International Journal of Academic Research and Development
ISSN: 2455-4197, Impact Factor: RJIF 5.22
www.academicsjournal.com
Volume 1; Issue 6; June 2016; Page No. 01-05

Foreign direct investment (FDI) in India: A key for economic growth in India

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Abstract

Foreign Direct Investment (FDI) is the major monetary source for economic growth in India. Foreign companies invest directly in fast growing private Indian businesses to take benefits of cheaper wages and changing business environment of India. FDI helps in transferring of financial resources, technology and innovative and improved management techniques along with raising productivity. This paper tries to highlight the impact of FDI on the Indian Economy. The government recently has announced the foreign investment of 49% stake for the foreign players to enter into the retail segment. Recently, Government of India allowed FDI in different sectors of Indian economy. Ministry of Commerce & Industry, Government of India is the nodal agency for monitoring and reviewing the FDI policy. But several opposition parties are making it a political issue in parliament on these policy decisions and amendments. FDI seen as an important catalyst for economic growth in the developing countries, It affects the economic growth by stimulating domestic investment, increasing human capital formation and by facilitating the technology transfer in the host countries. During the FY2015, India received the maximum FDI equity inflows from Singapore at US$ 10.99 billion, followed by Mauritius (US$ 6.12 billion), USA (US$ 3.51 billion), Netherlands (US$ 2.15 billion) and Japan (US$ 1.08 billion). Foreign Direct Investment in India increased by 1850 USD Million in March of 2016. The Government has put in place a liberal policy on FDI, under which FDI, up to 100%, is permitted, under the automatic route, in most sectors/activities.

Keywords: Foreign Direct Investment, Indian Economy, Globalization, economic growth

1. Introduction

Today, Foreign Direct Investment (FDI) is one of the measures of growing economic globalization. Investment has always been an issue for the developing economies such as India. Foreign investment plays a significant role in development of any economy as like India. Many countries provide many incentives for attracting the FDI. Need of FDI depends on saving and investment rate in any country. 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. FDI refers to capital inflows from abroad that is invested in or to enhance the production capacity of the economy. The FDI Policy is governed by the Government of India and with the provision of Foreign Exchange Management Act (FEMA) 1999. The regulation is framed by Government FDI in sectors, not covered under automatic route requires prior approval of the government which is considered by Foreign Investment Promotion Board (FIPB), Department of Economic Affairs (Ministry of Finance). It usually involves participation in management, joint venture, transfer of technology and expertise. FDI can be used as one measure of growing economic globalization.

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 Gross Domestic Products (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. It helps in generation of employment and also helps poverty eradication.

2. Objectives of the Study

1. To evaluate the Impact of FDI on Indian Economy
2. To analyze the recent trends and pattern of FDI.

3. Review of Literature

Singh J., Chadha S., and Sharma A. (2012) [5] in his study "Role of Foreign Direct Investment in India: An Analytical Study" investigated the Foreign Direct Investment flows are supplementing the scare domestic investments in developing countries particularly in India. But foreign investor never adopts environment friendly technique to maximize their profit. They found that the highest amount of FDI gone to financing sector, insurance sector, real estate and business services which is 33.05% of total cumulative inflow of FDI.

Pavithra J. (2012) [3] in his paper "A Study on the Role of Foreign Direct Investment in Retail industry in India" examined the foreign investment in retail which was once a prohibited sector now became the FDI in retail has now gained momentum in both single brand retail and multi brand retail. The prohibited sector has got so much of momentum the single brand retail has allowed 100% FDI. The foreign direct investment and politically sensitive multi brand retail have been facing a lot of trouble, yet policies are to be changed and should allowed in a phased manner. They concluded that, the growth of retail industry will be tapped which will allow foreign players to play a major role in upbringing retail industry as an emerging sector.

Kumar Vinay (2012) [14] in his study "Trend of FDI in India and Its Impact on Economic Growth" Investigated the FDI trend in Indian economy is moving in upward direction that too with the good speed. On the basis of analysis it is quite evident to say that Indian economy is one of the most promising investment destinations for most of the developed and developing nations. But one question that is striking my mind is that in spite of having good inflow of FDI in India just after the recession period. As the growth rate of FDI in India for the period of 2010 to 2014 is not much attractive.

Gola K. R., Dharwal M., and Agarwal A. (2013) [4] in his study "Role of Foreign Direct Investment in the Development of Indian Economy" it implies that the spirit in which the economy has been liberalized and exposed to the world economy at the late eighties and early nineties has not been achieved after so many years. A large number of changes that were introduced in the country`s regulatory economic policies heralded the liberalization era of the FDI policy regime in India and brought about a structural breakthrough in the volume of the FDI inflows into the economy maintained a fluctuating and unsteady trend during the study period. It might be interest to note that more than 50% of the total FDI inflows received in India come from Mauritius, Singapore and the USA.

Malhotra B. (2014) [7] in his paper "Foreign Direct Investment: Impact on Indian Economy" examined the India's FDI policy has been gradually liberalized 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 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. FDI also helps to establish new companies.

Abhishek Vijaykumar Vyas (2015) [11] in his paper "An Analytical Study of FDI in India (2000 -2015)" examined the FDI in India has a significant role in the economic growth and development of India. FDI in India to various sectors can attain sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries. The inflow of FDI in service sectors and construction and development sector, from April, 2000 to June, 2015 attained substantial sustained economic growth and development through creation of jobs in India.

4. Research Methodology

This paper is a descriptive study in nature. The study is based on secondary data. The required data has been collected from various sources i.e. journals, magazines, and websites particularly from the Department of Industrial Policy & Promotion, Publications from Ministry of Commerce & Industry, World Investment Reports, Asian Development Bank`s Reports, Various Bulletins of Reserve Bank of India, etc. It is a time series data and relevant data have been collected for the period of 2013-14 to 2015-16. The data collected has been analyzed through tables & graphs.

5. Foreign Direct Investment (FDI) In India

Foreign Direct Investment (FDI) in India dates back to the pre independence period, where it was handled predominantly by the East India Company with British companies being a major source of FDI. Foreign Direct Investment plays a crucial role in enhancing the economic growth and development of the country. Moreover, FDI as a strategic component of investment is needed by India for achieving the objectives of its second generation of economic reforms and maintaining the pace of growth and development of the economy. The fast-tracked liberalization of the Indian economy introduced in 1991 brought with it a radical shift in the policy towards FDI. In fact, FDI policy reform formed part of the first package of industrial reforms in July 1991 and was reflected in the Industrial Policy announced in 1991. Foreign Investment in India is governed by the FDI policy announced by the Govt. of India and the provision of the Foreign Exchange Management Act (FEMA) 1999. The Reserve Bank of India (RBI) in this regard had issued a notification, which contains the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000. This notification has been amended from time to time. Department of Industrial Policy and Promotion (DIPP) under the Ministry of Commerce & Industry, (GOI) is the nodal agency for monitoring and reviewing the FDI policy on continued basis and changes in sectoral policy/sectoral equity cap which goes from 26% to 100% at present. The FDI policy is notified through Press Notes/Policy Circulars by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP) Ministry of Commerce & Industry. FDI is allowed under Direct Route and Government. The foreign investors are free to invest in India, except few sectors/activities, where prior approval from the RBI or Foreign Investment Promotion Board (FIPB) would be required. FDI brings better technology and management, access to marketing networks and offers competition, the latter helping Indian companies improve, quite apart from being good for consumers. This efficiency contribution of FDI is much more important. Govt. of India allowed FDI in different sectors of economy. At present India is the 4th largest and 2nd fastest growing economy in the world. It is the11th largest economy in terms of industrial output and has the 3rd largest pool of scientific and technical manpower. According to Department of Industrial Policy and Promotion (DIPP), the total FDI investments India received in April-December period of 2015 was US$ 40.82 million, indicating that government's effort to improve ease of doing business and relaxation in FDI norms is yielding results. During FY2015, India received the maximum FDI equity inflows from Singapore at US$ 10.99 billion, followed by Mauritius (US$ 6.12 billion), USA (US$ 3.51 billion), Netherlands (US$ 2.15 billion) and Japan (U$ 1.08 billion).

Budget 2016-17 has proposed several reforms in FDI Policy in areas of insurance and pensions, asset reconstruction companies and stock exchanges, such as easier governing and fund raising norms, clarification of tax related matters and higher FDI limits. The Govt. of India has amended the FDI policy regarding Construction Development Sector. The amended policy includes easing of area restriction norms, reduction of minimum capitalization and easy exit from project. The Govt. of India has recently relaxed FDI policy in 15 sectors, such as raising the foreign investment limit for some sectors, easing the conditions for others and putting many on the automatic route for approval. The Govt. of India recently relaxed the FDI policy norms for Non-Resident Indians (NRIs). Under this, the non-reportable investments made by the Persons of Indian Origin (PIOs), Overseas

Citizens of India (OCI) and NRIs will be treated as domestic investments and will not be subject to FDI caps. Foreign Direct Investment in India increased by 1850 USD Million in March of 2016. FDI in India averaged 1148.61 USD Million from 1995 until 2016, reaching an all-time high of 5670 USD Million in February of 2008 and a record low of - 60 USD Million in February of 2014. FDI in India is reported by the RBI

5.1 Structure of Foreign Direct Investment (FDI) in India

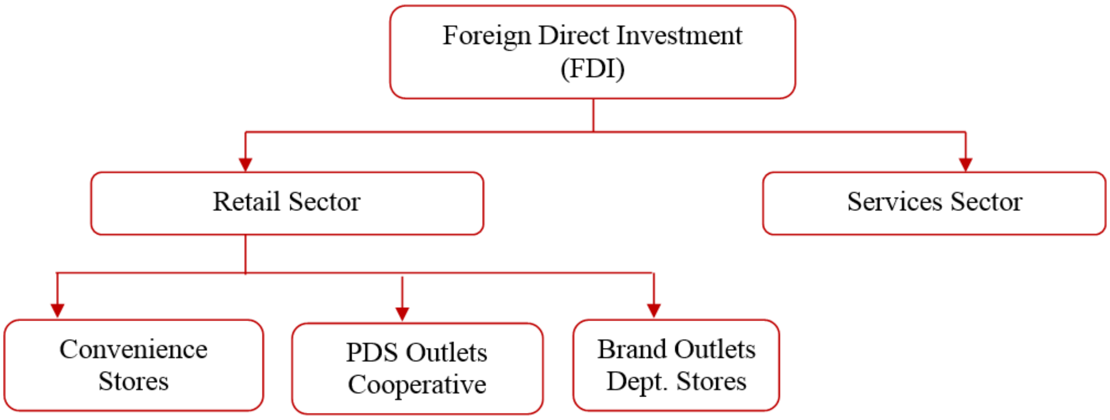

Fig 1: Structure of Foreign Direct Investment (FDI)

5.2 Regulation of Foreign Direct Investment (FDI) in India

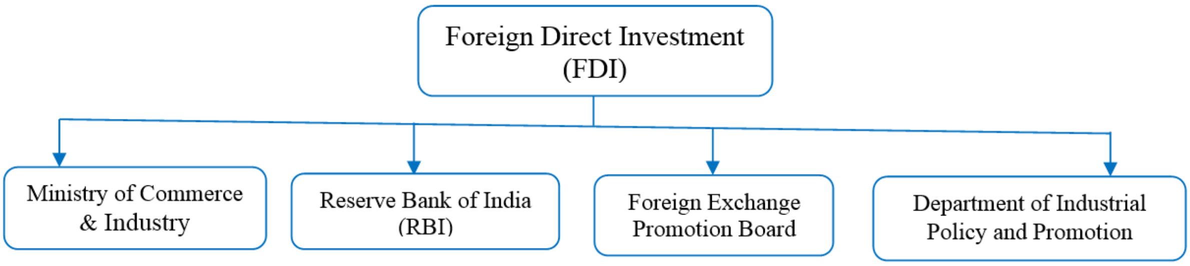

Fig 2: Regulation of Foreign Direct Investment (FDI)

5.3 Current Status of FDI in India Retail Sector

As of June 2015, the Government of India allowed FDI in single and multi-brand retailing along with the following conditions:-

A) Up to 100% FDI in single brand retail trading.

- By only one non-resident entity whether owner or the brand or otherwise.
- 30% domestic sourcing requirement eased to preferable sourcing rather than compulsory.
- Further clarification on FDI companies that cannot engage in B2C e-commerce.
- Products to be sold should be of a “single brand”. Product should be sold under the same brand internationally.
- “Single brand” product retailing would cover only products, which are branded during manufacturing.

B) Up to 51% FDI in multi brand retail trading.

- At least 100 million US$ must be invested into Indian company.
- At least 50% of the total FDI is to be invested in back end infrastructure within 3 years.
- At least 30% of the value of procurement of processed product shall be sourced from Indian small industry.
- Fresh agriculture produce is permitted to be sold unbranded.
- Indian states have been given the discretion to accept of refuse the implementation of Foreign Direct Investment.
- Retail outlets can be set up in cities having population of at least 1 million.
- Application needs to be approved by two levels at Department of Industrial Policy and Promotion and Foreign Investment Promotion Board.

5.4. Current Status of FDI in India Service Sector

FDI plays a major role in the dynamic growth of the service sector. The service sector in India has tremendous growth potential and as a result it attracts huge FDI.

- The Computer Software and Hardware enjoy the permission of 100% FDI under automatic route.
- The limit of FDI in Telecom sector was increased from 49% to 74%. FDI up to 49% is permissible under automatic route but FDI in the licensee company/Indian promoters including their holding companies shall require approval of FIPB.
- Over one crores new jobs expected to be created.
- New manufacturing opportunities will open for the nation’s micro small and medium enterprises.

6. Performance of Foreign Direct Investment (FDI) In India

Table 1: Share of Top Investing Countries FDI Equity Inflows *(Financial Years): Amount Rupees in crores (US$ in millions)*

Ranks	Country	2013-14 (Apr -Mar	2014-15 (Apr - Mar)	2015-16 (Apr, 15 - Mar, 16)	Cumulative Inflows (Apr '00 - Mar '16)	%age to total Inflows (in terms of US $)
1	Mauritius	29,360 (4,859)	55,172 (9,030)	54,706 (8,355)	480,363 (95,910)	33%
2	Singapore	35,625 (5,985)	41,350 (6,742)	89,510 (13,692)	256,667 (45,880)	16%
3	U.K.	20,426 (3,215)	8,769 (1,447)	5,938 (898)	115,592 (23,108)	8%
4	Japan	10,550 (1,718)	12,752 (2,084)	17,275 (2,614)	110,671 (20,966)	7%
5	U.S.A.	4,807 (806)	11,150 (1,824)	27,695 (4,192)	94,575 (17,943)	6%
6	Netherlands	13,920 (2,270)	20,960 (3,436)	17,275 (2,643)	94,533 (17,314)	6%
7	Germany	6,093 (1,038)	6,904 (1,125)	6,361 (986)	44,870 (8,629)	3%
8	Cyprus	3,401 (557)	3,634 (598)	3,317 (508)	42,681 (8,552)	3%
9	France	1,842 (305)	3,881 (635)	3,937 (598)	26,525 (5,111)	2%
10	UAE	1,562 (255)	2,251 (367)	6,528 (985)	21,648 (4,030)	1%
Total FDI Inflows From All Countries*		147,518 (24,299)	189,107 (30,931)	262,322 (40,001)	1,495,859 (288,634)	

Source: FDI Statistics, Department of Industrial Policy& Promotion, Ministry of Commerce & Industry

The above Table depicts the country having the highest FDI in India. The report shows that the MAURITIUS country has the highest foreign investor in India with 35%. After Mauritius, Singapore and U.K. invest the highest FDI in India with 16% and 8% respectively. Japan also gets 4th position with 7% FDI in India.

Table 2: Sectors Attracting Highest FDI Equity Inflows: *Amount in Rs. crores (US$ in millions)*

Ranks	Country	2013-14 (Apr - Mar)	2014-15 (Apr - Mar)	2015-16 (Apr, 15 -Mar, 16)	Cumulative Inflows (Apr, 00 – Mar, 16)	%age to total Inflows (in terms of US $)
1	Services Sector **	13,294 (2,225)	27,369 (4,443)	45,415 (6,889)	258,354 (50,792)	18%
2	Construction Development: Townships, Housing, Built-Up Infrastructure	7,508 (1,226)	4,652 (769)	727 (113)	113,936 (24,188)	8%
3	Computer Software & Hardware	6,896 (1,126)	14,162 (2,296)	38,351 (5,904)	112,184 (21,018)	7%
4	Telecommunications (Radio Paging, Cellular Mobile, Basic Telephone Services)	7,987 (1,307)	17,372 (2,895)	8,637 (1,324)	92,729 (18,382)	6%
5	Automobile Industry	9,027 (1,517)	16,760 (2,726)	16,437 (2,527)	81,394 (15,065)	5%
6	Drugs & Pharmaceuticals	7,191 (1,279)	9,052 (1,498)	4,975 (754)	70,097 (13,849)	5%
7	Chemicals (Other Than Fertilizers)	4,738 (878)	4,658 (763)	9,664 (1,470)	59,555 (11,900)	4%
8	Trading	8,191 (1,343)	16,755 (2,728)	25,244 (3,845)	68,837 (11,872)	4%
9	Power	6,519 (1,066)	4,296 (707)	5,662 (869)	52,613 (10,476)	4%
10	Hotel & Tourism	2,949 (486)	4,740 (777)	8,761 (1,333)	49,710 (9,227)	3%

Source: FDI Statistics, Department of Industrial Policy& Promotion, Ministry of Commerce & Industry

The above Table depicts the sector having the highest FDI equity inflow in India. The report shows that Service sector has the highest FDI Equity inflow 18%, followed by Construction development, Computer Software and Hardware, Telecommunication, Automobile Industry sector having 8%, 7%, 6%, and 5% respectively. Other sectors like

Drugs and Pharmaceuticals carries 5% and Chemicals, Power; Trading Industries carries 4% FDI inflow each, whereas the least is of Hotel & Tourism - 3%.

7. Conclusion

Foreign Direct investment plays a very important role in the development of the nation. FDI is an important stimulus for the economic growth of India. FDI plays an important role in the development of infrastructure because many countries invest in the infrastructure sector and service and banking finance sectors. FDI create high perks jobs for skilled employee in Indian service sector. Foreign Direct Investments (FDIs) have given the Indian economy a tremendous boost. While India needs these investments to maintain a steady rate of economic growth, the government needs to tread with caution and ensure foreign investors do not take control of the Indian economy as a result of its liberalized policies. The Modi government has introduced a number of initiatives to both attract the FDI and liberalize the FDI policy. These include improving infrastructure, revisiting the land-acquisition law, reforming the labor law, and streamlining the process for obtaining environmental clearances. Another important step by the government has been the clearance of 100% FDI in railway infrastructure. Foreign Direct Investment in India increased by 1850 USD Million in March of 2016.

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