# Foreign Direct Investment in India

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**Abstract**

Foreign Direct investment plays a very important role in the development of the nation. Sometimes domestically available capital is inadequate for the purpose of overall development of the country. Foreign capital is seen as a way of filling in gaps between domestic savings and investment. FDI has been associated with improved economic growth and development in the host countries which has led to the emergence of global competition to attract FDI . Foreign Direct Investment offers number of benefits like overture of new technology, innovative products, and extension of new markets, opportunities of employment and introduction of new skills etc., which reflect in the growth of income of any nation.

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**Key Words :** Foreign Direct Investment (FDI), Development , inflow etc.

## INTRODUCTION

Foreign direct investment is one of the measures of growing economic globalization. Investment has always been an issue for the developing economies such as India. The world has been globalizing and all the countries are liberalizing their policies for welcoming investment from countries which are abundant in capital resources. The countries which are developed are focusing on new markets where there is availability of abundant labors, scope for products, and high profits are achieved. Therefore Foreign Direct Investment (FDI) has become a battle ground in the emerging markets. Foreign Direct Investment (FDI) is a type of investment in to an enterprises in a country by another enterprises located in another country . FDI through foreign collaboration was welcomed in the areas of high technology and high priorities to build national capability and discouraged in low technology areas to protect and nurture domestic industries . FDI may well head to increased employment with local firms as some result of backward and send linkages so the direct employment just by foreign internet marketers may well take too lightly that total impact

## DEFINITION

**According to the international monetary fund, FDI is defined as** “ Investment that is made to acquire lasting interest in an enterprise operating in an economy other than that of investor. The investors purpose is being to have an effective voice in the management of enterprise.”

## OBJECTIVES

- To discuss the FDI policy framework in India.
- To identify the various determinants of FDI.
- To understand the importance and need for FDI in India.
- To Study the trends of FDI Flow in India

## RESEARCH METHODOLOGY :

The study based on Secondary data which have been collected through reports of the Ministry of Commerce and Industry, Department of Industrial Promotion and Policy, Government of India, Reserve Bank of India, and World Investment Report.

## FDI POLICY FRAMEWORK IN INDIA

Policy regime is one of the key factors driving investment flows to a country. Apart from underlying overall fundamentals, ability of a nation to attract foreign investment essentially depends upon its policy regime - whether it promotes or restrains the foreign investment flows. undertakes a review of India’s FDI policy framework. There has been a sea change in India’s approach to foreign investment from the early

1990s when it began structural economic reforms about almost all the sectors of the economy.

**a) Pre-Liberalisation Period:**

Historically, India had followed an extremely careful and selective approach while formulating FDI policy in view of the governance of import-substitution strategy" of industrialisation. The regulatory framework was consolidated through the enactment of Foreign Exchange Regulation Act (FERA), 1973 wherein foreign equity holding in a joint venture was allowed only up to 40 per cent. Subsequently, various exemptions were extended to foreign companies engaged in export oriented businesses and high technology and high priority areas including allowing equity holdings of over 40 per cent. Moreover, drawing from successes of other country experiences in Asia, Government not only established special economic zones (SEZs) but also designed liberal policy and provided incentives for promoting FDI in these zones with a view to promote exports. There was supported by trade liberalisation measures in the form of tariff reduction and shifting of large number of items from import licensing to Open General Licensing (OGL).

**b) Post-Liberalisation Period:**

A major shift occurred when India embarked upon economic liberalisation and reforms program in 1991 aiming to raise its growth potential and integrating with the world economy. Industrial policy reforms slowly but surely removed restrictions on investment projects and business expansion on the one hand and allowed increased access to foreign technology and funding on the other. A series of measures that were directed towards liberalizing foreign investment included

**Type of FDI :**

| Market-seeking | Resource/asset-seeking: | Efficiency-seeking |
|---|---|---|
| • Market size and per capita income<br>• Market growth<br>• Access to regional and global markets<br>• Country specific consumer preferences<br>• Structure of markets | • Raw materials<br>• Low cost unskilled labour<br>• Skilled labour<br>• Technological, innovatory and other created assets<br>• Physical infrastructure (ports, roads, power, telecommunication) | • Cost of resources and assets adjusted for productivity for labour resources<br>• Other input costs, e.g transport and communication<br>• Membership of a regional integration agreement conducive to the establishment of regional corporate network |

**<u>IMPORTANCE AND ADVANTAGES OF FDI-</u>**

• **Employment generation-** Unemployment continues to plague the Indian youth and is one of the major issues facing India. FDI creates new jobs in the target country due to the setting up of new companies. In India, it is generally agreed that an increase in the manufacturing sector can generate new jobs because the government jobs are limited and cannot provide employment to the millions of educated youths of the country.

• **Quality of products and flow of technology-** The quality of products manufactured by the company increase greatly due to the increased competition in the market. Modern technologies brought by the foreign companies into India will give the much needed boost to the Indian industries and make them more competitive in the world.

- **Improvement of agricultural sector-** The Indian farmers are in a pitiable state. Every year thousands of farmers are committing suicide all over the country due to the lesser returns generated by their agricultural produce. FDI will bring about a significant change in the lives of the farmers as they would earn more income for their products.
- **Increase in government revenue-** The revenue earned by the government is estimated to be increase. This increased revenue would be highly beneficial for the development of India. The Indian economy would receive a huge boost and would greatly contribute to the country's quest to become an economic powerhouse.
- FDI provides capital which is usually missing in the target country-Long term capital is suitable for economic development.
- Foreign investors are able to finance their investments projects better and often cheaper.
- Foreign corporations usually have a positive effect on the trade balance

**DETERMINANTS OF FDI:-**

The determinant varies from one country to another due their unique characteristics and opportunities for the potential investors. In specific the determinants of FDI in India are:

**1) Stable policies:**

India stable economic and socio policies have attracted investors across border. Investors prefer countries which stable economic policies. If the government makes changes in policies which will have effect on the business. The business requires a lot of funds to be deployed and any change in policy against the investor will have a negative effect.

**2) Economic factors:**

Different economic factors encourage inward FDI. These include interest loans, tax breaks, grants, subsidies and the removal of restrictions and limitation. The government of India has given many tax exemption and subsidies to the foreign investors who would help in developing the economy.

**3) Cheap and labour:**

There is abundant labour available in India in terms of skilled and unskilled human resources. Foreign investors will to take advantage of the difference in the cost of labour as we have cheap and skilled labours. Example: Foreign firms have invested in BPO's in India which require skilled labour and we have been providing the same.

**4) Basic infrastructure:**

India though is a developing country, it has developed special economic zone where there have focused to build required infrastructure such as roads, effective transportation and registered carrier departure worldwide, Information and communication network/technology, powers, financial institutions, and legal system and other basic amenities which are must for the success of the business.

**5) Unexplored markets:**

In India there is large scope for the investors because there is a large section of markets have not explored or unutilized. In India there is enormous potential customer market with large middle class income group who would be target group for new markets.

Example: BPO was one sector where the investors had large scope exploring the markets where the service was provided with just a call, with almost customer satisfaction.

**6) Availability of natural resources:**

As we that India has large volume of natural resources such as coal, iron ore, Natural gas etc. If natural resources are available they can be used in production process or for extraction of mines by the foreign investors.

**NEED OF FOREIGN INVESTMENT IN INDIA**

As India is a developing country, capital has been one of the scare resources that are usually required for economic development. Capital is limited and there are many issues such as Health, poverty, employment, education, research and development, technology obsolesce, global competition. The flow of FDI in India from across the world will help in acquiring the funds at cheaper cost, better technology, employment generation, and upgraded technology transfer, scope for more trade, linkages and spillovers to domestic firms. The following arguments are advanced in favour of foreign capital.

**1) High level of investment:**

As all the under-developed and the developing countries want to industrialize and develop themselves, therefore it becomes necessary to raise the level to investment substantially. Due to poverty and low GDP the saving are low. Therefore there is a need to fill the gap between income and savings through foreign direct investments.

**2) Technological gap:**

In Indian scenario we need technical assistance from foreign source for provision if expert services, training of Indian personnel and educational, research and training institutions in the industry. It only comes through private foreign investment or foreign collaborations.

**3) Exploitation of natural resources:**

In India we have abundant natural resources such as coal, iron and steel but to extract the resources we require foreign collaboration.

**4) Understanding the initial risk:**

In developing countries as capital is a scare resource, the risk of investments in new ventures or projects for industrialization is high. Therefore foreign capital helps in these investments which require high risk.

**5) Development of basic economic infrastructure:**

In the recent years foreign financial institutions and government of advanced countries have made substantial capital available to the under developed countries. FDI will help in developing the infrastructure by establishing firm's different parts of the country.

There are special economic zones which have been developed by government for improvising the industrial growth.

**6) Improvement in the balance of payments position:**

The inflow FDI will help in improving the balance of payment. Firms which feel that the goods produced in India will have a low cost, will produce the goods and export the same to other country. This helps in increasing the exports.

**7) Foreign firm's helps in increasing the competition:**

Foreign firms have always come up with better technology, process, and innovations comparing with the domestic firms. They develop a completion in which the domestic firms will perform better it survive in the market.

**ROUTES OF FOREIGN INVESTMENT INFLOW :**

An Indian company may receive Foreign Direct Investment under the two routes as given under:

1. **Automatic Route:** FDI in sectors /activities to the extent permitted under the automatic route does not require any prior approval either of the Government or the Reserve Bank of India.

2. **Government Route:** FDI in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, and Ministry of Finance.

| ***DIRECT INVESTMENT*** | ***INDRECT INVESTMENT*** |
|---|---|
| I) Equity | |
| (a) Government (SIA/FIPB) | (I) GDRs/ADRs |
| (b) RBI | (II) FIIs |
| (c) NRI | (III) off-shore funds and others |
| (d) Acquisition of shares | |
| (e) Equity capital of | |
| (f) Unincorporated bodies | |
| II) Re-invest Dearing | |
| III) Other capital Determinates | |

**SUGGESTIONS FOR INCREASED FLOW OF FDI INTO THE COUNTRY:-**

**1) Flexible labour laws needed:**

China gets maximum FDI in the manufacturing sector, which has helped the country become the manufacturing hub of the world. In India the manufacturing sector can grow if infrastructure facilities are improved and labour reforms take place. The country should take initiatives to adopt more flexible labour laws.

**2) Re look at sectoral caps:**

Though the Government has hiked the sectoral cap for FDI over the years, it is time to revisit issues pertaining to limits in such sectors as coal mining, insurance, real estate, and retail trade, apart from the small-scale sector. Government should allow more investment into the country under automatic route.

**3) Geographical disparities of FDI should be removed:**

The issues of geographical disparities of FDI in India need to address on priority. Many states are making serious efforts to simplify regulations for setting up and operating the industrial units. However, efforts by many state governments are still not encouraging.

**4) Promote Greenfield projects:**

India's volume of FDI has increased largely due to Merger and Acquisitions (M&As) rather than large Greenfields projects. M&A's not necessarily imply infusion of new capital into a country if it is through reinvested earnings and intra company loans. Business friendly environment must be created on priority to attract large Greenfields projects. To maximize the benefits of FDI persistently, India should also focus on developing human capital and technology.

**5) Develop debt market:**

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. Therefore it is said that countries with well-developed financial markets tend to benefits significantly from FDI inflows.

**6) Education sector should be opened to FDI**:

India has a huge pool of working population. However, due to poor quality primary education and higher education, there is still an acute shortage of talent. FDI in Education Sector is lesser than one percent. By giving 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 education. The issues of commercialization of education, regional gap and structural gap have to be addressed on priority.

**7) Strengthen research and development in the country:**India should consciously work towards attracting greater FDI into R&D as a means of strengthening the country's technological prowess and competitiveness.

**Conclusions**

FDI in India has some significant role in commercial growth in conjunction with the development of India. FDI in India to several sectors may well get permanent industrial growth together with development as a result of the formation of work opportunities, improvement of existing manufacturing market sectors. Need of FDI depends on saving and investment rate in any country. 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 that promote efficiency and productivity of the existing production capacity and generate new production opportunity.

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