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Contribution of Foreign Direct Investment in India: Its Growth and Issues

Reena Khurana[1], Vikas Nain[2]
[1,2]Assistant Professor, Panipat Institute of Engineering and Technology, Samalkha

Abstract*-- 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 & managerial efficiency that promote efficiency and productivity of the existing production capacity and generate new production opportunity. The flow of foreign capital in a profit making industries such as insurance, real estate, and business services serve as a catalyst for the growth of economy in India. The present study focuses on assessing the requirement of the amount of foreign investment in India and the prevailing trend and role of FDI & FIIs.
***Keywords*-- Foreign Direct Investment, Foreign Indirect Investment, Balance of Payment**

I. INTRODUCTION

FDI stands for Foreign Direct Investment, a component of a country's national financial accounts. FDI is investment of foreign assets into domestic structures, equipment and organization. FDI is generally defined as "A form of long term international capital movement, made for the purpose of productive activity and accompanied by the intention of managerial control or participation in the management of foreign firm."

Foreign Indirect Investment refers to portfolio investment, which does not seek management control, but is motivated by profit. It occurs when individual investors invest, mostly through stock brokers in stocks of foreign companies in foreign countries in search of profit opportunities.

The inflow of foreign investment comes through various routes, viz:

Equity (Government, RBI, NRI, Acquisition, shares); re-invested earning and others

Portfolio investment (GDR/ADR, FIIs, Off shore funds and others)

Determinants of FDI in Host Country

A. Host country Determinants

1) Policy framework for FDI
2) Economic, political & social stability
3) Rules regarding entry & operations
4) Standards of treatment of foreign affiliates
5) Policies on functioning & structure of markets especially competition and M&A policies
6) International agreements on FDI
7) Privatization Policy
8) Trade Policy and coherence of FDI and trade policies
9) Tax Policy

B. Economic Determinants

1) Resource/Asset seeking
2) Raw material
3) Low-cost unskilled labor
4) Skilled labor
5) Technology& Innovation
6) Infrastructure

C. Business Facilitation

1) Investment Promotion

2) Investment incentives (image building & investment generating activities)
3) Hassle costs (corruption, administrative efficiency)
4) Social amenities (bilingual schools, quality of life)
5) After-investment services

II. FDI POLICY IN INDIA

India has among the most liberal and transparent policies on FDI among the emerging economies. FDI up to 100% is allowed under the automatic route in all the sectors except the following, which require prior approval of Government:

- Sectors prohibited for FDI.
- Activities that require industrial license.
- Proposals in which the foreign collaborator has an existing financial/technical collaboration in India in the same field.
- Proposals for acquisition of shares in an existing Indian Company in financial service sector and where SEBI regulations, 1997 is attracted.
- All proposals falling outside notified sectoral policy in which FDI is not permitted.

Foreign Direct Investment in India is permitted as under the following forms of investments:

- Through financial collaborations.
- Through joint ventures and technical collaborations.
- Through capital markets via Euro issues.
- Through private placements or preferential allotments.

FDI is *not* permitted in the following industrial sectors:

- Arms and ammunition.
- Atomic Energy.
- Railway Transport.
- Coal and lignite.
- Mining of iron, manganese, chrome, gypsum, sulphur, gold, diamonds, copper, zinc.

Foreign direct investments in India are approved through two routes**:**

A. Automatic approval by RBI

The Reserve Bank of India accords automatic approval within a period of two weeks (provided certain parameters are met) to all proposals involving:

1) Foreign equity up to 50% in 3 categories relating to mining activities.
2) Foreign equity up to 51% in 48 specified industries.
3) Foreign equity up to 74% in 9 categories.
4) FDI up to 26% in the Insurance sector is allowed on the automatic route subject to obtaining licence from Insurance Regulatory & Development Authority (IRDA)

Investments in high-priority industries or for trading companies primarily engaged in exporting are given almost automatic approval by the RBI.

FDI in India on automatic route is not allowed in the following sectors:

1) Proposals that require an industrial licence and cases where foreign investment is more than 24% in the equity capital of units manufacturing items reserved for the small scale industries.
2) Proposals in which the foreign collaborator has a previous venture/tie-up in India.
3) Proposals relating to acquisition of shares in an existing Indian company in favour of a Foreign/Non-Resident Indian (NRI)/Overseas Corporate Body (OCB) investor; and
4) Proposals falling outside notified sectoral policy/caps or under sectors in which FDI is not permitted and/or whenever any investor chooses to make an application to the Foreign Investment Promotion Board and not to avail of the automatic route.

B. FIPB Route

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Foreign Investment Promotion Board (FIPB) is a competent body to consider and recommend foreign direct investment, which do not come under the automatic route. Normal processing time of an FDI proposal in FIPB is 4 to 6 weeks. FIPB is located in the Department of Economic Affairs, Ministry of Finance. Its constitution is as follows:

1) Secretary, Department of Economic Affairs (Chairman)
2) Secretary, Department of Industrial Policy & Promotion (Member)
3) Secretary, Department of Commerce (Member)
4) Secretary, (Economic Relation), Ministry of External Affairs (Member)

FIPB can co-opt Secretaries to the Govt. of India and other top officials of financial institutions, banks and professional experts of industry and commerce, as and when necessary.

III. FDI OPPORTUNITIES ACROSS INDUSTRIES

India has been a major recipient of FDI Inflows in the majority of sectors. There has been an unnerving upsurge in the economic developments of the country. In the liberalization era, India is known to have attracted a quantum amount of Foreign Direct Investment, especially after the liberalization.

A. IT sector

The huge market for computer hardware in India, coupled with the availability of skilled workforce in this sector has boosted the inflow of FDI. High growth prospects, in terms of increased consumption in the India as well as increasing demand for exports are expected to lead to more Foreign Direct Investments in this sector.

B. Telecommunication

FDI opportunities in the telecommunication sector in India exist in the areas of Ecommerce, Manufacturing of equipments and components, Tele-education, Telebanking, Exports of telecom equipment and services, Telemedicine, Setting up a national long distance bandwidth capacity in the country.

C. Construction

Construction projects which have received the maximum FDI include, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure. FDI Inflows in the construction industry in India are permissible under automatic route to ensure flexibility in construction activities which will boost the Indian economy.

D. Real Estate

In the real estate sector, the foreign investors are not allowed to sell undeveloped land, such as, lands which do not have proper facilities of roads, water, electricity, drainage and all other basic requirements for inhabitation.

E. Power

The huge size of the market in the power sector in India and high returns on investment are important factors in boosting FDI inflows to power. There are huge opportunities of FDI in power sector in India. Opportunities of Foreign Direct Investment (FDI) in the Power Sector in India exist in Hydro Projects, Captive Power, Ultra Mega Power Projects, Nuclear Power, National Grid Program, Rural Electrification, Trading, Renewable etc.

F. Home Appliances & Electronics

Important factors which are conductive to FDI Inflows to Electronics are the availability of low-cost, efficient, and technically skilled workforce, opportunities for the manufacturing of consumer electronic goods and mobile handsets are high given the growing demand in the domestic electronics market, electronics hardware is growing leaps and bounds globally, large-scale manufacturing units of electronics hardware will be set up in the special economic zones with a total exemption of duties and taxes.

IV. ANALYSIS OF INDIA’S FDI INFLOWS

Share of top investing countries fdi equity inflows *(financial years)*

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Table 1 Country–wise FDI Inflows - Top 10 countries (From 2013-2016), amount rupees in crores

Ranks	Country	2013-2014 (April-March)	2014-2015 (April-March)	2015-16 (April-March)	Cumulative Inflows (April '00-March '16)	% to total inflows (in terms of US$)
1	Mauritius	29,360	55,172	54,706	480,363	33%
2	Singapore	35,625	41,350	89,510	256,667	16%
3	U.K.	20,426	8,769	5,938	115,592	8%
4	Japan	10,550	12,752	17,275	110,671	7%
6	U.S.A	4,807	11,150	27,695	94,575	6%
5	Netherlands	13,920	20,960	17,275	94,533	6%
8	Germany	6,093	6,904	6,361	44,870	3%
7	Cyprus	3,401	3,634	3,317	42,681	3%
9	France	1,842	3,881	3,937	26,525	2%
10	UAE	1,562	2,251	6,528	21,648	1%
Total FDI Inflows from all countries*		147,518	189,107	262,322	1,495,859	85%

Source: Government of India (GOI, FDI Statistics, Fact sheet on FDI)

**Includes inflows under NRI Schemes of RBI.*

India's 85% of cumulative FDI is contributed by above listed ten countries while remaining 15% by rest of the world. The analysis of country wise inflows of FDI in India indicates that during 2015-16, the total amount of Rs 262,322 crores of FDI was received reaching a cumulative total of 1,495,859 crores in the period of 2000-2016 from 152 countries including NRI investments.

India's perception abroad has been changing steadily over the years. This is reflected in the ever growing list of countries that are showing interest to invest in India. ***Mauritius*** emerged as the most dominant source of FDI contributing 33% of the total investment in the country. ***Singapore*** was the second dominant source of FDI inflows with 16% of the total inflows. However, ***USA*** bagged fifth position with 6% contribution in the total inflows. **UK** occupied third position with 8% followed by Japan with 7%, Netherlands with 6%, Germany with 3%, Cyprus with 3%, France with 2%, and the UAE with 1%.

FDI Inflows in India – Sectoral Analysis of Top 10 Sectors

Sector-wise FDI Inflows in India from April 2013- March 2016

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Table 2 *Sector–wise FDI Inflows, rupees in crores*

Ranks	Sector	2013-14 (April-March)	2014-15 (April-March)	2015-16 (April-March)	Cumulative Inflows (Apr '00-March '16)	% age to total inflows
1	Services Sector	13,294	27,369	45,415	252,354	18%
2	Construction Development	7,508	4,652	727	113,936	8%
3	Computer Software & Hardware	6,896	14,162	38,351	112,184	7%
4	Telecommunications	7,987	17,372	8,637	92,729	6%
5	Automobile Industry	9,027	16,760	16,437	81,394	5%
6	Drugs & Pharmaceuticals	7,191	9,052	4,975	70,097	5%
7	Chemicals (other than Fertilizers)	4,738	4,658	9,664	59,555	4%
8	Trading	8,191	16,755	25,244	68,837	4%
9	Power	6,519	4,296	5,662	52,613	4%
10	Hotel & Tourism	2,949	4,740	8,761	49,710	3%

Note: FDI Sectoral data has been revalidated / reconciled in line with the RBI, which reflects minor changes in the FDI figures (increase/decrease) as compared to the earlier published sectoral data.

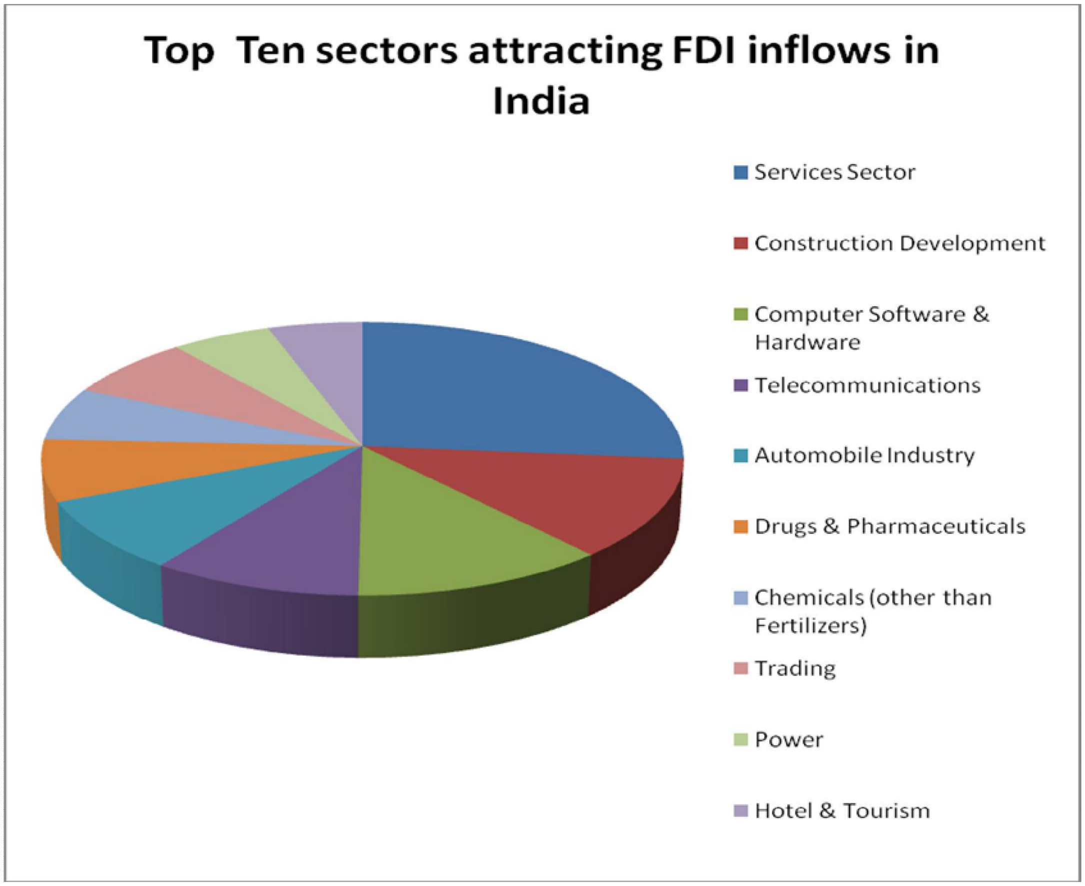

Fig 1 Graph Showing Top Ten Sectors attracting FDI Inflows in India since April 2000- March 2016

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The sector wise analysis of FDI inflow in India reveals that maximum FDI has taken place in the service sector including the telecommunication, information technology, travel and many others. The service sector is followed by the construction development including townships, housing, built-up infrastructure in terms of FDI. High volumes of FDI take place in telecommunication, computer software & hardware, Drugs & Pharmaceuticals, etc.

FDI Inflows to **construction activities** has led to a phenomenal growth in the economic life of the country. India has become one of the most prime destinations in terms of construction activities as well as real estate investment. FDI inflows to **real estate sector** in India have developed the sector. The increased flow of foreign direct investment in the real estate sector in India has helped in the growth, development, and expansion of the sector.

The rapid development of the **telecommunication** sector was due to the FDI inflows in form of international players entering the market and transfer of advanced technologies. Indian telecom industry has witnessed the highest growth rate in the world. The FDI in **automobile** industry has experienced huge growth in the past few years. The increase in the demand for cars and other vehicles is powered by the increase in the levels of disposable income in India. The options have increased with quality products from foreign car manufacturers. The introduction of tailor made finance schemes, easy repayment schemes has also helped the growth of the automobile sector. The basic advantages provided by India in the automobile sector include, advanced technology, cost-effectiveness, and efficient manpower. Besides, India has a well-developed and competent Auto Ancillary Industry along with automobile testing and R&D centres. The automobile sector in India ranks third in manufacturing three wheelers and second in manufacturing of two wheelers. Opportunities of FDI in the Automobile Sector in India exist in establishing Engineering Centres, Two Wheeler segment, Exports, Establishing Research and Development Centres, Heavy truck Segment, Passenger Car Segment.

The increased FDI Inflows to **Chemicals** industry in India has helped in the growth and development of the sector. The increased flow of foreign direct investment in the chemicals industry in India has helped in the development, expansion, and growth of the industry. This in its turn has led to the improvement of the quality of the products from the industry.

Based upon the data, it can be analyzed that in India there are sixty three (63) sectors in which FDI inflows are seen but it is found that top ten sectors attract almost sixty four percent (64%) of FDI inflows. The cumulative FDI inflows from the above results reveals that service sector in India attracts the maximum FDI inflows amounting to Rs. 252,354 crores, followed by Construction Development amounting to Rs. 113,936 crores. These two sectors collectively attract twenty eight percent (26%) of the total FDI inflows in India.

Financial Year-wise FDI Equity Inflows

Table 3: Year-wise FDI Inflows, amount in rupees crores

S No.	Financial Year (April-March)	Amount of FDI Inflows (in Rs. Crores)	%age growth over previous year (in terms of US$)
1.	2000-01	10,733	-
2.	2001-02	18,654	+65%
3.	2002-03	12,871	-33%
4.	2003-04	10,064	-19%
5.	2004-05	14,653	+47%
6.	2005-06	24,584	+72%
7.	2006-07	56,390	+125%
8.	2007-08	98,642	+97%
9.	2008-09	142,829	+28%
10.	2009-10	123,120	-18%
11.	2010-11	97,320	-17%
12.	2011-12^	165,146	+64%
13.	2012-13	121,907	-36%
14.	2013-14#	147,518	+8%
15.	2014-15#	189,107	+27%
16.	2015-16#	262,322	+29%
Cumulative Total (from April,2000 to March, 2016)		1,495,860	-

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Source: *As per DIPP's FDI database-equity capital components only*

Note: (i) including amount remitted through RBI's-NRI Schemes (2000-2002).

Figures for the years 2013-14 to 2015-16 are provisional subject to reconciliation with RBI.

^ Inflows for the month of March, 2012 are as reported by RBI, consequent to the adjustment made in the figures of March, '11, August, '11 and October, '11.

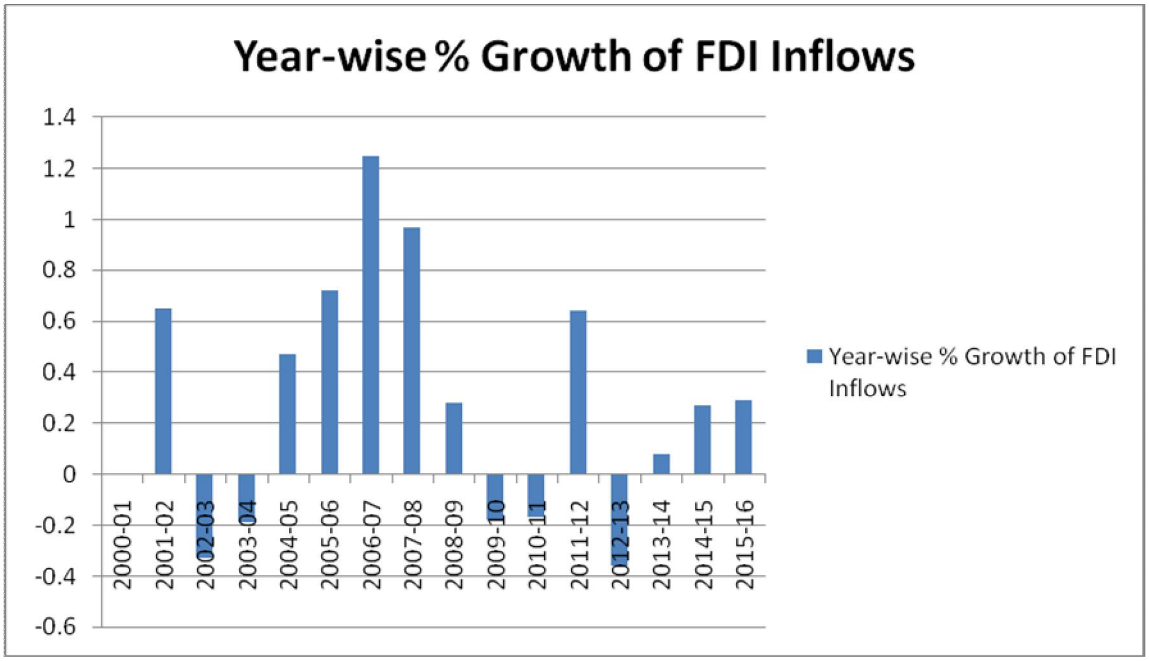

Fig 2: Graph showing %age growth in FDI Inflows over previous year in India

V. FDI ISSUES AND POLICY RECOMMENDATION

A. FDI can be instrumental in developing rural economy. There is abundant opportunity in Greenfield Projects. But the issue of land acquisition and steps taken to protect local interests by the various state governments are not encouraging. MOU Arecelor-Mittal controversy is one of the best examples of such disputes.

B. India has a huge pool of working population. However, due to poor quality primary education and higher there is still an acute shortage of talent. This factor has negative repercussion on domestic and foreign business. FDI in Education Sector is less than 1%. Given the status of primary and higher education in the country, FDI in this sector must be encouraged. However, appropriate measure must be taken to ensure quality. The issues of commercialization of education, regional gap and structural gap have to be addressed on priority.

C. Indian economy is largely agriculture based. There is plenty of scope in food processing, agriculture services and agriculture machinery. FDI in this sector should be encouraged. The issue of food security, interest of small farmers and marginal farmers need cannot be ignored for the sake of mobilization of foreign funds for development.

D. India has a well developed equity market but does not have a well developed debt market. Steps should be taken to improve the depth and liquidity of debt market as many companies may prefer leveraged investment rather than investing their own cash. Looking for debt funds in their own country invites exchange rate risk.

E. In order to improve technological competitiveness of India, FDI into R&D should be promoted.

F. Various issues pending relating to Intellectual Property Rights, Copy Rights and Patents need to be addressed on priority. Special package can be also instrumental in mobilizing FDI in R&D.

G. Though service sector is one of the major sources of mobilizing FDI to India, plenty of scope exists. Still we find the financial inclusion is missing. Large part of population still doesn't have bank accounts, insurance of any kind, underinsurance etc. These problems could be addressed by making service sector more competitive. Removal of sectoral cap in insurance is still awaited.

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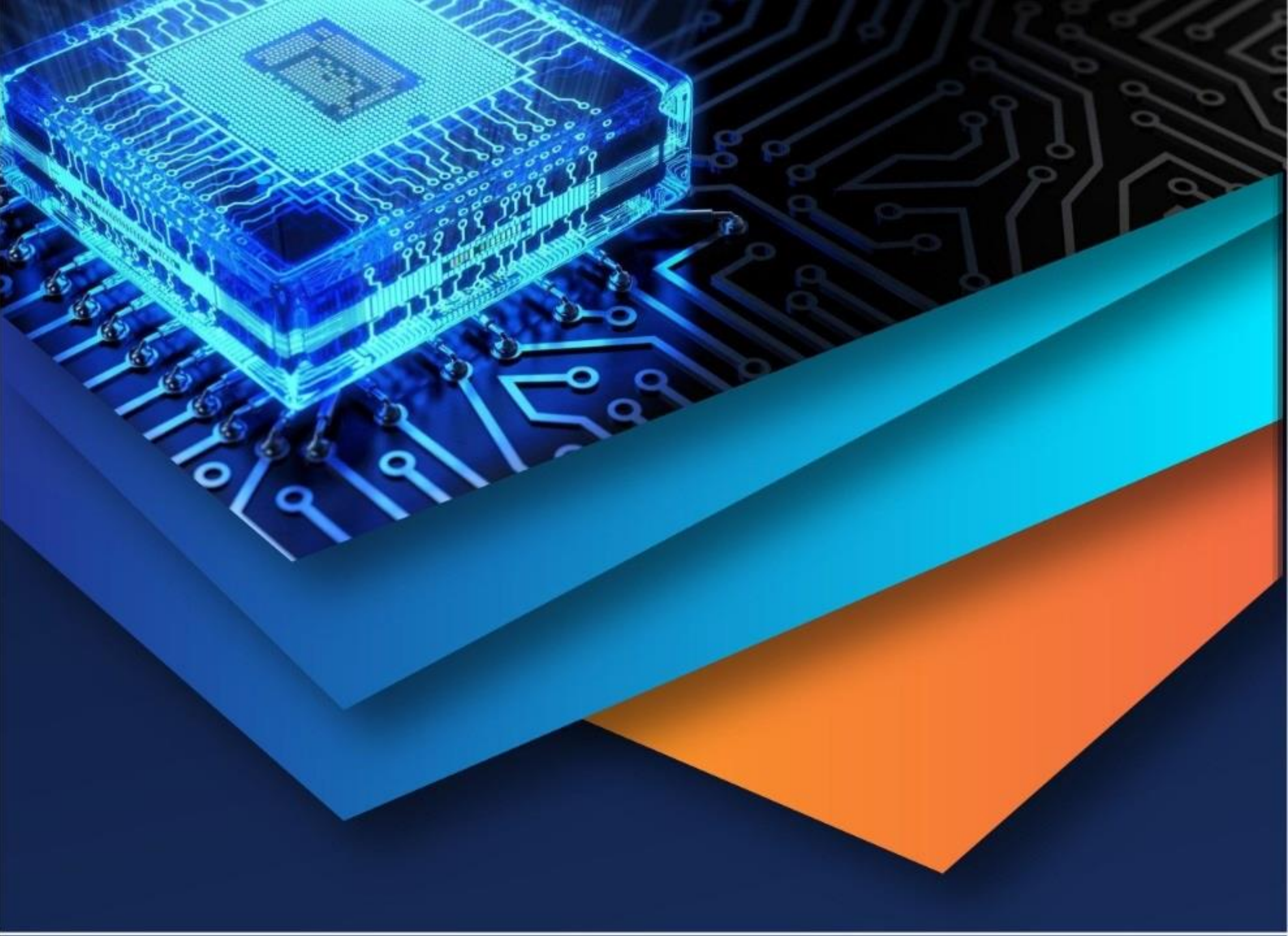

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