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ORIGINAL ARTICLE

RELATIONSHIP BETWEEN FDI AND ITS DETERMINANTS - AN IMPACT STUDY ON FDI BY ITS DETERMINATS

Narendra

M.Phil. Research Scholar , Department Of Commerce, Delhi School Of Economic
University Of Delhi New Delhi .

Abstract:

this paper is examine the show the impact of determinants factors of FDI on FDI. this paper purely based theoretical in nature. no empirical work to be done in this paper. Moreover this paper also examine the effect of spill-over on inward FDI. this paper found that some determinants shows the positive impact on FDI, some are negative and some are neutral.

KEYWORDS:

Foreign direct investment (FDI) ,theoretical , production or business .

INTRODUCTION

Foreign direct investment (FDI) is a direct investment into production or business in a country by an individual or company of another country, either by buying a company in the target country or by expanding operations of an existing business in that country. Foreign direct investment is in contrast to portfolio investment which is a passive investment in the securities of another country such as stocks and bonds. Broadly, foreign direct investment includes "mergers and acquisitions, building new facilities, reinvesting profits earned from overseas operations and intra company loans". In a narrow sense, foreign direct investment refers just to building new facilities. there is different types of FDI are as below

1. Horizontal FDI arises when a firm duplicates its home country-based activities at the same value chain stage in a host country through FDI.
2. Platform FDI Foreign direct investment from a source country into a destination country for the purpose of exporting to a third country.
3. Vertical FDI takes place when a firm through FDI moves upstream or downstream in different value chains i.e., when firms perform value-adding activities stage by stage in a vertical fashion in a host country

IMPACT RELATIONSHIP BETWEEN FDI ANT IT'S DETERMINANTS FACTORS.

There are so many determinants of FDI in the economy as suggested by existing literature available on this issue. There is need to know the expected relation between FDI and these determinants before doing empirical investigation regarding relationship of FDI and some variables taken in this study so as to find main determinants of FDI in India.

(i) Market Size: Market size which is measured in terms of GDP is expected to have positive relationship with FDI. Countries having more GDP growth rate can attract more FDI inflows. Market oriented FDI aims to set up enterprises to supply goods and services to the local market. This kind of FDI may be undertaken to exploit new markets. The market size of host countries is very important location factor for market oriented FDI. there is a positive effect of FDI and market size, if market size is large so it attract more capital inflow and vice-versa or spill-over effect is more in case of large market size it attract large capital inflow

(ii) Portfolio Diversification: The diversification of portfolio is also considered to be another determinant. The approximate mix of bonds, securities, stock, debenture, depository receipts, etc. refers to portfolio

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investment. The maturity of these instruments may vary from few months to few years. The concern of an investor is for these instruments at a time of risk perceptions. It implies that the investors are able to invest in or take out their capital for diversification of their portfolio assets due to perceived risk in a country. The higher is the perceived country risk due to political, economic and financial changes in one country, an investor would like to take out his capital out of the country

(iii) Resource Location: Location- specific determinants have a crucial influence on a host country's inflow of FDI. The relative importance of different location-specific determinants depends on at least three aspects of investment:

(1) The motive for investment (e.g., resources, market or efficiency-seeking),
(2) The type of investment (e.g., services or manufacturing), and
(3) The size of the investors (small and medium MNEs or large MNEs)
Natural resources protected from international competition by imposing high tariffs or quotas, still play an important role in attracting FDI by a number of developing and developed countries. exim policy that is export and import policy attract high FDI. FDI positive relate with the exim policy. more FDI attract in case of import of more and more goods and service. whereas export of more and more good and service leads towards the high capital outflow. equal spill-over effect in both export and import policy

(iv) Differential Rate of Return: This theory explains mostly the held belief that the FDI flows to that country which has relatively higher return on the investment. No investor would like to invest if the rate of return on investment is low. Therefore, the flow of capital will be in those countries which ensure the highest possible rate of return . in this zero spill-over effect , no capital inflow, no additional benefit in case of differential rate of return.

(v) Foreign Exchange Reserves: The high level of foreign exchange reserves in terms of import cover reflects the strength of external payments position and vice-versa. so there is positive relationship between foreign exchange reserves and FDI. increase in foreign exchange reserves lead towards the high FDI and vice-versa. high spill-over effect with foreign exchange rate.

(vi) Internationalization: Internationalization refers to minimize or eliminate cost of external transaction by increasing transaction within subsidiaries. This theory explains that FDI is an outcome of need to lower the cost of transaction. In other words, need for internationalization of transaction cost determines the FDI inflows. The internationalization of transaction cost is achieved through FDI investment in subsidiary to eliminate high cost of transaction or replace high cost transaction through low cost when it is impossible to eliminate. internationalization always attract high capital inflow or high spill-over effect and vice-versa.

(vii) Openness: openness is measured by proportion of export plus imports over GDP at market price. there is positive relationship between trade openness and FDI, if trade openness is high, it attract high capital inflow thereby high spill-over effect and vice-versa.

(viii) Government Regulations: This consists of rules and regulations governing the entry and operations of foreign investors. FDI cannot take place unless it is allowed to enter in a country. Its potential relevance is evident when policy changes sharply in the direction of more or less openness. It should be noted, however that policy changes in the direction of openness differ in an important way from those in the direction of restriction. Open policies are basically intended to induce FDI while restrictive policies such as sweeping nationalization of foreign affiliates, can effectively close the door to FDI.

(x) Tax Policies: Fiscal policies determine general tax levels, including corporate and personnel tax rates and thereby influence inward FDI. Other things being equal a country with lower tax rates should stand a greater chance of attracting FDI project than a country with higher rates. It is difficult to ascertain how much influence it can have on the total inflows of FDI.

(xi) Inflation: Low inflation rate is considered to be a sign of internal economic stability in the host country. High inflation rate indicates incapability of the government to balance its budget and failure of the central bank to conduct appropriate monetary policy. Changes in inflation rates of the domestic or foreign country are anticipated to alter the net returns and optimal investment decisions of the MNEs. It is expected to give negative impact on FDI. high inflation no FDI , less inflation, more FDI.

(xii) Industrial Organization: Industrial organization theory states that firm specific advantages, competition capabilities, managerial skills and practice etc. are some of the crucial points for industrial organization to survive. The relative advantages to TNCs in terms of these points make FDI to flow to a country of their choice.

(xiii) The Level of External Indebtedness: The level of external indebtedness means the net external assistance to India in the form of loans. It is expected to have a negative impact on FDI inflows. The level of indebtedness shows the burden of repayment and debt servicing on the economy, thus making the country less attractive for foreign investors.

(xiv) Foreign Exchange Rate: It is the rate at which one currency may be converted into another. In other words it is the relative strength of the domestic country in relation to the foreign country. high foreign exchange rate lead towards the high FDI and vice versa, but it has negative impact on economy of India.

CONCLUSION:

this research article basically shows the different determinants factors, which either positive related with FDI or negative along with the spill over effect. this article found some determinants factors having positive impact on FDI means that attract FDI from host country to home country. whereas some factors having negative impact on FDI means that don't attract FDI from host country to home country. Some factors have a neutral impact on FDI. in that case they only attract more FDI if high spill-over effect be there, means some additional benefits if having with FDI if capital inflow from host country to home country.

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