

Foreign Direct Investment: Survival of the fittest

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Whether it's the extremely valorous Phogat sisters in Dangal or the spry student in school who used to ace all the races like a pro, it has always been that the fearless overcomes the fearful. **Survival of the Fittest** -When we first look at this term we take in the basic idea that the weak and seemingly unfit die out, while the strong and the perseverant continue to survive.

'Survival of the fittest' is a phrase that originated from Darwinian evolutionary theory as a way of describing the mechanism of natural selection. In Darwinian terms the phrase is best understood as "Survival of the form that will leave the most copies of itself in successive generations.

However, Charles Darwin did not mean that the toughest will survive, the swiftest will win, the smartest will succeed, or the biggest will dominate. What Darwin meant was that the organism that best "fits" its environment had the best chance of survival. The plant or animal who can best adapt to its natural environment would be the most likely to survive and thrive.

Here we will try to apply this fascinating concept in the arena of economics. We will discuss how foreign direct investment fits into this concept. "How is the concept of the Survival of the Fittest making the Indian economy its slave?"

Consider a country like India where the main source of monetary flow for economic development is **foreign direct investment (FDI)**.

FDI is an investment made by a company or individual in one country for business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country. Put simply it's more of a mutual

agreement when both parties, the host country and the country bringing investment benefit from each other.

FDI may take place due to huge interest rate differences between the two economies or differences in tax rates and this is where the concept of capital flight and hot money comes in.

Capital flight occurs when asset or money rapidly flow out of a country, due to an event of political or economic instability or capital controls.

This can be an increase in taxes on capital or the inability of the government to repay its debt, thereby reducing its creditworthiness that causes investors to lower their valuation of the assets in that country. This affects the exchange rates of the country.

Suppose there is a rise in taxes on capital in India. As a result of this more and more foreigners will start withdrawing their investment from India. There will be excess demand of foreign exchange. Foreigners will try to sell domestic assets tending to cause the exchange rate to depreciate. Depreciation means that our goods will become cheaper. Our imports will fall and exports will rise which implies that output will come back to its original level. Thus, all fluctuations die out and this level of output that prevails is the fittest that survives.

Similarly, **Hot money** is the flow of funds from one country to another. The main reasons for this can be to earn a short-term profit due to interest rate differences or anticipated changes in exchange rates. Capital flows out of the country which

experiences a financial crises and it creates a boom in the country it enters which leads to rising asset prices, consumption and indebtedness.

For e.g., if the national average rate of one year certificate of deposit in the United States is 0.95% and in china, it is 3%, then if an investor in the US deposits his or her money in a Chinese bank, the investor would get a higher return than that in the situation in which he or she deposits money in a US bank. This makes China a prime target for hot money inflows.

When the interest rate in India is above that in other countries, there will be Inflow of massive capital which will cause asset prices to inflate and inflation to rise. The sudden inflow of large amounts of foreign money would increase the monetary base of India .There will be exchange rate appreciation which will reduce the competitiveness OF Indian goods or make our goods expensive thereby reducing exports and increasing imports which will worsen the trade balance.

When interest rate in India is lower than the world level of interest rate, the sudden outflow of hot money would deflate asset prices and could cause the collapse value of the currency. This will lead to exchange rate depreciation as our goods become cheaper thus reducing imports and increasing exports, improving trade balance and thereby a rise in output.

What is the impact of FDI on domestic market?

We see that FDI leads to the introduction of new varieties of capital goods and more advanced knowledge (**capital deepening**) which helps to raise output, productivity and exports in various sectors and leads to the creation of more employment, more GDP and higher growth.

For understanding how FDI's provide the greatest benefit to domestic firms, we need to be crystal clear of the working of the

concept of **Technological Diffusion** that seeks to explain how, why, and at what rate new ideas and technology spread.

Technological diffusion is the process by which innovations (new products, new processes or new management methods, expertise, technical knowhow) spread within and across economies by positive spill overs which stimulates technological progress. It involves transmission of ideas and new technologies .It further affects rate of economic growth and development. Thus, FDI may benefit the domestic firms through these positive externalities.

On the other hand, As FDI brings in advances in technology and processes; it increases the competition in the domestic economy of the developing country that has attracted the FDI. Also, it is most likely that a foreign firm that decides to invest in another country enjoys lower costs than its domestic competitors deriving from higher productive efficiency. The higher efficiency may owe partly to the combination of foreign advanced management skills with domestic labour and inputs. Thus, it may affect domestic firms in a negative way and hinder domestic investment.

Thus, we see that those domestic firms which are unable to compete with FDI die out. Only those survive which are able to take advantage of increased productivity through spill over of technical progress. The FDI's are the indoor example of the survival of the fittest where one needs to make out how beneficial they are to our economy? So **who survives and who wins depends on how much the FDI or the Indian companies are able to adapt to each other.**

Depending on whether a firm thinks it can survive or not, they merge or acquire stakes in other companies leading to mergers and acquisitions. These are one of the ways in which they make themselves fittest in order to survive. Below are the two cases.

Ranbaxy-Daiichi Sankyo

In June 2008, Daiichi-Sankyo-the second largest pharmaceutical in Japan, acquired a 34.8% stake in Ranbaxy for a value \$2.4 billion. In November 2008, Daiichi-Sankyo completed the takeover of the company in a deal worth \$4.6 billion by acquiring a 63.92% stake in Ranbaxy.

Ranbaxy is a generics company and Daiichi Sankyo is an innovator company. The acquisition of Ranbaxy not only provided a low cost manufacturing set up to Daiichi but also helped Daiichi Sankyo establish itself in the field of generic drugs which is a huge market in India.

At the time when the pharma sector in India was battling with declining pipelines, patent expirations and clampdown on health care spending, this acquisition gave Ranbaxy an access to Japanese drug market and other developed markets and a chance to develop expertise outside India and create a base for infrastructure. the addition of Ranbaxy Laboratories extended Daiichi-Sankyo's operations, with the combined company worth of about US\$30 billion and the merged company is 15th largest drug maker in the world.

Wal-Mart

'India is not a homogeneous market, so ours is not a cookie-cutter approach from the U.S. Wal-Mart is in no hurry to unfurl the Wal-Mart flag nationally. The easiest thing is to roll out stores, but the most difficult is to sustain and feed them.' –Raj Jain, President of **Wal-Mart** India in May 2009.

In December 2006, Wal-Mart, the world's largest retailer believed that by the year 2015, 35% of India's retail sales could be from chain stores. Presently, it has opened 73 stores in India and aims of opening another 50 in the next 5 years.

The reason for Wal-Mart's entry in India was clear – The Indian middle class. A country like India having \$250 billion retail business which is currently eighth

largest in the world is an immense opportunity for Wal-Mart.

After seven years Wal-Mart and Indian retail partner Bharti Enterprises ended the 50/50 joint venture launched by the two firms in 2006.

The main reasons why Wal-Mart had a tough journey in India and wasn't able to sustain this partnership was its reluctance to adapt to the conventions of Indian market, that is, sourcing at least 30% of the products from small industries in India and 50% of investment in back-end infrastructure (an important part of green field investment where a company builds the entirety of its operations in a foreign market or a green field starting from scratch)

This example clearly shows that only when Wal-Mart realised that to survive in India, it needs to adapt to the Indian environment and modify its ways of doing business, then only it was able to establish its roots in India and target an untapped Indian market brimming with opportunities.

Conclusion

Survival of the fittest is a scientific theory which in fact is not something new or astounding. It is something that we can see everywhere and anywhere. Through this article, we just tried to relate it to the widely discussed and debated topic of Foreign Direct Investment and tried to justify the actions of various forces in the economy through this theory. It is not just a phrase but a world in itself and can be applied to various other arenas.

In reality, we are **SLAVES** of this theory. We may not realise this but our lives are governed by this theory-the fittest only survives!

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