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A study on flow of FDI with respect to growth of GDP in India

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Abstract
FDI has become a key component of national development strategies for all most all the countries over the Globe. FDI is considered to be an essential tool for jump-starting economic growth through its bolstering of domestic capital, productivity and employment.
FDI are investments made by residents of one economy with the objective of establishing a lasting interest in a company located in another economy (host economy). With `lasting interest' we mean both the existence of a long-term relationship and a degree of ownership of the foreign firm. In statistics, ownership of at least 10 percent of the ordinary shares in US, India etc. and 25 per cent in Britain has been the criterion for the existence of a direct investment relationship. Ownership of less than 10 percent is considered as a portfolio investment. The presence of foreign investors means that firms controlled by foreigners produce part of domestic output. Foreign direct investment has grown at rates far beyond those of international trade since the late 1980s. Especially in the second half of the 1990s, firms were exceptionally active in cross border Mergers and Acquisitions (M&A). The outstanding global stock of FDI more than doubled in ten years time from 8.3 percent of world output in 1990 to 17.5 percent in 2000. It is conceivable that the larger presence of FDI is partly responsible for the observed increase in cross-country business.
FDI refers to the purchase by the citizens of one country of non-financial assets in another country. Foreign direct investment involves the acquisition or establishment of a firm, company or enterprise in a country outside of the registered corporate home country. FDI in real estate involves acquisition of land or building across all commercial, residential and retail segments. Any construction activity is also included in FDI.

Keywords: FDI, growth, firm

Introduction
According to the IMF's *Balance of Payments Manual* 5th Edition, along with OECD's *Benchmark Definition of Foreign Direct Investment* 3rd Edition (OECD 1999) [35], FDI is defined as: '*[...] the objective of obtaining a lasting interest by a resident entity in one economy ("direct investor") in an entity resident in an economy other than that of the investor ("direct investment enterprise")*'.
FDI can be categorized into three components: equity capital, reinvested earnings and intra-company loans. *Equity capital* comprises of the shares of companies in countries foreign to that of the investor. *Reinvested earnings* include the earnings not distributed to shareholders but reinvested into the company. *Intercompany loans* relate to financial transactions between a parent company and its affiliates.
FDI is an investment made to acquire a lasting management interest (normally 10% of voting stock) in a business enterprise operating in a country other than that of the investor defined according to residency.

Importance of FDI
Numerous literature points out the benefits and costs of FDI for the host country, especially a developing one. The arguments for the positive impacts of FDI centre around three prevalent benefits that are important to a developing country, inflow of physical capital, technology spillovers, and employment. Inflow of physical capital in the form of FDI could also increase the rate of economic growth particularly for developing one where capital is scare. The leakage of technology spillover from MNEs enables domestic firms to improve their

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productivity and that allows the host country to enhance its long-term economic development. The growth enhancing ability of FDI also depends on the chosen mode of FDI. Greenfield FDI can result in an increase in the host country's stock of capital whereas the Brownfield FDI (M&A) can only result in positive externalities of technological spillover.

The Foreign Direct Investment has been one of the economic aspects where 'economics' and 'politics' remained closely interwoven. The two major reasons for attracting foreign direct investment are that it adds to the total investible resources on one hand and acts as a vehicle for transferring various advanced technological and managerial skills on the other hand. It must be noted that attraction of FDI is significant in the economies of the developing countries. In addition to this FDI can also contribute toward debt servicing repayments, stimulate export markets and produce foreign exchange revenue. Further FDI may stimulate product diversification through investments in new business, reducing market dependence on a limited number of products.

The developing countries are now shifting their priorities from import substitution towards structural adjustments via free market economies and increasing emphasis on FDI. The latter is now accepted as panacea for all types of scarcities of financial capital, technological know-how, efficient managerial techniques, organizational skill and access to market abroad. As against portfolio investment, FDI is a source of creation of tangible and intangible assets, employment and wealth in the host economy. It may provide rents, potential spillovers and externalities that are highly beneficial to the host country's economic growth. Foreign Direct Investment (FDI) has increasingly been viewed as a catalyst to economic growth, particularly in developing countries. More importantly, FDI as a principal means of transfer of technology, know-how and management skills, besides supplementing capital into developing countries, contributes to economic growth (Blomstrom *et al.* 1994).

FDI inflows can be a tool for bringing knowledge, managerial skills and capability, product design, quality characteristics, brand names, channels for international marketing of products, etc. and consequent integration into global production chains, which are the foundation of a successful exports strategy (Kokko 1999) [33]. FDI could benefit both the domestic industry as well as the consumer, by providing opportunities for technological transfer and up gradation, access to global managerial skills and practices, optimal utilization of human capabilities and natural resources, making industry internationally competitive, opening up export markets, providing backward and forward linkages and access to international quality goods and services and augmenting employment opportunities. For all these reasons, FDI is regarded as an important vehicle for economic development particularly for developing economies. FDI flows are usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors. In a world of increased competition and rapid technological change, their complimentary and catalytic role can be very valuable.

However, these benefits do not come alone. The adverse effect of FDI inflows to the host country (i.e., developing one) should not be overlooked. Firstly, larger foreign firms may take dominant market shares, thereby reducing competition. Because of their economic power, they can establish monopoly position in the host country market and exploit resources more cheaply. Secondly, large foreign firms lead to negative effects on local firms and employments because they can crowd out small domestic firms. Thirdly, export and import activities of foreign-owned firms may lead to balance of payment volatility. Fourthly, when profits and capital of MNEs are repatriated, the value of the home currency may decline. But such costs can be corrected through appropriate host country policy measures.

According to the OECD report on foreign direct investment for development, the benefits of FDI do not occur automatically. The policies in both host countries and home countries matter. Only enterprises that operate in a generally sound national and international environment can bring the full benefits of FDI on the host economy.

The top ten Asian countries with regard to level of FDI are China, Hong Kong, Singapore, Korea, India, Malaysia, Thailand, Indonesia, Philippines and Sri Lanka with FDI of the level of 60.63, 34.04, 16.06, 7.67, 5.34, 4.64, 1.06, 1.02, 0.47 and 0.23 billion US $ respectively (Source: UNCTAD-World Investment Report 2005). The first ten largest investors in India are the Mauritius, US, Japan, Netherlands, UK, Germany, Singapore, France, South Korea and Switzerland with the share 37.25, 15.80, 6.79, 6.65, 6.26, 4.27, 3.14, 2.55, 2.28 and 1.98 per cent respectively (Source: FDI Policy 2009).

As far as sectoral distribution of FDI is concerned, Electrical equipments (including computer software and electronics), Transportation industries, Services sector, Telecommunications, Fuels (Power and refineries), Chemicals (other than fertilizers), Food processing industries, Drugs and pharmaceuticals, Cement & gypsum products and Metallurgical industries were the dominant sectors inviting 16.50, 10.34, 9.64, 9.58, 8.41, 5.86, 3.67, 3.18, 2.54 and 2.10 per cent of the total FDI respectively (Source: FDI Policy 2009).

Significance of the study

Many studies have been carried out to study various aspects of FDI. Several studies analyse inter-country differences in foreign direct investment (FDI) emphasizing location advantages (Wei 2000). These studies have identified various location advantages such as size of the market, income and its growth rate; membership of a regional union; labour and skill content of the population; infrastructure facilities like transport, tele-density, electricity, and port facilities; and variables representing good governance such as, legal dispute settlement, the rule of law, spending on social sector to enhance the skills of the population, improving the health of the people by spending on sanitation, preventive medicine and potable water and, in general, all expenditures directed towards increasing the well-being of the citizens. More recent studies have focused on such factors as technological status, brand name, openness of the economy, macro trade policies of the government and intellectual property protection. Some of these variables are country specific rather than pertaining to a specific region or a State within a country. Keeping the above in mind the present study will focus on the trends and behaviour of FDI in India since 1991.

Review of literature

Moore, M. O. (1993) [18] attempted to look into the determinants of German Manufacturing Direct Investment to 17 countries during the period of 1980-88. The main object of the research is to shed light on the economic determinants that can best explain the privately financed manufacturing sector investment in German throughout the period. The study is based on the FDI outflow into five specific industries that are chemicals, steels, machinery, electronic and automotive sectors, the statistical model allows for estimation of country specific effects

Md. Shah Alam (1998) [17] examined an overview of FDI in Bangladesh. Analysis of the study is done based on economy, government policy and foreign direct investment. The study demonstrates that the economy of Bangladesh faces resource constraint, adverse balance of payments, negative balance of current account, debt burden and unemployment problem. In order to overcome the above situations, the Government of Bangladesh has liberalised investment policy to attract FDI. And found that mere FDI policy cannot attract sizable inflows of foreign investment. Along with FDI policy, congenial investment environment should be created for foreign investors

Sahhoo R. K. (1999) [22] studied an attempt to empirically understand separately the role of foreign and domestic firms in augmenting development process in post reform India. It takes in account export orientation, import dependency, capital intensity, profit intensity, vertical integration, product differentiation and effective tax rate as the indicators for assessing their comparative development effort. And found that foreign firms are relatively better export performer, less import dependent, less capital intensive and contributes more to the national exchequer.

Padhi S. P. (2002) [20] examined that FDI inflows are industry-specific and, therefore, are regional-specific. And noted that the regional FDI inflows related positively related to cross-regional differences in initial level of manufacturing output. That is especially when cross-regional differences in initial level of manufacturing output do not confirm to a regional manufacturing convergence process and point to cross-regional differences in production structures. And found that regional FDI inflows were attracted less by regional incentive pattern (both provisions of financial incentive and infrastructure facilities) that was independent of cross-regional differences in manufacturing levels. At the same time, though FDI inflows were attracted to regions with initial higher level of manufacturing output, they do not directly support a divergence process.

Sethi D. *et al.* (2003) [24] examined that provide a rationale for changing trends in the flow and determinants of FDI as a result of macro-economic and firm strategy considerations. They identify several factors that impact on such trends. Factors were lucrative market, liberal host government policies, technological infrastructure, skilled labour and cultural proximity. And found that the Asian region is not ideal according to the determinants of US FDI. The liberalization of these countries' economies and the improvements in their infrastructure have facilitated a shift in efficiency-seeking US FDI, and have contributed to a change in the FDI trend over time.

Hejazi *et al.* (2003) [29] examined the changing pattern of FDI stock have raised important questions about their impact on domestic economies. It is often thought that increased inward FDI contributes to domestic capital formation, whereas increased outward FDI reduces it. And found that rapid growth in outward FDI, relative to inward growth, should not be considered as a negative development, and may reflect success.

Wilbur Chung. *et al.* (2003) [30] examined the US auto-component industry between 1979 and 1991. During this period, Japanese automobile assemblers began to produce vehicles in North America, and began to purchase inputs from US auto-component manufacturers. Those US manufacturers that sold components to Japanese transplants would be direct recipients of any technologies transferred from the Japanese. And found that the direct investment made by Japanese assemblers was associated with overall productivity improvement in the US auto-component industry and little evidence of direct technology transfer. The productivity growth of US suppliers affiliated with Japanese assemblers was no greater than that of other, non-affiliated US suppliers. Further they found that the Japanese assemblers tended to purchase components from less productive US suppliers and moreover, that low-productivity supplier that sold goods to Japanese assemblers had a higher survival rate than low- productivity suppliers that did not sell to Japanese firms. They suggest that increased competitive pressure in the auto-sector was the main cause of overall productivity improvement, at least during the initial stages of FDI of the 1980s.

Bodla, B. S. *et al.* (2004) [6] studied that there is a misconception that FDI comes to India because of cheap labour and found that MNC's look more at productivity than low wage in any country, and suggest that accelerated investment is the need of hour.

Venkateswatlu *et al.* (2004) [21] studied that cross-country variation in FDI inflow can be explained by factors such as market size and its growth, R&D intensity, skill intensity, economies of scale, tariff barriers, accumulated experience with a given economy, exchange rate differential, dependence on host country raw materials and political stability. And found that FDI determinants were the level of per capita GDP and growth rate of GDP. The implication was clear. A good deal of homework by the host country is must if the country is serious about relatively large magnitudes of FDI inflow.

Arindam Banerajee (2005) [1] examined the grey areas of Indian economic policies, which prevent the free flow of FDI into India. To sustain the growth rate, Indian economy needs impetus through capital inflow. And found that the factors which determine the FDI inflows are economic and political stability, national policy towards foreign investment, country's regulatory, availability of quality and quantity of physical and financial infrastructure, good governance, size of local market and labour cost.

Basu P. *et al.* (2005) [2] examined empirically inter-industry analysis, the time effects of the variables influencing the FDI inflows to India during the post reforms periods with special reference to temporal variations in the effect of these determinants using time dummies for both intercept and elasticity. They found that at the initial factor-driven stage of the development, resource-seeking FDI was strongly influenced by such determinants as marketing-intensity, gross fixed assets and to some extent by export-import ratio. However, the elasticity or the response of FDI to these stimuli started declining in early 1997. The situation started improving by 2000.

Bayineni S. (2005) [5] examined that a modern economy requires a massive amount of capital goods. So developing countries actively look for foreign direct investment to strengthen industrial competitiveness and improve their growth prospects. Developing economies search for FDI as a source of economic growth and development, modernization and employment generation. FDI can also do much for productivity- by providing access to new technologies, management expertise and export markets. And found that, why FDI need investment climate? If India wants attract FDI, it has considerably cut its bureaucratic structure and makes more efficient the system of licenses and clearness at a single window. Further, India has to develop its infrastructure including ports, airports, roadways, and rail network and guarantee a solid supply of power to foreign investors.

Krishna *et al.* (2005) [15] compared two nations such as India and China with respect to FDI and Productivity, and tried to explore the reasons as to why FDI inflows less into India in comparison to China and found that are six major constraints in India, which restrict FDI inflows i.e. Image and Attitudes, Domestic Policy, Procedures, Quality of Infrastructure, State Government Level Obstacles and Delays in Legal Process.

Mahakud, J. *et al.* (2005) [16] studied different trends and determinants of foreign capital financing and estimated Panel data Models. More specifically, it looks into the fixed effect firms and time models by using data for 787 companies for the period, 1992-93 to 2003-04 for empirically identifying the factors, which affect the demand for foreign capital of the private corporate sector in India. They found that there was an increasing trend in foreign capital financing in India. Sizes of firms, liquidity market growth are the major determinants of the demand for foreign capital in the Indian Corporate Sector.

Subramanian S (2005) [23] studied India and China is two emerging economies that have many common factors for FDI attractions but unfulfilled agendas. Panoramic views of the software sector in these two promising countries are need of the hour. And found that China is more recipient of FDI than India in software sector. Supporting factors for more FDI in China are improved infrastructure for software industry, electronic information technology, domestic telecommunications, digital-controlled machine tool, hospital, social securities, demand for software and vast land.

Objectives of the study

The present study will be conducted:

1. To analyze the nature, extent and trends of FDI in India since 1991
2. To analyze the regional distribution of FDI in India since 1991
3. To analyze the flow of FDI with respect to growth of GD Pin India since 1991
4. To make a comparative study of the key drivers of FDI in India
5. To suggest measures to increase the FDI in India and recommend guidelines for policy formulation and execution by government.

Research methodology

The study would be built on the existing research studies and methodologies, to test the determinants of foreign investment in India. Relevant studies, done so far, have been both quantitative and qualitative in nature. The qualitative methods used include surveys and questionnaires and oral interviews. However, there are a number of challenges and issues that crop up when qualitative are used. Therefore the present study would be based on quantitative aspects. In order to estimate the statistical interference statistical package such as SPSS will be used.

Data analyses and interpretation

For the purpose of analysis and logical conclusions from the data the simple statistical tool and techniques, such as average, bi-variants correlation, multiple regression, cross sectional and time series will be used.

Source of Data

The data for the study would be extracted from the following sources:

- Handbook of statistics on Indian economy, RBI various issues.
- UNCTAD, WIR, IMF various series
- Economic Survey, Government of India, various issues.
- World Bank data base, various issues.
- CMIE data base

Apart from above data would be collected from various journals, newspaper and internet websites.

Scope of study

The study would be covering the pattern of FDI from 1991 to update. It include various sectors of economy of India to study the various aspect of FDI such as Power and fuel, Telecommunication, Service Sector, Chemicals (other than fertilizers), Food processing, Transport, Metallurgical Industry, Electricity Equipments (including software), Textiles, Paper and paper products and Industrial Machinery.

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