A CRITICAL ANALYSIS OF FOREIGN DIRECT INVESTMENT INFLOWS IN INDIA

S. Suriyakanth
Assistant Professor, PG & Research Department of Economics, H.H. The Rajah's College (Autonomous), Pudukkottai.

Abstract
Historically, India has followed an extremely cautious approach but after economic reforms in 1991, India has liberalized its foreign policy and took series of measures to attract FDI. As per UN report, India is an investment hub after China and USA for major global companies. The present study is based on secondary data and period of the study is from 1991 to 2015. Total FDI inflows have been raised from US $ 133 million in 1991-92 to US $ 27841 million in the year 2008-09 and the share of direct foreign investment through approvals in equity etc. stood at 65.79 per cent and that of portfolio investment was 34.21 per cent. Projections show that total FDI inflows will be US $ 46098 million in 2015-16. Mauritius and Singapore tops in FDI inflows and the FDI inflows in service sector were in highest position. They have positive impact on the related economic indicators on Indian Economy. GOI should attract more FDI through favourable policies and avoid uncertainties.

1. Introduction

Foreign Direct Investment (FDI) is an investment directly into production and services in a country by a company located in another country, either by buying a company or by expanding business in that country. It is a mode of doing business in a foreign country (P. Subba Rao, 2009). Foreigners may subscribe to shares and debentures of another country's concerns. Foreigners may subscribe to shares and debentures of another country's concerns. Basically, total FDI includes (a) Foreign direct investment- which includes the share of investment in equity through SIA / FIPB, RBI, NRI, acquisition of shares of Indian companies by NRIs under FEMA, equity capital of unincorporated bodies and other capital. and (b) Foreign portfolio investment-which consists of Global Depository Receipts (GDR), American Depository Receipts (ADR),Foreign Institutional Investors (FIIs),offshore funds and others. FDI introduces modern technologies, transfers knowledge, skill, provides access to export markets along with investment and managerial expertise. It provides the much needed foreign exchange to help reduce the deficit of balance of trade. When foreign enterprises enter into competition with local firms, the latter are forced to improve their technology, quality and management. FDI is treated as an important mechanism for channelizing transfer of capital and technology and thus perceived to be a potent factor in promoting economic growth in host countries. Moreover, MNCs consider FDI as an important mean to reorganize their production activities across borders in accordance with their corporate strategies and the competitive advantage of host countries (RBI Bulletin, 2012).

Historically, India has followed very cautious and selective approach regarding foreign capital, but after economic reforms in 1991, it has liberalized the foreign direct investment Policy. Number of measures was undertaken to promote FDI. Thus Government of India (GOI) has been succeeded in attracting more FDI in India. From the year 1991-1992 to 2014-15, India has fetched 4,26,318 US $ million FDI inflows. According to UN report, India is the third most favored destination for investment after China and the US for major global companies. India needs foreign capital due to inadequate domestic capital and also for economic development. FDI is generally known to be the most stable component of capital flows needed to finance the current account deficit. India has become an investment hub over last decade. The major areas of FDIs are- oil, mining, coal and gas, banking, insurance, transportation, finance, manufacturing, retailing etc. FDI is significant to India as an engine of growth.

2. Review of Literature

Andersen P.S and Hainaut P. (2004) in their paper "Foreign Direct Investment and Employment in the Industrial Countries" point out that while looking for evidence regarding a possible relationship between foreign direct investment and employment, in particular between outflows and employment in the source countries in response to outflows. They also find that high labour costs encourage outflows and discourage inflows and that such effect can be reinforced by exchange rate movements. The distribution of FDI towards services also suggests that a large proportion of foreign investment is undertaken with the purpose of expanding sales and improving the distribution of exports produced in the source countries. According to this study the principle determinants of FDI flows are prior trade patterns, IT related investments and the scopes for cross – border mergers and acquisitions. Finally, the authors find clear evidence that outflows complement rather than substitute for exports and thus help to protect rather than destroy jobs.

John Andreas (2004) in his work "The Effects of FDI Inflows on Host Country Economic Growth" discusses the potential of FDI inflows to affect host country economic growth. The paper argues that FDI should have a positive effect on economic growth as a result of technology spillovers and physical capital inflows. Performing both cross – section and panel data analysis on a dataset covering 90 countries during the period 1980 to 2002, the empirical part of the paper finds indications that FDI inflows enhance economic Growth in developing economies but not in developed economies. This paper has

assumed that the direction of causality goes from inflow of FDI to host country economic growth. However, economic growth could itself cause an increase in FDI inflows. Economic growth increases the size of the host country market and strengthens the incentives for market seeking FDI. This could result in a situation where FDI and economic growth are mutually supporting. However, for the ease of most of the developing economies growth is unlikely to result in market – seeking FDI due to the low income levels. Therefore, causality is primarily expected to run from FDI inflows to economic growth for these economies.

Klaus E Meyer (2005) in his paper "Foreign Direct investment in Emerging Economies" focuses on the impact of FDI on host economies and on policy and managerial implications arising from this (potential) impact. The study finds out that as emerging economies integrate into the global economies international trade and investment will continue to accelerate. MNEs will continue to act as pivotal interface between domestic and international markets and their relative importance may even increase further. The extensive and variety interaction of MNEs with their host societies may tempt policy makers to micro – manage inwards foreign investment and to target their instruments at attracting very specific types of projects. Yet, the potential impact is hard to evaluate ex ante (or even ex post) and it is not clear if policy instruments would be effective in attracting specifically the investors that would generate the desired impact. The study concluded that the first priority should be on enhancing the general institutional framework such as to enhance the efficiency of markets, the effectiveness of the public sector administration and the availability of infrastructure. On that basis, then, carefully designed but flexible schemes of promoting new industries may further enhance the chances of developing internationally competitive business clusters.

While favourable privatization strategies enhanced FDI flows into advanced countries. The reluctance to accept foreign investors' involvement in privatization plans was still regarded as a major handicap hindering FDI flows into other countries. With respect to absorbing FDI, Central Europe has been partially successful, but the situation is expected to improve in the near future .FDI has always been a subject of intense debate. About a decade back FDI was not easily welcomed by developing countries. Developed countries have been experiencing inflow but in recent time there is sudden increase in the level of the FDI inflow. The cause and the consequences of the FDI inflow indicates that large part of economic growth of developed countries is attributed to level of FDI inflow as in case of South Korea, Hong Kong and other and their high per capita income is attributed to high level of FDI inflows. Some of the factors which can be attributed to inflow of FDI to developing countries are-Demand for FDI due to drying up of domestic savings, Surplus generated by TNCs' need the markets for investment, new products and technologies, Need for the access and control over the latest technologies by developing countries, Control over the markets of developing countries by TNCs. (Danage and Phalatankar, 2012).

3. FDI Policy in India

In the pre-liberalization period, India had followed an extremely cautious and selective approach while formulating FDI policy. 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. Before independence, major FDI came from the British companies. After Second World War, Japanese companies entered in the Indian Market. After independence, issues relating to foreign capital, MNCs, gained attention of policy makers. The industrial policy of 1965, allowed MNCs to venture through technical collaboration in India. The govt. has provided many incentives such as tax concessions, simplified licensing etc to boost the FDI inflows. In fact, in the early nineties, Indian economy faced severe balance of payment crisis. India was left with that much amount of foreign exchange reserves which can finance its three weeks of imports. In this critical face of Indian economy, economic reforms were made in 1991 and India opened its doors of FDI inflows and adopted a more liberal foreign policy to restore the confidence of foreign investors (Sapana Honda 2011).

A series of measures that were directed towards liberalizing foreign investment included the following:

1. Introduction of duel route of approval of FDI**:** RBI's automatic route and Governments approval route through Foreign Investment Promotion Board (FIPB) and Secretariat for Industrial Assistance (SIA).
2. Automatic permission for technology agreements in high priority industries and liberalization of technology imports.
3. Permission to NRIs and Overseas Corporate Bodies to invest up to 100 per cent in high priorities sectors.
4. Hike in the foreign equity holding limits to 51 per cent and liberalization of the use of foreign brands name.
5. Signing of the convention of multilateral investment guarantee agency for protection of foreign investments. These efforts were boosted by the enactment of Foreign Exchange Management Act. 1999, that replaced the Foreign Exchange Regulation Act. 1973. This along with the sequential financial sector reforms paved way for greater capital account liberalization in India. GOI announced significant measures like 100 per cent FDI in business to business (B2B), airports, e-commerce, power sector, oil refining. Manufacturing activities in all SEZs can have 100 per cent Automatic route except for arms, explosives, allied defence equipments, narcotics etc. (P Subba Rao 2009).
6. On 20th Sept. 2012, Government of India (GOI) has taken a final decision and opened 51 per cent FDI in multi-brand retail sector. Foreign Retailers are permitted to set up malls only in cities with minimum population of 10

lakhs. There should be minimum investment of $ 100 million and 50 per cent of the investment should be in backend infra structure. There only 53 cities with population more than 10 lakhs. It is observed that more than 100 of Fortune 500 companies are investing India. China allowed FDI and benefited a lot in regard to foreign capital and global market share. Due to adoption of liberal policies, FDI in India showed positive growth trend and FDI in multi-brand retail will bring various benefits. On the contrary, Kirana shops in major cities will affect negatively and they may be converted from shopkeeper to doorkeepers (Teli, 2012).

4. Objectives of the Study

1. To study the year-wise FDI inflows in India.
2. To analyze the country-wise FDI inflows to India.
3. To analyze the sector-wise distribution of FDI inflows to India.

Nature and Sources of Data

The present study is based on secondary data. It has been collected from reports of the Ministry of Commerce and Industry, Department of Industrial Promotion and Policy, Reserve Bank of India, and World Investment Report. The time period of the study covers from 2000-01 to 2013-14.

Analysis of the Study

Table 1 presents the inflows data for 15 years period from 2000-01 to 2014-15. The change in the reporting practice which introduced new items such as equity capital of unincorporated bodies, reinvested earnings and other capital did contribute significantly to the reported higher total inflows. The cumulative FDI inflows (April, 2000-01 to March 2014-15) in terms of equity inflow were of the order of $356,691 million mainly through RBI's automatic route ($250,199 million) followed by re-invested earnings ($90,143 million) and other capital ($16,349 million). Though there exists year on year fluctuations in the total FDI inflows, however, the cumulative FDI inflows has raised to the tune of $368,439 million. The highest FDI inflows has been observed during the year 2011-12 ($46,556 million) and minimum FDI inflows has been observed during the year 2000-01 ($4,029 million). Further the highest annual growth rate in FDI inflows have been observed during the year 2006-07 (154.73 per cent) followed by the year of 2007-08 (52.65 per cent) and 2001-02 (52.15 per cent). The least positive annual growth rate has been observed during the year 2008-09 (20.18 per cent). Conversely, the highest negative annual growth rate in FDI inflows have been observed during the year 2012-13 (- 26.33 per cent) and the least has been observed during the year of 2009-10 (- 9.86 per cent). The FDI equity inflows during the five years 2010-11 to 2014-15 were almost six times those of the previous five years 2005-06 to 2009-10 (Chart 1).

Chart 1: Average Reported FDI Equity Inflows during Different Periods

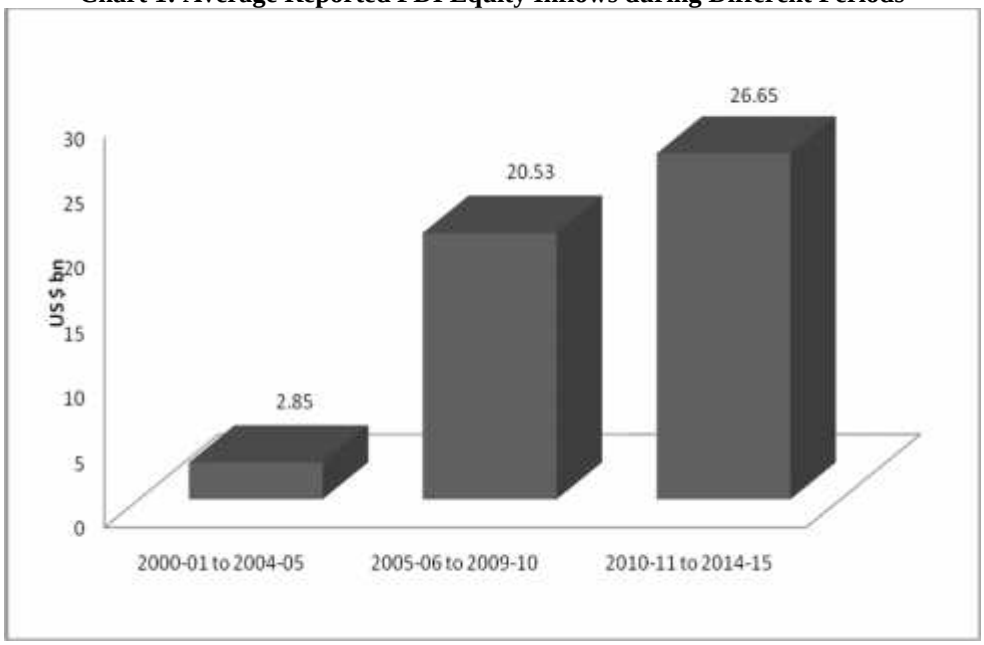

Table 1: Trends in FDI Inflows into India

(Amount US $ in million)

Financial Year (April -March)	Main Components					Share of new Items in the Total
	Equity		Reinvested Earnings	Other Capital	Total FDI Inflows	
	(FIPB /RBI's Automatic / Acquisition Route)	Equity capital of unincorporated bodies				
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*[3+4+5]/(6) x 100*
2000-01	2,339	61	1,350	279	4,029	41.95
2001-02	3,904	191	1,645	390	6,130 (52.15)	36.31
2002-03	2,574	190	1,833	438	5,035 (-17.86)	48.88
2003-04	2,197	32	1,460	633	4,322 (-14.16)	49.17
2004-05	3,250	528	1,904	369	6,051 (40.00)	46.29
2005-06	5,540	435	2,760	226	8,961 (48.09)	38.18
2006-07	15,585	896	5,828	517	22,826 (154.73)	31.72
2007-08	24,573	2,291	7,679	300	34,843 (52.65)	29.48
2008-09	31,364	702	9,030	777	41,873 (20.18)	25.10
2009-10 (P)	25,606	1,540	8,668	1,931	37,745 (-9.86)	32.16
2010-11 (P)	21,376	874	11,939	658	34,847 (7.68)	38.66
2011-12 (P)	34,833	1,022	8,206	2,495	46,556 (33.60)	25.18
2012-13 (P)	21,825	1,059	9,880	1,534	34,298 (-26.33)	36.37
2013-14 (P)	24,299	975	8,978	1,794	36,046 (5.10)	32.59
2014-15 (P)	30,934	952	8,983	4,008	44,877 (24.50)	31.07
Memorandum Items						
2000 - 01 to 2004 - 05	14,264	1,002	8,192	2,109	25,567	44.21
2005 - 06 to 2009 - 10	102,668	5,864	33,965	3,751	1,46,248	29.80
2010 - 11 to 2014 - 15	133,267	4,882	47,986	10,489	1,96,624	32.22
Cumulative Inflows (April, 2000 – March, 2015)	**250,199**	**11,748**	**90,143**	**16,349**	**368,439**	**32.09**

Notes: Figures in the bracket represents the percentage growth over previous year.
(P) All figures are provisional.
Source: Based on Department of Industrial Promotion and Policy (DIPP), "Fact Sheet on Foreign Direct Investment (FDI)", March 2015.

Table 2: Entry Route-wise Distribution of FDI Equity Inflows

(Amount US $ in million)

Year	Entry Route			Total (2)+(3)+(4)	Share in Total (%)		
	FIPB/SIA	Automatic	Acquisition of shares		FIPB/SIA	Automatic	Acquisition of shares
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
2000-01	1,456	521	362	2,339	62.25	22.27	15.48
2001-02	2,221	802	881	3,904	56.89	20.54	22.57
2002-03	919	739	916	2,574	35.70	28.71	35.59
2003-04	928	534	735	2,197	42.24	24.31	33.45
2004-05	1,062	1,258	930	3,250	32.68	38.71	28.62
2005-06	1,126	2,233	2,181	5,540	20.32	40.31	39.37
2006-07	2,156	7,151	6,278	15,585	13.83	45.88	40.28
2007-08	2,298	17,127	5,148	24,573	9.35	69.70	20.95
2008-09	4,699	17,998	4,632	27,329	17.19	65.86	16.95
2009-10(P)	3,471	18,987	3,148	25,606	13.56	74.15	12.29
2010-11(P)	1,945	12,994	6,437	21,376	9.10	60.79	30.11
2011-12 (P)	3,046	20,427	11,360	34,833	8.74	58.64	32.61
2012-13 (P)	2,319	15,967	3,539	21,825	10.63	73.16	16.22
2013-14 (P)	1,185	14,869	8,245	24,299	4.88	61.19	33.93
2014-15 (P)	2,219	22,530	6,185	30,934	7.17	72.83	19.99

Source: Based on RBI Bulletin May 2011, 2012, 2013, 2015
Excluding investments in Unincorporated Bodies, Reinvested Earnings and Other Capital.
(P): Provisional

Further, it can be seen from Table 2 that acquisition of existing shares of companies by foreign investors contributed substantially to the FDI Equity Inflows and it peaked in 2005-06 and 2006-07 to reach almost two-fifths of the total FDI Equity flows. Acquisition of shares together with reinvested earnings (which do not represent actual inflows) account for a substantial proportion of the reported total inflows. Another notable feature of the inflows is that the proportion of the inflows subject to specific government approvals declined from 62.25 per cent in 2000-01 to 7.17 per cent in 2014-15 reflecting the progressively greater freedom enjoyed by the foreign investors in making their investment decisions.

Chart 1.2: Relative Contribution of Reinvested Earnings and Acquisition of Shares to FDI Inflows

Table 3 exhibits the data pertaining to sector-wise break-up of FDI inflows in India during April, 2000 to March 2015. It could be seen that Services sector has registered top berth in attracting FDI with $42,713 million (17.19 per cent). In this respect, Construction Development followed the Services sector with $24,064 million (9.68 per cent) soon followed by Telecommunication with $17,058 million (6.86 per cent), Computer Software and Hardware $15,017 million (6.04per cent),

Drugs and Pharmaceuticals with $13,121 million (5.28 per cent) and Automobile industry with $12,383 million (4.98 per cent). There were some other sectors that have attracted FDI in tune of less than 5 per cent of the total FDI inflows, among them are Chemicals (4.16 per cent), Power (3.85 per cent), Metallurgical industries (3.44 per cent) and Trading (3.24 per cent).

Table 3: Share of Top 10 Sectors Attracting Highest FDI Inflows

(Amount US $ in million)

S. No	Sector	Cumulative Inflows (April, 2000 – March, 2015)	Percentage to Total Inflows	Rank
1.	Services Sector*	42,713	17.19	I
2.	Construction Development: Townships, Housing, Built-up infrastructure	24,064	9.68	II
3.	Telecommunications (radio paging, cellular mobile, basic telephone services)	17,058	6.86	III
4.	Computer Software & Hardware	15,017	6.04	IV
5.	Drugs & Pharmaceuticals	13,121	5.28	V
6.	Automobile Industry	12,383	4.98	VI
7.	Chemicals (other than fertilizers)	10,337	4.16	VII
8.	Power	9,557	3.85	VIII
9.	Metallurgical Industries	8,547	3.44	IX
10.	Trading	8,060	3.24	X

Note: (i) *Services sector includes Financial, Banking, Insurance, Non-Financial / Business, Outsourcing, R&D Courier, Tech. Testing and Analysis

(ii) Percentage of inflows worked out in terms of US$ & the above amount of inflows received through FIPB/SIA route RBI's automatic route & acquisition of existing shares only.

Source: Based on Department of Industrial Promotion and Policy (DIPP), "Fact Sheet on Foreign Direct Investment (FDI)", March 2015.

Another important aspect of the inflows is the substantial shift in the immediate source country for FDI into India (Table 1.4). While the prominence of Mauritius for routing foreign capital to India has been well known, the more recent period witnessed further strengthening of Mauritius as the source country. For the period April 2000 to March 2015, the country accounted for practically half of the total reported inflows. Interestingly, Singapore secured the second position with Cyprus and UAE entering the group of top 10 home countries for FDI into India.

Table 4: Share of Top 10 Countries Investing in India

(Amount US $ in million)

S. No	Sector	Cumulative Inflows (April, 2000 – March, 2015)	Percentage to Total Inflows	Rank
1.	Mauritius	87,555	35.23	I
2.	Singapore	32,188	12.95	II
3.	UK	22,210	8.94	III
4.	Japan	18,352	7.38	IV
5.	Netherlands	14,671	5.90	V
6.	USA	13,751	5.53	VI
7.	Cyprus	8,044	3.24	VII
8.	Germany	7,644	3.04	VIII
9.	France	4,513	1.82	IX
10.	UAE	3,045	1.23	X

Note: Percentage of inflows worked out in terms of US$ & the above amount of inflows received through FIPB/SIA route RBI's automatic route & acquisition of existing shares only.

Source: Based on Department of Industrial Promotion and Policy (DIPP), "Fact Sheet on Foreign Direct Investment (FDI)", March 2015.

Conclusion

India emerges as the fifth largest recipient of foreign direct investment across the world. India is considered to be the second largest country amongst all further developing countries and ranks fourth in the PPP in the world. The present study indicates that the total FDI inflow in India from April 2000 to March 2015 was $368,439 million. The study also reveals that Mauritius emerged as the most dominant source of FDI contributing $87,555 million of the total investment in the country. The services sector accounted for a steeply rising share of FDI stocks in India followed by construction development, Telecommunications and Computer Software & Hardwar.

References

1. Chaturvedi Ila, (2011) "Role of FDI in Economic Development of India: Sectoral Analysis" International Conference on Technology and Business Management, Japura Institute of Management, Ghaziabad.
2. Goel Shashank, Kumar K. Phani, Rao Samasiva (2012), "Trends and Patterns of FDI in India and its Economic Growth" *Asian Journal of Research in Business Economics and Management*, Vol. 2, No. 9.
3. K S Chalapati Rao, M R Murti, K V K Ranganathan, (1999)"Foreign Direct Investments in the Post- Liberalization Period: An Overview", *Journal of Indian School of Political Economy*, Vol. 4, No. 11.
4. Madem Srinu, Gudla Sandeep, Rao K Bhaskara,(2012)," FDI Trends during the Last Decade and its Effect on Various Sector in India", *International Journal of Scientific and Research Publications*, Vol. 12, No. 2.
5. N.J. Sebastian, (2010), "FDI in India and its Growth Linkages", National Council of Applied Economic Research, Department of Industrial Policy and Promotion.
6. R. Anitha (2012)" Foreign Direct Investment and Economic Growth in India" *International Journal of Marketing, Financial Services & Management Research*, Vol. 8, No. 1.
7. R. Nagaraj (2003)," Foreign Direct Investments in India in the 1990s Trends and Issues", *Economic and Political Weekly*, Vol. 38, No. 17, pp. 1701-1712.
8. Sahni Priyanka(2012), " Trends and Determinants of Foreign Direct Investment in India: An Empirical Investigation", *International Journal of Marketing and Technology*, Vol. 8, No. 2.
9. Singh Jasbir, Chadha Sumita, Sharma Anupama (2012),"Role of Foreign Direct Investment in India: An Analytical Study", *International Journal of Engineering and Science*, Vol. 1, No. 5, pp. 34-42.
10. Datt and Sundaram, (2011), *'Indian Economy,'* S. Chand and Co, New Delhi, 62nd Ed. 2011 pp. 349-357.
11. Johnson Andreas (2004): "The Effects of FDI Inflows on Host Country Economic Growth", http://www.infra.kth.se\cesis\research\publications\working
12. Mithani D. M. (2005), '*International Economics'*, HPH, 4th ed. pp. 149 -167.
13. Sapna Hooda, (2011), 'A Study on FDI and Indian Economy', Doctoral thesis, National Institute of Technology, Kurukshetra, Haryana.
14. V. K. Bhalla and S. Shiva Ramu, (2003), '*International Business*', 7th Ed. Anmol, New Delhi, pp. 475-482.
15. Papers presented in *National Workshop* (2006), on 'Foreign investment in India, - Opportunities and Challenges' held at S.U. Kolhapur.
16. Papers presented in *National Workshop* (2012), on 'Recent Trends in Commerce & Management', held at G.A. College Sangli. (Dandage & Phalatankar, Shinde & Herekar)
17. P. Subba Rao, (2009), *'International Business,'* HPH, Second Ed., pp. 124 - 138.
18. RBI Bulletin, 'Research study', May, 2012 pp. 997 - 1017.