Contents

Chapter 5

Pros & Cons To Indian Economy & Industry

5.01 Introduction

5.02 Advantages to Indian economy & industry

5.03 Disadvantages to Indian Economy

5.04 Measures to regulate FDI & Joint ventures
Chapter 5

Pros & Cons To Indian Economy & Industry

5.01 Introduction

Globalisation of Indian Economy took place by liberalisation of economic policies and removal of trade barriers. The Industrial policies pursued till 1990 enabled India to develop a vast and diversified industrial structure. India attained self – sufficiency in a wide range of consumer goods. However, the industrial growth was not rapid enough to generate sufficient employment, to reduce regional disparities and alleviate poverty.

1991, onward, the Govt. of India has taken several steps to attract Foreign Direct Investments and entry of Multinational companies to set up projects and industrial activities in India. Multinational companies has basic distinct features and comparative advantage over Indian companies.

Even before 1991, many multinational companies were in India but their role was limited in nature. MNCs were allowed to contribute upto 40 % of the total capital involved. The rest 60 % of the capital was contributed by the Indian partners. This way the management control was in the hand of Indian partners. Idea of the Govt. was to protect the Indian companies which were not powerful enough to compete with the giants of the world. But due to the protection provided by the Govt., Indian companies suffered from lack of competition which ultimately lead to high cost and deterioration of quality.

In broad sense, Multinational corporate means the corporate having presence in the form of managerial, manufacturing, source of material, supply of finished goods and investments in various part of the world. The ownership and holding may be at one country – host country.
Study of opportunities and threat to Indian industry is carried out considering the entry of MNC and their progress in India. Due to globalisation of economy, several MNCs has made investment in Indian industry for business developments and set up a industrial base in India. Joint Venture Business activities by motivation is beneficial to all partners and is in the interest of expansion of global trade co-operation and eventual equalisation of level of technological developments. FDI is extension of the product life cycle concept, hence FDI should take place in industries in which the home country has comparative disadvantage an host country a comparative advantages.

5.02 Advantages to Indian economy & industry

1. Higher Growth Rate in GDP

Since the reform process was initiated, the growth rate of the economy started picking up. Table 5.1 highlight the real GDP growth at factor cost in value term and percentage year to year (yoy) growth.

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP – value Rs. in billion</th>
<th>Index of GDP base year 1981-82</th>
<th>GDP – % yoy basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981-82</td>
<td>1298.9</td>
<td>100</td>
<td>6.1</td>
</tr>
<tr>
<td>1985-86</td>
<td>1565.7</td>
<td>120</td>
<td>4.1</td>
</tr>
<tr>
<td>1990-91</td>
<td>2122.5</td>
<td>163</td>
<td>5.4</td>
</tr>
<tr>
<td>1991-92</td>
<td>2139.8</td>
<td>165</td>
<td>0.8</td>
</tr>
<tr>
<td>1995-96</td>
<td>8358.6</td>
<td>643</td>
<td>7.3</td>
</tr>
<tr>
<td>1998-99</td>
<td>10818.3</td>
<td>832</td>
<td>6.8</td>
</tr>
</tbody>
</table>


It has been observed from the table 5.1 that the GDP at factor cost in value term was Rs.1298.9 bn in 1981-82 which has increased to Rs. 1565.7 bn in 1985-86 ie 20 % increase during 1981 – 86. GDP has further increased to Rs. 2122.5 bn with the index of 163 in 1990-91. GDP has marginally increased to Rs.2139.8 bn in 1991-92 with the index of 165.
Figure 5.01

Shows the Real Gross Domestic Products in Value Terms
Rs. in ‘000 billion
Impact of globalisation and FDI has witnessed after 1991, as GDP at factor cost has sharply increased to Rs. 8358.6 bn in 1995-96 i.e. index of 643. Index of GDP has increased by just 65 points during 1981-92 whereas it has increased by 478 points during 1991-96. The GDP has further increased to Rs. 10818.3 bn in 1998-99 with the index of 832. This shows that GDP has increased by more than five times during 1991-99 as compared to 1.63 times during 1981-91.

GDP on yoy basis has decreased from 6.1% in 1981-82 to 0.8% in 1991-92. After the liberalisation of economic policy and permission to MNC in India for FDI, GDP growth on yoy basis has increased to 7.3% in 1995-96. It has decreased to 6.8% in 1998-99 however in value term GDP has increased to Rs.10818.3 bn.

2. Improve the Balance of Payment position

FDI may bring about structural adjustments and improvements in Balance of Payments of Indian Economy. When India faced serious international liquidity problem in payment of IMF Loan, augmentation of enough forex reserves were felt. Due to negative trade balance increased during eighties and effected the balance of payments position, it has become essential to restore international confidence. In that direction, new balance of payment strategy was put in place emphasizing on exchange rate adjustment, fiscal correction and suitable structural reforms in industrial and trade policy. In 1992, the institution of Liberalised Exchange Rate management System (LERMS) marked a period of transition from a controlled exchange rate regime to market based system.

Table 5.02

<table>
<thead>
<tr>
<th>PARTICULARS</th>
<th>90-91</th>
<th>91-92</th>
<th>92-93</th>
<th>93-94</th>
<th>94-95</th>
<th>95-96</th>
<th>96-97</th>
<th>97-98</th>
<th>98-99</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current account - net</td>
<td>(173.7)</td>
<td>(22.4)</td>
<td>(127.6)</td>
<td>(36.4)</td>
<td>(105.8)</td>
<td>(196.1)</td>
<td>(129.4)</td>
<td>(208.9)</td>
<td>(167.9)</td>
</tr>
<tr>
<td>Capital account - net</td>
<td>129.0</td>
<td>95.1</td>
<td>118.8</td>
<td>304.2</td>
<td>287.4</td>
<td>155.6</td>
<td>371.6</td>
<td>375.4</td>
<td>350.3</td>
</tr>
<tr>
<td>Overall Balance</td>
<td>(44.7)</td>
<td>72.7</td>
<td>(8.8)</td>
<td>267.8</td>
<td>181.6</td>
<td>(40.5)</td>
<td>242.2</td>
<td>166.5</td>
<td>182.5</td>
</tr>
</tbody>
</table>

Source: Indiainfoline - economic survey -2001
Figure 5.02

Shows Balance of Payment position in Value Term

Rs. in billion
Above table indicates that net inflow in capital account has increased from Rs. 95.1 bn in 91-92 to Rs. 118.8 bn in 92-92 and Rs. 304.2 bn in 93-94. It has decreased in 94-95 and 95-96. However it has increased to Rs. 375.4 bn in 97-98 and marginally decreased to Rs. 350.3 bn in 98-99. The capital account of the BOP underwent a major compositional change after 1992-93 with non-debt creating inflows, FDI, FIIIs, Portfolio Investors – NRIs, GDR, ADR etc. There is distinct improvements in the current a/c and capital a/c of inflow.

Overall balance of payment position has improved from negative Rs. 44.7 bn in 90-91 to positive Rs. 72.7 bn in 91-92. It has increased to Rs. 181.6 bn in 94-95, Rs. 242.2 bn in 96-97. However it has decreased to Rs.166.5 bn in 97-98 and again increased to Rs.182.5 bn in 1998-99.

3. Improve the foreign exchange reserve position

The forex reserve position of the country has decreased to two weeks of import in May, 1991. The forex reserve position was Rs. 4388 crore in 1990-91, which has decreased from Rs. 7645 crore in 1986-87. The reserve position was badly effected due to increase in trade deficits, net current and capital inflow and balance of payment. After the liberalisation of economic policy and structural reform in industrial and trade policy, there is a remarkable increase in exports, FDI, invisibles inflow and external commercial borrowing. This has improved the balance of payment position and forex reserve.

<table>
<thead>
<tr>
<th>Year</th>
<th>Forex reserve Rs. in crore</th>
<th>Index of forex base year 1981-82</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981-82</td>
<td>3355</td>
<td>100</td>
</tr>
<tr>
<td>1986-87</td>
<td>7384</td>
<td>220</td>
</tr>
<tr>
<td>1990-91</td>
<td>4388</td>
<td>130</td>
</tr>
<tr>
<td>1996-97</td>
<td>80368</td>
<td>2395</td>
</tr>
<tr>
<td>1999-00</td>
<td>152924</td>
<td>4558</td>
</tr>
<tr>
<td>2000-01</td>
<td>184482</td>
<td>5498</td>
</tr>
</tbody>
</table>

The foreign exchange reserve was Rs. 3355 crore in 81-82 which has increased to Rs. 7384 crore in 1986-87. The index of forex has increased to 220. Forex reserve has decreased to Rs. 4388 crore in 1990-91. However with the base year index has increased to 130. Impact of globalisation and FDI inflow has witness by increasing the forex reserve to Rs.80368 crore in 96-97 and further to Rs.152924 crore in 99-00 and Rs. 184482 crore in 00-01. Index of Forex has increased by 30 % during 1981-1991, whereas it has increased from 130 index in 1990-91 to 5498 index in 00-01.

India’s forex reserve crossed the US $ 50 billion level on 15-2-2002. This was the totally different situation a decade ago when India had to ship a part of it gold reserves as collateral to avoid debt default and forex had dipped to less than two weeks’ import about US $ 975 million in 1990.

Further the quality of forex reserve has also undergone significant change as outstanding swaps have been eliminated and short term durability has been minimised. FDI comprises of direct investment, portfolio investment by FII, euro equity issue, ADR and GDR issue, external commercial borrowing and equity & project participation.

4. **Professionlisation of management**

In a highly protective environment, prior to 1991’s new economic policy, many person with no managerial abilities entered the field and set up industrial enterprises. Some of them indulged in malpractice. Some took a shorter – sighted view of development and concentrated on making quick money. In absence of favourable atmosphere, they are now well exposed to the twin challenge of growth with competition. It require thorough assessment of costs, productivity and quality compared to foreign companies in those countries which could export competitively to India. They must have a plan to improve performance.

MNC also bring with them new skills not only in the area of technology but also in the area of general management, marketing strategy etc. With the change in
With the entry of MNC in service industry like banking, insurance, port, energy, media, communication, road and strategic area, there is need of complex model of working, management techniques, study of human socio-economic factors for successful implementation. Indian bank, media and communication has improved a lot by introduction of Internet Banking, Online transfer, E-Commerce, Gateway for payments through internet, mobile tele communication techniques.

MNCs are giving full freedom to subsidiary in their operation and decision making. ABB Ltd., Hindustan Lever Ltd. etc. are function on this bases. Over the period, Indian Management Team are placed on overseas assignments of MNCs. This will help Indian Manager to get international exposure.

5. Hi-tech Technology Transfer

In India there is a great need for promoting an industrial environment where the acquisition of technological capability receives priority

In the first changing world of technology, the relationship between the suppliers and users of technology must be a continuous one, whereas governmental interference on a case to case basis involved inordinate delays and fostered uncertainty. Now in Indian companies are free to negotiate the term of technology transfer with their foreign counterparts according to their own commercial judgement within the specified parameters. This is expected to induce industry to develop indigenous competence and invest more in R&D due to greater combative pressure.

MNCs are more desirable from the point of the total host economy because of superior and sophisticated technical knowledge, design, drawings, specification and quality control. Developed Countries believed total quality management, improvements in product cycle and environments friendly products. Hence to
In service sector - transport, communication and trade industry has registered faster growth & attract higher FDI and contributed 43.4 % to GDP in 1999-2000. Financial, insurance and business services had contributed 25 % to GDP in 1999-2000. The high growth in services is suggestive of productivity gains in commodity producing sectors and the shift in employment away from commodity producing sector. Service will be one of the driver of the economy, with infomation technology, biotech, tourism, health, financial services and education being the potential high growth areas.

9. The Business Environment :-

The growth of MNCs cerates a positive impacts on the business environment in our country. Government has made necessary ammendment and changes in rules and regulation such as FERA, MRTP, The Companies Act, Income Tax Act, EXIM Policy to promote the Indian Trade. Government has also relax import duties and trade barriers for Merchant Export House & Star Trading House. However, by FDI in services and power sector has provided requires infrastructures for industrial growth. There have been phased out series of policy measures such as the downward exchange rate adjustment, trade reforms in the form of substantial rationalisation of licensing procedure and lowing tariffs, liberalisation in industrial licensing and foreign investments, phasing of fiscal deficits, financial sector and tax reforms and the tight monetary policy.

The environment context is viewed as one thing that depends on political, administrative and social factors. It is assumed that business can only adjust to the changing environment. The response of the business to the current environment is simply reactive, but it has potential to be pro-active. The country is under the difficult phase of medium term economic stabilisation and longer term structural adjustment. Adjustment will have to be structural to contain inflation, maximizes growth and safeguard and employment. It will also have to cope with external uncertainties as well as internal tension political, social, economic and communal. The mncs integrate national and international market. This growth in these days has remarkably influenced economic, industrial, social environment and business condition.
International trade and investments often form a vital process for developments of any nation. Trade not only encourages countries to specialise but also make them perform comparatively efficient. Since different nations are endowed with different resources, any country in order to novel in its production and operate at lower cost, it is only possible provided it transfer its cost advantages to another economy. In this direction, MNCs are ideal catalysts as these companies are highly sophisticated and their spectrum of operation is all over world, that they tend to take advantages of low factor cost in less developed economies.

10. Consumer Protection

A liberalised economic regime is in itself a way of protecting the interest of consumers. MNCs allots the consumers an opportunity from a wide range of products and services and this coupled with competition brings in sharp focus the fundamental aspects of Consumer taste. MNCs encourage domestic manufacturers to produce goods comparable to international standards unlike the protected regime of the past when manufacturers had almost the license to charge arbitrary prices due to the greater play of market forces. With the advent of the consumer protection Act 1986 and a liberalised economic regime manufacturers and traders are to expected to exercise due caution the goods and services offered should be true to the description in terms weight, conditions and durability.

11. Increase in transparency and corporate governance

The investment has been increased in capital market through primary and secondary route from FII, venture capital funds, mutual fund and institutional investors. The institutional investors are playing major role in disinvestment of public sector undertaking, investment in greenfield & infrastructure project, corporate investment, portfolio investment of NRI and high networth investors. As the share of investment and turnover as % of financial market has increased during 1991-2000, importance of institutional players in the market has gone up. The direct benefits of increased participation of institutional players in market is best insurance against manipulation, disclosure of financial information and
reduce volatility. The indirect benefits is that Indian companies become more transparent and improvement of corporate governance records. This has witness the several disclosures norms for company and body who are raising fund from market.

5.03 Disadvantages to Indian Economy

1 Unhealthy MNCs Strategy to enter the emerging economy.

After the collapse of USSR and formation European Union Nation, Global power has been concentrated with USA and EU nation. Major global trade and business has been carried out by this nation. This developed nations have very intelligently involved the international institution like IMF, IBRD, WTO and World bank for introducing globalisation and liberalisation strategy while giving assistance to needy developing nation. Thus by giving globalisation strategy to developing nation, MNC have easy entrance to vast market and set up unit for value addition and growth. While the western countries expect an open market system in developing eastern nations, they themselves are getting involved more and more in trade restrictions and protectionism by forming new economic regional block and deepening already existing one like North American Market, Quota systems, Pacific forum, European Community, European Monetary Union etc.

In 1980, US and UK and other western countries were suffering from shrinking demand. They need market to sell surplus products. Hence they evolved the concept of Globalisation of market in developing nations. The new concept has given legal form under GATT Agreements by establishing WTO which now is impressing "Globalisation" all over the world which make the functioning of MNC easier. The rich economies has woven a debt trap for developing countries. IMF & IBRD come to help with strict norms, terms & conditions and helpless country become victim and gets into vicious circle from where it is not easy to come out. The Governments looses its power to make independent decision for governing the economy. As noticed India has relaxed norms for entry of MNCs in non-propierty industry, setting up of 100% subsidiary of overseas company, permission of FDI in infrastructure and core projects. Hence over the period of
time, control of industry and business will be in the hands of MNCs and Indian will have limited share of management control.

2 Interference in State's Sovereignty

There are possibilities of interference by the home governments of the MNCs in the host countries policy matters, international economic & political relation through influence of the MNC. Home country will put pressure to make necessary amendments in govt. policy through IMF, World Bank to allow FDI and liberalise trade practice for the benefits of MNC. They may also play their power game in getting a political party of their own choice elected to the Governments.

As we have noticed that there was package programme from IMF and World Bank to globalise Indian Economy. The step given by them were to reduction of trade barriers, permit FDI investment in consumer, healthcare, core, infrastructure industry, abolish licence systems, relax forex norms, quality standard and quantitative restriction etc. There were several international Organisation like World Trade Organisation (WTO), IMF and World Bank has put pressure on Indian Govt. for implementing the measures for removal of import quantitative restriction, liberalise forex & FDI norms and sign GATT agreement etc.

3 Removal of Import Quantitative Restriction

India has lost its case on import quantitative restriction (QR) against US. While India has entered agreements with European Union, Japan, Australia and New Zealand on phased removal of QRs. The US has rejected such offers and moved the WTO. Now the WTO verdict has gone in favour of US, the Govt. of India has to start the process of removal of QRs. While 2700 items were under import curbs when the issue was taken to WTO by US, only 665 items remain under QR now, because the Govt. in its new Exim policy (1999-2000) has already removed restrictions on 894 items and placed an additional 414 items in the Special Import Licence route. The Govt. has been withdrawing QR through various notifications issued from time to time. India has therefore to conduct
negations over consumer goods like cars, domestic appliance, consumer electronic, alcohol, cigarettes, agro and food products.

With this removal of QR, there will be increase in import of non propriety products in India which will effect the balance of payments position, local farmers, industry, consumers etc. Govt. has increase the import duty certain extent to counter act the removal of QR.

4 Low R & D Investment by MNC

The foreign Company will set up manufacturing unit in India to cater vast Indian market. The firm supply technology, plant, equipment, drawing and management skill to Indian subsidiary company. However, they will not allow its subsidiary to undertake any research in deep. Complete technology and drawing will be provided by parent company. Subsidiary then have to take the help of contract manufacturing by providing them detailed specifications with required ingredients of the products and arranging them marketing network. Procter & Gamble, Coca Cola, Suzuki, Sony, IBM etc. are function on this base. India has still to become active, more conscious and aware about the necessity of R & D and should spend more on energy, research and creativity.

5 Import of Technology, know-how, key components.

MNC view India as marketing base and dump station for their products. Market in developed nation is saturated and growth is limited. MNC are surplus with funds and technology. Hence they are looking for additional market in developing nations. However, MNC does not transfer R & D base and drawing of key components to subsidiary company. Initially they invest minimum in manufacturing facility and more on setting up of marketing network, brand developments. MNC produces their products either at home or on contract manufacturing systems in India.

This strategy of MNC will lead to dependent for sourcing of basic raw materials, key components and technology from parent company. India’s out flow of funds
will be increased due to royalty, dividend, profits and import of materials. These will have pressure on reserve position. Example, Suzuki Corporation has not yet transferred the technology to manufacture gear box for automobile to there joint venture Maruti Udyog Ltd. Coco- Cola has not given the formula for making concentrate of soft drinks to Indian subsidiary company. Intel has not set up unit to manufacture computer processor – pentium in India.

6 Profit Maximisation

MNC strategy for FDI in developing nations to market their products and their outdated technology. Management policy are drawn for investment on short term basis rather than long term. As mentioned earlier, MNC make major investment in setting marketing network and brand developments. MNC source products from parent company by import under OGL. There basic objective is to profit maximisation through exploitation of country’s resources and intense competition with local products. MNCs products are cheaper and superior as compared with local due to economies of scale of operation and global presence.

MNC has capacity to make loss and run the business comfortably, due to financial muscle power of parent company. MNC are willing to sell products lower the price of local supplier and incurred loss. This will help them to enter the Indian market and have strong presence in market segments. Sustaining capacity of MNC is higher than Indian local company will help MNC to earn higher profit after 3 to 4 years of operation in India when Indian company are either closed or merge with MNC.

Major player in consumer durable and electronic industry in Indian Market has witness this MNC strategy. MNC like LG Electronic, Samsung, Akai, Awia, Thomson, Sony etc. has entered in Indian market with their products range to cater Indian. They have not set up own manufacturing base and approach contract manufacturing in certain products. Mass media coverage, marketing network developments, advertising spending, exchange products and consumer finance etc. has adopted by MNC. However they have incurred huge loss in initial years for product promotion and offer sale price lower to Indian products. Now after
making there strong presence in Indian market and sizeable share in product segments, they have increase the price and make good profit this year.

7 Strain of scarce Forex reserves

MNC belongs to the developed countries are usually making huge investments in the developing countries on the behalf their home country. They have pitched their investment costs at a higher than necessary level and the price of the power similarly. MNC has surplus funds and are looking for investment opportunity for business developments. However their cost of capital and borrowing is comparative lower than Indian company. Example LIBOR landing rate is 4.50 to 5.50 % for term landing where as RBI Prime Landing Rate is 10.00 to 11.00 %.

MNC make FDI in form capital investment such as plant & machinery, technical know how, key materials and brand name. MNC always make excess investments by over invoicing and heavy import of machinery and materials. FDI will bring forex by equity & capital investments ( one time ) and at the same time forex outflow for import of plant, equipment, machinery and royalty, know – how, fees etc. will higher. There is continuos out flow of forex to import basic materials, parts, upgraded technology, profits, dividend etc. to their home country. This may turn out to be more than the initial investments.

8 Minimum Transfer of Technology

It has been observed that MNC generally do not transfer their advanced technology to the host country. They bring in products and technology which are phased out in the home country on MNC. Certain products can’t be manufactured at home country due to environmental restriction are made at host country. Further they made little investment in R & D for technology up gradation. Technology supplied by MNC are capital intensive and import oriented which may not suit to our country. Extracting excessive profits and fees based on monopolistic advantage and price-fixing Most firms take advantage of fact that the technology they possess cannot be availed of easily.
Restricting access to modern technology by centralising research facilities in the home country and by licensing subsidiaries to use only limited or outdated technology. Dumping unwanted technology and even banned products especially medicines and chemical products jeopardising the health and life of host countries populations.

9 Insignificant employment potential

MNC mostly operate in capital intensive industry and have developed fully automatic technology. Owing to their labour saving technology approach, employment generation out of their investments is not very significant in our country. Moreover, they are not very keen to employ local people at higher level management cadre, technical and managerial post. MNC engaged in consumer durable industry and electronic parts prefer to import the finished product under OGL from home country. Hence FDI in this industry does not generate significant employment. MNC has entered in health care and skin care products, bakery, garments industry & article for domestic consumption like atta, salt, milk are displacing labour working in small scale and household sectors.

5.04 Measures to regulate FDI & Joint ventures

Host country - India should change their policy towards foreign direct investment and joint ventures from time to time depending on the amount of benefit derived from foreign investment and to provide direction of growth. This will provide freedom to grow multinational companies in home country without injustice to Indian firm and economic growth. The control is essential to regulate the FDI and structural development in economy.

Some of the measures can be considered for FDI policy are as follows:

- Requiring that foreign firm share ownership with nationals and also set limits on equity in the joint venture.
• Requiring that a specified proportion of key positions in the executive ranks and on the board of directors be manned by nationals with a gradual complete phasing out of expatriates.

• Not encouraging foreign participation in non-priority industries or industries which could be developed locally and encouraging joint ventures only in high technology or export-oriented industries.

• Placing ceiling rates on royalties and fees paid for technology and percentage that can be repatriated.

• Insisting that foreign firms raise more of their debt financing outside of local capital market to raise equity capital in order to contribute to the development of local financial institutions and markets.

• Pressuring foreign firms to engage in better training programmes for locals.

• Increasing local content requirements such as use of local raw materials and services even if higher priced in a phased manner.

India should phased manufacturing programmes are often undertaken with a good case in point being the Suzuki collaboration with Maruti a government company. This venture commenced with almost 100 per cent imports from Japan phased out over time to a level of about 20 per cent.

J.P. Morgan the third largest bank in the US has in the last few years transformed itself from a conventional bank to a European-style universal bank with a strong emphasis on investment banking and trading functions. The banks strategy is a global one It is today the only institution that is a primary government bond dealer in all seven major industrialised countries.
The Morgan Guarantee International Finance Corporation has entered the newly liberalised Indian market via a joint venture with the Industrial Credit and Investment Corporation of India (ICICI). It sees an opportunity for its own traditional multinational clients to expand current investment or to go into new investment. It also helps India clients to service their international needs and aids Indian government-owned companies in the process of disinvestment ICICI natural strength is with the India private sector and J. P. Morgan is with multinationals.