AN OVERVIEW OF FOREIGN DIRECT INVESTMENT IN INDIA

ABSTRACT

This paper attempted to make an analysis of FDI in India and its impact on growth. It also focuses on the determinants and needs of FDI, year-wise analysis, sectoral analysis and sources of FDI and reasons. One of the economic aspects of globalization is the fact that increasing investments in the form of foreign direct investments. In the recent times due to the global recession most of the countries have not been able to pull investments. India has been able to attract better FDI's than the developed countries even during the crisis period also. Especially in the recent years the FDI in India has been following a positive growth rate. Since 1991 the government has focused on liberalization of policies to welcome foreign direct investments. These investments have been a key driver for accelerating the economic growth through technology transfer, employment generation, and improved access to managerial expertise, global capital, product markets and distribution network. FDI in India has enabled to achieve a certain degree of financial stability; growth and development to sustain and compete in the global economy.

KEYWORDS: FDI, GDP, Growth & Development & Indian Economy.

INTRODUCTION

Foreign direct investment is one of the measures of growing economic globalization. Investment has always been an issue for the developing economies such as India. The world has been globalizing and all the countries are liberalizing their policies for welcoming investment from countries which are abundant in capital resources. The countries which are developed are focusing on new markets where there is availability of abundant labors, scope for products, and high profits are achieved. Therefore Foreign Direct Investment (FDI) has become a battle ground in the emerging markets. The objective behind allowing FDI is to complement and supplement domestic investment, for achieving a higher level of economic development and providing opportunities for technological upgradation, as well as access to global managerial skills and practices[1].

South Asian countries such as china have implemented open door policies during 1980's but India liberalized its policies in 1991. Before pre-liberalization India followed conservative policies to protect the indigenous investors and industrialist. The economic growth has not been achieved. In 1991, the then congress government had implemented liberalization policies to restructure the Indian economy.

OBJECTIVES

- To identify the various determinants of FDI
- To understand the need for FDI in India

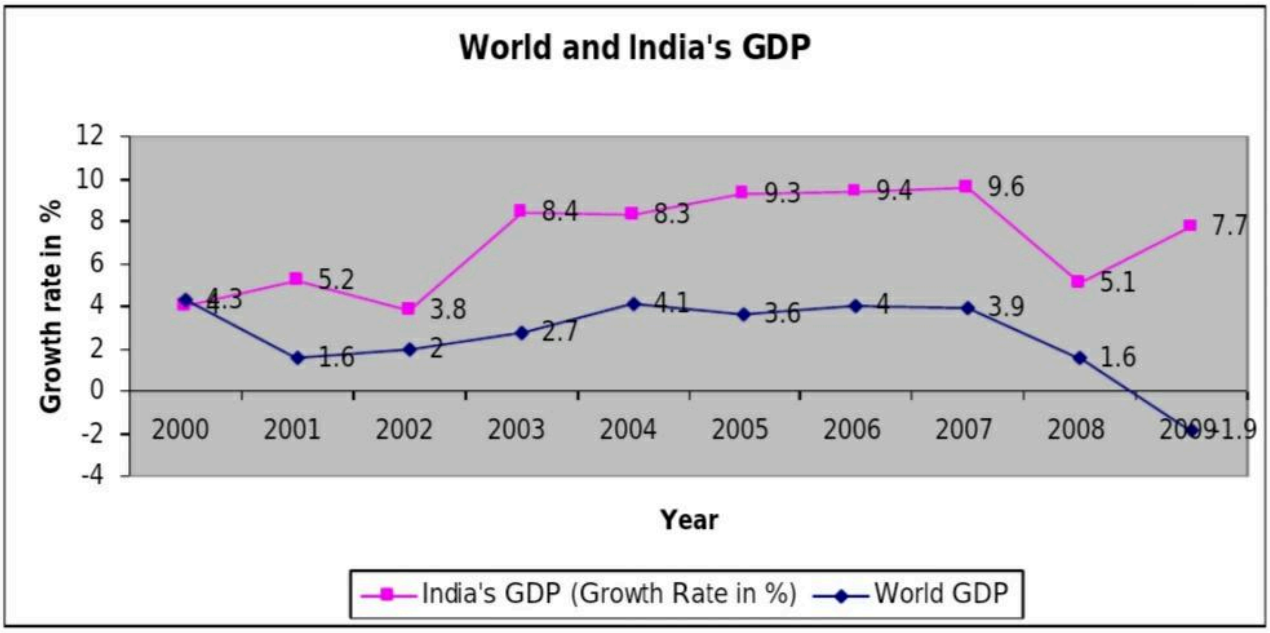
➢ To exhibit the sector-wise, year-wise analysis of FDI's in India.

RESEARCH METHODOLOGY

This research is a descriptive study in nature. The secondary data was collected from various journals, magazines, and websites particularly from the Department of Industrial Policy & Promotion, Ministry of Commerce and Industry, Indiastat etc. The study is based on the time period from 2000-2010. Simple percentages have been used to defect the growth rate of India and world GDP and to draw further comparison between the two. Graphs and tables have also been used where ever required to depict statistical data of FDI during the study period.

INDIA'S GDP

Mainly as a result of economic reforms initiated in 1991, long term trend rate of growth rate increased from 3.6% during the 1950-1970s, to 5.2% in the 1980s, 6.1% in the 1990s, and to more than 9% during from 2005-2007 (Asian Development Bank). "The growth rate of India declined by a modest 2-3% and is on track to regain its 9% growth by the next fiscal year," according to recent projections released by the Finance Minister and Ernst & Young[2] Before 1991 the GDP of India was low. Due to the welcome of FDI's there has been lot of growth in sectors such as IT, banking and financial sector, telecommunication, and infrastructure.



Source: World Bank, World development Indicators (2010).

FDI IN INDIA

The last decade of the 20th century witnessed a drastic increase in foreign direct investment (FDI), accompanied by a marked change in the attitude of most developing countries towards inward investment. FDI flows have grown in importance relative to other forms of international capital flows, and the resulting production has increased as a share of world output. Naturally, the attitude towards foreign capital was one of fears and sufficient, an account of the previous bitter experience draining away of the resources from the country, once better known as the golden birds[3].

Foreign direct investment (FDI) in India has played an important role in the development of the Indian economy during the recession. FDI in India has – in a lot of ways – enabled India to achieve a certain degree of financial stability, growth and development. This money has allowed India to focus on the areas that may have needed economic attention and address various problems that continue to challenge the country. The factors that attracted investment in India are stable economic policies, availability of cheap and quality human resources, and opportunities of new unexplored markets. Mostly FDI are flowing in service sector and manufacturing sector recorded very low investments. The investments in service sector will enhance the benefit of flow of funds to the home country. Presently India is contributing about 17% of world total population but the share of GDP to world GDP is 2%. India has been ranked at the second place in global foreign direct investments in 2010 and will continue to remain among the top five attractive destinations for international investors during 2010-12 period, according to United Nations Conference on Trade and Development (UNCTAD) in a report on world investment prospects titled, 'World Investment Prospects Survey 2009-2012'.

According to the fact sheet on foreign direct investment dated October 2010. Mauritius is the highest FDI investment in equity inflows with 42% of the total inflow followed by Singapore, USA, UK and Netherlands with 9%, 7%, 5% and 4% respectively. Service sector is the highest FDI attracting inflows with 21% of the total inflows, followed by computer software and hardware, telecommunication and housing and real estate with 9%, 8%, 7% and 7% inflows respectively. A report released in February 2010 by Leeds University Business School, commissioned by UK Trade & Investment (UKTI), ranks India among the top three countries where British companies can do better business during 2012-14. According to Ernst and Young's 2010 European Attractiveness Survey, India is ranked as the fourth most attractive foreign direct investment destination in 2010.

DETERMINANTS OF FDI

The determinant varies from one country to another due their unique characteristics and opportunities for the potential investors. In specific the determinants of FDI in India are:

- **STABLE POLICIES:** India stable economic and socio policies have attracted investors across border. Investors prefer countries which stable economic policies. If the government makes changes in policies which will have effect on the business. The business requires a lot of funds to be deployed and any change in policy against the investor will have a negative effect.

- **ECONOMIC FACTORS:** Different economic factors encourage inward FDI. These include interest loans, tax breaks, grants, subsidies and the removal of restrictions and limitation. The government of India has given many tax exemption and subsidies to the foreign investors who would help in developing the economy.

- **CHEAP AND SKILLED LABOR:** There is abundant labor available in India in terms of skilled and unskilled human resources. Foreign investors will to take advantage of the difference in the cost of labor as we have cheap and skilled labors. Example: Foreign firms have invested in BPO's in India which require skilled labor and we have been providing the same.

- **BASIC INFRASTRUCTURE:** India though is a developing country, it has developed special economic zone where there have focused to build required infrastructure such as roads, effective transportation and registered carrier departure world wide, Information and communication network/technology, powers, financial institutions, and legal system and other basic amenities which are must for the success of the business. A sound legal system and modern infrastructure supporting an efficient distribution of goods and services in the host country.

- **UNEXPLORED MARKETS:** In India there is large scope for the investors because there is a large section of markets have not explored or unutilized. In India there is enormous potential customer market with large middle class income group who would be target group for new markets. Example: BPO was one sector where the investors had large scope exploring the markets where the service was provided with just a call, with almost customer satisfaction.

- **AVAILABILITY OF NATURAL RESOURCES:** As we that India has large volume of natural resources such as coal, iron ore, Natural gas etc. If natural resources are available they can be used in production process or for extraction of mines by the foreign investors.

NEED FOR FDI IN INDIA

As India is a developing country, capital has been one of the scare resources that are usually required for economic development. Capital is limited and there are many issues such as Health, poverty, employment, education, research and development, technology obsolesce, global competition. The flow of FDI in India from across the world will help in acquiring the funds at cheaper cost, better technology, employment generation, and upgraded technology transfer, scope for more trade, linkages and spillovers to domestic firms. The following arguments are advanced in favor of foreign capital

- **SUSTAINING A HIGH LEVEL OF INVESTMENT:** As all the under-developed and the developing countries want to industrialize and develop themselves, therefore it becomes necessary to raise the level to investment substantially. Due to poverty and low GDP the saving are low. Therefore there is a need to fill the gap between income and savings through foreign direct investments.

- **TECHNOLOGICAL GAP:** In Indian scenario we need technical assistance from foreign source for provision if expert services, training of Indian personnel and educational, research and training institutions in the industry. It only comes through private foreign investment or foreign collaborations.

- **EXPLOITATION OF NATURAL RESOURCES:** in India we have abundant natural resources such as coal, iron and steel but to extract the resources we require foreign collaboration.

- **UNDERSTANDING THE INITIAL RISK:** In developing countries as capital is a scare resource, the risk of investments in new ventures or projects for industrialization is high. Therefore foreign capital helps in these investments which require high risk.

- **DEVELOPMENT OF BASIC ECONOMIC INFRASTRUCTURE:** In the recent years foreign financial institutions and government of advanced countries have made substantial capital available to the under developed countries. FDI will help in developing the infrastructure by establishing firm’s different parts of the country.

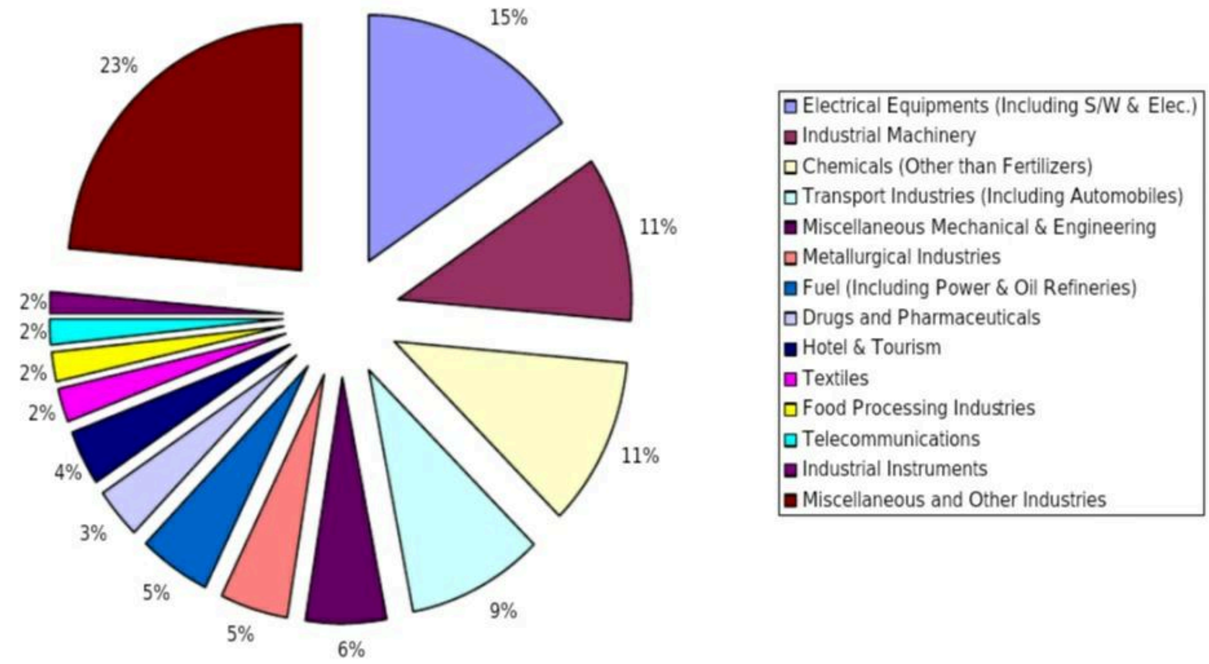
employment to about 15.6 lakhs persons, accounting for about 4 to 5% of the total employment in the organized sector. Class-3 cities provide employment to about 7.9 lakhs workers (more than 50% of the total). Sectors providing a relatively high share of employment in Class-3 cities include transport equipment; growing and processing of crops; construction parts; textiles; and non-metallic mineral products.

INVESTMENT PROPOSALS AND FOREIGN TECHNOLOGY COLLABORATIONS

Foreign technology induction can be encouraged through FDI and through foreign technology collaboration agreements. The sectors which have resources but do not have the required technology acquire foreign technology collaboration through RBI or Government approvals. The total number of approvals recorded for the period of 2000 to 2010 by the RBI, SIA and FIPB is 8080. The RBI has approved 4580 proposal whereas SIA and FIPB have approved 3500. Technical collaborations have put a positive effect on the domestic firms. It helped in establishing technology transfers.

Electrical equipments have recorded with 15.6% of the total approvals of foreign technology collaborations. Followed by chemicals, industrial machinery, transport industries, miscellaneous mechanical and engineering, metallurgical industry, Fuel, drugs and pharmaceuticals, hotel and tourism, textiles and other industries have been approved with a share of 11.2, 10.8, 9.4, 5.4, 4.7, 5, 3.4, 3.6, 2.1 and 23.5% respectively. Most of the sectors which have been approved are manufacturing sector requiring high technology.

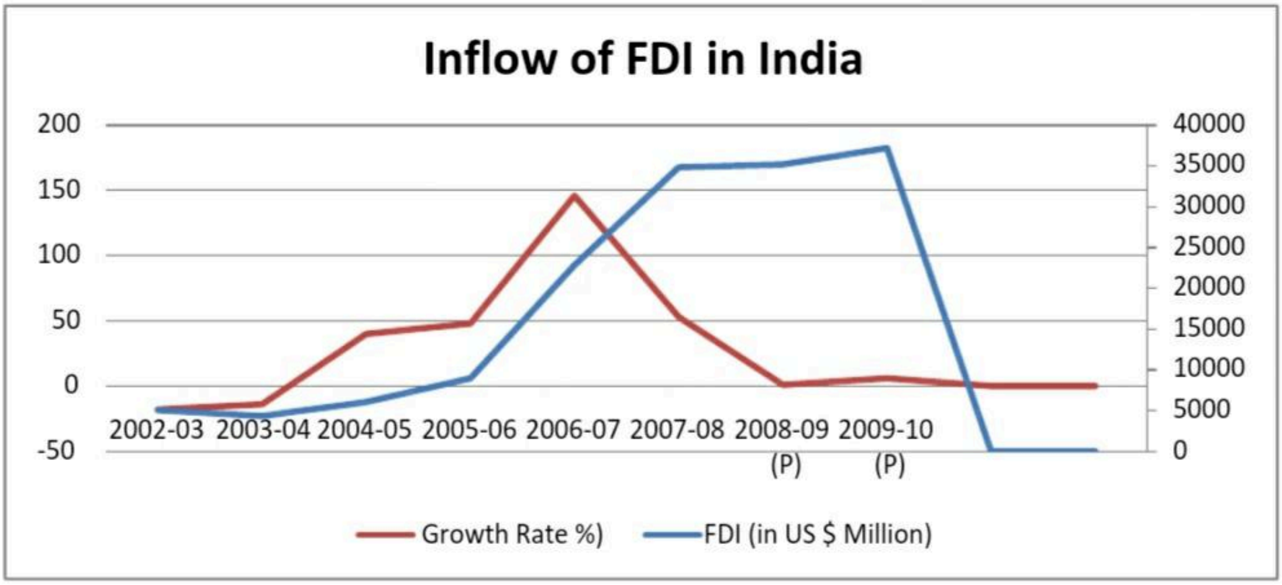
Sector-wise Foreign Technology Collaborations (Aug-1991 to Oct-2009)



Source: RBI

INVESTMENTS - YEAR WISE ANALYSIS OF FDI IN INDIA

The investment in the form of Non- debt has provided the India with financial support and stability in the post liberalization period. There have been fluctuations in the inflows of FDI from the period of 2000-2010. The finance ministry and the Reserve Bank of India (RBI) feel that foreign investment should be allowed in investment companies, since they are similar to holding companies[4]. From 2000- 2002 there has been increase in inflows from 4029 US$ millions to 6130 US$ millions but for the next two years i.e., 2002-2004 FDI have moved down to 4322 US$ millions. There has been in increasing in FDI from the period of 2004. India attracted 4322 US$ millions to 37182 US$ millions from 2004 to 2010. There has been growth but the marginal growth in percentages has been falling for the same period. It has been observed that from 2006- 2010, India has witnessed a falling marginal growth rate from 146% to 6%. We can find that there was no negative rate in India was recorded even in the recession period. The combination of recession in developed countries, lower commodity prices and reduced international capital flows will result in a sharp slowdown in growth in emerging markets, through most will avoid outright recession[5]. The UNCTAD report says the global FDI flows began to bottom out in the latter half of 2009 and has shown a modest recovery in the first half of 2010 with South Asia being the first to bounce back from the recent downturn.



Source: DIPP

SOURCES OF FDI

The largest inflows of FDI's over the period of April 2000 to October 2010 have been received from Mauritius, its share in these inflows have being as high as 42.16%. Singapore is second with a share of 9.35%. The other major sources of foreign direct investment are from U.S.A, UK, Netherlands, Cyprus, Japan, Germany, France, United Arab Emirates and their respective share of inflow of FDI are 7.49%, 5.07%, 4.28%, 3.52%, 3.51%, 2.35, 1.51%, and 1.48% respectively. The inflows from U.S.A are routed through Mauritius due to tax advantage. The tax advantage emanates from the double tax avoidance agreement that India has with that country USA. This agreement means that any foreign investor has the option of paying tax either in India or in Mauritius. The tax rates in Mauritius are amongst the lowest in the world. The other big investors included Singapore, the US, Britain and the Netherlands. While investors get higher returns on their money in India, those from Mauritius "get even

There are special economic zones which have been developed by government for improvising the industrial growth.

- **IMPROVEMENT IN THE BALANCE OF PAYMENTS POSITION:** The inflow FDI will help in improving the balance of payment. Firms which feel that the goods produced in India will have a low cost, will produce the goods and export the same to other country. This helps in increasing the exports.

- **FOREIGN FIRM'S HELPS IN INCREASING THE COMPETITION:** Foreign firms have always come up with better technology, process, and innovations comparing with the domestic firms. They develop a completion in which the domestic firms will perform better it survive in the market.

IMPACT ON INDIAN ECONOMY

FDI have helped India to attain a financial stability and economic growth with the help of investments in different sectors. FDI has boosted the economic life of India and on the other hand there are critics who have blamed the government for ousting the domestic inflows. After liberalization of Trade policies in India, there has been a positive GDP growth rate in Indian economy.

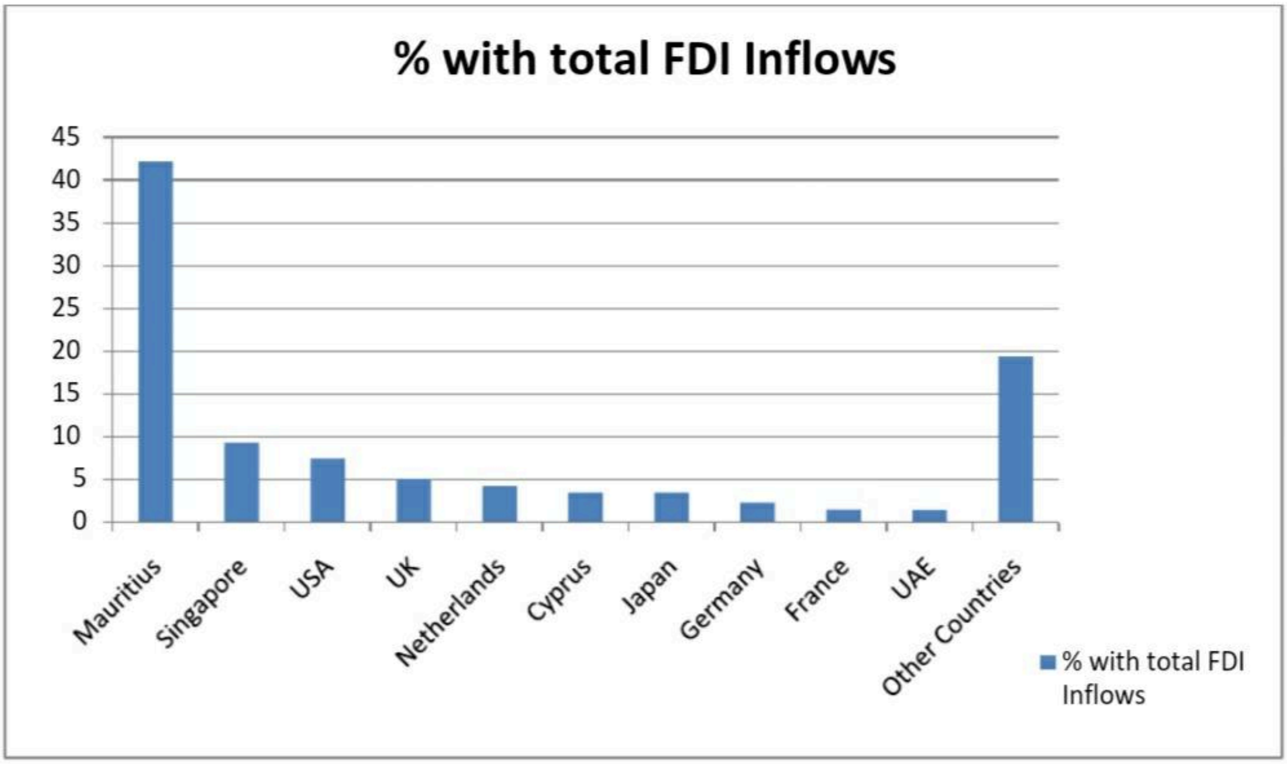
Foreign direct investments helps in developing the economy by generating employment to the unemployed, Generating revenues in the form of tax and incomes, Financial stability to the government, development of infrastructure, backward and forward linkages to the domestic firms for the requirements of raw materials, tools, business infrastructure, and act as support for financial system. Forward and back ward linkages are developed to support the foreign firm with supply of raw and other requirements. It helps in generation of employment and also helps poverty eradication. There are many businesses or individuals who would earn their lively hood through the foreign investments. There are legal and financial consultants who also guide in the early stage of establishment of firm.

It is the world largest democracy and crown at an impressive rate of over 6 percent, on an average per annum in the last decades. The number of proposal approved by the foreign investment board from the period of February 2003 to December 2009 were 3511 proposals and the proposed inflows of foreign direct investment is 194708.83 (Rs. in crores). During 2009 alone FIPB approved 300 proposals with FDI inflow of Rs.404111 crores. In the thirteenth round second quarter of financial year 2011 of the professional forecasters survey conducted by the RBI, expects the real GDP growth to be marginally higher at 8.5 percent in financial year 2011 from the last survey.

EMPLOYMENT

There is direct and positive relationship between FDI and employment. As firms are operated in India they require skilled and unskilled labor. In India labor is cheap source and available in abundant. Therefore, FDI provides employment to all the section of the people. They contribute a good proportionate of the total employment. Normally Greenfield's generates employment when they start a project or firm but mergers and acquisitions do not generate employment at the time of entry but over the period it creates employment and also develops trade linkages in the long run. One of the objectives of development of special economic zones is generation of employment. More than two-fifth of the market capitalization originates in Class-3 cities. FDI-enabled firms in manufacturing sectors provide higher returns on their capital as we have a double taxation avoidance treaty (DTA T) (with the island nation)," Crisil principal economist, Mr. D.K. Joshi[6].

There have been changes in the source countries due to the change of policies in 1991. Prior to 1991, India depended on a few developed western countries for capital. These included countries like Israel, Australia, South Korea, Malaysia; Singapore etc. after the policies have been implemented countries which did not had any share in India's FDI such as Thailand, Saudi Arabia and South Africa etc.

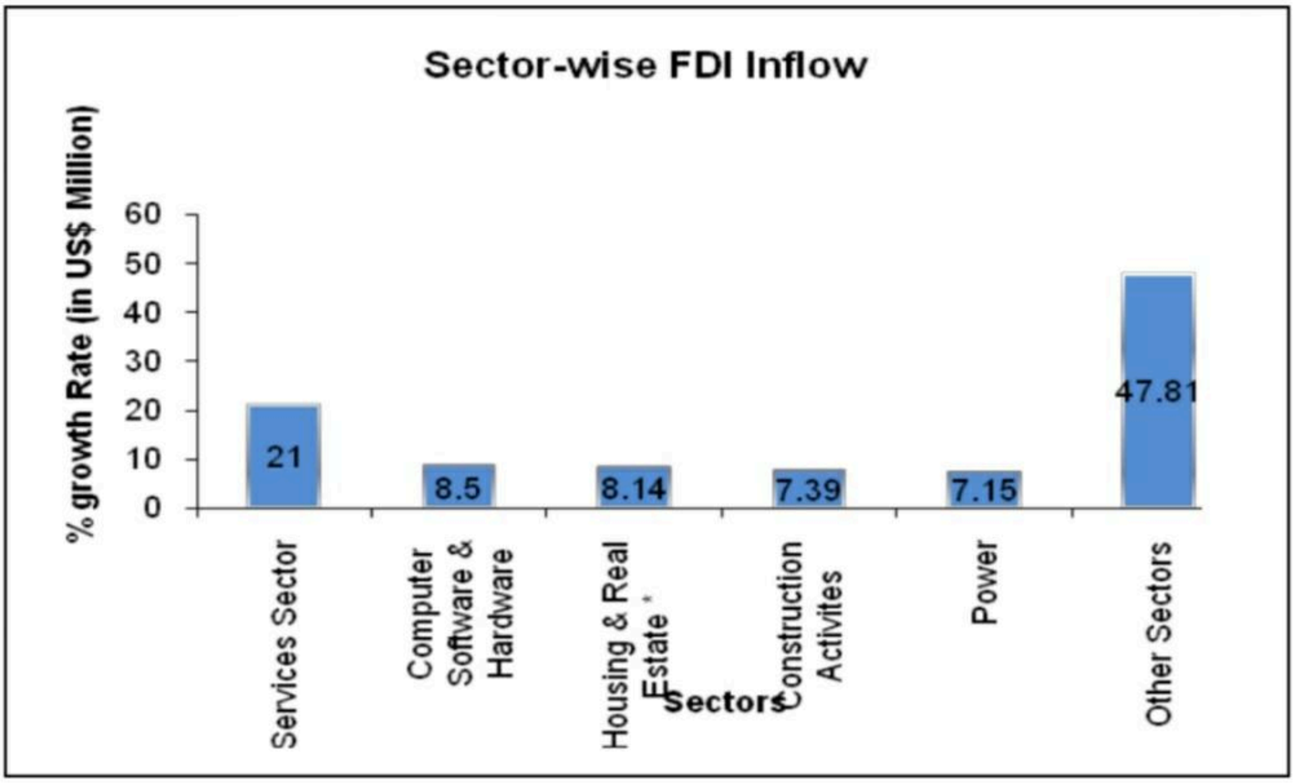


Source: DIPP

SECTORAL COMPOSITION OF FDI

The Sectoral composition of FDI over the period of April 2000 to October 2010, we can find that the largest recipient of such investment is service sector (Financial and non-financial services). The share of this sector in cumulative FDI flows is 21% of the inflow total foreign direct investment. The foreign investors are interested in mainly financial services due its profit generating advantage. This sector gives scope for the foreign investor to takes back the profits to the home country. As service sector the services are consumed in the host country and there by generating outflow of funds from the host country. The second recipient is computer software and hardware sector which shares 8.5% of total FDI. Housing and real estate, construction activities and power sector contribute 8.14%, 7.39% and 7.15% respectively. Whereas all the other sectors totally contribute about 47.81%. The keys takeaways regarding global flows are – the increase in the relative share of developing countries as both destination and sources and flow to the sector gaining over manufacturing.

There are Sectoral limits or caps designed by the RBI to limit the foreign direct investments. 100% investment has been allowed to the following sectors- private sector banking, NBFC'S, petroleum, housing and Real estate, Hotel and tourism, road and highways, ports and harbors, advertising, films, mass raped transportation, power, drug and pharmaceuticals, pollutions control and management and special economic zones. Other sectors such as airports are allowed with 74% caps and telecommunication with 49% and insurance with 26%.



Source: DIPP

CONCLUSION

This paper focuses on theoretical aspects of FDI in India during the last ten years, determinants and need of FDI in Indian scenario. India has been one of the developing countries and has managed to show a positive GDP growth even during the recession period. It has comparatively performed well, then the average growth rate of world GDP. According to UNCTAD in its World Investment Report 2010 "If the situation continues to improve, India is likely to be among the most promising investor-home countries in 2010-12 as well as the third highest economy for FDI in 2010-12". India has all the variables such as fine infrastructure, potential markets, abundant labour, availability of natural resources, and at last the economic and trades policies which has been favouring FDI. India is now rated as the second-most favoured destination for FDI in the world after China, but it is expected that in future India would out beet china as it has a large proportion of young population with one of the fastest growing economies. Instead of the government should formulate the policies which can attract more foreign investment in manufacturing sector rather than service sector.

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ANNEXURE

TABLE 1

FINANCIAL YEAR-WISE FDI INFLOWS

Year	Total FDI Inflow US$ (in Million)	Growth Rate %
2000-01	4029	
2001-02	6130	52
2002-03	5035	-18
2003-04	4322	-14
2004-05	6051	40
2005-06	8961	48
2006-07	22826	146
2007-08	34835	53
2008-09 (P)	35180	1
2009-10 (P)	37182	6

Source: Department of Industrial Policy & Promotion (Oct-2010), Ministry of Commerce and Industry. Note: P=Provisional Data

TABLE 2

STATEMENT ON SECTOR-WISE FDI INFLOWS (APR-2000 TO OCT-2010)

Sectors	Amount of FDI Inflows		% of Total FDI Inflows
	(Rs. in Crores)	(in US$ Million)	
Services Sector	115162.3	25763.7	21
Computer Software & Hardware	46371.2	10425.5	8.5
Housing & Real Estate *	45529.61	9992.7	8.14
Construction Activities	40663.69	9072.49	7.39
Power	38932.07	8771.02	7.15
Other Sectors	262299.6	58661.5	47.81
Sub-Total	548958.2	122687	100
RBI's - NRI Schemes	533.06	121.33	
Grand Total	549491.3	122808	

Source: DIPP

TABLE 3: SOURCES OF FDI APRIL – 2000 TO OCTOBER 2010

Country	Amount of FDI Inflows		% with total FDI Inflows
	(in Crores)	(in UC$ Million)	
Mauritius	231428.6	51719.5	42.16
Singapore	50961.66	11471.9	9.35
USA	41357.41	9186.37	7.49
UK	27569.08	6225.58	5.07
Netherlands	23613.63	5254.89	4.28
Cyprus	19733.74	4322.36	3.52
Japan	19547.36	4300.29	3.51

Germany	12848.04	2881.92	2.35
France	8403.64	1851.48	1.51
UAE	8255.88	1815.29	1.48
Other Countries	105239.2	23657.3	19.38
Sub Total FDI	548958.2	122687	100
RBI's - NRI Schemes	533.06	121.33	
Grand Total FDI	549491.3	122808	

Source: Department of Industrial Policy & Promotion (Oct-2010), Ministry of Commerce and Industry

TABLE 4

INVESTMENT PROPOSALS AND FOREIGN TECHNOLOGY COLLABORATIONS

Sectors	No. of Approval by RBI	No. of Approval by SIA+FIPB	Total	Sectoral Percentage
Electrical Equipments (Including S/W & Elec.)	811	450	1261	15.6
Industrial Machinery	623	249	872	10.8
Chemicals (Other than Fertilizers)	451	454	905	11.2
Transport Industries (Including Automobiles)	400	356	756	9.4
Miscellaneous Mechanical & Engineering	267	177	444	5.5
Metallurgical Industries	217	161	378	4.7
Fuel (Including Power & Oil Refineries)	56	349	405	5
Drugs and Pharmaceuticals	197	79	276	3.4
Hotel & Tourism	42	246	288	3.6
Textiles	75	95	170	2.1