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A critical analysis of India's foreign direct investment: Challenges & current status of FDI equity inflow

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Abstract
FDI FULL FORM is Foreign Direct Investment. It is an investment in a business by a company in another country. It is a controlling ownership in a business by an entity that is in another country. In India, FBI was introduced in 1991 under FEMA (Foreign Exchange Management Act) that is made by finance minister Mr. Manmohan Singh. Foreign direct investment (FDI) is direct investment into production in a country by a company located in another country, either by buying a company in the target country or by expanding operations of an existing business in that country. Foreign direct investment is done for many reasons including to take advantage of cheaper wages in the country, special investment privileges such as tax exemptions offered by the country as an incentive to gain tariff-free access to the markets of the country or the region. Foreign direct investment is in contrast to portfolio investment which is a passive investment in the securities of another country such as stocks and bonds.

Keywords: Foreign Direct Investment, Equity inflow, Investment, Foreign Company

1. Introduction

'Foreign Direct Investment - FDI' is an investment in a country by a company located in another country. The investment is called direct because the investor is foreign entities try to control or manage things of another country. It plays an extraordinary role in global business and helps in boosting the economy of any country.

FDI can be done in the following sectors:-

- Telecommunication
- Retail
- Computer hardware and software
- Production
- Construction
- Manufacturing
- Services of any kind

Foreign direct investment (FDI) will receive tremendous impetus in various sectors in the future times to come, especially in the developing countries of the world. Foreign direct investment (FDI) is an investment made by a company or individual in one country in business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company. Foreign direct investments are distinguished from portfolio investments in which an investor merely purchases equities of foreign-based companies. The key feature of foreign direct investment is that it is an investment made that establishes either effective control of, or at least substantial influence over, the decision making of a foreign business.

According to the International Monetary Fund, foreign direct investment, commonly known as FDI, "... refers to an investment made to acquire lasting or long-term interest in enterprises operating outside of the economy of the investor." The investment is direct because the investor, which could be a foreign person, company or group of entities, is seeking to control, manage, or have significant influence over the foreign enterprise.

Foreign direct investment (FDI) is made into a business or a sector by an individual or a company from another country. It is different from portfolio investment, which is made more indirectly into another country's economy by using financial instruments, such as bonds and stocks.

2. A Brief Review of the Literature

- **Lisa De Propis and Nigel Driffield (2006)** in their study "The Importance of Cluster for Spillovers from Foreign Direct Investment and Technology Sourcing", examine the link between cluster development and inward foreign direct investment. They concluded that firms in clusters gain significantly from FDI in their region, both within the industry of the domestic firm and across other industries in the region.
- **Rydqvist Johan (2005):** in his work "FDI and Currency Crisis: Currency Crisis and the inflow of Foreign Direct Investment" analyse if there are any changes in the flow of FDI before, during and after a currency crisis. The study found that no similarities in regions or year of occurrence of the currency crisis. The depth, length and structure of each currency crisis together with using the right definition of a currency crisis are two important factors relating to the outcomes in this study.
- **Pawin Talerngsri (2001):** in his study, "The Determinants of FDI Distribution across Manufacturing Activities in an Asian Industrializing Country: A Case of Japanese FDI in Thailand" identifies and investigates the 'industry – level Determinants' of FDI in the context of Asian industrializing countries by using the data on Japanese FDI in Thailand. The study examines the influences of location – specific characteristics of host industries such as factor endowments, trade costs, and policy factors. More

distinctively, it examines the effect of vertical (input-output) linkages among Japanese firms. The study finds out that Japanese FDI in Thailand was not evenly distributed across manufacturing activities.

- **Gazioglou S. and McCausland (2000):** in their study "An International Economic Analysis of FDI and International Indebtedness" developed a micro – foundations framework of analysis of FDI and integrated it into a macro level analysis. They highlighted the importance of profit repatriation in generating different effects of FDI on net international debt, trade and real exchange rate in developed economies compared to less developed economies.
- **John Andreas (2004):** in his work "The Effects of FDI Inflows on Host Country Economic Growth" discusses the potential of FDI inflows to affect host country economic growth. The paper argues that FDI should have a positive effect on economic growth as a result of technology spillovers and physical capital inflows. Performing both cross – section and panel data analysis on a dataset covering 90 countries during the period 1980 to 2002, the empirical part of the paper finds indications that FDI inflows enhance economic Growth in developing economies but not in developed economies. This paper has assumed that the direction of causality goes from inflow of FDI to host country economic growth.

3. Objective of the Study

- The main objective is to analyze the current scenario of FDI in India.
- To know the significance of FDI for developing countries.
- To assess the determinants of FDI inflows.
- To evaluate the likely challenges of FDI in India.

4. Research Methodology

This research is a descriptive study in nature. The present paper is the outcome of the research based on secondary sources. For collecting information a number of books, magazines, journals and internet sites are used.

5. Advantages of FDI

- **Economic growth:** This is one of the major sectors, which is enormously benefited from foreign direct investment. A remarkable inflow of FDI in various industrial units in India has boosted the economic life of country.
- **Trade:** Foreign Direct Investments have opened a wide spectrum of opportunities in the trading of goods and services in India both in terms of import and export production. Products of superior quality are manufactured by various industries in India due to greater amount of FDI inflows in the country.
- **Employment:** FDI has also ensured a number of employment opportunities by aiding the setting up of industrial units in various corners of India.
- **Development of Human Capital Resources:** One big advantage brought about by FDI is the development of human capital resources, which is also often understated as it is not immediately apparent. Human capital is the competence and knowledge of those able to perform labor, more known to us as the workforce.
- **Tax Incentives:** Parent enterprises would also provide foreign direct investment to get additional expertise, technology and products. As the foreign investor, you can receive tax incentives that will be highly useful in your selected field of business.
- **Resource Transfer:** Foreign direct investment will allow resource transfer and other exchanges of knowledge, where various countries are given access to new technologies and skills.
- **Reduced Disparity between Revenues and Costs:** Foreign direct investment can reduce the disparity between revenues and costs. With such, countries will be able to make sure that production costs will be the same and can be sold easily.
- **Increased Productivity:** The facilities and equipment provided by foreign investors can increase a workforce's productivity in the target country.
- **Increment in Income:** Another big advantage of foreign direct investment is the increase of the target country's income. With more jobs and higher wages, the national income normally increases. As a result, economic growth is spurred. Take note that larger corporations would usually offer higher salary levels than what you would normally find in the target country, which can lead to increment in income.

6. Status of FDI in India

Various studies have projected India among the favoured destination for FDI. Cumulative FDI equity inflows has been Rs. 47,183.37 crore (7,454.64Million US$) for the period 2015-16.

Table 1: The sector-wise information on FDI equity inflow (During Financial Year 2015-16 (up to May, 2015) is as below)

S. No	Sector	Amount of FDI Inflows	
		(In Rs crore)	(In US$ million)
1	Computer Software & Hardware	14,428.43	2,273.13
2	Automobile Industry	6,355.14	1,006.84
3	Trading	4,186.78	663.47
4	Services Sector (Fin., Banking, Insurance, Non Fin / Business, Outsourcing, R&D, Courier, Tech. Testing And Analysis, Other)	3,091.15	488.06
5	Construction (Infrastructure) Activities	2,357.32	373.90
6	Telecommunications	2,320.27	363.75
7	Sea Transport	1,147.55	182.33
8	Hospital & Diagnostic Centres	1,028.20	163.27
9	Drugs & Pharmaceuticals	1,010.25	158.66
10	Hotel & Tourism	999.91	157.58
11	Power	976.37	154.82

12	Chemicals (Other Than Fertilizers)	951.44	149.96
13	Soaps, Cosmetics & Toilet Preparations	830.78	132.35
14	Miscellaneous Industries	697.42	110.29
15	Electrical Equipments	681.29	107.82
16	Textiles (Including Dyed,Printed)	570.26	90.54
17	Rubber Goods	484.38	76.72
18	Metallurgical Industries	466.99	73.80
19	Education	464.29	73.77
20	Information & Broadcasting (Including Print Media)	454.23	71.55
21	Non-Conventional Energy	449.26	71.06
22	Industrial Machinery	413.47	65.44
23	Food Processing Industries	373.96	59.02
24	Miscellaneous Mechanical & Engineering Industries	353.84	56.04
25	Electronics	353.58	55.55
26	Earth-Moving Machinery	276.28	44.02
27	Printing Of Books (Including Litho Printing Industry)	189.67	30.00
28	Consultancy Services	185.82	29.29
29	Medical And Surgical Appliances	150.20	23.90
30	Diamond,Gold Ornaments	114.21	17.91
31	Timber Products	102.97	16.14
32	Ceramics	101.05	16.10
33	Prime Mover (Other Than Electrical Generators)	101.26	15.87
34	Sugar	90.00	14.34
35	Vegetable Oils And Vanaspati	78.37	12.28
36	Cement And Gypsum Products	57.20	9.12
37	Railway Related Components	41.05	6.54
38	Agriculture Services	37.64	5.99
39	Petroleum & Natural Gas	31.35	5.00
40	Leather,Leather Goods And Pickers	31.34	4.98
41	Machine Tools	22.18	3.51
42	Industrial Instruments	21.97	3.44
43	Air Transport (Including Air Freight)	21.57	3.39
44	Commercial, Office & Household Equipments	16.27	2.59
45	Paper And Pulp (Including Paper Products)	15.03	2.36
46	Mining	13.88	2.21
47	Fermentation Industries	12.70	2.00
48	Construction Development: Townships, Housing, Built-Up Infrastructure And Construction-Development Projects	12.06	1.90
49	Glass	6.02	0.95
50	Agricultural Machinery	5.14	0.81
51	Scientific Instruments	1.32	0.21
52	Dye-Stuffs	0.25	0.04
Grand Total		**47,183.37**	**7,454.64**

Source: This information was given by the Minister of State (Independent Charge) in the Ministry of Commerce. http://pib.nic.in/newsite/printrelease.aspx?relid=124367

Proposals for big investments pertain to Pharmaceuticals, Information & Broadcasting, Insurance, Non-banking Finance Companies, Private Banks and other financial sectors. There are 19 proposals of big investments, each in excess of Rs. 100 crores under consideration of Government. Estimated investment in respect of these proposals is Rs. 30,552.45 crores.

7. Challenges of FDI in India

FDIs are already generating employment opportunities, income, technology transfer and economic stability. India is focusing on maximizing political and social stability along with a regulatory environment. In spite of the obvious advantages of FDIs, there are quite a few challenges facing larger FDIs in India, such as:

- **Resource challenge:** India is known to have huge amounts of resources. There is manpower and significant availability of fixed and working capital. At the same time, there are some underexploited or unexploited resources. The resources are well available in the rural as well as the urban areas. The focus is to increase infrastructure 10 years down the line, for which the requirement will be an amount of about US$ 150 billion. This is the first step to overcome challenges facing larger FDI.
- **Equity challenge:** India is definitely developing in a much faster pace now than before but in spite of that it can be identified that developments have taken place unevenly. This means that while the more urban areas have been tapped, the poorer sections are inadequately exploited. To get the complete picture of growth, it is essential to make sure that the rural section has more or less the same amount of development as the urbanized ones. Thus, fostering social equality and at the same time, a balanced economic growth.
- **Political Challenge:** The support of the political structure has to be there towards the investing countries abroad. This can be worked out when foreign investors put

forward their persuasion for increasing FDI capital in various sectors like banking, and insurance. So, there has to be a common ground between the Parliament and the foreign countries investing in India. This would increase the reforms in the FDI area of the country.

- **Federal Challenge:** Very important among the major challenges facing larger FDI is the need to speed up the implementation of policies, rules, and regulations. The vital part is to keep the implementation of policies in all the states of India at par. Thus, asking for equal speed in policy implementation among the states in India is important.
- India must also focus on areas of poverty reduction, trade liberalization, and banking and insurance liberalization. Challenges facing larger FDI are not just restricted to the ones mentioned above, because trade relations with foreign investors will always bring in new challenges in investments.

8. Conclusion

Foreign direct investment (FDI) is a major source of non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions, etc. For a country where foreign investments are being made, it also means achieving technical know-how and generating employment. On the basis of study we draw conclusion that maximum global foreign investments flows are attracted by the developed countries rather than developing and under developing countries. Foreign investment flows are supplementing the scare domestic investments in developing countries particularly in India. We should welcome inflow of foreign investment in such way that it should be convenient and favorable for Indian economy and enable us to achieve our cherished goal like rapid economic development, removal of poverty.

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