

## Foreign Direct Investment (FDI): Trend Analysis of FDI Inflow 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. India can attract much larger foreign investments than it has done in the past. The present study has focused on the trends of FDI Flow in India during 2000-01 to 2016-17. The study highlights country wise approvals of FDI inflows to India. 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, Reserve Bank of India, and World Investment Report. The study concludes that Mauritius emerged as the most dominant source of FDI contributing. It is because the India has Double Taxation Avoidance Agreement (DTAA) with Mauritius.*

**Key Words:** FDI, Domestic Savings, Development, Taxation.

### Introduction

Foreign Direct Investment (FDI) is a type of investment in to an enterprises in a country by another enterprises located in another country by buying a company in the target country or by expanding operations of an existing business in that country. In the era of globalization FDI takes vital part in the development of both developing and developed countries, and is considered as an engine of economic growth. Foreign investment was normally permitted only in high technology industries in priority areas and in export oriented areas. So the inflow of FDI before 1990's was very low. To fully utilize the country's immense economic potential, the government launched Economic reforms in 1991. The new government policies are simple, transparent and promote domestic and foreign investment. India's abundant and diversified natural resources, its sound economic policy, good market condition and high skilled human resources make it a proper destination for FDI. After long years of journey FDI was also introduced in various sectors and states in 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 labours, scope for products, and high profits are achieved. Therefore Foreign Direct Investment (FDI) has become a battle ground in the emerging markets.

### Foreign Direct and Indirect Investment

FDI stands for Foreign Direct Investment, a component of a country's national financial accounts. Foreign direct investment is investment of foreign assets into domestic structures, equipment, and organizations. The FDI can take any route or form to enter into any nation. The three principal forms of FDI in India are joint ventures, acquisition of assets in a country and Greenfield ventures. Foreign indirect investment as portfolio investment, Portfolio investment does not seek management control, but is motivated by profit. Portfolio investment occurs when individual investors invest, mostly through stockbrokers in stocks of foreign companies in foreign land in search of profit opportunities. Rather than attracting as much FDI as possible host country governments would be well advised to focus their efforts in inviting the "right" kind of FDI. Foreign indirect investment (FIIs) the Inflow of Foreign Investment Comes through Various Routes viz:

1. Equity (Government, RBI, NRI, Acquisition, shares, Equity capital of unincorporated bodies); Reinvested earning; other capital.
2. Portfolio investment (GDR/ADR, FIIs, OFF shore funds and others)

### Exhibit 1 : MAJOR Features of Indian FDI during four phases

1.	<b>Phase 1 (1950-1967) Receptive Attitude and cautious welcome</b>	<ul style="list-style-type: none"> <li>• Non-discriminatory Treatment to FDI</li> <li>• No restriction on dividend remittance profits</li> <li>• Ownership &amp; control with Indians</li> </ul>
2.	<b>Phase 2 (1968-1980) Restrictive Attitude</b>	<ul style="list-style-type: none"> <li>• Restriction FDI without technology</li> <li>• Above 40% stake was not allowed, if allowed only in priority area</li> <li>• FDI controlled by FERA</li> </ul>
3.	<b>Phase 2 (1981-1990) Gradual Liberalization</b>	<ul style="list-style-type: none"> <li>• Higher foreign equity in export oriented units allowed</li> <li>• Procedures for remittance of royalty and technical fees Liberalized</li> </ul>
4.	<b>Phase 4 (1991 Onwards)</b>	<ul style="list-style-type: none"> <li>• Fast channels for FDI clearance</li> <li>• Liberal policies relating to technology collaboration, foreign trade &amp; foreign exchange</li> <li>• Encouraging FDI in core and infrastructure Industries</li> <li>• FERA replaced FEMA</li> <li>• Transparent Procedures FDI through M&amp;A FDI in services and financial Sectors</li> </ul>

Exhibit 1 : Furnishes the information on the major features of Indian FDI during four phases.

#### FDI Inflow Routes:

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.

#### Determinants of FDI

The investors consider and evaluate various aspects of a country before investing in it. The relative importance of these determinants of FDI varies not only between countries but also between different types of FDI. In specific the determinants of FDI in India are:

1. **Unexplored markets:** The developing countries possess substantial markets where the consumers demand for certain goods far exceed the available supplies. In India there is large scope for the investors because there is an 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 utmost customer satisfaction.
2. **Political Stability:** In many countries, the institutions of government are still evolving and there are unsettled political questions. India's stable economic and socio policies have attracted investors across border. Investors prefer countries with stable economic policies. The business requires a lot of funds to be deployed, and any change in policy against the investor will have a negative effect.

3. **Macro-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.
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. **Access to Manpower:** 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.

Table 1 & Group 1 Furnishes details of FDI equity inflows from 2000-17

### Need For FDI in India

FDI plays a major role in developing countries like India. The investors also bring along best global practices of management. FDI helps in promoting international trade. This investment is a non-debt, non-volatile investment and returns received on these are generally spent on the host country itself thus helping in the development of the country.

- 1) **Sustaining a 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. 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 of 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 scarce 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 competition in which the domestic firms will perform better it survive in the market.

### Attracting Larger FDI Inflows in India- Problems and Challenges

Both India and China are competing to get a larger share in world trade and investment. Although China continues to be India's major competitor, many new economies like Indonesia, Vietnam and Philippines have emerged as strong competitors. No doubt Indian government has implemented several reform measures in order to attract greater FDI but there are several studies which have highlighted India's weak spots. One such report is "Doing Business 2017", an annual report co-published by the World Bank and International Finance Corporation that brings out the differences in business regulations and their implementation across economies.

## Exhibit 2 : Doing Business in India.

Doing Business in India	Rank
Starting a Business	155
Dealing with Construction Permits	185
Getting Electricity	26
Registering Property	138
Getting Credit	44
Protecting Minority Investors	13
Paying Taxes	172
Trading across Borders	143
Enforcing Contracts	172
Resolving Insolvency	136

Source: Doing Business Data for India, Published by the World Bank Group

The Exhibit above indicates that India is performing well only on two indicators, namely, getting credit and protecting investors. India's performance on three indicators, namely, starting a business, dealing with construction permits and enforcing contracts shows a dismal picture of the investment climate in India. Another report "Global Competitiveness Report" published annually by "World Economic Forum" ranks 148 economies on their competitiveness with respect to indicators like infrastructure, institutions, macro-economic stability, innovation etc. India's overall rank for 2013-14 on the Global Competitiveness Index was 60. The most problematic factors for doing business identified in the report are inadequate supply of infrastructure, corruption, inefficient government bureaucracy, policy instability, tax regulation and restrictive labour regulations. Table 2 and Graph 2 furnishes details of FDI show of top investing Countries.

### Major Impediments

The major deterrents to larger flows of FDI to India are listed below:

- 1) **Weak infrastructure:** Infrastructural bottlenecks continue to be a major cause of concern in India. When it comes to competition, India doesn't stand against other emerging markets in terms of ports, roads, skills sets, education etc. A study conducted by the Federation of Indian Chambers of Commerce and Industry in 2015, revealed that each day Indian companies are losing up to Rs. 40,000 because of power shortages; and due to power cuts, 61% companies suffer more than 10% loss in production. Warehousing and cold storage facilities are also in short supply, because of which 40% of the fruits, vegetables and other perishable products get destroyed before reaching the markets. In the World Competitiveness Index for 2015-16, India ranked 85 out of 148 countries for its infrastructure, much behind China which ranked 48.
- 2) **Complicated tax structure:** Stability and transparency in tax regime along with clarity in tax laws can have far reaching impact on investments in any country. The taxation policies in India remain inherently complex despite the fact that government has taken several steps to simplify and redesign it. In the recent years, India has witnessed several tax disputes with respect to cross border transactions involving big MNCs. India has implemented Goods and Services Tax (GST) effective from 1<sup>st</sup> July 2017. The implementation of GST is expected to bring in the much-needed boost to the nation's economy. Market experts believe that the implementation of the new tax structure will attract more Foreign Direct Investment (FDI) and increase tax compliance.
- 3) **Restrictive labour laws:** India is known worldwide for its stringent and rigid labour laws and over-regulated labour market. Over the years, Indian government has enacted a large number of legislations to protect the interests of labour covering different aspects namely fixation and revision of wages, worker's health and safety,

mode of payment of wages, payment of compensation in the event of industrial accident, provision of social security such as provident fund, gratuity, insurance and so on. Indian economy has turned highly inflexible due to these laws. These laws contain strict rules regarding overtime and imposes financial obligation on the employer upon worker retrenchment.

- 4) **Bureaucracy, regulations and corruption:** Yet another handicap that India suffers from is bureaucracy, red-tapism and corruption. It takes months to obtain licenses, approvals and permits. As per the doing business report, it takes 67 days for a company to obtain electricity connection, 16 days to obtain clearances and export goods from India, 182 days for dealing with construction permits and 1420 days for enforcing contracts. It takes 4 to 8 weeks for a new company to get itself registered in India as compared to few days in most developed and developing markets. Many a times, the FDI approvals are kept pending for months that prompts the investor to drop out. With respect to FDI policies, even though several liberalization measures have been undertaken by the government but FDI regulations continue to remain restrictive as compared to many other nations. India has been selective in opening sectors for FDI and FDI in India is subject to sectoral caps ranging from 20 to 100%.

### Road Ahead 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. Reforms like bringing more sectors under the automatic route, increasing the FDI cap and simplifying the procedural delays has to be initiated.
- 3. Geographical disparities of FDI should be removed:** The issues of geographical disparities of FDI in India need to be addresses 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. Even the state like West Bengal which was once called Manchester of India attracts only 1% of FDI inflow in the country. West Bengal, Bihar, Jharkhand, Chhattisgarh are endowed with rich minerals but due to lack of proper initiatives by governments of these states, they fail to attract FDI.
- 4. Promote Greenfield projects:** Greenfield investment is investment in new plants. It is establishing new production capacity by an investor or company. On the other, Brown field investment is an investor investing in an existing plant. Brownfield investment is mainly made through merger and acquisitions. India's volume of FDI has increased largely due to Merger and Acquisitions (M&As) rather than large Green fields 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 Green fields projects.
- 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. 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.

### Interpretation

Table 1 furnishes the details of FDI equity inflows, year-wise. The cumulative total equity inflows from the year 2000-2017 is Rs 1,787,555 crores. Table 2 furnishes the details of Share of Top Investing Countries FDI Equity Inflows

(Financial Years) Amount Rupees in Crores. The inflows from U.S.A are routed through Mauritius due to tax advantage. The tax advantage emanates from the double tax avoidance agreement that India has with that country USA. This agreement means that any foreign investor has the option of paying tax either in India or in Mauritius. The tax rates in Mauritius are amongst the lowest in the world. While investors get higher returns on their money in India, those from Mauritius get even higher returns on their capital on the grounds of double taxation avoidance treaty (DTAT) prevalent there.

Graph 1 provides information on Financial Year-Wise FDI Equity Inflows. The Graph 1 shows the total inflow of FDI in India during the last 17 years i.e. 2000 to 2017. The FDI inflow has been escalating from 10,733 Crores in 2000-2001 to 291,696 Crore Rupees in 2016-2017. Hence it is evident that FDI in India is on the upward trend and has ushered a prosperous phase in business scenario. The Graph 2 indicates that the largest inflows of FDI's over the period of April 2000 to June 2017 has been received from Mauritius accounting to as high as 34%. Singapore is second with a share of 16%. The other major sources of foreign direct investment are from UK, Japan, Netherlands, U.S.A., Cyprus, Germany, France, and their respective share of inflow of FDI are 7%, 8%, 6%, 6%, 3%, 3%, 2%.

## Discussion & Conclusion

There is a global race for attracting FDI in all developed and developing countries of the world. Although, the developing countries need to modify the level of educational, technological and infrastructure background to promote the FDI, however, India has observed a remarkable growth in the flow of FDI over the last one decade may be because of large market size in terms of GDP and GNI, tax incentives and availability of high quality multilingual work force. In India some of the sectors such as Service sector, Telecommunication sectors are most preferred in terms of Foreign investment and Mauritius and Singapore are such countries which revealed full confidence in India concerning to FDI inflow. India's GDP has grown about 35%-36% in the first half year of 2017, though world FDI has decreased by 5%. However, India receives comparatively much lesser FDI than China and other smaller economies in Asia. To achieve the highest foreign investment India need to develop such an attractive investment avenues and need to frame liberal economic policies and required to develop the level of Infrastructure in India.

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Table No.1: Financial Year-Wise FDI Equity Inflows

Sl. No	Financial Year	Rupees In Crores	Percentage Growth over years
1	2000-01	10,733	
2	2001-02	18,654	(+) 65 %
3	2002-03	12,871	(-) 33 %
4	2003-04	10,064	(-) 19 %
5	2004-05	14,653	(+) 47 %
6	2005-06	24,584	(+) 72 %
7	2006-07	56,390	(+) 125 %
8	2007-08	98,642	(+) 97 %
9	2008-09	142,829	(+) 28 %
10	2009-10	123,120	(-) 18 %
11	2010-11	97,320	(-) 17 %
12	2011-12	165,146	(+) 64 %
13	2012-13	121,907	(-) 36 %
14	2013-14	147,518	(+) 8%
15	2014-15	189,107	(+) 27%
16	2015-16	262,322	(+) 29%
17	2016-17	291,696	(+) 9%
<b>CUMULATIVE TOTAL (from April, 2000 to March, 2017)</b>		<b>1,787,555</b>	

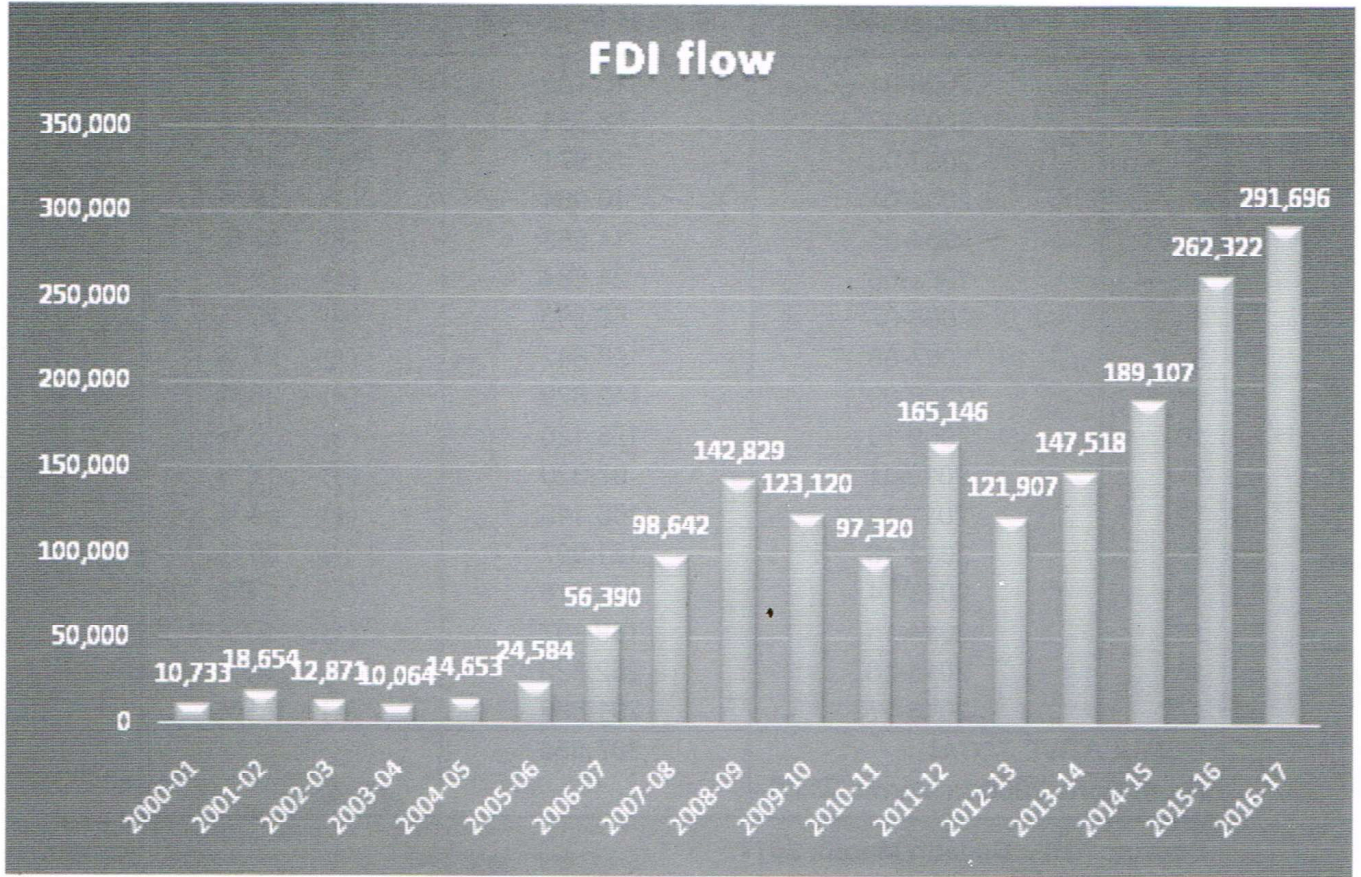
Source: RBI's Bulletin March, 2017

Table No.2: Share of Top Investing Countries FDI Equity Inflows (Financial Years) Amount Rupees in Crores

Rank	Country	2014-15 (April – March)	2015-16 (April March)	2016-17 (April March)	Cumulative Inflows (April, 00 - March, 17)	%age to total Inflows
1	MAURITIUS	55,172	54,706	105,587	585,950	34%
2	SINGAPORE	41,350	89,510	58,376	315,042	16 %
3	JAPAN	12,752	17,275	31,588	142,260	8%
4	U.K.	8,769	5,938	9,953	125,545	7 %
5	NETHERLANDS	20,960	17,275	22,633	117,167	6 %
6	U.S.A.	11,150	27,695	15,957	110,532	6 %
7	GERMANY	6,904	6,361	7,175	52,045	3 %
8	CYPRUS	3,634	3,317	4,050	46,731	3 %
9	FRANCE	3,881	3,937	4,112	30,637	2 %
10	UAE	2,251	6,528	4,539	26,187	1 %
<b>TOTAL FDI INFLOWS FROM ALL COUNTRIES *</b>		<b>189,107</b>	<b>262,322</b>	<b>291,696</b>	<b>1,787,555</b>	

Source: FDI Statistics, Department of Industrial Policy &amp; Promotion, Ministry of Commerce &amp; Industry, Government of India, 2017

Graph 1: Financial Year-Wise FDI Equity Inflows



Graph 2 : Share of Top Investing Countries FDI Equity Inflows

