

A Study on the Growth of Foreign Direct Investment in India

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ABSTRACT

Foreign Direct Investment (FDI) plays a very important role in the development of the nation especially in the case of developing countries. Generally the developing nations are characterised by a low level of capital formation existence in the country because of low level of savings and income. The need of capital for the development of the country is highly required in a developing nations to ensure a sustain growth of the economy. The shortage of financial resources creates a wider gap between the demand and supply of financial resources in the nation. In such kind of situation, foreign direct investment plays a vital role through providing more funds in the form of capital which fill the gap between the required financial resources and the available resources.

It plays an important role in the long-term development of a country. FDI is not only consider as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities. In India, FDI plays a vital role in the development of the country especially after the year 1991. With the advent of FDI, India's GDP growth rate increased substantially in the past two and a half decades with an increase of decent per capita income of the citizens in the country.

In this paper, I made an attempt to study the growth of FDI in India in the last decade. This paper examines the set of various factors which determine the flow of FDI in the country. Sector-wise FDI flows over the past few years are also analysed and ranked the top ten attracting sectors of FDI in India.

Keywords: Capital formation, growth rate, per capita income, multinational corporations(MNCs)

1. INTRODUCTION

FDI refers to capital inflows from abroad that are invested in or to enhance the production capacity of the economy. FDI is an investment made by a company or individual in one country in business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company. FDIs are distinguished from portfolio investments in which an investor merely purchases equities of foreign-based companies. Firms that provide FDI are referred to as multinational corporations. The main feature of the FDI is an investment made that establishes either effective control of, or at least substantial influence over the decision making of a foreign business.

2. METHODS OF FDI

The foreign direct investor may acquire voting power of an enterprise in an economy either by incorporating a wholly owned subsidiary or company anywhere, or by acquiring shares in an associated enterprise, otherwise through a merger or an acquisition of an unrelated enterprise participating in an equity joint venture with another investor or enterprise

3. OBJECTIVES OF THE STUDY

- To study the growth of the foreign direct investment in India.
- To know about the various sectors attracting the FDI.
- To know about the various countries contribution in the capital inflow in India
- To analyse the trend in FDI flow in the past few years in India

4. METHODOLOGY OF THE STUDY

Source of Data: Secondary Data is used from the various journals, articles and websites

Tools of the Study: Time series analysis is used to analyse the trend of FDI inflows in India from the financial year 2001 to 2016. Tables and various graphs are used to explain the FDI inflow in the country.

5. NEED OF FDI

Developing countries like India; there is an insufficient domestic capital for the purpose of economic growth. There is a gap arises between the demand and supply of capital in the country. This gap will be filled through allowing the foreign capital resources in the nation. Foreign capital is not only provides capital for the production activities, it also brings it with other scarce productive factors like technical know-how, business expertise and knowledge. Foreign direct investment has become an integral part of national development strategies for almost all the nations globally. Its global popularity and positive output in augmenting of domestic capital, productivity and employment, indispensable tool for initiating economic growth for the countries.

IMPORTANCE OF FDI

The importance of foreign direct investment and the obstacles are discussed further. The rapid growth of world population since 1950 has occurred mostly in developing countries. This growth has been matched by more rapid increases in gross domestic product, and thus income per capita has increased in most countries around the world since the year 1950. An increase in FDI may be associated with improved economic growth due to the influx of capital and increased tax revenues for the host country. Host countries often try to channel FDI investment into new infrastructure and other projects to boost the development of the country. Greater competition from new companies can lead to productivity gains and greater efficiency in the host country and it has been suggested that the application of a foreign entity's policies to a domestic subsidiary may improve corporate governance standards. Furthermore, foreign investment can result in the transfer of soft skills

through training and job creation, the availability of more advanced technology for the domestic market and access to research and development resources. The local population benefit from the employment opportunities created by new businesses by the MNCs. But the main drawback in the foreign direct investment is the investing company is simply transferring its older production capacity and machines, which might still be appealing to the host country because of technological lags or under-development, in order to avoid competition against its own products by the host country.

DETERMINANTS OF FOREIGN DIRECT INVESTMENT

Even though the government allows foreign direct investment in India, other important factors also play a vital role in determining the inflow of foreign direct investment. The first and foremost factors determine the FDI is the size as well as the growth prospects of the economy of the country. If there is a vast opportunity available for the growth aspects in the country, automatically it attracts more FDI. Availability of resources ensures the productivity of any products without any interruption as well for the smooth production activities. Infrastructural factors like the status of telecommunication and railways are also required for transferring goods and services from the production area to the distribution area as well as to communicate with distributors and others without any interruption.

If the exchange rate is stronger the foreign currency is in comparison to that of the host country, lesser will be the amount of investment required. Other words, depreciation of currency in the host country will lead to more investments. Size of the market is also plays a vital role in determining the foreign direct investment. The size of the market refers to the GDP growth. Developing and emerging countries are more likely to attract investments because there is highest possibility for the growth aspects in the country. Because the resources may not be utilised fully in the developing nations which means that the multinational corporations can easily get the required resources such as manpower, land, water and other natural resources at a very lesser cost and this may be utilized by the multinational corporations to produce their products at a cheaper cost and due to the availability of more consumers, they can also sell more products to the consumers at a high price compared with the production cost.

Infrastructure facilities like electricity, water, and proper sewage system, transport and communication facilities are also determining factor of foreign direct investment. Investors will invest in a country if they think that the country has suitable infrastructure to support the business. Another important determining factor is tax regime - MNCs are subject to tax in both the parent as well as host country. The host country which attempts to reduce this double taxation of multinational corporations will attract more FDI. Labour market conditions such as the educational levels of the labour as well as the wage rates also play a major role in determining the flow of FDI. If the labours are available for cheaper wages compared with their parent countries may attract the FDI in the host country.

Financial and economic stability also required to attract foreign direct investment. If there is a fluctuations or violations in the economic condition in the host country will create a fear in the mind of the investors to invest in the host country. Last but not the least the stable government is

required to attract more FDI, because the stable government alone can ensure the same policies over a period of time. If there is an unstable government is existent in the host country, then the rules and regulations as well as policies related to the external affairs are changes often and this kind of policy changes will affect the business environment in the country.

FOREIGN DIRECT INVESTMENT IN INDIA

Economic liberalization started in India in wake of the 1991 economic crisis and since then FDI has steadily increased in India. It was Manmohan Singh (Finance Minister) and P.V.Narasimha Rao (Prime Minister) who brought FDI in India. India has been ranked among the top 10 attractive destinations for inbound investments. Since 1991, the regulatory environment in terms of foreign investment has been consistently eased to make it investor-friendly.

FDI in India is the major monetary source for economic development in India. Foreign direct investment is a major source of non-debt financial resource for the economic development of India. Foreign companies invest in India directly to take advantage of relatively lower wages, special investment privileges such as tax exemptions, etc. FDI policy reforms are meant to provide ease of doing business to the investors and accelerate the pace of foreign investment in the country.

The sectors which attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, the US and the UK were among the leading sources of FDI.

Foreign investment was introduced in 1991 under Foreign Exchange Management Act (FEMA). Started from a baseline of less than US\$1 billion in 1990. According to the Financial Times, in 2015 India overtook China and the US as the top destination for the Foreign Direct Investment. In first half of the 2015, India attracted investment of US\$31 bn. compared to US\$28bn. and US\$27bn. of China and the US respectively.

ROUTES OF FDI IN INDIA

Foreign direct investments are allowed in India through two routes.

Automatic Route: In this route, no Central Government/RBI permission is required.

Government Route: Under this route applications are considered by the Foreign Investment Promotion Board. Prior approval by government is needed via this route. Foreign Investment Promotion Board is the responsible agency to oversee this route.

Exchange Control Management - FEMA

The Reserve Bank of India's Exchange Control Department, administers Foreign Exchange Management Act, 1999, (FEMA) which has replaced the earlier act, FERA, with effect from June 1, 2000. The new legislation is for "facilitating external trade" and "promoting the orderly development and maintenance of foreign exchange market in India". FEMA extends to the whole of India. Under FEMA, an Indian company with foreign equity participation is treated at par with

other locally incorporated companies. Accordingly, the exchange control laws and regulations for residents apply to foreign-invested companies as well.

ROLE OF FDI IN INDIA

Foreign direct investment (FDI) in India has played an important role in the development of the Indian economy. FDI in India has in a lot of ways enabled India to achieve a certain degree of financial stability, growth and development. The FDI has allowed India to focus on the areas that needed a boost and economic attention, and address the various problems that continue to challenge the country.

FDI in India has contributed effectively to the overall growth of the economy in the recent times. FDI inflow has an impact on India's transfer of new technology and innovative ideas, improving infrastructure, thus makes a competitive business environment. FDI policy is reviewed on an ongoing basis and measures for its further liberalization are taken by the government often. They act as a long term source of capital as well as a source of advanced and developed technologies.

The investors bring best global practices of management in the host country. The amount of capital comes in through these foreign direct investments more and more industries are set up in India. It also helps in increasing employment, promoting international trade. This investment is a non-debt, non-volatile investment and returns received on these are generally spent on the host country itself thus helping in the development of the country. Some of the sectors that attract high FDI inflows in India are the hotel and tourism industry, insurance sector, telecommunication, real estate, retail, power, drugs, financial services, infrastructure and pollution control etc. FDI is not permitted in the following sectors due to safety & security reasons i.e., Railways, Atomic energy, Defense, Coal and lignite.

INDIA FOREIGN DIRECT INVESTMENT (1995-2018)

Foreign Direct Investment in India increased by 1571 USD Million in October of 2017. Foreign Direct Investment in India averaged 1280.24 USD Million from 1995 until 2017, reaching an all time high of 8579 USD Million in August of 2017 and a record low of -60 USD Million in February of 2014. (Source: www.tradingeconomics.com).

SECTORS ATTRACTING FDI EQUITY INFLOWS IN INDIA

Amount: US\$ in Million

RANKS	SECTOR	2014-15 (APRIL - MARCH)	2015-16 (APRIL - MARCH)	2016-17 (APRIL - MARCH)	CUMULATIVE INFLOWS (APRIL '00 TO MARCH '17)
1	Service sector	4,443	6,889	8,684	59,476
2	Computer software & hardware	2,296	5,904	3,652	24,669
3	Construction	769	113	105	24293
4	Telecommunications	2,895	1,324	5,564	23,946

5	Automobile industry	2,726	2,527	1,609	16,674
6	Drugs & Pharmaceuticals	1,498	754	857	14,707
7	Trading	2,728	3,845	2,338	14,211
8	Chemicals (other than fertilisers)	763	1,470	1,393	13,293
9	Power	707	869	1,113	11,589
10	Metallurgical Industries	359	456	1,440	10,331

TABLE NO 1

The above table depicts the FDI equity inflows in India in the past 3 consecutive years (2014-15, 2015-16 and 2016-17. The data visibly shows the foreign direct investment equity inflows in various sectors. Among all the sectors, the service sector was attracted a huge FDI (US\$ 59,476 million in the past three years) than other sectors. Next to the service sector, the computer software and hardware sectors attract more FDI in the past three consecutive years (US\$ 24,669 million) in India. The rest of the sectors were also listed and ranked based on the inflow of FDI equity in India. From the above table, the top ten sectors attracted the Foreign Direct Investment equity inflows are service sector, computer software & hardware, construction sector, telecommunications, automobile industry, drugs & pharmaceuticals, trading, chemicals (other than fertilizers), power and, metallurgical industries.

SECTOR-WISE EQUITY INFLOWS IN INDIA

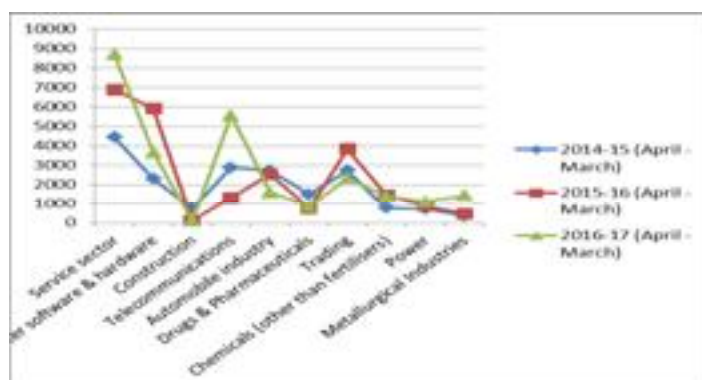


FIG NO 1

The above diagram shows the sector-wise contribution of foreign direct investment through equity inflows. The top ten sectors attracted the FDI equity inflows in the year 2014-15, 2015-16, 2016-17 was shown in the picture. Even though there might be some fluctuations in the investment in the last three years, it was visibly shown that the service sector is attracted more FDI compared with all other sectors.

**YEAR-WISE FDI INFLOWS DATA
(Amount US\$ Million)**

FINANCIAL YEAR (APRIL - MARCH)	TOTAL FDI FLOWS	%AGE GROWTH OVER PREVIOUS YEAR (IN US\$ TERMS)	3 YEARLY MOVING AVERAGE
2001-02	6,130	52	
2002-03	5,035	-18	5,162
2003-04	4,322	-14	5,136
2004-05	6,051	40	6,445
2005-06	8,961	48	12,613
2006-07	22,826	155	22,210
2007-08	34,843	53	33,181
2008-09	41,873	20	38,154
2009-10	37,745	-10	38,155
2010-11	34,847	-8	39,716
2011-12	46,556	34	38,567
2012-13	34,298	-26	38,967
2013-14	36,046	5	38,497
2014-15	45,148	25	45,550
2015-16	55,457	23	
2016-17 (April 2016 - Sept. 2016)	29,016		
Cumulative Total (from April 2001 to September 2016)	4,49,154		

TABLE NO 2

FDI INFLOWS IN INDIA

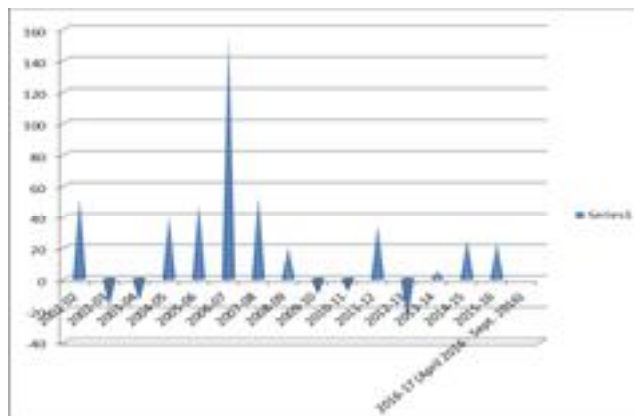


FIG NO 2

The above table and the graph express the FDI inflows in India from the financial year 2001-02 to 2016-17. It can be seen that the FDI inflows increases substantially over a period of time from US \$ 6,130 Million in the financial year 2001-02 to US \$55,457 million in the financial year 2015-16. It shows the upward trend over the foreign direct investment in India due to the frequent changes in the policies and the regulations which makes a favourable atmosphere in India for the foreign investors. From the data, we can observe that some oscillations in the investment in some years caused due to the various factors involved which determines the flow of FDI.

FDI INFLOWS IN INDIA – THREE YEARLY MOVING AVERAGES

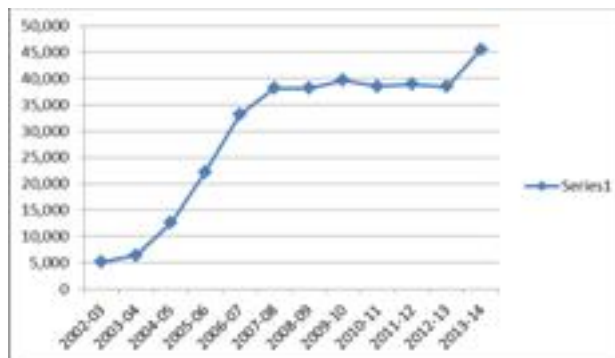


FIG NO 3

Three yearly moving averages are used to analyse the trend in foreign direct investment in India from the year 2001 to 2015. The trend line shows that there was a sharp rise in the FDI during the year 2004 to 2007 and thereafter it has a stable flow of FDI in India from the year 2007 to 2014, and again in the financial year 2014-15, there was a slight increase in the flow of FDI which was increased from US \$36,046 million to US \$45,148 & US \$ 55,457 million (2015-16). From the data, as well as the trend analysis, we can see the trend of increase the inflow of FDI in India over a period of time.

COUNTRY-WISE FDI EQUITY INFLOWS (APRIL 2000 TO SEPTEMBER 2016)

According to the RBI website, 152 countries are invested in India through foreign direct investment in the year 2016. Out of these 152 countries, the topmost contributed countries in our nation’s FDI are listed below.

S.N O.	NAME OF THE COUNTRY	FDI INFLOWS (IN US\$ MILLION)	%AGE WITH INFLOWS
1	Mauritius	1,01,759.68	32.81
2	Singapore	50,559.91	16.3
3	U.K.	24,072.30	7.76
4	Japan	23,760.47	7.66
5	U.S.A.	19,380.43	6.25
6	Netherlands	18,929.16	6.1
7	Germany	9,217.02	2.97
8	Cyprus	8,933.35	2.88
9	France	5,294.36	1.71
10	UAE	4,384.82	1.41

The above table clearly depicts the percentage of FDI inflow contributed by various countries in India from the year 2000 to 2016. The flow of FDI was converted to 100%, and the percentage of FDI inflows contributed by the various countries investors are also analyzed and ranked the

countries based on their percentage contribution in India's FDI inflow. Out of the 100% of FDI in India, Mauritius is the highest contributor with the share of 32.81% of the overall inflow in our country's foreign direct investment. The second position is held by Singapore with 16.3 % of contribution in India's FDI over the period from 2000 to 2016. Countries like United Kingdom and Japan hold the position of third and fourth with the share of 7.76 and 7.66 respectively and so on. Apart from these top ten countries, Switzerland was contributed around 1.15% in our country's total FDI's percentage, rest of the countries are contributed less than one percentage.

6. CONCLUSION

India has become an attractive market for manufacturers and investors to attract FDI. In the last three years, the government has eased 87 FDI rules across 21 sectors to accelerate economic growth and boost jobs. "The country has now become the top most attractive destination for foreign investment," the ministry said in a statement. From the data, we can clearly understand that India has now become the top most attractive destination for foreign investment. The increased inflow of Foreign Direct Investment in India in a climate of contracting worldwide investments indicates the faith that overseas investors have imposed in the country's economy and the reforms initiated by the Government towards ease of doing business. The FDI inflow during the financial year 2014-15, 2015-16 & 2016-17 was spread across the sectors and it clearly depicts the fact of positive ecosystem of investment opportunities which India is now providing to the worldwide investors. India stands committed to have a FDI policy and regime which is investor friendly and also promotes investment leading to increased manufacturing, job creation and overall economic growth of the country. The government has phased out FDI-favoured policies, India will be increasingly recognised as a favoured destination by overseas investors.

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