FDI AND ITS IMPACT ON SSI: ADVANTAGES & PROBLEMS

DR. PALLAVIKRANGANDH
Director, S.D Signodia PG Centre
E-Mail: pallavikranganadh@gmail.com
palluranga@rediffmail.com

ABSTRACT

FDI plays an important role in any country's economical activities. Companies big or small can not solely depend on the conventional source of finance all together. For financial and technological support they have to depend on foreign resources. For big companies getting FDI is not difficult issue because of financial security, reach in global market and business experience but in SME/SSI it still an unsolved puzzle or a buzzword.

The paper is concerned with one of the ways of contributing to strengthening the indigenous SME sector in a situation of resource scarcity. Specifically, the paper is concerned with the potential role of foreign direct investment (FDI) in relation to the long term competitive development and inter-nationalization of the SME sector in transition and developing countries.

Keywords: *Current Trend, Key Statistics, Advantages of SSI, Problems by SSI*

INTRODUCTION

Capital is stated as the engine of economic growth. Foreign direct investment (FDI) plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development. Foreign direct investment, in its classic definition, is defined as a company from one country making a physical investment into building a factory in another country. In other word FDI is an investment involving a long term relationship and reflecting a lasting interest and control of a resident entity in one economy in an enterprise resident in an economy other than that of the foreign direct investor. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment which is considered an indirect investment. In recent years, given rapid growth and change in global investment patterns, the definition has been broadened to include the acquisition of lasting management interest in a company or enterprise outside the investing firm's home country. As such, it may take many forms, such as a direct acquisition of a foreign firm, construction of a facility, or investment in a joint venture or strategic alliance with a local firm with attendant input of technology, licensing of intellectual property. In the past decade, FDI has come to play a major role in the internationalization of business. Reacting to changes in technology, growing liberalization of the national regulatory framework governing investment in enterprises, and changes in capital markets profound changes have occurred in the size, scope and methods of FDI. New information technology systems, decline in global communication costs have made management of foreign investments far easier than in the past. The sea change in trade and investment policies and the regulatory environment globally in the past decade, including trade policy and tariff liberalization, easing of restrictions on foreign investment and acquisition in many nations, and the deregulation and privatization of many industries, has probably been then most significant catalyst for FDI's expanded role. The most profound effect has been seen in developing countries , where yearly foreign direct investment flows have increased from an average of less than $10 billion in the 1970‟s to a yearly average of less than $20 billion in the 1980‟s ,to explode in the1990‟s from $'26.7billion in 1990 to $179 billion in 1998 and $208 billion in 1999 and now comprise a large portion of global FDI.Driven by mergers and acquisitions and internationalization of production in a range of industries, FDI into developed countries last year rose to$636 billion ,from $481bilion in 1998 (source UNCTAD) For small and medium sized companies, FDI represents an opportunity to become more actively involved in international business activities.

1. Current Trend of FDI

The vast majority of FDI originates from the developed world, with the countries in the developed economies making up 83.0% of the world's total in 2005 (UNCTAD, 2006). Similarly, it is developed countries that remain the main destinations for FDI, accounting for 59.2% of the world's total, although the proportion destined for transition and developing countries has been growing: by six times between 1990-98, and from 18% of global FDI flows in the mid 1980s to 42% in 1998 (World Bank, 1999); fluctuating between 27% and 37% during the 2001-5 period (UNCTAD, 2006). Moreover, FDI inflows can represent significant sums for developing countries, several of which record levels of FDI that are large, when considered in relation to the size of the domestic economy. However, the distribution of FDI between developing and transition economies is very uneven. For example, despite an increase in volume, FDI to Africa and Latin America represents a smaller proportion of the world's total in 2001 than it did in the mid-1990's.In recent years, MNEs have been increasing their level of outsourcing, although this often involves subcontracting out parts, components and services to a smaller number of key suppliers with whom they develop collaborative arrangements. Whilst this process of Consolidation can result in MNEs taking first tier multinational suppliers with them into transition and developing countries, opportunities for local SMEs can exist at the second or third tier supplier level. Traditionally, FDI has been seen to be the preserve of large firms, both in developed and developing countries. However, there is growing evidence of changes in patterns of foreign direct investment, involving a wider range of source and destination countries and the increasing involvement of SMEs as foreign investors, as well as larger firms and MNEs. Unfortunately, most official investment reports do not separately identify FDI activity by the size of the investing firm. Nevertheless, there is evidence that a growing number of medium sized firms, in particular, are internationalizing their operations as a strategic response to increasing competitive pressure. In this context, internationalization represents a means of reducing costs, as well as of opening up new market opportunities, thereby enabling them to combine greater flexibility with cost reduction.

2. Why FDI is Important for a Global Appearance:

The simple answer is that making direct foreign investment allows companies to accomplish several tasks: Avoiding foreign government pressure for local production. Circumventing trade barriers, hidden and otherwise. Making the move from domestic export sales to a locally -based national sales office. Capability to increase total production capacity. Opportunities for co-production, joint ventures with local partners, joint marketing arrangements, licensing etc.A more complete response might address the issue of global business partnering in very general terms .while it is nice that many business writers like the expression, "think globally act locally", this often used cliché does not really mean very much to the average business executive in a medium and small size companies. MNCs almost always concerned with world wide manufacturing capacity and proximity to major markets .SMEs tends to be more concerned with selling their products in overseas markets. The advent of internet has ushered in a new very different mindset that tends to focus more on access issues. SMEs in particular are now focusing on access to markets, access to expertise and most of all access to technology.

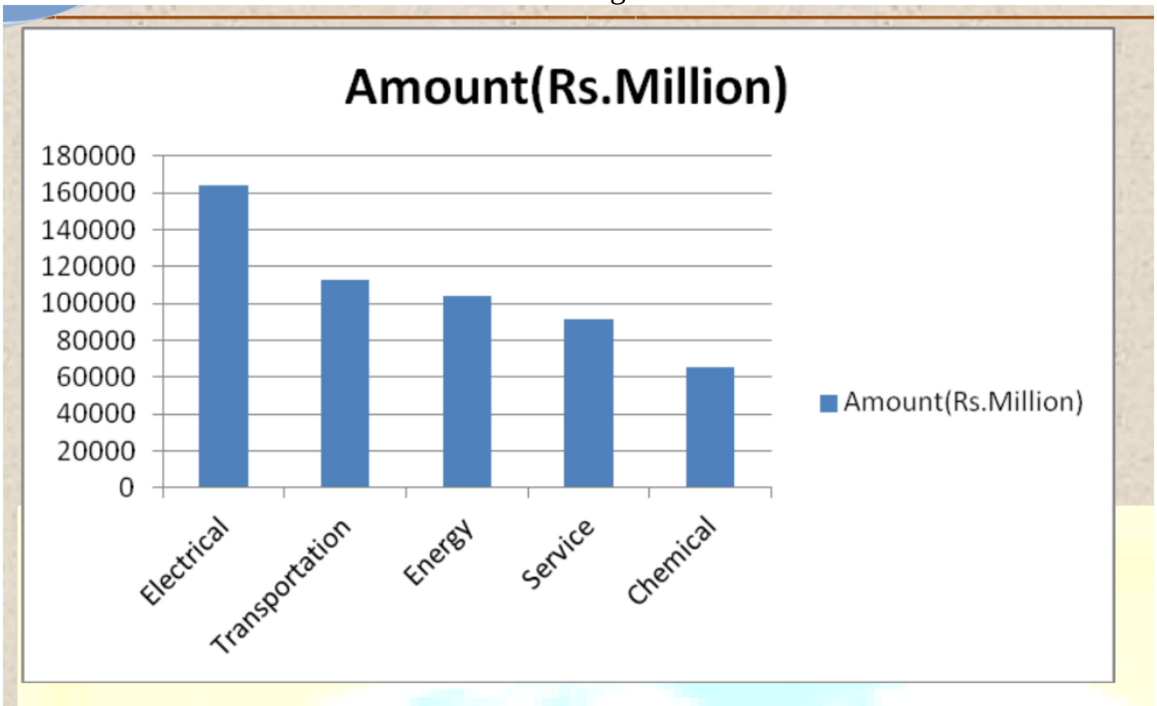
BASIC REQUIREMENTS OF COMPANIES TO GO FOR FDI

Depending on the industry sector and type of business, a foreign direct investment may be an attractive and viable option. With rapid globalization of many industries and vertical integration rapidly taking place on a global level, at a minimum a firm needs to keep abreast of global trends in their industry. From a competitive standpoint, it is important to be aware of whether a company's competitors are expanding into a foreign market and how they are doing that. At the same time, it also becomes important to monitor how globalization is affecting domestic clients. Often it becomes imperative to follow the expansion of key clients overseas if an active relationship is to be maintained. New market access is another major reason to invest in foreign country. At some stage export of product or service reaches a critical mass of amount and cost where foreign production or location begins to be more cost effective. Any decision on investing is thus a combination of a number of key factors including: Assessment of internal resources, competitiveness Market analysis Market expectation.

KEY STATISTICS

FDI inflows rose by 36 per cent to US$ 23.69 billion during January-October 2011, while the cumulative amount of FDI equity inflows from April 2000 to October 2011 stood at US$ 226.05 billion, according to the latest data released by the Department of Industrial Policy and Promotion (DIPP).The services (including financial and non-financial) sectors attracted highest FDI equity inflows during April-October 2011-12 at US$ 3.43 billion. India received maximum FDI from countries like Mauritius, Singapore, and the US at US$ 61.2 billion, US$ 15.2 billion and US$ 10 billion, respectively, during April 2000-October 2011. Global consultancy firm Ernst & Young (E&Y) has stated that the value of mergers and acquisition (M&A) deals involving Indian companies aggregated to US$ 34.4 billion in 2011 involving 806 transactions. There were 177 outbound deals with an aggregate disclosed value of US$ 8.8 billion in 2011; forming 25.6 per cent of the total M&A pie.Adani Enterprises‟ acquisition of Abbot Point Coal Terminal in Australia (US$ 2 billion) and the GVK Group‟s purchase of Australia-based Hancock Coal‟s Queensland coal assets (US$ 1.3 billion) were among the biggest outbound deals recorded in 2011.According to data released by auditing and consultancy firm KPMG, India Inc witnessed a 31 per cent increment in private equity (PE) investment to US$ 7.89 billion during the first three quarters of 2011. PE firms like Blackstone India and Kohlberg Kravis Roberts & Co (KKR & Co) are betting high on Indian markets. The Blackstone India chief was reported to have said that he intends to close 5-6 deals a year in India whose financial valuations would revolve around roughly US$ 100 million to US$ 120 million each. According to the weekly statistical supplement of the Reserve Bank of India (RBI), India‟s foreign exchange reserves (forex) stood at US$ 293.54 billion for the week ended January 6, 2012. Foreign currency assets aggregated to US$ 259.80 billion and the value of gold reserves stood at US$ 26.62 billion for the week. The value of special drawing rights (SDRs) was calculated at US$ 4.41 billion, and India's reserves with the International Monetary Fund (IMF) came out to be US$$ 2.69 billion.

Top Five Industrial Sectors in Term of FDI Inflow During 1991-2004.



IMPORTANT DEVELOPMENTS

The government of India is continuously working towards increasing FDI flows into the country. FDI rose by an impressive 56 per cent to US$ 2.53 billion in November 2011. The cumulative flows of for April-

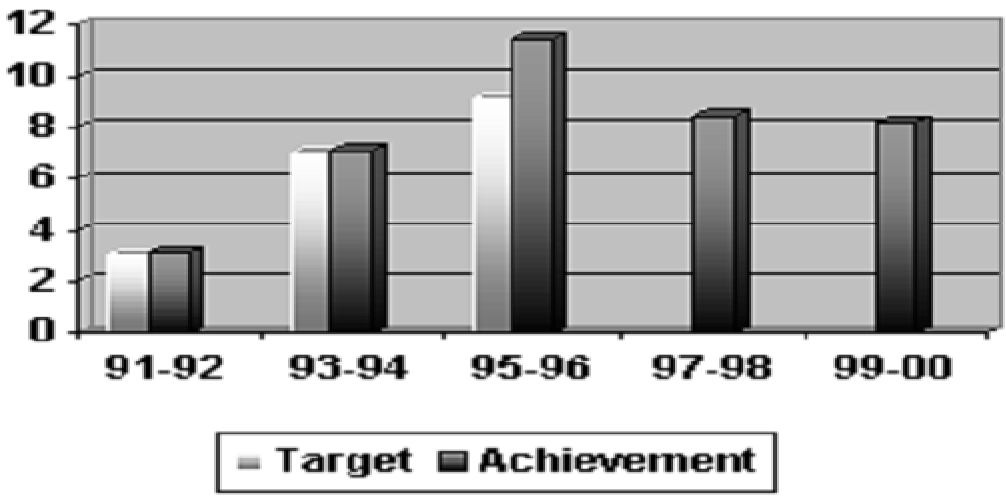
November 2011 aggregated to US$ 22.83 billion, exceeding the total FDI of US$ 19.43 billion for 2010-11 fiscal. Recently, the Government has approved 20 FDI proposals worth Rs 1,935.24 crore (US$ 384.5 million). The approved major investments that were consulted with Foreign Investment
Promotion Board (FIPB) as well, are enlisted below: Sterlite Grid had proposed to act as an investment company and invest Rs 1,150 crore (US$ 228.48 million) via FDI Equitas Micro Finance would invest Rs 230.7 crore (US$ 45.83 million) for demerging its microfinance business with its wholly-owned subsidiary TV Vision proposed to induce Rs 200 crore (US$ 39.81 million) of foreign investment through an issue of equity shares via an initial public offer (IPO). The deal is to undertake the business of broadcasting a non-news and current affairs TV channel.

3. ADVANTAGES IN SSI

Small Scale Industries -may sound small but actually plays a very important part in the overall growth of an economy. Small Scale Industries can be characterized by the unique feature of labor intensiveness. The total number of people employed in this industry has been calculated to be near about one crore and ninety lakhs in India, the main proponents of Small scale industries. The importance of this industry increases manifold due to the immense employment generating potential. The countries which are characterized by acute unemployment problem especially put emphasis on the model of Small Scale Industries. It has been observed that India along with the countries in the Indian continent have gone long strides in this field. This industry is especially specialized in the production of consumer commodities. Small scale industries can be characterized with the special feature of adopting the labor intensive approach for commodity production. As these industries lack capital, so they utilize the labor power for the production of goods. The main advantage of such a process lies in the absorption of the surplus amount of labor in the economy who were not being absorbed by the large and capital intensive industries. This, in turn, helps the system in scaling down the extent of unemployment as well as poverty.

IMPORTANCE OF SSI IN INDIAN ECONOMY

The small-scale industries sector plays a vital role in the growth of the country. It contributes almost 40% of the gross industrial value added in the Indian economy. It has been estimated that a million Rs. of investment in fixed assets in the small scale sector produces 4.62 million worth of goods or services with an approximate value addition of ten percentage points. The small-scale sector has grown rapidly over the years. The growth rates during the various plan periods have been very impressive. The number of small-scale units has increased from an estimated 0.87 million units in the year 1980 -81 to over 3 million in the year 2000.When the performance of this sector is viewed against the growth in the manufacturing and the industry sector as a whole, it instills confidence in the resilience of the small-scale sector.

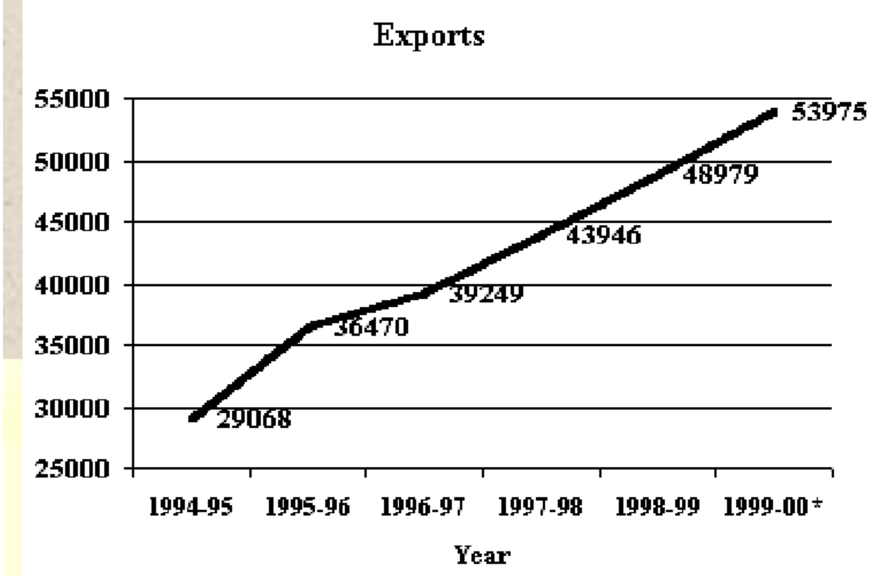


Year	Target	Achievement
1991-92	3.0	3.1
1992-93	5.0	5.6
1993-94	7.0	7.1
1994-95	9.1	10.1
1995-96	9.1	11.4
1996-97	9.1	11.3
1997-98	*	8.43
1998-99	*	7.7
1999-00	*	8.16
2000-01 (P)	*	8.90

P-Projected (April-December)

Employment SSI Sector in India creates largest employment opportunities for the Indian populace, next only to Agriculture. It has been estimated that 100,000 rupees of investment in fixed assets in the small-scale sector generates employment for four persons. Export SSI Sector plays a major role in India's present export performance. 45%-50% of the Indian Exports is contributed by SSI Sector. Direct exports from the SSI Sector account for nearly 35% of total exports. Besides direct exports, it is estimated that small-scale industrial units contribute around 15% to exports indirectly. This takes place through merchant exporters, trading houses and export houses. They may also be in the form of export orders from large units or the production of parts and components for use for finished exportable goods. It would surprise many to know that non-traditional products account for more than 95% of the SSI exports. The exports from SSI sector have been clocking excellent growth rates in this decade. It has been mostly fuelled by the performance of garments, leather and gems and jeweler units from this sector. The product groups where the SSI sector dominates in exports, are sports goods, readymade garments, woolen garments and knitwear, plastic products, processed food and leather products. The SSI sector is reorienting its export strategy towards the new trade regime being ushered in by the WTO.

Year	Exports (Rs. Crores) (at current prices)
1994-95	29,068 (14.86)
1995-96	36,470 (25.50)
1996-97	39,249 (7.61)
1997-98	43946 (11.97)
1998-99	48979 (10.2)
1999-00 (P)	53975 (10.2)



4. Problems Faced by SSI

Finance is a key input of product distribution and development. It is therefore, aptly described as the life blood of industry and is a prerequisite for accelerating the process of Industrial development. An important problem faced by small scale industries in the country is that of finance. The problem of finance in small sector is mainly due to two reasons. Firstly, it is party due to scarcity of capital in the country as a whole .Secondly it is party due to weak credit worthiness of small units in the country. Due to this weak economic base, they find it difficult to take financial assistance from the commercial banks and financial institutions. As such they are bound to obtain credit from the money lenders on a very high rate of interest and are thus exploited in practice. The small scale industries facing problems are regarding problem of raw material, problem of finance, problem of marketing, problem of underutilization of capacity, outdated technology, poor project planning and absence of vertical growth. Ancillary units face the problems of this own types ,like delayed payment by parent units, inadequacy of technological support extended by parents unit ,non adherence to quality and delivery schedules ,disturbing the programs of parent unit and absence of a well defined pricing system and regulatory laws. The lack of effective coordination among the various support organizations set up for the development of small scale industries .the problem of periodic markets ,location problem ,problem of space, infrastructural problems, market participants problem ,lack of storage facility and quick post harvest disposal ,problem of quick and cheap transportation ,problem of delayed payment, finance problem, inadequate market intelligence ,slow performance of operation and costly and inefficient labour are the major problem in financial performance.

5. Can FDI be an answer to Financial Problems in SSI?

The current FDI norms impose a ceiling of 24 per cent FDI for companies in the SSI sector i.e. small scale units having capital investment in plant and machinery not exceeding Rs. 50,000,000 (USD 1,250,000). Further, SSI units with foreign investment exceeding the notified sectoral cap are liable to lose their status as SSI units.

With a view to liberalizing the SSI sector and augmenting economic activity in the country, it is announced that FDI norms governing SSIs would be relaxed and a notification is likely to be tabled before Parliament, enabling an increase in the limits of FDI in the SSI sector. If such notification is passed, SSI units would be eligible to raise foreign equity in accordance with caps governing the sectors in which they operate, thereby improving their access to technology and capital and assisting in the growth and modernization of the sector.

CONCLUSION

The SMEs the world over have been undergoing crucial changes in response to the manifold imperatives of globalization. The potential of neo-localism having been much emphasized, the SMEs in developing countries have often been split between national strategies and objectives of promoting this vital and most promising sector and the demands of a globalizing business environment. In India, the historical role of SMEs in creating ample opportunities for employment for the teeming millions has come to occupy secondary status in the face of novel strategies to ensure external orientation, achieving manufacturing competitiveness and emerge notable global player. While there is much merit in recognizing the relative advantages and disadvantages of participating in a fervent global market, it is equally important to take stock of the ground realities that indicates a poor and inadequate infrastructure base for SMEs; this situation is particularly worse in rural areas as even in small towns, where a major proportion of SMEs function. Of the most vital infrastructure bottlenecks, access to adequate, reliable and reasonably priced power remains a challenge for SMEs progress and competitiveness. Further, poor transport network (whether roads, railways or ports) have emerged as important constraints to the development of SMEs in a dynamic fashion. Despite decades of small industry policy making, even during the reforms period, there has been a definite decline in the access to credit by the small (and within it the so-called tiny sector) enterprises. It is clear that there is no dearth of capital available but there remain serious implementation snags, including complex and unhelpful procedural requirements, which, ultimately result in dwindling access to loan finance. The situation is similar when it comes to the intractable product reservation policy Given the large scale attempts to promote industrial clusters in the SME sector, it needs to be underscored that, despite the potential of neo-localism, cluster promotion in the Indian context must move beyond the sectoral bind; a comprehensive regional development strategy needs to be woven into the cluster development policy. While a plethora of new measures have been initiated in the recent MSMED Act, much would again depend upon how these function on ground. External orientation and a global outlook for the SME sector must first address persisting basic constraints facing the sector. The garment case brings out this point in some detail. In fact, as the Indian SMEs are looking forward to a newer and larger market space, with its numerous advantages of skills, raw materials and large domestic market as well, networking with various stakeholders both within and outside the country is a worthwhile attempt. To the extent such networking contributes to mutual benefit in terms of technology and market, the new initiatives are welcome. But complacency in such issues as employment creation and neglect of the vast segment of small and tiny units operating within a „low-road" syndrome could be a major roadblock to the sector. If globalization and external orientation, including being connected to the global production networks or value chains, fail to be broad-based and, essentially, turns advantageous to a small section of limited sectors of production, the strategy needs a serious rethink.

REFERENCES

1. http://www.forbes.com/forbes/welcome/
2. https://en.wikipedia.org/wiki/Foreign_direct_investment
3. http://www.fdiintelligence.com/
4. http://www.ibef.org/economy/foreign-direct-investment.aspx