ISSN Print: 2394-7500
ISSN Online: 2394-5869
Impact Factor: 3.4
IJAR 2015; 1(8): 51-54
www.allresearchjournal.com
Received: 01-05-2015
Accepted: 16-6-2015

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Foreign investment in Indian industry during post reform period

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Abstract
FDI has a major role to play in the economic development of the host country. Over the years, foreign direct investment has helped the economies of the host countries to obtain a launching pad from where they can make further improvements. This trend has manifested itself in the last twenty years. Any form of foreign direct investment pumps in a lot of capital knowledge and technological resources into the economy of a country. The present paper attempts to analyze significance of the FDI Inflows in Indian industry since 1991 and relating the growth of FDI.

Keywords: FDI, Multinational Corporations, Portfolio Investment, Exponential Trend

1. Introduction

India has opened its economy and has allowed the entry of Multinational Corporation as a part of reform process which was started at the beginning of the 1990's. Like many countries, India also has offered greater incentives to encourage FDI inflows into its economy. In this context, it is imperative to access the impact of FDI inflows in the core sector in India. This assessment is also motivated by recent political developments in India, following the opening of such sector as insurance and telecommunication with the increased financial gap for private players. In particular, the left parties, who are the main coalition partners of the present government in India, are not in favor of the provision of increased financial gap to private players in these sectors. They are also against the disinvestment of public enterprises. An empirical analysis could offer the basis for a further opening up the Indian economy if FDI inflows into core Sector set a positive spillover in the economy.

Foreign Direct Investment inflows into the core sectors are assumed to play a vital role as a source of capital, management and technology in transitional economies. It implies that FDI can have positive effects on a host economy's development efforts. The economy of India is the largest in the world as measured by purchasing power parity (PPP), with a Gross Domestic Product (GDP) of US $ 3.611 trillion. When measured in US $ exchange rate, it is the tenth largest in the world with a GDP of US $ 800.8 billion (2006). India is the second fastest growing economy in the world, with a GDP growth rate of 8.9% at the end of first quarter of 2006-07. However, India's huge population results in a per-capita income of$ 3,300 at PPP and $ 714 at nominal.

2. Forms of Foreign Capital

2.1 Direct Foreign Investment: Foreign capital can enter directly into India. These companies have either started there subsidiary offices of branches in India or they may buy stock and debentures of Indian Companies**.**

2.2 Foreign Collaboration: When there is joint participation of foreign and domestic capital than it is known as foreign collaboration. There are three types of foreign collaboration i.e. (a) joint participation between private parties, (b) between foreign firms and Indian government and (c) between foreign government and Indian government

2.3 Inter government loans: In this, there has been tendency towards direct Inter-government loans and grants**.**

2.4 Loans from international institutions: The international institutions will also play an important role in providing capital to India. These institutions are International Monetary fund (IMF), Asian Development Bank (ADB) and the World Bank.

3. Objective of the Study

1. To know the growth, extent and trend of foreign investment in Indian Industry
2. To investigate the role of foreign capital in India.
3. To highlight impact of foreign capital in India in the change scenario of globalization.
4. To suggest some policy recommendation.

4. Methodology

To analyze the trend, growth and impact of foreign capital in Service sector, we have collected the data for the post liberalization period i.e. from 1991 to 2007 from various publication of Reserve Bank of India, Handbook of Industrial Statistics, Government of India, Economic Survey, various published and unpublished research work.

The percentage share in total investment exponential trend and growth rates has been calculated for the entire period.

The equation of the exponential trend is

$$Y = ab$$

Where a is Y- intercept and b slope of the curve at the origin of x.

In the logarithm form, the above equation is written as under:

$$Log\ Y = Log\ a + x\ Log\ b$$

The annual rate of growth in case of exponential trend is obtained as:

$$R = Antilog\ (log\ b – 1)\ x\ 100$$

4.1 Foreign Direct Investment in India

To examine the impact of recent FDI policy changes on the economy, quantitative information is required on the numerous dimensions. The most easily available information with regards to FDI is FDI inflows across industries and regions wise from August 1980 to September 2005. There are several limitations of such statistics because of multiple agencies are involved in collection of data. The recent change in the policy and adopting automatic route has further reduced the reliability of such quantitative information.

4.2 Foreign Direct Investment and Portfolio Investment

Table 1.1: Foreign Direct Investment & Foreign Portfolio Investment in India during 1991 to 2005

Year	Direct Investment in US$ million	Share in total In %	Portfolio Investment in US$ million	Share in total In %	Total Investment in US$ million
199-91	97	94.2	6	5.8	103
1991-92	129	97.0	4	3.0	133
1992-93	315	56.4	244	43.6	559
1993-94	586	14.1	3567	85.9	4153
1994-95	1314	25.6	3824	74.4	5138
1995-96	2144	43.8	2748	56.2	4892
1996-97	2821	46.0	3312	54.0	6133
1997-98	3557	66.1	1828	33.9	5285
1998-99	2462	102.5	--	--	--
1999-00	2155	41.6	3026	58.4	5181
2000-01	4029	59.3	2760	40.7	6789
2001-02	6130	75.2	2021	24.8	8151
2002-03	5035	83.7	979	16.3	6014
2003-04	4322	27.5	11377	72.5	15699
2004-05	6051	39.4	9315	60.6	15366
Total	41147	47.8	44850	52.2	85997

Source: Data complied in handbook of statistics in Indian Economy, published by Reserve bank of India, available at (www.rbi.org.in / scripts/ Annual Publication)

Table 1.1 shows the inflow of Direct Investment, Portfolio investment and Total investment in US $ million terms since 1991-91to 2004-05year wise. The percentage share of FDI and portfolio investment in total investment is calculated for all the years. Total inflow of both direct investment and Portfolio Investment during the period of August in 1991 to December 2005 was $ 5997 million. The share of direct investment was 47.8% and the share of portfolio investment was 52.2% of the total inflow of FDI up to 2005. Table 3.1 shows that there has been massive increase in foreign investment inflows into the country since 1990-91 (both as a consequence of increase in FDI and portfolio investment) from US $ 103 million to US $ 5138 million in 1994-95. The increase in FDI is due to the policy of liberalization adopted by the government. After this policy the amount of portfolio investment in the country increased at a much faster rate. During 1991-91 the portfolio investment in India was US $ 6 million only but in 1992-93it rose to US $ 244 million in the next year there was vast increase in the portfolio investment and it was amounted to US $ 3567 million. Direct investment approved during this period also show positive sign and the direct investment in 1993-94 was US $ 583 million. The total foreign direct investment during 1993-94 was US $ 41133 million. In 1990-9, the share of direct investment in total investment was 94.2% whereas the share of portfolio investment was just 5.8%. Their was a dramatic change seen in the year 0993-94, in this year share of portfolio investment rose up to 85.9% but the share of direct investment remained 14.1% only.

The foreign direct investment will go on increasing and reached at a peak of US $ 6133 million in 1996-97 because of impressive increase in both FDI and portfolio investments. During this period the percentage of direct investment and portfolio investment nearly remained the same. Thereafter in the next two successive years i.e. 1997-98, 1998-99 there was a decrease in the foreign investment. In 1997-98, the foreign investment decreases due to decrease in portfolio investment from US $ 3312 million to US $ 1828 million so there was a vast decrease in the portfolio investment but direct investment during this year increase but there was overall decrease in foreign investment during this period. In 1998-99. There was an outflow of funds due to which the overall portfolio investment was negative i.e (-61 US $ million).

This was for the first time after 1990 that the portfolio investment shows an outflow. During this period the direct investment will also decline and the total foreign investment during this period will reduce upto US $ 2401 million. However, portfolio investment recovered strongly in the next year to US $ 3026 million, FDI inflow in 1999-00 was US $ 2155 million, the over all foreign investment inflows rose to US $ 5181 million.

Below we consider trends in foreign investment it is necessary to point out that the data since 2000-01 are not comparable to the data prior to this year. This is an account of the change in the definition of foreign investment in an attempt to bring it in line with international practices. In India, FDI inflows were recorded under five heads.

- Reserve Bank of India's automatic approval route for equity holding up to 50%
- Foreign Investment Promotion Board or Secretariat of Industrial Approval discretionary approval route for larger projects with equity holding greater than 51%
- Acquisition of shares route since 1996 (relating to acquisition of shares of Indian companies by residents under section 29 of PERA)
- RBI's non-resident Indian
- External commercial borrowing.

The definition differed from that of the IMF which includes external commercial borrowings, reinvested earnings and subordinated debt. In an effort to bring Indian definition in line with IMF's definition, the coverage of FDI since 2000-01 includes, besides equity capital, reinvested earnings and other direct capital. In table 3.1, data on FDI prior since 2000-01 are presented on the basis of the earlier definition while data since 2000-01 are presented on the basis of the new definition.

As it is clear from table 1.1, that the foreign direct investment rose to US $ 4026 million this increase is due to the changes made by the government. But there was certain amount of decrease in portfolio investment which declined to US $ 2760 million and the total investment during this period rose to US $ 6789 million. In year 2001-02 again there was increase in the direct investment i.e.$ 6130million and portfolio investment will continuously decline in this year also. The % share of portfolio investment in the total investment remained only 24.8%. In 2002-03 the direct investment declined but there was large amount of fall in portfolio investment. That was due to outflow of funds by foreign investment decreased. In this year portfolio investment contributed less than 20% in the foreign direct investment.

The year 2003-04 registered record foreign investment inflows of US $ 15699 million. The increase is because of hike in portfolio investment by US $ 11377 million. As compare to earlier years the scenario has totally changed in the single year. In this year the share of portfolio investment was increased to 72.5% of the total investment in the country. Again in 2004-05 the foreign investment. Inflows amounted to US $15366 million. This was again due to huge amount of portfolio investment i.e. US $99315 million. Even though the percentage share and amount of Portfolio investment was less than earlier year but yet there was huge investment in the economy.

4.3 Exponential Trend for Foreign Direct Investment and Portfolio Investment

Table 1.2: Exponential Growth of Foreign Direct Investment and Foreign Portfolio Investment in India during 1991 to 2005

Year	Direct Investment			Portfolio Investment			Total (A+B)		
	Rs. Crore	US $ Million	Exponential Trend $ Million	Rs. Crore	US $ Million	Exponential Trend $ Million	Rs. Crore	US $ Million	Exponential Trend $ Million
1990-91	174	97	220.3	11	6	60.95	185	103	444.6
1991-92	316	129	290.4	10	4	84.33	326	133	587.5
1992-93	965	315	382.8	748	244	116.7	1713	559	776.2
1993-94	1838	586	504.7	11188	3567	161.4	13026	4153	1288
1994-95	4126	1314	665.3	12007	3824	223.4	16133	5138	1355
1995-96	7172	2144	877.0	9192	2748	309.0	16394	4892	1791
1996-97	10015	2821	1156	11758	3312	427.6	21773	6133	2366
1997-98	13220	3557	1524	6794	1828	591.6	20014	5385	3126
1998-99	-	-	-	-	-	-	-	-	
1999-00	9338	2155	2649	13112	3026	1132	22450	5181	5458
2000-01	18406	4029	3491	12609	2760	1567	31015	6789	7211
2001-02	29235	6130	4603	9639	2021	2168	38874	8151	9528
2002-03	24367	5035	6067	438	979	2999	29105	6014	12590
2003-04	19860	4322	7998	52279	11377	4150	72139	15699	16630
2004-05	27188	6051	10540	41854	9315	7541	69042	15366	21980

Equation of exponential trend is Y =ab^x

Note: Exponential trend for A = Logy + 30183 = 0.12x

Exponential trend for B = Logy = 2.772 + 0.141x

Exponential trend for (A+B) = Logy = 3.495 + 0.121x

Annual Growth rate: - -r = (Antilog b – 1) x 100

For A = 13.18%

For B = 13.84%

For (A+B) = 13.18%

In Table 3.2, exponential trend was calculated for foreign direct investment, portfolio investment and for the total investment in the country during the period 1991-2005. While calculating the exponential growth the figures for 1998-99 have been ignored because during this period portfolio investment was negative. The exponential trend rate for the year 1990-91 for direct investment was 220.3 and portfolio investment shows exponential trend rate equal to 6095 but exponential trend for total foreign investment was 444.6.

During the period from 1990-95, the total investment in the economy increased. Initially, the exponential trend for the direct investment was more than the exponential trend for the portfolio investment. During this time period exponential trend for all the investment shows a steady rate. In 1991-92 the exponential trend for direct investment was 382.8, portfolio investment was 116.7 and trend for total foreign investment was 776.2

The period from 1995-00 shows many changes. During this period, certain years there was an increase in FDI, in some years there are decreases in FDI with there is also an exceptional year in which portfolio investment will be negative or there is an outflow of funds. When we make comparison of exponential trend and amount of inflow of FDI between two years i.e. 1996-97 and 1997-98, we find that direct investment has been increased from US $ 2821 million to US $ 3557 million and there is also increase in exponential trend from 1156 to1524. The government has made change in the definition of FDI in 2000 due to this inflow of FDI has been increased after this time period.

The annual growth rate for direct investment, portfolio investment and the total FDI was also calculated. The annual growth for all the types of investment was nearly the same. The annual growth rate for direct investment (A) was 13.6 percent, for portfolio investment (B) it was a little more i.e. 13.84 percent and the annual growth rate for total FDI inflows amount to13.18 percent.

5. Conclusion

In short, we conclude from our study that foreign direct investment helps Indian economy to reach in the orbit of high rate of economic growth. After liberalization, the inflow of FDI is continuously increasing which helps a lot in the development of the economy. The inflow of FDI was at the rate of 13.18 percent per annum respectively. FDI in the form of technological know-how, skilled manpower promote development of the economy.

The question which will always remain in mind is that whether FDI is good for the third world countries like India? What is the purpose of investment made by the Donor country towards recipient Country? Whether FDI should be welcomed or not? If it should be welcomed than in which sector.

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