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Dr. Vinay Kumar Singh
Assistant Professor, Chas College Chas, Bokaro, Jharkhand, India

Corresponding Author:
Dr. Vinay Kumar Singh
Assistant Professor, Chas College Chas, Bokaro, Jharkhand, India

Role of foreign direct investment in India: A study in India

Dr. Vinay Kumar Singh

Abstract
Economic Development of any country. Foreign Direct Investment is one and only major instrument of attracting International Economic Integration in any economy. It serves as a link between investment and saving. Many developing countries like India, are facing the deficit of savings. This problem can be solved with the help of Foreign Direct Investment. Foreign investment helps in reducing the defect of BOP. The flow of foreign investment is a profit making industry like insurance, real estate and business services and serving as a catalyst for the growth of economy in India. The present study is based on the objectives like (a) to know the requirement of amount of foreign investment by India, for its economic Development and (b) to analyze the trend and role of FDI & FIIs in improving the quality and availability of goods has been beyond doubt. To analyze all these objectives data has been gathered through secondary sources like reports and publication of Govt. and RBI relating to foreign Investment. After analyzing all the facts it may be concluded that maximum global foreign investment's 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.

Keywords: Foreign Direct Investment, Foreign indirect investment, Internal Personal Disparity, Portfolio Investment Policy, Balance of Payment

Introduction
Foreign investment plays a significant role in development of any economy as like India. Many countries provide many incentives for attracting the foreign direct investment (FDI). Need of FDI depends on saving and investment rate in any country. Foreign Direct investment

t act 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.

Objectives of Study
1. To study the significance of FDI for developing countries in bridging the gap between the saving and Investment.
2. To analyse the trends of FDI & FIIs in the recent past in developing country like India after economic reforms.
3. To study the impact of FDI & FIIs in improving the quality and availability of goods has been beyond doubt.
4. To know the requirement of amount of foreign investment by India, for its economic Development.

Research Methodology
The present study is based on the objectives like how much amount of foreign investment is required for India‟s economic growth and to analysis the trend of FDI & FIIs for economic development and how the status of economy has improved after economic reforms. To fulfill all above said objectives data has been gathered from secondary sources like reports and publication of Govt. and RBI relating to foreign Investment, economic journals, books, magazines and internet etc.

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.

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 investor's purpose is being to have an effective voice in the management of enterprise."

Foreign indirect investment as portfolio investment,

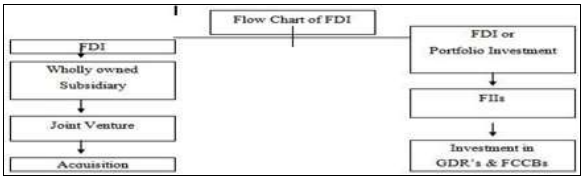
Portfolio investment does not seek management control, but it motivated by profit. Portfolio investment occurs when individual investors invest, mostly through stockbrokers in stocks of foreign companies in foreign land in search of profit opportunities.

Foreign investment comes in host country in through various route and many forms. 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. among all various routes the two main routes are:

1. Foreign Direct investment (FDI)and
2. 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); Re- invested earning; other capital.
2. Portfolio investment (GDR/ADR, FIIs, OFF shore funds and others)



ROUTES OF FOREIGN INVESTMENT INFLOW

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 of FDI in Host Country

I. Host Country Determinants:

1. Policy framework for F.D.I.
2. Economic, political & social stability
3. Rules regarding entry & operations.
4. Standards of treatment of foreign affiliates.
5. Policies on functioning & structure of markets (esp. competition & merger and acquisition [M&A] Policies
6. International agreements on FDI
7. Privatization Policy.
8. Trade policy (barriers-tariff & non-tariff) and coherence of FDI and trade policies
9. Tax Policy

II: Type of FDI /Principal Economic Determinants in Host Countries

1. A Market-seeking
2. Market size & per captaincies
3. Market growth
4. Access to regional and global markets
5. Country specific consumer preferences
6. Structure of markets

III: Economic Determinates

1. Resource/Asset- Seeking
2. Raw materials
3. Low-cost unskilled labor
4. Skilled labor
5. Technological, innovatory and other created
6. Assets (e.q. brand name as embodied in dividable, firms and clusters
7. Physical
8. Infrastructure (Ports, roads, power & telecommunication

IV: Business Facilitation

1. Investment promotion
2. Investment incentives (including image building & investment generating activities and investment facilitation services)
3. Hassle costs (corruption, administrative efficiency & the like)
4. Social amenities (bilingual schools, quality of life etc.)
5. After-investment services

V: Efficiency Seeking

1. Cost of resources and assets adjusted for productivity for labour resources.
2. Other input costs like easy transport & communication economy and cost of other intermediate products
3. Membership of a regional integration agreement conducive to the establishment of regional corporate networks

The following table shows the sector wise FDI flows in India

Table 1: The Sector wise FDI flows in India

Sr. No	Industrial Sector	Percentage of Limit
1.	Insurance	26/ 49 (auto route)
2.	Airlines	49
3.	Airport	49
4.	Telecom	74 (Basic cell and value added service
5.	Real estate	100 (for creating integrated township)
6.	Trading	51 (auto rote for export)
7.	Power	100 (for case carry)
8.	Print Media	26 (news paper and news periodicals)
9.	Road and Highways	100
10.	Defense	26 (Subject to licenses)
11.	Banking	100 (Indian subsidiary under the RBI Regulation
12.	Petroleum	100 (Marketing pipeline and ail exploration)
13.	Journal	100 (Scientific and technical)
14.	Advertising	100 (auto rute)
15.	Film	100 (auto rute)
16.	Tea	100 (including plantation with prior approval of govt.)
17.	Courier Services	100 (with prior approval of Govt.)
18.	Drugs and pharmaceutical	100 (auto rute excluding which attract compulsory license)
19.	Hotel and Tourism	100 (auto route)

Source: Business Environment authored by Francis Cherunilam.

Need of Foreign Investment in India:-

India is suffering from the scarcity of financial resources and low level of capital formation because it has to majorly depend upon the external sources of Finance. Also the domestic resources are entirely inadequate to carry out development programmes.

Table 2: Saving-Investment Rates in India

Year	Investment	Saving	Deficit	Year	Investment	Saving	Deficit
1990-91	23.4	22.9	-0.5	2001-02	23.5	24.9	1.4
1991-92	23.9	21.3	-2.6	2002-03	26.4	25.9	-0.5
1992-93	23.3	21.3	-2.0	2003-04	29.7	29.0	-0.7
1993-94	26.9	21.7	-5.2	2004-05	31.1	32.4	1.3
1994-95	27.1	23.6	-3.5	2005-06	32.4	33.4	1.4
1995-96	27.3	23.6	-3.7	2006-07	34.8	34.6	-0.2
1996-97	25.7	22.4	-3.3	2007-08	36.4	36.8	0.4
1997-96	24.8	24.2	-0.6	2008-09	37.5	32.0	-5.5
1998-99	22.6	23.2	0.6	2009-10	35.6	33.8	-1.8
1999-00	24.8	25.7	0.9	2010-11	36.5	32.3	-4.2
2000-01	23.4	23.8	0.4				

Source: CMIE, Economic Survey 2012

The table (2) shows that rate of investment in India is more than saving rate from 1998-99 to 2001-02 and 2004-05, 2005-06,2007-08. So that it is necessary to attract more and more foreign investment to reduce the gap between saving & investment and the deficit of trade of India.

Inflow of Foreign Investment in India

In India foreign capital comes from private individual and institutional investors on commercial terms in the form of Euro-issues comprising, external commercial borrowings, portfolio investments by non-resident of India‟s, overseas corporate bodies and investments by foreign financial institutions.

Table3: FDI and Portfolio Investment in India (in % age)

Year	FDI in % age	Portfolio in% age	Total
1992-93	56.35	43.65	559
1993-94	14.11	85.89	4153
1994-95	25.57	74.43	5138
1995-96	43.83	56.17	4892
1996-97	46.00	54.00	6133
1997-98	66.05	33.95	5385
1998-99	102.54	-2.54	2401
1999-00	41.59	58.41	5181
2000-01	59.34	40.66	6789
2001-02	75.20	24.80	8151
2002-03	83.72	16.28	6014
2003-04	27.53	72.47	15699
2004-05	39.38	60.62	15366
2005-06	41.77	58.23	21453
2006-07	76.52	23.48	29829
2007-08	56.09	43.91	62106
2008-09	157.77	-57.77	23983
2009-10	53.84	46.16	70139
2010-11	49.12	50.88	61851

Source: Report of RBI Negative (-) sign indicates outflow

Foreign investments have played a pivotal role in India to supplement the low level of domestic investment. The flows of foreign investments in India takes the form of direct investment and portfolio investment which are non-debt creating flows in nature. The FDI flows in India took a new turn with announcement of New Economic Policy in 1991. The FDI allowed in priority sectors for the development of industries. The table no 3 depicts that flows of FDI in India has increased from 599 million dollar in 1992-93 to 61851 million dollar in 2010-11. It also shows that out of total inflows, direct investment constituted 56.35 percent (315 million dollar) and portfolio investment worked out 43.65 percent (244 million dollar) in 1992-93. Over the period of 19 years, we found a drastic (U) turn in the share of direct and portfolio investments.

Table 4: Route-wise Foreign Investment in India (in % age)

Year	FIPB/ RBIs Automatic/ Acquisition	Equity Capital of Unincorporated	Re-invested Earning	Other Capital	Total FDI Flows (US Million Dollars)	%age Growth Over Previous Year
2000-01	58.05	1.51	33.50	6.92	4029	-
2001-02	63.68	3.11	26.83	6.36	6130	(+) 52
2002-03	51.12	3.77	36.40	8.69	5035	(-) 18
2003-04	50.83	0.74	33.78	14.64	4322	(-)14
2004-05	53.71	8.72	31.46	6.10	6051	(+)40
2005-06	61.82	4.85	30.80	2.52	8961	(+)48
2006-07	68.28	3.92	25.53	2.26	22826	(+)146
2007-08	70.54	6.57	22.00	0.83	34835	(+)53
2008-09	72.22	1.86	23.86	2.05	37838	(+)09
2009-10	67.81	4.07	22.95	5.15	37763	(-)0.2
2010-11	71.89	2.43	24.80	0.86	27024	(-)28
Cumulative Total (2000 to 11)	67.90	3.90	25.10	3.10	194814	

Source: RBI‟s bulletin May 2011

The table 4 depicts that route –wise foreign investment inflow of FDI from 2000-01to 2010-11. Table shows that FIPB, RBIs, Automatic and Acquisition have the maximum contribution in total FDI in India. Their shares remain more than 50 %. It was minimum (50.83 %) in 2003-04 and maximum (72.22%) in 2008-09. FDI through equity was minimum (0.74%) in 2003-04 and maximum (8.72%) in 2004-05. FDI through Re-invested was minimum (22%) in 2007-08 and maximum (36.40%) in 2002-03. FDI through Other Capital was minimum (0.83%) in 2007-08 and maximum (14.64%) in 2003-03. It shows the very high fluctuation in FDI in India. It shows negative growth also.

Table 5: Including & Excluding Advances FDI Inflows in India (US Million Dollars)

Year	Including Advances	%age Growth Over Previous Year	Excluding Advances	%age Growth Over Previous Year
1991-00	16698	-	16684	-
2000-01	2908	-	2463	-
2001-02	4222	(+) 45	4065	(+) 65
2002-03	3134	(-) 26	2722	(-) 33
2003-04	2634	(-) 16	2225	(-) 18
2004-05	3759	(+) 43	3219	(+) 45
2005-06	5546	(+) 47	5546	(+) 72
2006-07	15726	(+) 183	15726	(+) 184
2007-08	24579	(+) 56	24579	(+) 56
Sub Total (2000 to 08)	62509 (26.71)		60545 (27.56)	
Cumulative Total (1991 to 08)	79207 (78.92)		77029 (78.60)	

Source: RBI‟s bulletin May 2011 Note: brackets shows the percentage change in cumulative and total

The table 5 depicts the inflow of FDI including and excluding advances from 2000-01to 2007-08. Including and excluding advances FDI has increased from 2908 and 2463 million dollar in 2001-02 to 24579 and 60545 million dollar in 2007-08. It shows that it has reported 8.45 and 10.0 time hike during above said period.

Table 6: Route –wise Foreign Investment (Billion Dollars)

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
I) Equity (a+b+c+d+e)	2144 (100)	2821 (100)	3557 (100)	2462 (100)	2155 (100)	2400 (59.57)	4095 (66.80)	2764 (54.89)	2229 (51.57)	3778 (62.43)	5820 (75.37)	16065 (82.25)	4191 (76.24)
a) Govt.	1249	1922	2754	1821	1410	1456	2221	919	928	1062	1126	2156	-
b) RBI	169	135	202	179	171	454	767	739	534	1258	2233	7151	-
c) NRI	715	639	241	62	84	67	35	739	534	1258	2233	7151	-
d) Acquisition	11	125	360	400	490	362	881	916	735	930	2181	6278	-
e)Equity capital	-	-	-	-	-	61	191	190	32	528	280	480	-
II) Re-invested earning	-	-	-	-	-	1350 (33.71)	1645 (26.84)	1833 (36.41)	1460 (33.78)	1904 (31.47)	1676 (21.70)	2936 (15.03)	1829 (33.27)
III) other capital	-	-	-	-	-	279 (6.92)	390 (6.36)	438 (8.70)	633 (14.65)	369 (6.10)	226 (2.93)	530 (2.71)	409 (7.44)
Total (I+II+III)	2144 (100)	2821 (100)	3557 (100)	2462 (100)	2155 (100)	4029 (100)	6130 (100)	5035 (100)	4322 (100)	6051 (100)	7722 (100)	19531 (100)	5497 (100)

Source: Indian journal of account and finance
Note: brackets show the percentage.
(--) data is not available.

The table 6 depicts the inflow of FDI route-wise in million dollars from 1996 to 2008. The average inflow of first route was 2144 million dollar in 1996 that has increased 4191 million dollar in 2008. From the route II & III FDI inflow was 1350 and 279 million dollar in 2001 that has increased 1829.14 and 409.28 million dollar in 2008. Percentage share of route II & III is very small in total FDI in India.

India's Portfolio Investment Policy

Portfolio Analysis

Prior to 1992 only NRIs and overseas corporate bodies (OCBs) were allowed to make portfolio investment in India. Due to recommendations of the high level committee on BOP under Chairmanship of C Rangarajan, FIIs also allowed to invest in the Indian debt and equity market. Apart from equity, registered FIIs can invest 100 percent in debt instruments both governments as well as corporate. Current aggregate ceiling is $ 1 billion. India also allowed to corporate sector to across equity capital from foreign resources in the form of ADR/GDR and euro issue. At present, policy on international offerings on ADRs/GDRs has been liberalized. Corporate also allowed raising fund by ADRs/GDRs under automatic route according to specified guidelines.

Table 7: Foreign Investment Inflow Country-wise in India (US Million Dollars)

Year/ Country	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Mauritius	33.83	31.20	41.23	60.92	59.79	59.64	56.90	56.49	48.77
USA	13.69	19.81	24.43	11.90	8.04	5.85	9.13	10.57	8.16
UK	14.59	9.19	3.69	6.30	17.64	6.32	4.37	3.57	5.27
Singapore	1.63	2.03	6.72	6.51	5.43	16.51	17.50	12.95	11.90
Germany	6.18	4.45	5.29	7.18	1.12	2.76	3.18	3.40	1.39
Netherlands	7.64	26.91	9.75	1.80	6.05	3.73	4.47	4.89	8.46
Japan	17.68	4.29	4.60	4.93	0.79	4.38	2.05	6.44	10.90
France	4.80	2.09	4.27	0.42	1.09	0.77	2.36	1.64	5.12
Total	100	100	100	100	100	100	100	100	100

Source:-RBI Annual Report 2011-12. Note: brackets shows the percentage

Table no 7 shows that highest amount of FDI in India from 2002-03 to 2010-11 came from Mauritius. Mauritius had secured first place with 42.76 percent in the above said period. While USA, Singapore, Netherlands and UK has secured second12.40 %, third 9.02%, fourth 8.2%, fifth place with 7.8% respectively.

Table 8: Foreign Investment Inflow Country-wise in India (US Million Dollars)

Year/Country	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Mauritius	33.83	31.20	41.23	60.92	59.79	59.64	56.90	56.49	48.77
USA	13.69	19.81	24.43	11.90	8.04	5.85	9.13	10.57	8.16
UK	14.59	9.19	3.69	6.30	17.64	6.32	4.37	3.57	5.27
Singapore	1.63	2.03	6.72	6.51	5.43	16.51	17.50	12.95	11.90
Germany	6.18	4.45	5.29	7.18	1.12	2.76	3.18	3.40	1.39
Netherlands	7.64	26.91	9.75	1.80	6.05	3.73	4.47	4.89	8.46
Japan	17.68	4.29	4.60	4.93	0.79	4.38	2.05	6.44	10.90
France	4.80	2.09	4.27	0.42	1.09	0.77	2.36	1.64	5.12
Total	100	100	100	100	100	100	100	100	100

Source:-RBI Annual Report 2011-12. Note: brackets shows the percentage

Table no 8 shows that highest amount of FDI in India from 2002-03 to 2010-11 came from Mauritius. Mauritius had secured first place with 42.76 percent in the above said period. While USA, Singapore, Netherlands and UK has secured second12.40 %, third 9.02%, fourth 8.2%, fifth place with 7.8% respectively.

Pattern of FDI (Industry wise)

Only quantity of FDI is not important but it is more important that where this amount is invested. If FDI is coming in heavy industry, Basic capital Goods industry, infrastructure Development, Agriculture Development etc, certainly it will be fruitful and would increase the growth and production of Indian economy. If it will be invested in the more profit making non-priority industries such as luxurious, semi-luxuries industries i.e. A.C, T.V. Refrigerator, cosmetics etc. there will be increase in the consumption rate only and not in the capital formation in Indian economy. In this context, we would like to analyse the pattern of FDI inflow in the Indian economy in the following paragraphs. The data pertaining to the above discussion is given in table no 10. During the period 2002-11 highest amount of FDI went to financing sector and Insurance sector. Real estate, Business services and manufacturing got the second place in same period. The third important sector which attracted next highest amount of FDI was computer services industry and construction industry that held the 4th place and services sector held the 5th place in same period. While investment through FDI came lowest in research & service (0.07%), education (0.61%), mine (0.23%), Health and Medical (0.83%) etc in above said period.

On the base of above discussion it is clear that most of the FDI has gone to non-priority sector. Because FDI depends on profitability, industrial policy, customs, rates, FERA, regulations etc. But in case of India inflow of FDI is not satisfactory for the point of view of objectives of development of industries.

Findings of the Study: - On the basis of present study the findings are:

- The study reveals that the saving rate is less than investment rate in the study period.
- The foreign investment increased in both term i.e. FDI and FIIs.
- The FDI has better performance that attracts the 58.29 percent amount of total foreign investment inflow.
- Equity is the important route of FDI inflow that is 50289.96 billion dollar in India.
- Second important route of foreign indirect investment is FIIs. Through this route inflow of foreign investment found 56800 billion Dollars (US Dollar).
- The highest amount 6878 billion dollars of FDI in India came from Mauritius which is 42.76 percent of total cumulative FDI in study period while USA has 2nd and UK has 5th place.
- The highest amount of FDI has gone to financing, Insurance, Real Estate and Business services which are
- 33.05 percent and minimum went to research & scientific services which is 0.07 percent of total cumulative inflow of FDI study period in India.

Conclusion & Recommendation

On the basis of study we draw conclusion that maximum global foreign investment’s 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. But foreign investor never adopts environment friendly technique to maximize their profit. These investments met the financial requirement for building up the basic and essential infrastructure industries of priority sector. But we finds that the highest amount of FDI gone to financing sector, insurance sector, Real estate and Business services which is 33.05 percent of total cumulative inflow of FDI in study period in India. It’s a serious matter in context of foreign direct investment objectives. Main reason of this sifting is high risk and low profit in concern sectors. Because the FDI are associated with various types of risks which are expected to provide various linkages in the development of Indian economy. But there is an upward trend in the flows of foreign investment particularly in study period. We should provide the better environment for attracting the foreign investment through direct as well as indirect methods. 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, internal personal disparity in the development and making our Balance of Payment favorable.

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