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RESEARCH ARTICLE

Impact of Foreign Direct Investment in India: An Analytical Study

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Abstract

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International Economic Integration plays a vital role in Economic Development of any country. Foreign Direct Investment is one and only major instrument of attracting International Economic Integration in any economy. It serves as a link between investment and saving. Many developing countries like India are facing the deficit of savings. This problem can be solved with the help of Foreign Direct Investment. Foreign investment helps in reducing the defect of BOP. The flow of foreign investment is a profit making industry like insurance, real estate and business services and serving as a catalyst for the growth of economy in India. With the initiation of globalization, developing countries, particularly those in Asia, have been witnessing a immense surge of FDI inflows during the past two decades. Even though India has been a latecomer to the FDI scene compared to other East Asian countries, its considerable market potential and a liberalized policy regime has sustained its attraction as a favourable destination for foreign investors. This research paper aims to examine the impact of FDI on the Indian economy, particularly after two decades of economic reforms, and analyzes the challenges to position itself favourably in the global competition for FDI.The major weakness of the Indian economic reforms is that the economy is growing in sustainable way but with 'jobless growth' during the post liberlisation period. The liberlisation policy have generated the employment opportunities but not to the quantum planned.

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I. INTRODUCTION

FDI stands for Foreign Direct Investment, a component of a country's national financial accounts. Foreign direct investment is investment of foreign assets into domestic structures, equipment, and organizations. The FDI can take any route or form to enter into any nation. The three principal forms of FDI in India are joint ventures, acquisition of assets in a country and Greenfield ventures.

According to the international monetary fund, FDI is defined as:

"Investment that is made to acquire lasting interest in an enterprise operating in an economy other than that of investor. The investor's purpose is being to have an effective voice in the management ofenterprise."

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Foreign investment plays a significant role in development of any economy as like India. Many countries provide many incentives for attracting the foreign direct investment (FDI). Need of FDI depends on saving and investment rate in any country. Foreign Direct investment acts as a bridge to fulfill the gap between investment and saving. In the process of economic development foreign capital helps to cover the domestic saving constraint and provide access to the superior technology that promote efficiency and productivity of the existing production capacity and generate new production opportunity.One of the most striking developments during the last two decades is the spectacular growth of FDI in the global economic landscape. This unprecedented growth of global FDI in 1990 around the world make FDI an important and vital component of development strategy in both developed and developing nations and policies are designed in order to stimulate inward flowsFDI gives a win – win situation to the host and the home countries. In fact, both the countries are directly concerned in inviting more and more FDI, as they benefit a lot from these types of investments. The 'home' countries have the advantage of the vast markets opened by industrial growth. On the other side, the 'host' countries are having the advantage to acquire technological and managerial skills and aid domestic savings and foreign exchange. As a result, Foreign Direct Investment (FDI) is now been a vital driver of growth. Many Emerging Market Economies (EMEs) are looking upon FDI as one of the easiest means to satisfy and fulfill their financial, technical, employment generation and competitive efficiency requirements. Gradually they also realized that substantial economic growth is inevitable without global integration of business process. This created opportunities for vocational advantages and thus facilitated strategic alliances, joint ventures and collaborations over R & D. In 1980 the total stock of FDI equal only 6.6 percent of world Gross Domestic Product (GDP), while in 2003, the share had increased to 23 percent (UNCTAD 2004). Foreign direct investment (FDI) has become a key battleground for emerging market. In the Indian scenario, the New Economic Policy (NIP) introduced in 1991, along with subsequent doses of liberlisation have heralded a new era in which FDI plays a crucial role in supplementing domestic resources.

II. STATEMENT OF THE PROBLEM

To study the Foreign Direct Investment in India and its role in Indian economy. The study is undertaken, entitled as, "Impact of Foreign Direct Investment in India: An Analytical Study".

III. OBJECTIVES OF THE STUDY

The research paper covers the following objectives:

- To study the trends and pattern of flow of FDI.
- To assess the determinants of FDI inflows.
- To evaluate the impact of FDI on the Indian economy.
- To find out the future prospects of FDI in Indian economy.

IV. RESEARCH METHODOLOGY

The present study is based on the objectives andis analytical innature and makes use of secondary data.The required& relevant secondary data are collected from various publications of Government of India, Reserve Bank of India, World Investment Reports, Publications from Ministry of Commerce &from the websites of Dept. of Industrial Policy &Promotions (Govt. of India), World Bank, IMF, WTO, RBI, UNCTAD, etc.

V. A BRIEF REVIEW OF THE LITERATURE

Review of various literatures available on FDI reveals that foreign investment is still a matter of debate. Whether FDI is boom or bane for host countries economic growth and development? Opinions are still divided. FDI has its own advantages and disadvantages. Many scholars argue that through FDI developed nations may try to invade the sovereignty of host country.

Agarwal and Khan conducted the study on "Impact of FDI on GDP: A Comparative Study of China and India", the study found that 1% increase in FDI would result in 0.07%increase in GDP of China and 0.02% increase in GDP of India. We also found that China's growth is more affected by FDI, than India's growth.

Balasubramanyam and Sapsford stated in their article “Does India need a lot more FDI” compared the levels of FDI inflows in India and China, and found that FDI in India is one tenth of that of china. The paper also concluded that India may not require increased FDI because of the structure and composition of India’s manufacturing, service sectors and her endowments of human capital and the country is in a position to unbundle the FDI package effectively and rely on sources other than FDI for its capital requirement.

NirupamBajpai and Jeffrey D. Sachs (2006) in their paper “Foreign Direct Investment in India: Issues and Problems”, at- tempted to identify the issues and problems associated with India’s current FDI regimes, and more importantly the other associated factors responsible for India’s unattractiveness as an investment location. Despite India offering a large domes- tic market, rule of law, low labour costs, and a well working democracy, her performance in attracting FDI flows have been far from satisfactory.

ChandanChakraborty, Peter Nunnenkamp (2004) in their study “Economic Reforms, FDI and its Economic Effects in India” assess the growth implications of FDI in India by subjecting industry – specific FDI and output data to Granger causality tests within a panel co -integration framework. It turns out that the growth effects of FDI vary widely across sectors. FDI stocks and output are mutually reinforcing in the manufacturing sector. Most strikingly, the study finds only transitory effects of FDI on output in the service sector, which attracted the bulk of FDI in the post – reform era. These differences in the FDI – Growth relationship suggest that FDI is unlikely to work wonders in India if only remaining regulations were relaxed and still more industries opened up o FDI.

Naga Raj R (2003) in his article “Foreign Direct Investment in India since 1990s: Trends and Issues” discusses the trends in FDI in India in the 1990s and compare them with China. The study raises some issues on the effects of the recent investments on the domestic economy. Based on the analytical discussion and comparative experience, the study concludes by suggesting a realistic foreign investment policy.

VI. Foreign Direct Investment in India: FDI and Economic Growth

Before this, the historical background of FDI in India can be traced back with the establishment of East India Company of Britain. British capital came to India during the colonial era of Britain in India. However, researchers could not portray the complete history of FDI pouring in India due to lack of abundant and authentic data. Before independence, major amount of FDI came from the British companies. After Second World War, Japanese companies entered Indian market and enhanced their trade with India, yet U.K. remained the most dominant investor in India. Further, after Independence issues relating to foreign capital, operations of MNCs, gained attention of the policy makers. Keeping in mind the national interests the policy makers designed the FDI policy which aims FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resources. The first Prime Minister of India considered foreign investment as “necessary” not only to supplement domestic capital but also to secure scientific, technical, and industrial knowledge and capital equipment. How- ever, the country faced two severe crises in the form of foreign exchange and financial resource mobilization during the second five-year plan (1956 -61). Therefore, the government adopted a liberal attitude by allowing more frequent equity participation to foreign enterprises, and to accept equity capital in technical collaborations. With time and as per economic and political regimes there have been changes in the FDI policy too. The industrial policy of 1965, allowed MNCs to venture through technical collaboration in India. The government also provided many incentives such as tax concessions, simplification of licensing procedures and de- reserving some industries such as drugs, aluminium, heavy electrical equipment, fertilizers, etc. in order to further boost the FDI inflows in the country. This liberal attitude of government towards foreign capital lures investors from other advanced countries like USA, Japan, and Germany, etc. But due to significant outflow of foreign reserves in the form of remittances of dividends, profits, royalties etc., the government had to adopt stringent foreign policy in 1970s. During this period the government adopted a selective and highly restrictive foreign policy as far as foreign capital, type of FDI and ownerships of foreign companies was concerned. The world economy has observed a phenomenal change in volume and pattern of FDI flow from developed nations to EMEs in 1980s and 1990s compared to earlier decades. The hostile attitude of developing nations regarding multinationals investment has become generous during this transition period. FDI was fostered by liberalisation and market-based reforms in EMEs. The financial sector deregulation and reforms in the industrial policy further paved the way for global investments. Some of the most phenomenal developments during the last 20 years is the fabulous growth of FDI in the global economic arena. Starting from a baseline of less than USD 1 billion in 1990, a recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010-2012. As per the data, the sectors which attracted higher inflows were ser- vices, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, the US and the UK were among the leading sources of FDI to the country. In 2013, the government relaxed FDI norms in several sectors, including telecom, defence, PSU oil refineries, power exchanges and stock exchanges, among others. In retail, UK-based Tesco submitted its application to initially invest US$ 110 million to start a supermarket chain in collaboration with Tata Group's Trent. In civil aviation, Malaysia-based Air Asia and Singapore Airlines teamed up with Tata Group to launch two new air- line services. Also, Abu Dhabi-based Etihad picked up a 24 per cent stake in Jet Airways that was worth over Rs 2, 000 crores (US$ 319.39 million).Currently, while foreign portfolio investments to India are slowing, net foreign direct investment (FDI) inflows, which are far more stable, have touched a record high of $34.9 billion in 2014-15. In fact, net FDI in- flows touched 1.7% of gross domestic product (GDP) in the just-ended fiscal year, up from 1.1% of GDP the previous year. Foreign investment inflows to India are predominantly to infra- structure, mainly telecom, oil and gas, mining sectors, as well as the services sector. Higher FDI flows are good for India's cur- rent account deficit and also help drive domestic investments. With the government opening up various sectors such as insurance and defence, these stable flows may continue this year as well.

Current Trends &Issues

New Zealand is looking to establish an office in Mumbai to broaden its education footprint in India. It plans to set up an education promotion and market development role within the New Zealand Consulate General, Mumbai. There was an increase of more than 10 per cent in student visas issued to Indian nationals in 2013, making India among the fastest growing student markets for New Zealand. Korean South-East Power Company (KOSEP), part of South Korean state-owned power generator Korea Electric Power Corporation, has signed an initial agreement with Jinbhuvish Group, Mumbai, for technical support for its Rs 3, 450-crore (US$ 549.31 million) project in Maharashtra. The 600 megawatt (mw) power plant, which will be set up in Yavatmal district, is expected to be commissioned in 2016. India and UAE have agreed to promote collaboration in renewable energy, focusing in the areas of wind power and solar energy. A Memorandum of Understanding (MoU) was signed by Dr Farooq Abdullah, Minister of New and Renewable Energy of India and Dr Sultan Ahmed Al Jaber, Minister of State of UAE in Abu Dhabi on January 18, 2014. Luxury watch brand Jaeger-LeCoultre from Switzerland has filed for a 100 per cent single brand application to enter the Indian retail market. It thus became the first luxury company to apply for FDI through this route. Geneva-based Richemont SA that owns the luxury brand filed the application with the Department of Industrial Policy and Promotion (DIPP). France's Lactalis, the biggest dairy products group in the world, will most likely buy out Hyderabad-based Tirumala Milk Products for US $275–300 million. Lactalis has a yearly turnover of about US $21 billion. Tirumala had a turnover of Rs 1, 424 crore (US$ 226.71 million) for FY 2012–13. The Hyderabad-based company, which was founded in 1998, makes dairy products such as sweets, flavoured milk, curd, ice- cream, etc.

India received $19.78 billion (Rs 1.3 lakh crore) FDI in 2014- 15 from a dozen major FDI source countries that Prime Minister Mr. Modi has visited since taking over in May last year. This accounts for more than half of the $34.93 billion FDI the country received in the fiscal year, which was 27 per cent more than the year before. FDI grew quicker after the launch of the Make in India programme in September 2014 — inflows jumped 48 per cent between October 2014 and April 2015 over the year-earlier period, data from the Department of Industrial Policy and Planning showed. The ex-mentor of confederation of Indian industries (CII) Tarun Das said about the "Modi govt. and current trends and issues of FDI" – "Modi has been able to integrate foreign policy with economic and corporate policies. India is emerging as the apple of everybody's eye as other BRICS economies are witnessing downslide; a big change has been brought in the approach towards foreign investors by the PM deciding to meet individual CEOs of global business giants. When domestic investments are constrained and Indian banks have huge NPAs, FDI is key to boosting economy. Among the countries that Modi visited, Japan has committed to invest about $35 billion in five years and South Korea about $10 billion. China has assured $20 billion in the next five years, while France has announced $2 billion Euros ($2.26 billion). The UAE has assured to pump in money for India's $75-billion infrastructure fund. The UK has launched a programme for investments here ahead of Modi's planned trip in November and Germany has also made announcements related to the Make in India initiative during Chancellor Angela Merkel's visit to New Delhi in the first week of October.

Evaluation of FDI and GDP in India during (2000-2001 to 2014-2015).

In the following table, the FDI & its related data are taken from the website of "department of industrial policy and promotions, Ministry of Commerce & Industry, Govt. Of India" & GDP and its related data are collected from

RBI's "Handbook on Statistics and Indian Economy". So overall it depicts the picture of FDI inflows & its impact on the GDP of India.

Years	FDI Inflow (Rs. Crores)	FDI Inflow (US Million $)	Growth rate of FDI Inflow	GDP at current prices	Growth rate of GDP	FDI as a % of GDP
	Equity Capital Components Only		(In terms of $)	(In Crores)	(In terms of Rs)	
2000-01	10,733	2463	-	2,000,743	-	0.54
2001-02	18,654	4065	+65	2,175,260	8.72	0.84
2002-03	12,871	2705	-33	2,343,864	7.75	0.55
2003-04	10,064	2188	-19	2,625,819	12.03	0.38
2004-05	14,653	3219	+47	2,971,464	13.16	0.50
2005-06	24,584	5540	+72	3,390,503	14.10	0.72
2006-07	56,390	12,492	+125	3,953,276	16.60	1.43
2007-08	98,642	24,575	+97	4,582,086	15.75	2.15
2008-09	1,42,829	31,396	+28	5,303,567	15.75	2.70
2009-10	1,23,120	25,834	-18	6,108,903	15.18	2.02
2010-11	97,320	21,383	-17	7,248,860	18.66	1.34
2011-12	1,65,146	35,121	+64	8,391,691	15.77	1.97
2012-13	1,21,907	22,423	-36	9,388,876	11.88	1.29
2013-14	1,47,518	24,299	+8	10,472,807	11.54	1.41
2014-15	1,89,107	30,931	+27	11,550,240	10.28	1.64

From the data shown in the table we can verdict that FDI has been increasing with increasing rate except in 2 or 3 years when it had decreased. If we talk comparatively between FDI & GDP, we can say that since 2000-01 to the 2014-15 the impact of FDI on GDP has been vigorous except same in those years when the FDI was down. It also presupposes that the impact may also be more strengthen in the coming years since the regime of FDI has been easing down.

Future Outlook

India is estimated to require around US$ 1 trillion during the 12th Five-Year Plan period (2012–17), to fund infrastructure in sectors such as roads, airports and ports. The government is in the process of liberalising FDI norms in construction activities and railways, which could bring in investments to meet the target. The government is also relaxing FDI norms in other sectors for foreign investors to invest. FDI in multi-brand retail has been allowed up to 51 per cent. The minimum requirement for the FDI is US$ 100 million, of which at least 50 per cent must be invested in 'backend infrastructure' within three years following the initiation of the FDI. FDI limit in single-brand retail has been increased to 100 per cent; 49 per cent will be under the automatic route and the rest through the FIPB route.

Current Challenges and Improvement Areas

India is definitely a lucrative place for FDI, but there are certainly some challenges and areas for improvement still present. Until, these areas are honed to perfection, India will not become the number one place for FDI. India is focusing on maximizing political and social stability along with a regulatory environment. In spite of the obvious advantages of FDIs, there are quite a few challenges facing larger FDIs in India, such as:

• **Resource challenge**: India is known to have huge amounts of resources. There is manpower and significant availability of fixed and working capital. At the same time, there are some underexploited or unexploited resources. The Foreign Direct Investment: Impact on Indian Economy 23 resources are well available in the rural as well as the urban areas. The focus is to increase infrastructure 10 years down the line, for which the requirement will be an amount of about US$ 150 billion. This is the first step to overcome challenges facing larger FDI.

• **Equity challenge:** India is definitely developing in a much faster pace now than before but in spite of that it can be identified that developments have taken place unevenly. This means that while the more urban areas have been tapped, the poorer sections are inadequately exploited. To get the complete picture of growth, it is essential to make sure that the rural section has more or less the same amount of development as the urbanized ones. Thus, fostering social equality and at the same time, a balanced economic growth.

• **Political Challenge:** The support of the political structure has to be there towards the investing countries abroad. This can be worked out when foreign investors put forward their persuasion for increasing FDI capital in various sectors like banking, and insurance. So, there has to be a common ground between the Parliament and the foreign countries investing in India. This would increase the reforms in the FDI area of the country.

• **Federal Challenge:** Very important among the major challenges facing larger FDI, is the need to speed up the implementation of policies, rules, and regulations. The vital part is to keep the implementation of policies in all the states of India at par. Thus, asking for equal speed in policy implementation among the states in India is important.

•India must also focus on areas of poverty reduction, trade liberalization, and banking and insurance liberalization. Challenges facing larger FDI are not just restricted to the ones mentioned above, because trade relations with foreign investors will always bring in new challenges in investments.

VII. RESEARCH FINDINGS

From the above analysis the following main research findings came out:

- Although India's share in global FDI has increased considerably, but the pace of

FDI inflows have been slower than developed countries like China, Singapore etc.

- From the above analysis we can say that since 2000-01 to the 2014-15 the impact of FDI on GDP has been vigorous except same in those years when the FDI was down.
- India due to its flexible investment regimes and policies prove to be the horde for the foreign investors in finding the investment opportunities in the country.
- FDI grew quicker after the launch of the Make in India programme in September 2014 - inflows jumped 48 per cent between October 2014 and April 2015 over the year-earlier period.
- FDI is key to boosting Indian economy.

VIII. SUGGESTIONS

- ➢ Government should ensure the equitable distribution of FDI inflows among states. The central government must give more freedom to states, so that they can attract FDI inflows at their own level.
- ➢ The policy makers should focus more on attracting diverse types of FDI.
- ➢ The policy makers should design policies where foreign investment can be utilized as means of enhancing domestic production, savings, and export.

IX. CONCLUSION

India's Foreign Direct Investment (FDI) policy has been gradually liberalised to make the market more investor friendly. The results have been encouraging. These days, the country is consistently ranked among the top three global investment destinations by all international bodies, including the World Bank, according to a United Nations (UN) report. For Indian economy which has tremendous potential, FDI has had a positive impact. FDI inflow supplements domestic capital, as well as technology and skills of existing companies. It also helps to establish new companies. All of these contribute to economic growth of the Indian Economy. FDI of course might be one of the important sources of financing the economic development. However, one should not forget that FDI alone is not a solution for poverty eradication, unemployment and other economic ills. India needs a massive investment to achieve the goals of vision 20-20. Policy makers need to ensure transparency and consistency in policy making along with comprehensive long term development strategy.

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