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Foreign Direct Investment (FDI): A Future Key Driver for India's Growth

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ABSTRACT

"Never Depend on a Single Income Make Investment to Create a Second Source".

Investment is a tool for building or creating wealth by employing funds with an aim of achieving additional income or growth in the value and waiting for a reward. Investments are spread across in various avenue and countries in order to achieve a gain in terms of appreciation in the value. FDI (Foreign Direct Investment) is an investment in by foreign investors in the foreign based company either through Green Field Investment (by establishing a new or a fresh company in a foreign country) and other is through portfolio investment i.e. foreign company shares are purchased and ownership is acquired in foreign company. It is rightly quoted by ***Patrick Barkey "Foreign Investment is what keeps the whole show going"*** *which indicates that investment is significant to make the money grow. In India there are two ways of getting investment approval from automatic route or RBI (Reserve Bank of India) and Government of India. This paper highlights the role and its significance of FDI, various types and methods of FDI, sector wise contribution and opportunities of FDI, issues & challenges. In today's world India is one among of the fast growing economies and is among top 10 attractive destinations for inbound investment. Government has taken steps to open new sectors for FDI by increasing sectoral limit of existing sectors and simplifying the conditions of FDI policy which facilitates the ease of doing business and accelerate the pace of foreign investment in the company. The paper concludes by emphasing on the latest trends in FDI which will boost the investment spirit.*

Keywords: FDI, Green Field Investment, Government of India, Issues & Challenges and Reward.

INTRODUCITON

Domestic capital is inadequate for the purpose of economic growth whereas foreign capital is usually essential at least as a temporary measure during the period when the capital market is in the process of development. Foreign capital usually brings with it the scarce productive factors like technical knowhow, business expertise and knowledge. FDI is often seen as a source of economic development, modernization, income growth and employment opportunities for developing countries and emerging economies where policies have been liberalized to attract investments. It has grown dramatically as a major form of international capital transfer over the past decade. FDI refers to controlling ownership in a business enterprise in one country by an entity that is based in another country which involves participation in management, transfer of technology, joint venture and expertise. Foreign companies invest in India to take advantage of relatively lower wages, cheaper production facility, access to new technology and products. The Indian government's favourable policy regime and robust business environment have ensured that foreign capital keeps flowing into the country where many initiatives in recent years have been taken such as relaxing FDI norms across sectors such as defence, PSU oil refineries, telecom, power exchanges, and stock exchanges, among others.

There are several reasons that led to the development of FDI:

- ✓ Form of Business expansion in the firm situated in other country for more growth

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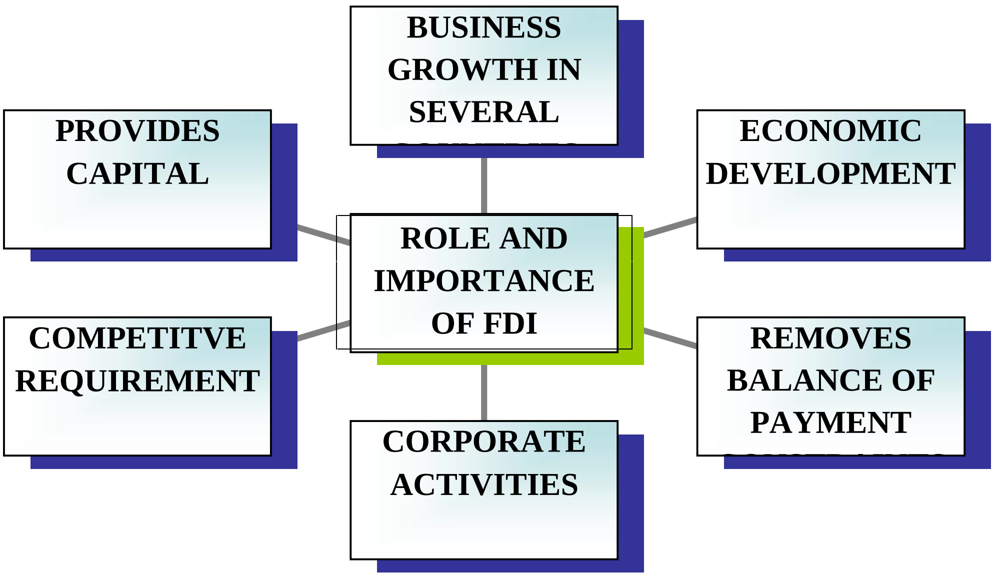
- ✓ Incorporation of wholly owned subsidiary
- ✓ Merger or acquisition of different industry experience
- ✓ To Increase sales and profits
- ✓ Acquisition of shares related enterprises
- ✓ To acquire technical and managerial knowhow

ROLE AND IMPORTANCE OF FDI

FDI performs an important function inside the improvement method of a country. It has potential for making a contribution to the improvement through the switch of economic assets, generation and revolutionary and progressed management strategies in conjunction with elevating productivity. Developing nations like India need substantial foreign inflows to attain the required investment to accelerate monetary increase and development. It could act as a catalyst for home business improvement. In addition, it facilitates in speeding up monetary hobby and brings with it other scarce productive factors along with technical knowhow and managerial revel in, which can be similarly crucial or economic development. Various Methods are available for FDI to take place:

- ➢ Acquiring shares in an associated enterprise
- ➢ A merger or acquisition of an unrelated enterprise
- ➢ Incorporating a wholly owned subsidiary or company anywhere participating in equity joint venture with another enterprise



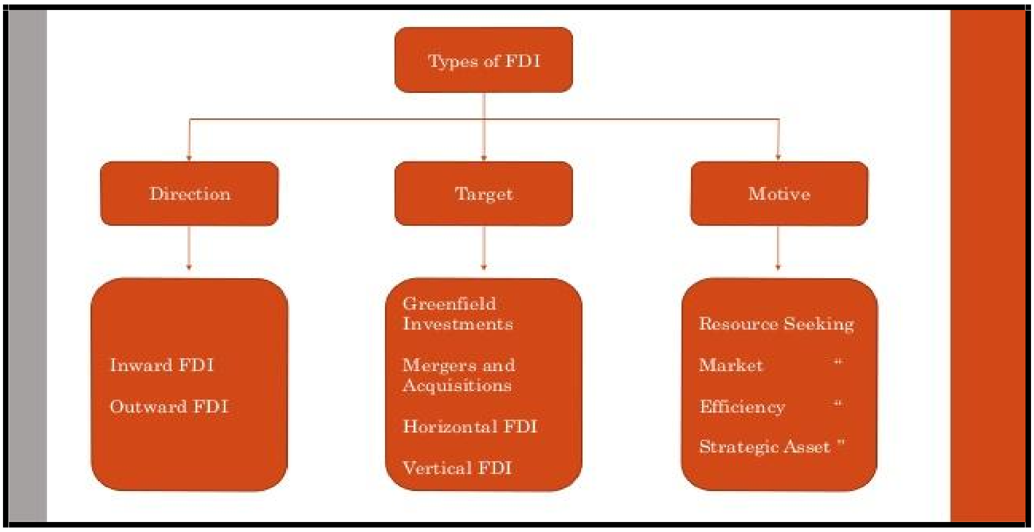
MERITS

- **Boost Employment –** It creates new jobs as investors build new companies in target country creating new opportunities.
- **Development of Human Resource Capital –** Training and sharing experience would increase education and overall capital of the country.
- **Easy International Trade -** By removing tariff barriers industries ensure their sales and goals are completely met with the help of FDI.

- **Provides Capital -** Foreign Direct Investment is expected to bring needed capital to developing countries to achieve increased targets of growth in national income.
- **Tax Incentives -** Parent enterprises would also provide foreign direct investment to get additional expertise, technology and products to receive tax incentives that will be highly useful in selected field of business.
- **Resource Transfer -** FDI permits resource transfers where various countries are given access to new technologies and skills.
- **Increment in Income -** Foreign direct investment increases income of the target country's by creating jobs and higher wages.

TYPES OF FDI

Foreign direct investment (FDI) is a significant factor in acquiring investments and grows the local market with foreign finances when local investment is unavailable. There are various formats of FDI and companies should do a good research before actually investing in a foreign country. It has been proved that FDI can be a win-win situation for both the parties involved. The investor can gain cheaper access to products/services and the host country can get valuable investment unattainable locally. FDI is an important source of externally derived finance that offers countries with limited amounts of capital get finance beyond national borders from wealthier countries. There are various types of FDI which explained below:



- **BASED ON DIRECTION:**
  (a) **Inward FDI –** In this foreign capital is invested in local resources
  (b) **(b) Outward FDI** – In this local capital is invested in foreign resources
- **BASED ON TARGET**
  (a) Green Field Investment – Building up new production capacity and expansion of existing production takes place
  (b) Merger and Acquisition - Transfers of existing assets from local firms to foreign firms takes place
  (c) Horizontal FDI – Company investment is made for conducting similar business operations in another country
  (d) **Vertical FDI –** The firm expands in production process other than that of the original business

➢ **BASED ON MOTIVE**

(a)Resource Seeking – It refers to obtaining or acquiring factors of production that is more efficient than obtainable in home country of the firm

(b) Market Seeking – Investment penetrates in new market or existing ones

(c)Efficiency Seeking – It exploits benefits of economies of scale and common ownership

(d) Strategic Asset Seeking – A tactical investment to prevent the gain of resource to a competitor

SECTOR WISE FDI (FOREIGN DIRECT INVESTMENT) INFLOWS

With strong governmental support, foreign direct investment has helped the Indian economy grow tremendously. Indian Sectors Attracting Highest FDI Inflows are service, chemicals, food processing and telecommunications. FDI inflows to different sectors in India have increased over the years. There are different sectors that have attracted high FDI inflows in India which are discussed below. FDI is an investment by foreign investors in foreign based company. Factors that determine Sector Wise FDI Inflows in India are: Size and Growth of the Sector, Labour and Advertisement Intensity, Export Orientation, Profitability, Import Intensity and import technology. They are two ways for setting investment approval in India is getting approval from:

✓ **Automatic or RBI Route**: It does not require prior approval either by Government of India or Reserve Bank of India.

✓ **Government Route**: It should get approval from Government of India and by Foreign Investment Promotion Board(FIP

❖ **SERVICE SECTOR**

It is the largest and rapidly growing sector in the global market as it forms large share of production and employment in the world. It contributes to about 60 % of country's GDP and 35% of employment. Service sector has opened the doors of opportunities where it provides 100 % FDI in Insurance Sector subject to opening license from IRDA where foreign companies grabbed 22% market share in life insurance business and 20% in general insurance through automatic route.

❖ **CONSTRUCTION SECTOR**

It is a booming sector which has sustained growth by spending on housing, resorts, commercial premises and educational institutions.FDI permitted up to 100% under automatic route for development of industry infrastructure and construction development.FDI is prohibited in real estate and construction of farm houses. The Indian Government has recently relaxed FDI rules for the sector in an effort to attract more housing, hotels and townships into the country. Minimum cash investments have been reduced to $5 million, enticing investors with less cash who are prepared to take on less risk – making it more ideal for foreign investors.

❖ **TELECOMMUNICATION SECTOR**

It is one of the fastest growing sectors in the world where Government policies and regulatory framework implemented by TRAI have provided comfortable environment for providing service.FDI opportunities in India exists for Tele Education, export of telecom equipment and tele banking. Establishing a telecommunication network requires excessive amounts of capital and there is serious competition in the industry, despite being a service in high demand.

❖ **COMPUTER SOFTWARE AND HARDWARE SECTOR**

India is a premier destination for IT and ITES outsourcing market because of cost effectiveness, utilization rates and due to regulatory measures taken by Indian Government ,tax benefits and increased freedom of recruiting and laying off employees have contributed to the growth of FDI.

❖ DRUGS AND PHARMACEUTICALS SECTOR

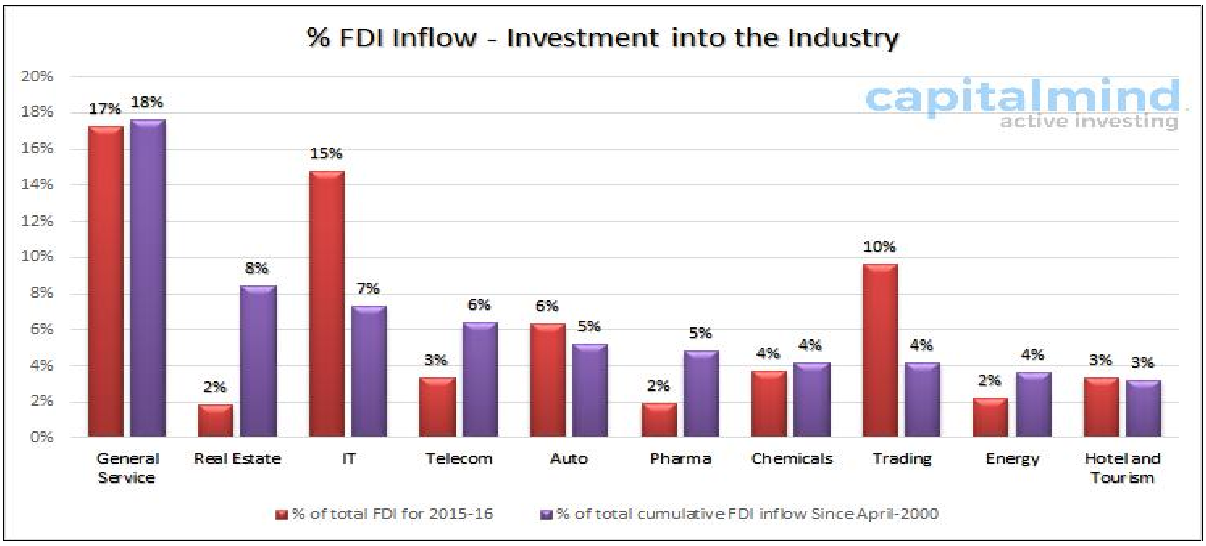
It is a strong and a self reliant industry which has low R& D ,low cost of production and scientific manpower. Government of India allowed 100% FDI through automatic route in drugs and pharmaceuticals widely on the condition that activity should not fall in the category that require license. This has become a very popular route for FDI in recent years, particularly considering the fact that healthcare is an industry that grows steadily with the population.

❖ AUTOMOBILE SECTOR

It is Indians major sector where it contributes 22 % GDP of country's manufacturing and has advanced technology and efficient manpower.

❖ POWER SECTOR

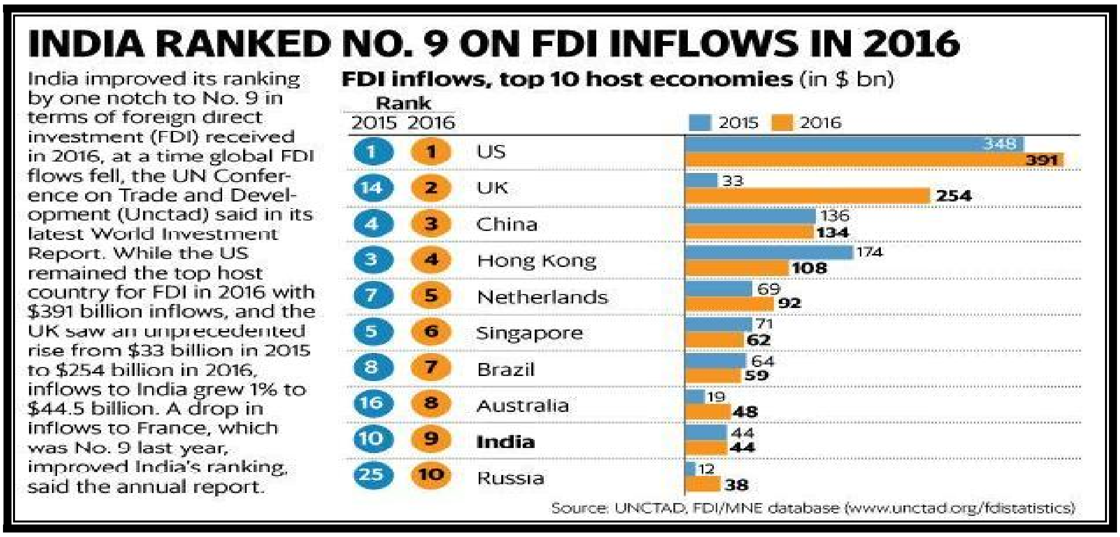
India is 5th largest in electricity generation and grown significantly due to market size and return on investment in capital. FDI inflow in electricity currently allows for some great opportunities for those willing to invest the high start-up capital requirements into the industry. India does not cap FDI in electricity, with 3.88% of total FDI surfacing in this industry.



GRAPH DEPICTING GROWTH OF FDI IN VARIOUS SECTORS

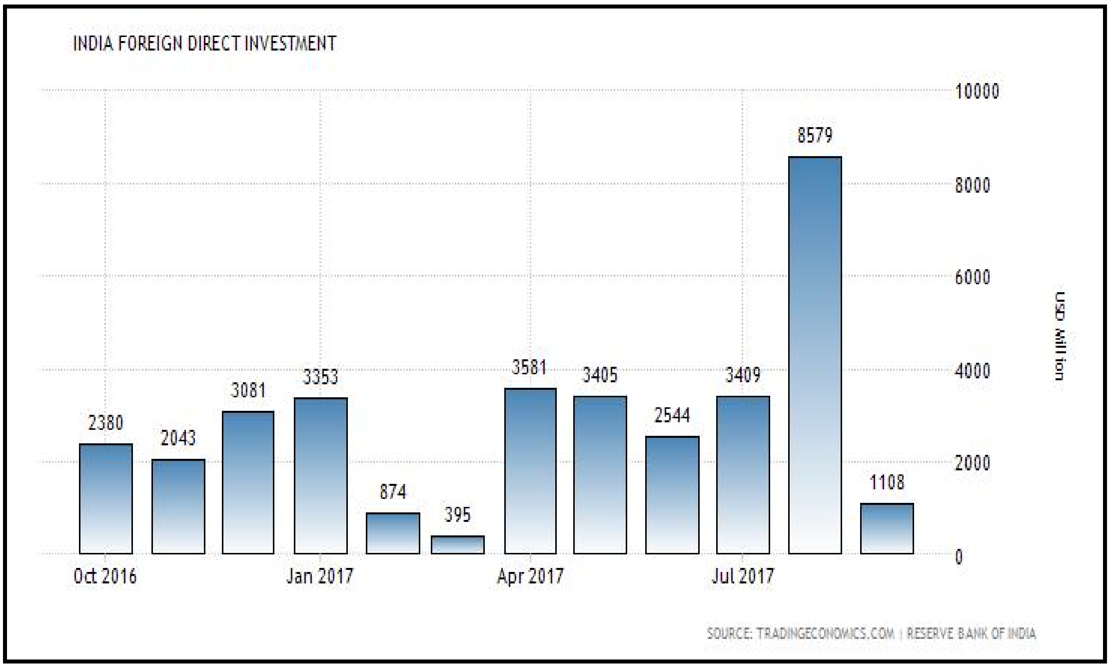
INDIA'S POSITION IN FDI

India improved its ranking by one notch to 9th position as one of the highest recipients of foreign direct investment (FDI) in 2016, at a time global FDI flows fell. While the US remained the top host country for FDI in 2016 with $391 billion inflows, and the UK saw an unprecedented rise from $33 billion in 2015 to $254 billion in 2016, inflows to India grew 1% to $44.5 billion. A drop in inflows to France, which was at 9th position last year, improved India's ranking. In early 2017, the economic situation in developing Asia ranked as the top macroeconomic factor influencing FDI, with the favourite FDI destinations remaining the US, China and India.



TRENDS IN FDI

FDI inflows were at $55.6 billion for the year ending March 2016, which was a record. In 2016-17, the FDI inflows were even higher at $60.08 billion. Foreign Direct Investment in India increased by 1108 USD Million in September of 2017. Foreign Direct Investment in India averaged 1279.16 USD Million from 1995 until 2017, reaching an all time high of 8579 USD Million in August of 2017 and a record low of -60 USD Million in February 2014. FDI trends during the last three years, and after the launch of Make in India initiative is shown below:



Source:*tradingeconomics.com/india/foreign-direct-investment*

A. Trends for the period of last 3 years (2014-15 to 2016-17)

- The FDI equity inflow received during the last three financial years is US$ 114.41 billion. It shows an increase of 40% compared to previous period of three financial years (2011-12 to 2013-14) (US $ 81.84 billion).
- The FDI equity inflow received through approval route amounts to US$ 11.69 billion, which is 64% higher than the previous three years (US $ 7.15 billion).
- The overall manufacturing sectors have witnessed a growth of 4% in comparison to previous three financial years (i.e. from US$ 48.03 billion to US$ 50.09 billion).
- The total FDI inflow during last three years grew by 38%.

B. Trends after Make in India initiative (October, 2014 to March, 2017)

- The FDI equity inflow received after the launch of Make in India initiative i.e. October, 2014 to March, 2017 of 30 months is US$ 99.72 billion. It shows an increase of 62% compared to previous 30 months before the launch of MII initiative i.e. April 2012 to Sept. 2014 (US $ 61.41 billion).
- The overall manufacturing sectors have witnessed a growth of 14% in comparison to previous 30 months before launch of Make in India initiative (i.e. from US$ 35.52 billion to US$ 40.47 billion).
- The total FDI inflow grew by 51%, i.e. US $ 137.44 billion in comparison to US $ 90.98 billion of the previous 30 months before the launch of Make in India initiative i.e. April 2012 to Sept. 2014.

C. Trends in the Financial Year 2016-17

- The FDI equity inflow received during the F.Y. 2016-17 is US$ 43.48 billion. It shows an increase of 9% compared to previous F.Y. 2015-16 (US $ 40.00 billion). It is the highest ever for a particular financial year.
- The FDI equity inflow received through approval route during F.Y. 2016-17 amounts to US$ 5.90 billion, which is 65% higher than the previous year (US $ 3.57 billion).
- The overall manufacturing sectors have witnessed a tremendous growth of 52% in comparison to previous F.Y. 2015-16 (i.e. from US$ 13.35 billion to US$ 20.26 billion).
- The total FDI inflow grew by 8%, i.e. US $ 60.08 billion in 2016-17 in comparison to US $ 55.56 billion of the previous year. It is the highest ever for a particular financial year. Prior to this, the highest FDI inflow was reported in the F.Y. (2015-16).

RECENT FDI POLICY MEASURES:

- 49% FDI under automatic route permitted in Insurance and Pension sectors
- Foreign investment up to 49% in defence sector permitted under automatic route. The foreign investment in access of 49% has been allowed on case to case basis with Government approval in cases resulting in access to modern technology in the country or for other reasons to be recorded
- FDI limit of 100% (49% under automatic route, beyond 49% government route) for defence sector made applicable to Manufacturing of Small Arms and Ammunitions covered under Arms Act 1959
- FDI up to 100% under automatic route permitted in Teleports, Direct to Home, Cable Networks, Mobile TV, Headend-in- the Sky Broadcasting Service
- In case of single brand retail trading of ‘state-of-art’ and ‘cutting-edge technology’ products, sourcing norms can be relaxed up to three years and sourcing regime can be relaxed for another 5 years subject to Government approval
- In order to provide clarity to the e-commerce sector, the Government has issued guidelines for foreign investment in the sector. 100% FDI under automatic route permitted in the marketplace model of e-commerce
- 100% FDI under Government route for retail trading, including through e-commerce, has been permitted in respect of food products manufactured and/or produced in India

- 74% FDI under automatic route permitted in brownfield pharmaceuticals. FDI beyond 74% will be allowed through government approval route
- For establishment of branch office, liaison office or project office or any other place of business in India if the principal business of the applicant is Defence, Telecom, Private Security or Information and Broadcasting, approval of Reserve Bank of India would not be required in cases where FIPB approval or license/permission by the concerned Ministry/Regulator has already been granted

KEY AMENDMENTS BROUGHT BY THE FDI POLICY 2017

New Streamlined Procedure for Government Approval

- **Abolition of the Foreign Investment Promotion Board (FIPB):** The most significant amendment to the FDI regime has been the institutional change brought by notification dated June 5th, 2017 issued by the Department of Economic Affairs confirming the abolition of the FIPB (the erstwhile government body authorised to approve proposals for FDI requiring government approval); and the introduction of the 'Foreign Investment Facilitation Portal' (**FIFP**), an administrative body to facilitate FDI applicants.
- **Introduction of 'Competent Authorities':** The FDI Policy 2017 defines and lists sector-specific administrative ministry / department as 'Competent Authorities' empowered to grant government approval for FDI. Competent Authorities listed in the FDI Policy 2017 include the DIPP in respect of applications for FDI in the Single Brand, Multi Brand and Food Product retail trading and the Department of Economic Affairs of India for FDI in the financial services sector.
- **Introduction of 'Standard Operating Procedure' (SOP) to process FDI proposals:** The DIPP had also issued the SOP which sets out a detailed procedure and timeline for applications as well as the list of 'competent authorities' for processing government approvals for FDI in India.
- **Key provisions likely to benefit applicants with proposals for FDI:** Consultation with the DIPP has been made strictly need based, leading to a more streamlined procedure and expeditious timeline (maximum time of 10 weeks) for approval. Moreover, the FDI Policy 2017 also states that the Competent Authority may only reject a proposal, or stipulate conditions in addition to those listed in the FDI Policy 2017 / applicable sectoral laws with the concurrence of the DIPP.

CONCLUSION

India is definitely a lucrative place for FDI but there are certain challenges and areas of improvement. India has become the most emerging market for global partners investment for coming 12 months as per market survey conducted by Emerging Market Private Equity Association. World Bank stated that private investment in India is expected to grow by 8.8% in FY 2018-19 to overtake private consumption growth of 7.4% with India’s GDP to drive in FY 2018-19. The Government of India plans to scrap the Foreign Investment Promotion Board (FIPB), which would enable the foreign investment proposals requiring government approval to be cleared by the ministries concerned, and thereby improve the ease of doing business in the country.

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