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Foreign direct investment and economic growth in India

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Abstract
Foreign Direct Investment (FDI) has been established as a most helpful international capital to the host country compared to portfolio investment that has short term characteristics. FDI plays a very important role in the development of the nation. 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 economy. FDI are distinguished from portfolio investment in which an investor merely purchases equities of foreign – based companies. However, the fact that FDI does not bring quick returns to any economy cannot be denied. In India, FDI is considered as a development tool, which helps in achieving self-reliance in various sectors and in overall development of the economy. To attract various FDI, Government of India needs to increase the investment climate for foreign capital through the maintenance of political as well as economic stability along with constraint of corruption

Keywords: Foreign direct investment, economic growth, portfolio investment

1. Introduction

Foreign Direct Investment (FDI) has played a major role in the process of globalisation during the past two periods. Apart from being a criticising driver of economic growth, FDI is a major source of amortize financial resource for the economic development of India. Foreign Direct Investment plays a reciprocal role in overall capital formation by filing the gap between domestic investments and savings. Capital formation is an important deciding factor of economic growth. In developing countries like India, FDI helps to manage socio-economic problems such as unemployment, deficit balance of payment, shortage of capacity and inadequacy of foreign exchange and lack of technological ability. In India FDI means the investment made by non-resident person/individual of India, in the capital entity/company and they get helpful in the development of our economy.

2. Objectives of FDI

This study is based on the following objectives.

- To maintain a high level investment.
- To determine the factors which influence the flow of Foreign Direct Investment in India.
- To retain technological gap between under developed countries and advanced countries.
- To verify the misuse of exploitation in natural resource.
- To identify the expansion of basic economic infrastructure.

3. Characteristics of FDI

- In all such deal transactions there is a basic purpose to participate in the management to the target company.
- In most cases it involves a long term bond there is no intention to seek quick capital gains.
- By agreement an investment is considered as FDI when it includes acquisition of a minimum 10% of the paid up equity of the target company.
- Generally all such investments are followed by technology transfers and access to newer markets therefore the partnership include entry to raw materials for the foreign entity and access to technology for the target company.

- Investment by foreign entity may include fresh issue of capital or sale of shares held by promoters in the target company. Therefore such transactions are essentially primary market operations.

4. Importance of FDI

Foreign Direct Investment plays a major role in the growth of economy due to various reasons, some of which are listed below:

(a) Helps to escape foreign government pressure for local manufacture.
(b) Foreign Direct Investment is an important source of external finance which means that countries with less amount of capital can have finance beyond national borders from healthy countries.
(c) Facilitate in avoiding trade barriers.
(d) Approval for making the movement from domestic export sales to a locally based national sales office.
(e) Improvement in increasing the entire production capacity.
(f) Present more opportunities for co-production, joint ventures with local partners, joint marketing arrangements, licensing etc.

5. Types of Foreign Direct Investment

1. **Greenfield investment:** Direct investment in the new provision / expansion of existing facilities. Objective to create new production capacity and jobs, transfer technology and know – how and from links to the global market place. Profits from production do not feed back into the local economy but to the multinational's home economy.

2. **Mergers and acquisition:** Primary type of FDI involving transfer of existing assets from local firms to foreign firms. Cross-border merger means assets and operation of firms from different countries are joined to establish a new legal entity. Cross-border acquisition means control of assets and operations is transferred to foreign company by its local affiliate company.

3. **Horizontal Foreign Direct Investment:** Investment in the identical industry in the aboard as a firm operates in at home.

4. **Vertical Foreign Direct Investment: (i) Backward Vertical:** Industry abroad supply inputs for a firm's domestic production processes. **(ii) Forward Vertical:** Industry abroad sells the outputs of a firm's domestic production processes.

6. Advantages of FDI

- Capital inflows create higher output and jobs.
- Infrastructure and technology transfer increased productive efficiency due to competition from multinational subsidiaries.
- Long term capital inflows are more sustainable than short term portfolio inflows. Example: credit crunch, bank can easily withdraw portfolio investments.
- Increase employment opportunity.
- Consumer benefit.
- Increase in saving and investment.
- Easy International trade.
- Development of human capital resource.
- Tax incentives.
- Transfer of resource.
- Reduced disparity between revenue and costs.

7. Disadvantages of FDI

- Hindrance to domestic investment.
- Risk from political charges.
- Negative influence on exchange rates.
- Higher costs.
- Economic non-viability.
- Expropriation.
- Negative impact on the country's investment.

8. Challenges of FDI

India is focusing on maximising political and social security along with a regulatory environment. Inspite of the clear advantages of FDIs, there are quite a few challenges facing larger FDIs in India such as:

a. **Resource Challenges:** India is known to have enormous amount of resources. There is manpower and important availability of fixed and working capital. At the same time, there are some unexploited resources.

b. **Equity Challenges:** India is surely developing in a much faster pace now than before but inspite of that it can be identified that developments have taken place unevenly. To get the complete picture of growth, it is necessary to make sure that the rural section has more or less the same amount of development as the urbanised one.

c. **Political Challenges:** 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 pressure for increasing FDI capital in various sectors like banking and insurance.

d. **Federal Challenges:** Tremendously major challenges facing larger FDI, is the need to speed up the performance of policies, rules and regulations. Thus asking for equal speed in policy implementation among the states in India is important.

9. Major Sectors of Foreign Direct Investment in India

1. **Private Sector Banking:** Non – Banking Financial Companies (NBFC) 49% of FDI is permitted from all sources on the automatic route subject to guidelines issued from RBI from time to time. The NBFC activities are merchant banking, underwriting, portfolio management services, investment advisory services, financial consultancy, stock broking, asset management, venture capital, custodial services, credit rating agencies, housing finance etc. There are separate prescribed minimum capitalization norms for fund/no-fund based NBFCs.

2. **FDI in Telecommunication Sector:** FDI plays a major role in telecom sector as well as an economy as a whole. Earlier, there are very few public players like BSNL, MTNL and VSNL in this sector but as the time proceed and competition increased, the private players like Airtel, Reliance, Tata Vodafone and Idea came into play which changed whole framework of telecom sector. FDIs are important because they not only bring

capital and technology into the market but they provide employment opportunities and effective productivity also.

3. **Hotel & Tourism Industry:** FDI in Hotel & Tourism sector in India- 100% FDI is acceptable in the sector on the automatic route. The term hotels include restaurants, beach resorts, and other tourist complex providing accommodation and /or catering and food facilities to tourists. Tourism related industry involve travel agencies, tour operating agencies units providing facilities for cultural etc.

10. Foreign Direct Investment & Economic Growth in India

- Improvements in Foreign Direct Investment guide to higher rates in financially developed countries differentiate to rates identified financially in poor countries.
- The determinants of economic growth have attracted increasing attention in theoretical and applied research. Despite the deficiency of a unifying theory, there are various partial theories that consider the role of various factors in determining economic growth.
- Other determinants of economic growth are economic policies and macro-economic conditions. Economic policies can affect various aspects of an economy through investment in human capital and infra-structure, development of political and legal institutions and so on. A fixed macro-economic environment may favour growth, mostly through reduction of uncertainty whereas macro-economic uncertainty may have a refusal impact on growth through its effects on productivity and investment.
- Local surroundings such as development of financial markets and the education level of the country, affect the influence of economic growth.
- Foreign Direct investment has recently played a critical role of internationalizing economic activity and it is a primary origin of technology transfer and economic growth. Foreign Direct Investment plays a remarkable and growing role in global business. It can arrange a firm with new markets and marketing channels, inexpensive production facilities, entry to new technology and financing for a host country, it can provide a source of new technologies, capital, processes, organisational technologies and managerial skills and such can provide a strong motivation to economic development.
- Policy makers should have movement care when trying to engage Foreign Direct Investment is supportive to local production, the best relationship between final and intermediate industry sectors, not surely between domestic and foreign final goods producers.
- After independence, the Government of India accept foreign direct investment as an important addition to domestic savings for the development of country and in 1972, Government of India distinct to allow wholly owned subsidiaries but done to restrictiveness of government policies, FDI remained remarkably low till the 1990s. Areal trust is yet to begin with the announcement of the economic reforms measures taken since July 1991.
- Human capital plays a negative role in achieving growth advantage from FDI.
- The quality and quantity of fruitful factors may respond to changes in inward FDI into two well defined ways:

1 If FDI helps to simple quantitative curtailment that disrupt the host country from realising an economically best level of capital formation.

2 When foreign FDI has effects in the host country (so called spill-over) on capacity and skills beyond the investing enterprise. The inflow of foreign capital promote growth in the host economy by relieve scarcity of capital, foreign exchange skill. FDI helps to escalate the profitability of domestic investment.

11. Recent Foreign Development Policy in India

1. The ministry of Home Affairs has ultimately given the acceptance to the proposal of allowing FDI in railways. The Cabinet Committee on Economic Affairs (CCEA) is anticipated to examine the plan. Foreign investors can invest only in construction and maintenance of railway projects and not in operations.
2. FDI refers to capital inflows from abroad that are invested in or to upgrade the production capacity of the economy of the country, Foreign Investment in India is governed by the FDI policy announced by the Government of India and the supply of Foreign Exchange Management Act (FEMA) 1999.
3. The Reserve Bank of India (RBI) in this view had issued a notification, which contains the Foreign Exchange Management Regulations 2000. This notification has been revised from time to time. The Ministry of Commerce and Industry, Government of India is the nodal agency for motoring and reviewing the FDI policy on continued basis and changes in sectoral policy/sectoral equity capital. The FDI policy is informed through press notes by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP).
4. Based on the guidance of Foreign investment Promotion Board (FIPB) made on December 30,2013 the foreign investors are free to invest in India, expect few sectors/activities where previous acceptance from the RBI.

12. Conclusion

FDI plays a major role in the long-term growth of a country not only as a source of capital but also for increase competitiveness of the domestic economy through transfer of technology, strong infrastructure and initiate new employment opportunities. India appears as the fifth largest recipient of foreign direct investment across the globe and second largest among all other developing countries. India’s FDI policy has been moderately liberalised to make the market more investor friendly. Further, it was found that even though there has been increased flow of FDI into the country during the post liberalisation period, the global share of FDI in India is very less when it is balance to other developing countries. For Indian economy which has huge potential, FDI has a positive impact. It also helps to construct new companies. All of these present to economic growth of the Indian Economy.

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