

A STUDY OF GLOBAL VALUE CHAINS IN FOREIGN DIRECT INVESTMENT IN INDIAN ECONOMY

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ABSTRACT

Foreign direct investment (FDI) in India is a major monetary source for economic development in India. In 2019, worldwide FDI flows grew 12 percent to USD 1,426 billion compared to 2018. However, flows remained extremely low in 2019, which accounted for only 1.6 percent of GDP from 2015 to 2017 compared with more than 2 percent since the 2018 FDI reform was very low. FDI flows were lower in 2018 and 2019, as flows fell in the aftermath of the 2008 global financial crisis, than they did at any time since 2010. This newsletter focuses mainly on FDI status in 2019 before many economies began to suffer from the COVID-19 virus. Section 4 and a separate notice on COVID-19 impact on FDI flows provide further information on current FDI flows and projections by the end of 2021. Foreign companies directly invest in rapidly expanding Indian private enterprises to benefit India from cheaper salaries and changing business environments. Economic freedom started in India, and since then, in India, FDI has steadily grown, creating over one crore (10 million) in jobs in the future. On 17 April 2020, the Department of Promotion of Industry and Internal Trade announced that India had revised its strategy for FDI to shield Indian companies from "opportunistic takeovers of Indian companies by virtue of the new COVID-19 pandemic." Although the new FDI Policy does not restrict markets, the Policy ensures that the Ministry of Commerce and Industry now scrutinizes all FDIs.

KEYWORDS: Foreign Direct Investment, India, economic development, foreign companies, Indian businesses

INTRODUCTION

The favorable policy regime of the Indian Government and the robust business environment ensure the continued flow of foreign capital into the country. In recent years the government has taken many initiatives, including relaxing FDI standards in sectors such as defence, refineries of PSU oil, telecommunications, electricity exchanges and stock exchanges. The FDI equity influx in India amounted to US\$ 469.99 billion in April 2000 and March 2020, the Department of Industry Promotion and Internal Trade, which states that the efforts made by government to improve business ease and the relaxation of FDI standards yield results. Equity inflow to India in 2019-20 amounted to US\$ 49.97 billion. The 2019-20 data show that the highest inflow of US\$ 7.85 billion in service equity, computer and hardware in US\$ 7.67 billion, telecommunications in US\$ 4.44 billion, and US\$ 4.57 billion in trade has been reported in the services sector. Data for the 2019-20 financial years the maximal inflow of FDI's equity in Singapore (14.67 billion USD) during 2019-20 has been received by India, followed by Mauritius (8.24 billion USD), the Netherlands (6.50 billion USD), the US (4.22 billion USD) and Japan (3.22 billion USD). Foreign Direct Investment (FDI) was a big non-debt financial aid for Indian economic development, apart from being the vital engine of economic growth. In order to make use of relatively low incomes, foreign companies invest in India, special investment privileges such as tax exemptions, etc. It also means achieving technical know-how and job creation in a country where foreign investment is made.

In order to limit the spread of the COVID-19 pandemic, several governments have taken strict public health measures. These measures on public health led to severe economic disturbances, which affected the decisions of firms on foreign direct investment (FDI). In order to avoid, or buffer, the economic effects of the public health crisis, the governments have also taken substantial economic policies. The impact that these public health and economic policy responses will have on FDI flows depends on the success. In the post-pandemic economic recovery, FDI could play an important role in supporting economies. Evidence of past crises has shown that, thanks to its relationships and access to financial resources of its parent businesses, foreign affiliates, including small and medium-sized enterprises, can demonstrate greater resilience during crises. For emerging and developing economies, FDI could have been especially important given that these economies were fled other sources of international funding, including portfolio investment. Sadly, it appears that the pandemic has a particularly severe effect on FDI flows to such economies. The primary and manufacturing sectors, for example, that make up a greater share of FDI in many of these countries than in most developed economies, have been especially hard hit by the pandemic (see the upcoming OECD report on public-health and development finance impacts of COVID-19).

♣ During and after the crisis FDI may play an important role to aid economies, helping governments to tackle the pandemic and liaison with local businesses by helping their affiliates financially.

♣ FDI flows to developing countries are expected to decrease further as a large part of their FDI is accounted of by sectors which have been seriously affected by the pandemic, including the main and manufacturing industries.

♣ FDI flows are projected to decline over 30%, even in the most optimistic public health scenario in 2020, and government economic support policies to tackle the COVID-19 pandemic and its consequent recession.

♣ FDI flows have steadily declined over the past five years, and they could remain below pre-crisis levels throughout 2021 if the public health measures and economic support policies are not effective.

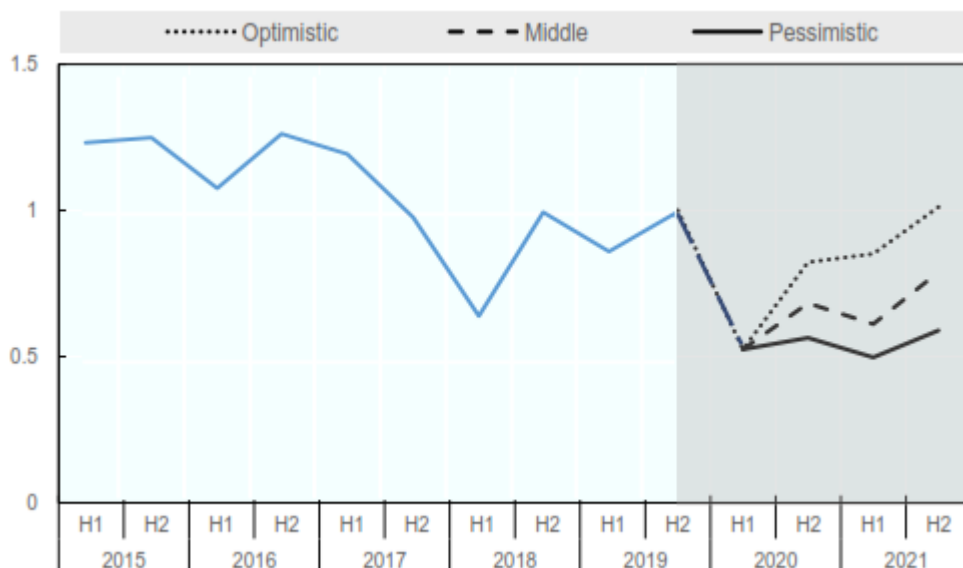


Figure1. FDI Flows under Different Scenarios on the Effectiveness of Public Health and Economic Policy Measure

The OECD estimates show that FDI flows are projected to plunge by at least 30 percent in 2020 compared with 2019 before returning to pre-crisis rates by the end of 2021, even under the most optimistic scenario. The six-month patterns from 2015 until 2019 and potential scenarios are illustrated in Figure 1 on a half-year basis up to 2021. It indicates that the flows of FDI in the first half of 2020 are projected to drop sharply. The effect on FDI flows will then rely on the effectiveness of government policies on public health and economic policy. The fall in FDI flows continues longer under the negative scenario.

REVIEW OF LITERATURE

LakshmanaRao, Ravikanth (2019), in their studies it is noted that the key motive behind the goal is to focus on heavy industrial plants, public corporations, work creation, etc. It is stated that the investing company in the overseas region may invest in any of the foreign subsidiaries or associates. For acquisition of shares and title the company may invest in diverse sectors.

Aditya and Nigam (2017) in his work “Globalization in the Indian Pharmaceutical Industry FDI spillovers and implications on Domestic Productivity: 1991-2007”, made an attempt to analyze and study the impact of globalization in the pharmaceutical industry and FDI spillovers in various forms to the domestic pharmaceutical industry in terms of domestic productivity and competitiveness etc.

Prasad, et. al. (2017), in their article, Studies encouraging FDI and international cooperation have been investigated. After its inception, foreign investment has been primarily in use in the manufacturing and service industries. Our research also explored the fields in which restrictions such as agriculture, real estate, and rail transport were placed on the government. The government also funds certain sectors of the economy and makes use of foreign investment.

Dunning, Lundan (2018), in this article, the relation between the FDI and the economic agents of the host country was highlighted as a spillover effect. In terms of further investment in the emerging sector, the FDI has generated industrial growth.

Narayana (2019), in this research article, the key policymakers attract more foreign direct investment. Direct foreign inflows were attracted in large quantities and certain basic restrictions in general and direct foreign investment.

Narula and Lal(2016) emphasizes that the factors that led to an optimization of the benefits from FDI for the host country. “With weak local capabilities, industrialization has to be more dependent on FDI. However, FDI cannot drive industrial growth without local capabilities”.

Divestments could also have an impact on FDI flows

Disposition is typically a regular and normal part of global supply chains, allowing businesses to adapt their activities to alter market circumstances rapidly. Out of every 5 international companies was allocated every 5 years by an OECD survey. An OECD report found that A global survey showed before the outbreak that 84 percent of the companies surveyed expected to conduct such operations in 2020-21. Understanding the dynamics of divestment is critical , especially as divestments can impact the output of affected companies and the well-being of employees and their communities. Even more serious effects on jobs and production in effective communities would, for example, occur, if formerly foreign companies that were sold out to their global parent, on average about 25 percent decrease in sales and values as well as 15 per cent in employment.

FDI flows through the end of 2021

The effect on flows will differ significantly in the medium term (second half of 2020 and 2021) depending on the performance of public health policies and economic policies. The optimistic scenario is that income is projected to begin increasing by the end of 2021, when the economy improves, in the second half of 2020 and that the share reinvested by direct investors will also be restored to historic levels. Nearly all the previously reported M&A deals pending and the Greenfield developments revealed would be completed. Although the lack of new investment negotiations could lead to a medium-term decline, new investments return to normal at the end of 2021. Historical rates of departments will remain. Consequently, FDI flows are expected to drop from 30 per cent to 40% in 2020 before they will return to pre-crisis levels by similar amounts in 2021. As already mentioned, it is important to note that the flows in FDI have decreased since 2015, and the flows in FDI have been lower since 2018 and 2019 than in any other year.

Under the middle scenario, the economic recovery will be uneven. While the income will recover in some sectors, others will remain below pre-crisis levels; the share of income reinvested will recover slightly but not historically in all industries. The pending M&A transactions and planned developments in Greenfield will be completed, but further investments will be abandoned. In addition to the lack of newly negotiated projects during this time, capital flows are being reduced by the continued decline in new transactions. Nonetheless, other foreign acquisitions may take place when stronger financial firms buy properties at competitive rates. Divestments by financially troubled firms would also reduce equity capital flows. Selling existing companies, but even liquidation will require these divestments. In total FDI flows will decline by 35 to 45% in 2020, but would remain around a third below their pre-crisis rate until recovery in 2021.

Under the pessimistic scenario, earnings remain depressed in most sectors and so does the share of earnings reinvested. Capital flows are substantially decreased as many M&A transactions pending and Greenfield developments have been announced to be scrapped, as they are no longer of strategic value or the investor faces financial constraints and less investments in Greenfield are completed. There would have been declining new M&As and greenfield investments. Divestments by fighting companies, including more liquidation, would be more common. FDI flows in general will decrease by more than 40 % by 2020 and will continue to decline flat until 2021 if a vaccine launch enables recovery to begin.

Investments/ Developments

Some of the significant FDI announcements made recently are as follows:

- Between April 23 and July 16, 2020, Jio Platforms Ltd. sold 25.24 per cent stake worth Rs 1.52 trillion (US\$ 21.57 billion) to various global investors from separate deals involving Facebook, Silver Lake, Vista, General Atlantic, Mubadala, Abu Dhabi Investment Authority (ADIA), TPG Capital, L. Catterton, Public Investment Fund (PIF), Intel Capital, Qualcomm Ventures and Google. This is the largest continuous fundraise by any company in the world.
- In May 2020, Philips, Dutch health tech and consumer electronics company, announced its plan to invest Rs 250-300 crore (US\$ 35.47-42.56 million) to boost its manufacturing and R&D facilities in India.
- In January 2020, Amazon India announced investment of US\$ 1 billion for digitising small and medium businesses and creating one million jobs by 2025.
- In January 2020, MasterCard announced its plans to invest up to US\$ 1 billion in India over the next five years to double its research and development effort in the Indian market.
- In October 2019, French oil and gas giant, Total S.A., acquired 37.4 per cent stake in Adani Gas Ltd for Rs 5,662 crore (US\$ 810 million), making it the largest FDI in India's city gas distribution (CGD) sector.
- In August 2019, Reliance Industries (RIL) announced one of India's biggest FDI deals with Saudi Aramco to buy a 20 per cent stake in Reliance's oil-to-chemicals (OTC) business at an enterprise value of US\$ 75 billion.

Government Initiatives

In May 2020, Government increased FDI in Defence manufacturing under the automatic route from 49 per cent to 74 per cent.

In April 2020, Government amended existing consolidated FDI policy for restricting opportunistic takeovers or acquisition of Indian companies from neighboring nations.

In March 2020, Government permitted non-resident Indians (NRIs) to acquire up to 100 per cent stake in Air India.

In December 2019, Government permitted 26 per cent FDI in digital sectors.

In August 2019, Government permitted 100 per cent FDI under the automatic route in coal mining for open sale (as well as in developing allied infrastructure like washeries).

In Union Budget 2019-20, the Government of India proposed opening FDI in aviation, media (animation, AVGC) and insurance sectors in consultation with all stakeholders.

100 per cent FDI is permitted in insurance intermediaries.

The Government of India had been preparing a road map by February 2019 to achieve the USD 100 billion FDI influx goal.

The government of India published in February 2019 a draft e-commerce national policy intended to promote FDI on the e-commerce marketplace model. In addition, it claimed that the FDI e-commerce policy had been designed to provide all participants with a level playing field.

Through the Indian insurance intermediaries, the Government of India had intended to take into account 100 per cent FDI to promote and raise more funds.

In December 2018, FDI e-commerce laws were updated by the Indian Government. According to the revised regulations, the market-based e-commerce model provided for 100 percent FDI. Sales by any seller by an e-commerce marketplace company or its group companies were also limited to 25% of the revenue of that seller in total.

Coronavirus pandemic impact

On 18 April 2020, the Indian Government issued an order that protects Indian businesses against FDI during the pandemic. All countries that share an Indian land borders would now be examined before any FDI by the Ministry of Commerce and Industry. In terms of volume and value, India is the 3rd largest pharmaceutical market. The Indian pharmaceutical industry will expand at a compound annual growth rate of 20 percent between 2015 and 2020. In this sector, 74% FDI is allowed.

FDI in First Half Of 2020

As a result of the pandemic and the resultant supply disturbances, demand contractions and economic actors' pessimistic outlook, FDI is expected to drop sharply. The fall in FDI flows in the past five years is accentuated and accelerated (Figure 2). Investing capital flows will also have an immediate effect on FDI flows as fuse and acquisition (M&A) and Greenfield acquisitions are stopped, while. Equity capital flows will also be affected as companies retain.

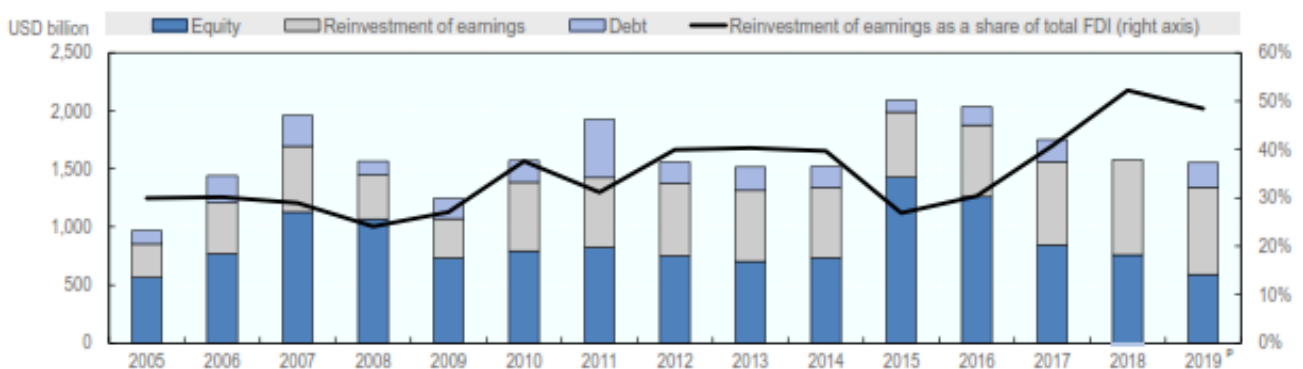


Figure 2. FDI flows by component, 2005 to 2019

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Reinvested income has become a component of FDI flows which are increasingly important and account for over half of FDI influxes in 2019. The amount of returns reinvested is determined by two factors: earnings from direct investment firms, and the share reinvested by the direct investor.

Figure 3 shows the share of FDI profits in OECD countries reinvested between 2005 and 2019. The share of returns reinvested has shown a growing increase since 2013. The share of revenues reinvested fell by about half in the period following the financial crisis, from 45% in 2007 to 24% in 2008. Some companies have a normal, constant sum of income, and others have paid a higher share of income to other parts of the MNE. The share of earnings which are reinvested in the first half of 2020 is therefore expected to decrease.



Figure 3. Share of earnings that are reinvested

The recent data from the refinitive report on cross-border M&As show a substantial fall in completed transactions over the first quarter of 2020 (figure 4), but a spike in withdrawn deals is not shown. Instead, pending deals have increased. This means that direct investors have not so far tried to reverse their deal, but have seemed to be stopping them, mainly because of the difficulty of valuation in the present situation. Some companies will probably wait until economic developments take such a step in the near future as it is difficult and potentially expensive for them to withdraw deals. In the short term, capital flows will decrease because of too many deals, but they can mean a future rise when such transactions are completed with the stabilization of the economy. In the absence of a recovery in the economy, however, firms that begin to abandon their businesses, maybe citing clauses which allow target companies to continue their routine business activities before the deal is closed. In developed economies with more than three quarter of completed cross-border M&A, cross-border M&A is a especially significant factor. Greenfield investments, on the other hand in emerging and developing economies, tend to play a greater role in FDI.

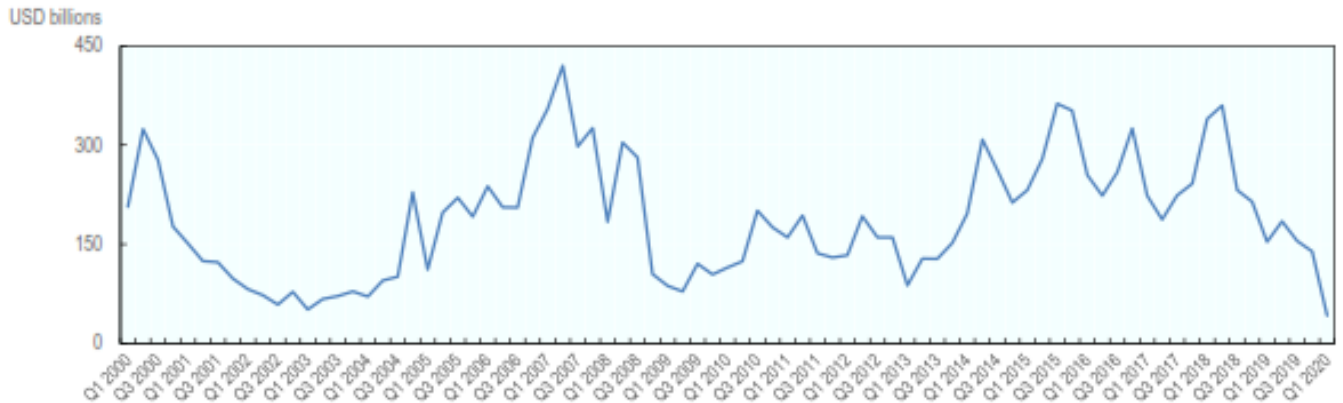


Figure 4. Completed cross-border M&A deals in advanced economies, 2000-2020

The latest Greenfield FDI data from the FDI Markets database from the Financial Times further show that investors are increasingly reluctant to explore new opportunities for investment in the face of the pandemic. This is evidenced by the decrease in new project launches compared with previous years in the first two months of 2020 (Figure 5). The value of greenfield FSP promises fell by more than 36% compared with 2019 and 15 to 30% compared to 2018 in non-OECD economies. This decrease is more pronounced. In January 2020, the announced investments in non-OECD economies were marginally less than in February.

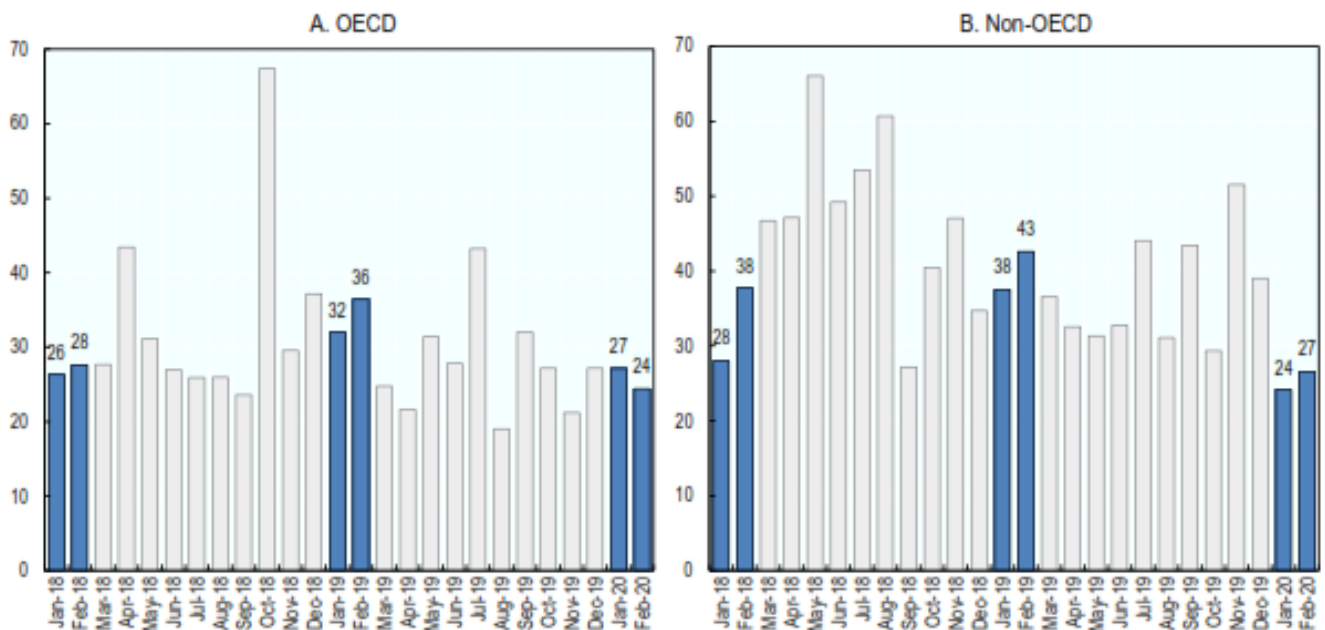


Figure 5. Value of announced Greenfield projects, 2018-2020

CONCLUSION

According to a recent survey, in India, foreign direct investment (FDI) has been significantly improved by the Make in India system. Flows from FDI (40%) increased unbelievably in particular in manufacturing from 2019 to 2020. India is the fourteenth largest producer of the world. This study emphasizes recent efforts by the government to support and promote FDI in various sectors. Foreign direct investment has developed tremendously in India in different sectors of the economy. While FDI is developed by the Indian Government in various areas, the main focus of this document is to explain the impact of make on FDI in Indian countries. The competitive investment environment in India has brought FDI to India and the competitive environment is the basis for the company and its development. Different key policy initiatives are needed to enhance the Indian infrastructure and increase the potential for internal absorption. The FDI will be the best influx and the most promoting of economic growth to enrich local companies, enhance macroeconomic conditions and increase development.

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