functioning of the Indian economy was unsatisfactory on several counts. Neither the industrial growth nor the growth of the economy as a whole was impressive. Lack of competition due to protective shelter has resulted in high cost inefficient economy characterized by low and stagnant productivity. A plethora or rules and regulations have created a cumbersome system involving too many agencies leading to time and cost over-run for many investment proposals. Aggressive import substitution and export pessimism has led to Balance of Payments problems.

CONCLUSION: In a globalized economy, the world marked is reduced as a village market. There is a wider transaction of goods and services between the countries in the world. Each and every country in the world has necessarily to depend other countries in the world for the development of their economy. ODI inflows and outflows create higher level of employment generation in the world, because of the MNCs there is no questions of unemployment in the world in general, the Developing countries in particular but there is only a question of employability. The impact of ODI inflows into India in recent years is highly significant.

ODI in India has a significant role in the economic growth and development of India. ODI in India to various sectors can attain sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries. The inflow of ODI in service sectors and construction and development sector, attained substantial sustained economic growth and development through creation of jobs in India. Computer, Software & Hardware and Drugs & Pharmaceuticals sector were the other sectors to which attention was shown by Outside Direct Investors (ODI). The other sectors in Indian economy the Outside Direct Investors interest was, in fact has been quite poor. ODI has helped to raise the output, productivity and employment in some sectors especially in service sector. Indian service sector is generating the proper employment options for skilled worker with high perks. On the other side banking and insurance sector help in providing the strength to the Indian economic condition and develop the Outside exchange system in country. So, we can conclude that ODI is always helps to create employment in the country and also support the small scale industries also and helps country to put an impression on the world wide level through liberalization and globalization.

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