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A study of foreign direct investment in India

Rashmi Ahuja

Assistant Professor (Ad-hoc), SPMC, University of Delhi, India

Abstract

In this age of globalization, Foreign Direct Investment (FDI) has become an important instrument for economic growth and development for most of the developing economies across the globe. The emerging market economies offer various tax and other incentives to woo more and more foreign capital into their economies. For the past few years, India has emerged as an attractive destination for FDI. With the increasing importance of foreign capital inflows in India, this study analyzes the overall trend and pattern of foreign capital inflows into India for the period 2000-2016.Further, it also examines the country-wise as well as sectoral trend of FDI into India to understand how foreign direct investment into India has undergone a transition in the past few years.

Keywords: foreign direct investment, service sector, India, economic growth

1. Introduction

For the past few decades, foreign capital inflows have become an integral component of increasing economic integration in developing economies across the world. These economies are rapidly integrating into the world economy through increasing foreign investment specifically foreign direct investment (FDI).FDI not only fills the gap between domestic savings and investment but it also serves as an important source of new technology, knowledge-base and managerial practices that promotes efficiency and productivity of the existing production facilities. In addition, it also helps in employment generation and provides access to new regional and global markets.

The role of foreign capital becomes even more important in case of developing and emerging market economies like India which are capital deficient. Since 1991, India is able to attract large amount of foreign investment and rank second to China in attracting foreign investment. According to World Investment Report 2016, India continues to be among the top ten countries in terms of foreign direct investment (FDI) inflows globally and also fourth in the developing Asia. Apart from that, it was also noted that in a year when many other major FDI destinations posted declines, India experienced one of 2014's best FDI growth Rates, increasing its number of projects by 47 percent [1]. India also remains among the top ten countries in AT Kearney Foreign Direct Investment Confidence Index ranking for the second consecutive year. It shows that the investor friendly and pro-growth policies of India have a positive impact on the foreign direct investment intentions and preferences of the countries in the world. With the radical changes introduced by the government of India in FDI policy regime in the last two years, most of the sectors in India are open for FDI under automatic approval route [2]. Apart from that, various initiatives and other developmental flagship programs like Make in India, Skill India and Digital India introduced by the government of India in the past few years also contributed to the increased attractiveness of India as FDI destination.

There exists vast amount of literature on foreign direct investment into developing economies. It categorizes FDI based on the reasons for investment into i) Resource Seeking FDI or Vertical FDI. ii) Market Seeking FDI or Horizontal FDI. iii) Efficiency Seeking FDI. Apart from it, literature also categorizes FDI based on different modes of entry used by the foreign firms. Based on the mode of entry used by the foreign firms, the FDI can be classified into two types: Greenfield FDI and Merger & Acquisition (M&A). Each kind of FDI contributes to the host economy in a different manner. Broadly; the literature can be further divided into two parts. One part deals with the determinants of foreign capital inflows into the developing economies and other part examines the impact of foreign capital inflows on host country. Most of the FDI theories stated in the first part of literature are fairly straightforward, from the multinational enterprises (MNEs) aspect, focusing on the determinants of FDI. These theories have addressed the question why a firm engages itself in international production. Some of the well-known FDI theories include the classical industrial organization theory, the product cycle theory, the internationalization theory, the dynamic comparative advantage theory and the eclectic theory etc. [3]. In contrast to the above well-known FDI theories, there have been different theoretical perspectives that addressed the macroeconomic effects of FDI on developing host countries. According to Modernization theory, foreign capital penetration has a positive effect in host countries while dependency theory considers foreign capital penetration as harmful for the host economies.

From the above review of literature, it is implied that FDI is still a matter of a debate because it has its associated benefits as well as harmful effects. Thus, examining the

[1] *According to Times of India article titled, "India pips US, China as No. 1 foreign direct investment destination" dated 30th September,2015.*

[2] except a small negative list.

3A detail review of such theories can be found in Dunning, 1993.

trend and pattern of FDI in India will help us better understand the kinds of FDI attracted by India and their possible impacts on India. With this objective in mind, this study documents the overall trend and patterns of foreign capital inflows in India during the period 2000-2016.We examine how foreign capital inflows in India has undergone a transition in the past few years. Then, we also perform sectoral and country-wise analysis of FDI into India to gain more insights about the foreign direct investment received into India during the above period.

2. Methodology

This study is based on secondary data. It is quantitative and analytical in nature. It covers the period from 2000-2016. The required data is obtained from SIA Annual issues, newsletter, world development Indicators (WDI), UNCTAD, RBI Bulletin etc. For FDI data from SIA newsletter and annual issues, we have considered the calendar year i.e. Jan-Dec. Trend analysis, Graphs, fitting linear trend equation and statistical tool of correlation are used to analyze the data.

3. Analysis and Interpretations

In this section, we examine the FDI inflows in India over the period 2000-2016.Firstly, we probe into detail the pattern of FDI year-wise and then analyze the country-wise and sector-wise trends.

3.1 Year-wise FDI inflows in India

Table 1 shows the year-wise FDI inflows [4] into India for the past seventeen years. FDI inflow in India soared from Rs. 104,410 million in 2000 to Rs. 3,116,439 million in 2016, at a compounded annual growth rate of 22.11 percent. The total Cumulative FDI inflows received during the year 2000-2016 amounts to Rs 17,391,669 million.

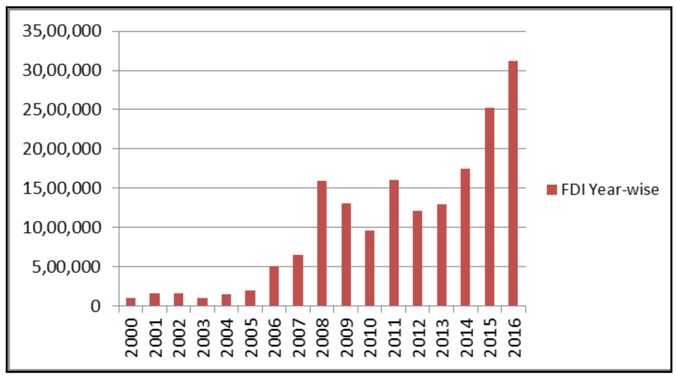
Table 1: FDI inflows in India during 2000-2016

Calendar Year	FDI inflows (Rs. million)	Annual growth rate(AGR)
2000	104,410	
2001	160,711	(+)53.9
2002	161,345	(+) 0.4
2003	95,640	(-)40.7
2004	147,814	(+)54.5
2005	192,707	(+)30.4
2006	503,573	(+)161.3
2007	654,950	(+)30.1
2008	1,595,295	(+)143.6
2009	1,309,799	(-)17.9
2010	960,150	(-)26.7
2011	1,599,349	(+)66.6
2012	1,215,914	(-)23.9
2013	1,294,825	(+)6.5
2014	1,753,134	(+)35.4
2015	2,525,614	(+)44.1
2016	3,116,439	(+)23.33
Total Cumulative FDI (2000-2016)	**17,391,669**	**CAGR =22.11%**

Note: 1) AGR is % growth over previous year 2)CAGR=Compounded Annual growth rate.
Source: Compiled from SIA Newsletter, Jan 2017

4*Note: This is the cumulative total FDI inflows through Govt. approval route, automatic route, RBI various NRI's schemes and inflows through acquisition of existing shares route.*

The trend of FDI during the past decade has been fluctuating. It is observed that FDI inflow into India increases during the year 2000-2002. Then, in 2003, it decreases by about 40 percent as compared to year 2002. Then, up to 2008, it shows an increasing trend with year 2006 and 2008 showing an exceptional growth of about 161.3 percent and 143.6 percent respectively. The reason for this higher growth rate is attributed to the opening up of FDI through automatic rate and 100 percent FDI allowed in various sectors. In 2009 and 2010, FDI inflows decline by 17.9 percent and 26.7 percent respectively due to the aftermath of global financial crisis. Then, the FDI inflows in India again revived in year 2011 with an increase of about 66.6 percent. In year 2012, it again declines by 23.9 percent which is largely due to the uncertanities in the global economy during that period. While during the year 2014, FDI inflows into India again registered an increase of 35 percent. This upward trend in FDI continues in year 2015 and 2016 with a growth of 44.1 percent and 23.33 percent respectively. However, it is noticed that the increase in FDI inflows has been at a lower rate in 2016 as compared to 2015

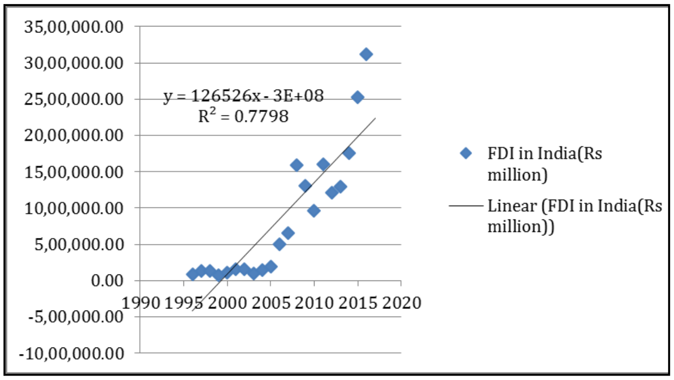


Source: Constructed from data in SIA Newsletter, Jan 2017

Fig 1: FDI Inflows (in Rs. Million) in India during 2000-2016

Some of the important factors like various FDI-related reforms, positive outlook for growth in India, ease of doing business in India, liberalization of some of the major sectors etc. has a huge impact in creating investor-friendly climate in India. Apart from this, certain steps taken by the new government in power also contributed to this increased attractiveness for FDI. For instance, introduction of new tax reform resolution of Goods and Services tax (GST), simpler and less complicated procedures for FDI (New form INC-29 for new business) in India. The Make in India initiative introduced during September 2014 also contributed to a large extent to the increasing trend of foreign capital inflows after 2014.It aims at promoting India as an important investment destination and a global hub for manufacturing, design and innovation.

We also estimated the trend of FDI inflow in India for the period from 2017-2019.The linear trend model is used to fit the regression line to the FDI data in excel. The equation thus obtained is : Y=126526x-3E+08 and R^2 =0.779 percent. The projected values of foreign direct investment for the year 2017, 2018 and 2019 are found to be Rs. 2240103.286 million, Rs 2366629.177 million and Rs 2601636.275 million respectively. Our projected data suggests that FDI will be following an increasing trend in the future too.



Source: constructed by Author

Fig 2: Trend Projection of FDI in India from 2017 to 2019

3.2 Country-wise FDI inflows in India

To understand more clearly the pattern of FDI into India, a probe into which are the top investing countries into India during the period 2000-2016 is made in Table 2. It is clear that Mauritius emerged as the most dominant source of FDI inflows in India contributing about cumulative total FDI inflow of 108,916.72 million US $ between the period 2000 and 2016, equal to approximately 33.5 percent of total FDI equity inflows in India. This can be largely explained by the double taxation treaty between India and Mauritius i.e. Double Taxation Avoidance Agreement (DTAA).Singapore emerges as the second highest investor in India during the period 2000-2016. It is clear that Singapore and Mauritius contributes more than 50 percent of the total FDI inflows into India during the year 2000-2016.

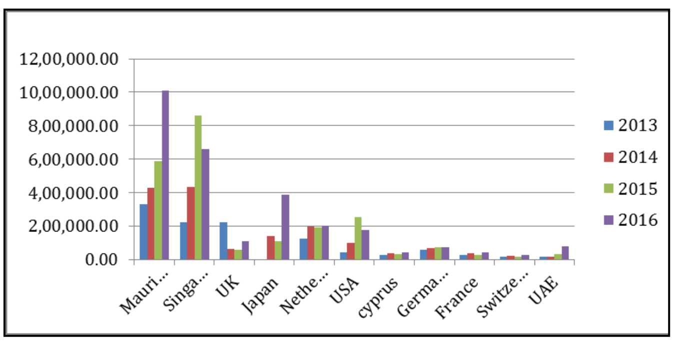
It is also observed that Singapore and Mauritius swapped top investor position in the year 2015 (Figure 3). FDI inflows from Singapore have increased at a faster pace especially after 2012.The reason for this can be attributed partly to the big quantum of international investors' money flowing into Indian e-commerce and internet sector at large. For instance, India's top ecommerce firm Flipkart is based in Singapore. Several other key players of Indian digital economy are also based in Singapore. Apart from that, Singapore also enjoys a double taxation avoidance agreement (DTAA) like Mauritius. However, it is also observed that in 2016, Mauritius again emerges as the highest investor in India followed by Singapore. Japan emerges as the third highest investor totaling cumulative FDI inflows of Rs. 1,395,376.94 million during the period 2000-2016. Similarly, UK, one of the G20 economies emerges as the fourth highest investor totaling cumulative FDI inflows of Rs. 1,241,292.44 million during the period 2000-2016.The last row in Table 2 also shows that the share of total FDI inflows contributed by these top eleven countries has increased over the period 2000-2016.Our analysis also suggest that these top eleven countries accounted for a major part of FDI inflows in India. About 87.8 percent of total FDI inflows (*excluding RBI-NRI Schemes)* are contributed by these top eleven countries during the period 2000-2016.

Table 2: Country-wise FDI inflows (Rs. million) in India

Top investing countries	2000-2011	2000-2012	2000-2013	2000-2014	2000-2015	2000-2016
Mauritius	2,817,218.47 (37.6)	3,308,637.31 (38.1)	3,639,927.82 (36.4)	4,069,384.56 (34.6)	4,659,693.30 (33.7)	5,672,023.36 (37.1)
Singapore	713,175.23 (9.5)	865,596.99 (9.9)	1,087,713.30 (10.9)	1,520,574.35 (13)	2,383,565.29 (16.7)	3,043,301.09 (19.93)
UK	736,560.26 (9.8)	780,279.03 (8.9)	1,005,269.91 (10.1)	1,071,125.22 (9.1)	1,129,920.13 (7.9)	1,241,292.44 (8.13)
Japan	567,762.89 (7.5)	671,407.12 (7.7)	753,751.36 (7.5)	896,435.15 (7.6)	1,007,278.94 (7.1)	1,395,376.94 (9.14)
Netherlands	307,106.55 (4.1)	396,633.29 (4.5)	521,951.35 (5.22)	720,144.00 (6.1)	905,839.94 (6.35)	1,113,686.41 (7.29)
USA	473,329.18 (6.3)	507,162.07 (5.8)	551,943.82 (5.52)	653,419.94 (5.6)	912,692.62 (6.4)	1,081,867.44 (7.08)
Cyprus	268,321.71 (3.5)	318,424.03 (3.6)	346,410.77 (3.47)	386,346.19 (3.3)	419,532.99 (2.9)	464,337.56 (3.04)
Germany	197,340.66 (2.6)	236,171.22 (2.7)	292,873.80 (2.93)	363,535.30 (3.1)	435,944.16 (3.1)	510,067.72 (3.34)
France	123,396.51 (1.6)	159,573.43 (1.8)	185,050.81 (1.24)	222,439.52 (1.9)	249,988.08 (1.8)	293,757.45 (1.92)
Switzerland	92,915.03 (1.2)	107,485.03 (1.2)	124,117.65 (1.27)	146,602.91 (1.2)	163,788.07 (1.1)	192,905.08 (1.26)
UAE	95,472.86 (1.3)	109,783.79 (1.3)	1,26,738.89 (1.26)	143,751.72 (1.2)	177,224.82 (1.2)	257,784.18 (1.68)
Total FDI inflows (Does not include RBI-NRI Schemes)	*6,392,599.35 (85.5)*	*7,461,153.31 (85.8)*	*8,635,749.48 (85.86)*	*10,193,758.9 (86.8)*	*12,445,468.3 (87.2)*	15,266,399.67 *(87.80)*

Source: Compiled from data in SIA Newsletter, various Annual Issue. Percentage share with total FDI inflow are in brackets.

It is also found that UK was the second highest investment country and Singapore was the third highest investment country over the period 2000-2011.However, it is observed that Singapore overtook UK to become the second highest investment country in India during the periods 2000-2012, 2000-2013, 2000-2014, 2000-2015 and 2000-2016.USA which occupies the fifth largest investor position during the period 2000-2015 now becomes the sixth largest investor during 2000-2016. Japan which stood at fourth position in 2000-2015 now moves one step up to become the third largest investor in India during the period 2000-2016.This increase in investments from japan can be the result of double action plan signed between India and Japan for doubling of Japanese investments into the Indian firms in the next five years [5]. Also, it is in line with Prime Minister's Make in India plan to further investments from Japan into the country's manufacturing sector. A fast track mechanism named "Japan Plus" is also set up last year to follow up Japanese investments into India. Japanese investments into India are majorly into automobiles, pharmaceuticals and service sector. In addition, this increase in FDI into India from Japan is also due to the Tokyo Declaration for Japan-India Special Strategic and Global Partnership under which a target of doubling Japanese FDI and the number of Japanese firms in India by 2019 is set. Germany which stood at eighth position in 2000-2014 now moves one step up to become the seventh largest investor in India during the period 2000-2015 as well as 2000-2016. There are more than 1600 Indo-German collaborations and over 600 Indo-German joint ventures in operation [6].



Source: *Compiled from data in SIA Newsletter January 2017.*

Fig 3: Top Countries investing in India

3.3 Sector-wise FDI in India

As far as FDI is concerned, it is not only the quantity of FDI that matters but it is also important to examine that where this amount is invested into the host country. For instance, if FDI is coming into heavy industries, basic capital goods, infrastructure and agriculture etc. certainly it would increase the production and growth of Indian economy. If it is going to more non-priority industries, where profit is high then it would only lead to increase in consumption and not capital formation. Figure 4 provides insight into sectoral FDI inflow in India during the year 2013-2016.

Table 4 shows that during the calendar year 2016 (Jan-Dec), Service sector is the most attractive sector for investment with investments to the tune of Rs. 684,051.94 million. The service sector is gaining huge importance in service driven economy like India. The various reforms like simpler taxation rules and fund raising norms has been introduced into the IT industry because of its higher growth potential in India. Despite 'Make in India' initiative introduced in September 2014, Service sector again stood at first position during the year 2016.One of the reason for this is the sustainable growth of service sector in Indian economy. Besides that, the increase in investment cap in various sectors including insurance sector [7], defense and railways has also contributed to this notable increase in FDI inflows during the period 2014-2016.Telecommunication which was the most attractive sector in the year 2014 dropped and become the seventh most attractive sector in the year 2015 with investment of Rs. 83,373.33 million. However, it regains its second most attractive sector position in 2016. The reason for this can be the existence of attractive market for telecommunication in India especially mobile phone and mobile based internet services. Even though the investments in trading sector decreased in 2016, it becomes the third most attractive sector with investments to the tune of Rs. 210,535.96 million in 2016.

The service sector has also been able to draw the highest amount of cumulative foreign direct investment inflows in the country, totaling up to Rs. 3,090,656.32 million during 2000-2016.After services, Telecommunications and Computer software and Hardware are the second highest and third highest investment attractive sectors with percentage share of 7.47 percent and 7.15 percent respectively in total cumulative FDI inflows during 2000-2016. Automobile industry stood at the fourth position in total cumulative FDI inflows. Besides these sectors, other promising sectors with high potential to attract foreign capital inflows into India are Trading, Drugs & Pharmaceuticals, Chemicals, Food processing, Power, Hotel & Tourism and Petroleum and Natural Gas.

We also looked at the relationship between the FDI in the selected sectors and GDP growth of India for the period 2008-2016.We calculated Karl Pearson coefficient of correlation using Stata(Table 4).It is found that there exists a positive and significant impact of FDI in telecommunication and FDI in construction infrastructure on GDP growth rate in India for the period 2008-2016.This can be because FDI into these two sectors i.e. telecommunication and infrastructure which are considered to be the two important pillars of any economy, further lead to positive spillovers into the other sectors and hence leads to positive impact on growth of any economy.

[5] *India, Japan sign action plan to double investments in 5-years",Business Standard dated May 1,2015.*

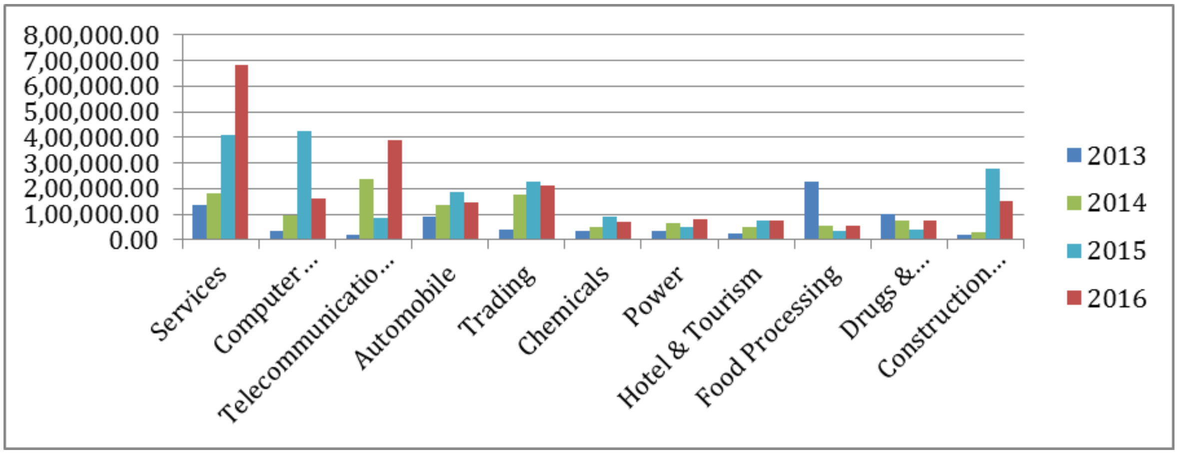
[6] Angela Merkel's visit strengthens 15-year Indo-German engagement, Business Today, dated 17th November,2015.

7For instance, investment cap in insurance sector increases from 26 percent to 49 percent.

Table 3: Sector-wise FDI inflow in India (in Rs. million)

Sectors	2013	2014	2015	2016	Cumulative FDI, 2000-2016	% share in total FDI
Services sector	136,161.47	179,500.90	409,974.58	684,051.94	3,090,656.32	17.7
Construction infrastructure	21,166.22	31,207.63	276,932.40	151,974.63	573,074.23	3.29
Computer Software & hardware	36,598.31	95,622.02	425,370.39	161,969.13	1,244,380.43	7.15
Telecommunications	17,700.03	234,555.11	83,373.33	389,710.04	1,300,087.84	7.47
Automobile Industry	90,020.28	136,349.52	185,207.61	148,087.03	918,452.64	5.28
Drugs & Pharmaceuticals	100,054.57	73,763.98	40,268.56	72,923.61	748,586.48	4.30
Chemicals (other Than fertilizers)	35,785.86	51,131.82	91,951.18	70,857.16	648,529.59	3.73
Trading	40,846.89	174,613.39	228,091.39	210,535.96	823,818.24	4.73
Power	33,770.79	66,773.12	50,097.23	79,270.20	592,571.21	3.4
Hotel & tourism	22,320.33	48,652.88	73,028.78	73,540.81	544,480.31	3.13
Food processing	225,963.29	55,677.83	33,095.02	52,511.13	447,607.39	2.57
Petroleum & Natural gas	6,853.28	61,549.23	7,933.32	7,787.11	332,075.37	1.91
Total					17,385,778.54	61.06

Source: Compiled from SIA Newsletter, Jan 2017



Source: Constructed from data from SIA Newsletter Jan 2017 issue.

Fig 4: Sector-wise FDI inflows during the years 2013-2016

Table 4: Correlation coefficient between sectoral FDI and GDP growth in India for the period 2008-2016

FDI in service sector	-0.423 (0.2561)
FDI in construction Infrastructure	0.8238*** (0.0063)
FDI in Telecommunication	0.6367* (0.0652)
FDI in Computer software and Hardware	0.5540 (0.1217)
FDI in Automobiles	-0.3408 (0.3695)

Source: Calculated by Author based on secondary data from SIA & WDI.

Note: p-values in brackets; *** indicates significant at 1 percent and * significant at 10 percent.

4. Conclusion

It can be concluded that FDI has been playing a pivotal role in accelerating the process of economic growth and development in India during the past few decades. It shows a phenomenal growth especially during 2006-2008.Thereafter,the decreasing trend of FDI inflows due to the global financial crisis was revived fully after 2012 and it shows an increasing trend. From the country-wise analysis, Mauritius emerges as the most dominant source of investment in India for the past several years. Besides Mauritius, other big investors into India have been from singapore, Japan, Netherlands and USA. This shows that India is emerging as one of the safest destination for investment by both developed as well as developing economies. Despite the 'Make in India' initiative aimed at making India a manufacturing hub, launched in 2014, Service sector emerges as one of the most attractive sectors for foreign direct investment inflows in India during the period 2000-2016.This finding confirms with the fact that India has the second fastest growing service sector in the world. Besides that, Telecommunication, computer software and hardware, Drugs and pharmaceuticals also appears to be the other attractive sectors for investments in India. It in-turn implies that the impact of this core initiative is yet to be visibly seen in the amount of sectoral FDI received in India.

In the past few years, gradual liberalization of FDI policies along with some of the major flagship development programs like Make in India, Digital India and Skill India are partly responsible for improving the investment climate of India and making it one of the promising destinations for investment by both the developed and developing economies. An important point that emerges from the above study is different kinds of policies have helped India in attracting FDI from different sources and into different sectors. It is noted that not all the FDI are the same and hence cannot be attracted by the same factors. Hence, different policies to attract FDI need to be aligned with our economic goals of increasing consumption, capital formation and employment generation etc.

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