Some Important Issues on Foreign Direct Investment in India

Dr.Sukhen Kali*

Subrata Jana**

*Associate Professor, Dept. of Commerce, Bankura Sammilani College, Bankura

**Assistant Professor, Dept. of Commerce, Bankura Sammilani College, Bankura

Abstract

India's economic reforms way back in 1991 has generated strong interest in foreign investors and turning India into one of the favourite destinations for global FDI flows. According to A.T. Kearney, India ranks second in the World in terms of attractiveness for FDI. A.T. Kearney's 2007 Global Services Locations Index ranks India as the most preferred destination in terms of financial attractiveness, people and skills availability and business environment.

India is a developing country with large young labour force, massive potential market, natural and mineral resources, but the growth of the various sectors and the economy as a whole does not touch the expectation due to lack of adequate capital. In this scenario, FDI plays a vital role in enhancing the economic growth and development of the country. In the era of globalization, Foreign Direct Investment (FDI) plays an important role in the economy of any country. The 'home' countries want to take the advantage of the vast markets opened by industrial growth. On the other hand the 'host' countries want to acquire technological and managerial skills and supplement domestic savings and foreign exchange. The integration of global financial markets paves ways to this explosive growth of FDI around the world. In this paper, we are trying to point out the trend of FDI inflow in India and its impact on Indian economy

Key Words: FDI, Potential market, economic growth, inflow

Introduction:

FDI is defined as the net inflows of investment (inflow minus outflow) to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. In other words, Direct investment is a category of international investment in which a resident entity in one economy (direct investor (DI) acquires a lasting interest in an enterprise resident in another economy (Direct Investment Enterprise (DIE).

The market in India is vast with a population of over 120 crores, a growing middle class, efficient and man power. It is also attractive to businesses, with FDI-friendly policies, the use of English for business and demand for many products and services outstripping supply. According to the 2010 FDI Survey conducted by the Federation of Indian Chambers of Commerce & Industry (FICCI), foreign investors characterize the Indian market as ‘high growth rate, somewhat difficult market penetration, intense competition and consequent pressure on profitability margins’.

Components of FDI:

i) **Equity capital:** When the foreign direct investor purchases shares of an enterprise in a country other than its own.

ii) **Reinvested earnings:** It means the direct investor’s share of earnings not distributed as dividends - such retained profits by affiliates are reinvested.

iii) **Intra-company loans** or intra-company debt: It refers to short or long-term borrowing and lending of funds between direct investors and affiliate enterprises.

Table 1: Reported FDI Inflows to India and their Main Components (As per International Best Practices) **(US $ million)**

Financial Year (April-March)	Equity inflows (FIPB,Automatic & Acquisition Routes)	Equity capital of unincorporated bodies	Re-invested earnings	Other capital	Total FDI inflows
2000-01	2,339	61	1,350	279	4,029
2001-02	3,904	191	1,645	390	6,130
2002-03	2,574	190	1,833	438	5,035
2003-04	2,197	32	1,460	633	4,322
2004-05	3,250	528	1,904	369	6,051
2005-06	5,540	435	2,760	226	8,961
2006-07	15,585	896	5,828	517	22,826
2007-08	24,573	2,291	7,679	292	34,835
2008-09	31,364	702	9,032	776	41,867
2009-10	25,609	1,540	8,669	1,945	37,763
2010-11	21,326	874	11,939	658	34,847
2011-12	34,833	1,022	8,206	2,495	46,556
2012-13	21,825	1,059	11,025	2,951	36,860
2013-14	24,299	975	8,978	1,794	36,046
2014-15	30,933	978	9,988	3,249	45,148
2015-16	40,001	1,111	10,413	4,034	55,559

Source: Based on DIPP, "Fact Sheet on Foreign Direct Investment (FDI)", April, 2016

Entry Routes for FDI in India:

Under Foreign Direct Investment scheme investments can be made by non-residents in the shares/convertible debentures of an Indian company, under two routes; **Automatic Route and Government Route.**

Under the **Automatic Route**, the foreign investor or the Indian company does not require any approval from the Reserve Bank or Government of India for the investment.

Under the **Government Route**, prior approval of Government of India, Ministry of Finance, Foreign Investment Promotion Board (FIPB) is required. Entry route for nonresident investors in India as well as sector specific investment limits in India

A person resident outside India (other than a citizen of Pakistan or Bangladesh) or an entity incorporated outside India, (other than an entity incorporated in Pakistan or Bangladesh) can invest in India, subject to the FDI policy of the Government of India. A person who is citizen of Bangladesh or an entity incorporated in Bangladesh can invest in India under the FDI scheme, with prior approval of FIPB.

Government of India welcomes FDI in all sectors where it is permitted, especially for development of infrastructure, technological upgradation of Indian industry through 'greenfield' investments and in projects having the potential of creating employment opportunities on a large scale. Investment for setting up Special Economic Zones (SEZs) and establishing manufacturing units are also welcomed. Prohibition on Investment in India Foreign Investment in any form is prohibited in a company or a partnership firm or a proprietary concern or any entity, whether incorporated or not (such as Trusts) which is engaged or proposes to engage in the following activities- i) Business of chit fund, ii) Nidhi Company, iii) Agricultural or plantation activities,iv) Trading in Transferable Development Rights (TDRs) v) Atomic Energy vi) Lottery Business viii) Gambling and Betting

.Table-2: Share of top ten investing countries in FDI inflows (US $ million)

Country	2013-14 (April-March)	2014-15 (April-March)	2015-16 (April-March)
Mauritius	4859	9030	8355
Singapore	5985	6742	13692
Japan	1718	2084	2614
U.K.	3215	1447	898
Netherlands	2270	3436	2643
U.S.A.	806	1824	4192
Germany	1038	1125	986
Cyprus	557	598	508
U.A.E	341	367	985
France	305	635	598

Source: Fact Sheet, FDI (2016)

The above table shows the actual investment flows of top ten countries during the period of 2008-09 to 2012-13. The FDI stock for this period from Mauritius is the largest 37 percent. The other top nine countries are Singapore, USA, UK, Netherlands, Japan, Cyprus, Germany, France and UAE. It implies that these top ten countries accounted for well over 85 percent of the FDI inflows during the above period. The Mauritius which was not in the picture till 1992 has the highest growth rate because such investment is represented by the holding companies of Mauritius set up by the US firms. The reason behind the US companies have routed through Mauritius is the tax treaty between Mauritius and India stipulates a dividend tax of five percent while the treaty between Indian and US stipulated a dividend tax of 15 percent.

Table 3: Sector wise FDI inflows in India since April 2000- March,2017

Industrial Sector	Rank
Service Sector	1
Computer Hardware and Software	2
Construction	3
Telecommunication	4
Automobile Industry	5
Drugs & Pharmaceuticals	6
Trading	7
Chemicals	8
Power	9
Metallurgical Industry	10

Source *Fact Sheets on FDI, DIPP, 2017*

The above 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 computer hardware and software in terms of FDI. High volumes of FDI take place in the sector of telecommunication, real estate, construction, power, automobiles. Based upon the data given by department of Industrial Policy and Promotion, top ten sectors attract almost seventy percent (70%) of FDI inflows in India. the sector wise inflows of FDI in India shows a varying trend but acts as a catalyst for growth, quality maintenance and development of Indian Industries to a greater and larger extend

Barriers and Recommendation:

The Asian Development Bank has identified following barriers of FDI in India:

i) infrastructure bottlenecks, ii) features of India's labour regulation iii) difficulties in the acquisition of land and environmental clearances for industrial activity

A Survey on FDI conducted by FICCI (2010) found that the three main challenges for foreign investors lie in procedural delays, the tax regime and labour laws. Recommendations from the survey to Government include:

i) Rationalising the tax structure.

ii) Simplifying procedures for repatriating funds.

iii) Modernising government systems and reducing bureaucracy.

iv) Improving infrastructure facilities.

v) Rationalising labour laws.

vi) Liberalising employment visa rules.

India as the founding member of GATT, WTO, a signatory member of SAFTA and a member of MIGA is making its presence felt in the economic landscape of globalised economies. The economic reform process started in 1991 helps in creating a conducive and healthy atmosphere for foreign investors and thus, resulting in substantial amount of FDI inflows in the country. Apart from capital generation, FDI provides the other facilities like development of infrastructures, transfer of technology, sound organizational and managerial practices as well as penetration to the international market. Developing countries like India need foreign Direct Inflow to achieve the required investment to gear up economic growth and development of the nation. It can act as a catalyst for domestic industrial development. Further, it helps in speeding up economic activity and brings with it other scarce productive factors such as technical knowhow and managerial experience, which are equally essential or economic development.

Conclusion

The role of Foreign Direct Investment (FDI) in the upgradation of technology, skills and managerial capabilities is now well accepted. The important effect of FDI is its contribution to the growth of the economy. FDI has an important impact on country's trade balance, increasing labour standards and skills, transfer of technology and innovative ideas, Additional investments with the available domestic resources help in providing much needed employment opportunities. Foreign Direct Investment (FDI) as a strategic component of investment is needed by India for its sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries, short and long term project in the field of healthcare, education, research and development (R & D) etc. Government should design the FDI policy such a way where FDI can help to raise the output, productivity and export at the sectoral level of the Indian economy. Therefore for further opening up of the Indian economy, it is advisable to open up the export oriented sectors and higher growth of the economy could be achieved through the growth of these sectors. Indian economy is largely agriculture based. There is plenty of scope in food processing, agriculture services and agriculture machinery. The Government should design policies where foreign investment can be utilised as means of enhancing domestic production, savings, and exports; as medium of technological learning and technology diffusion and also in providing access to the external market.

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