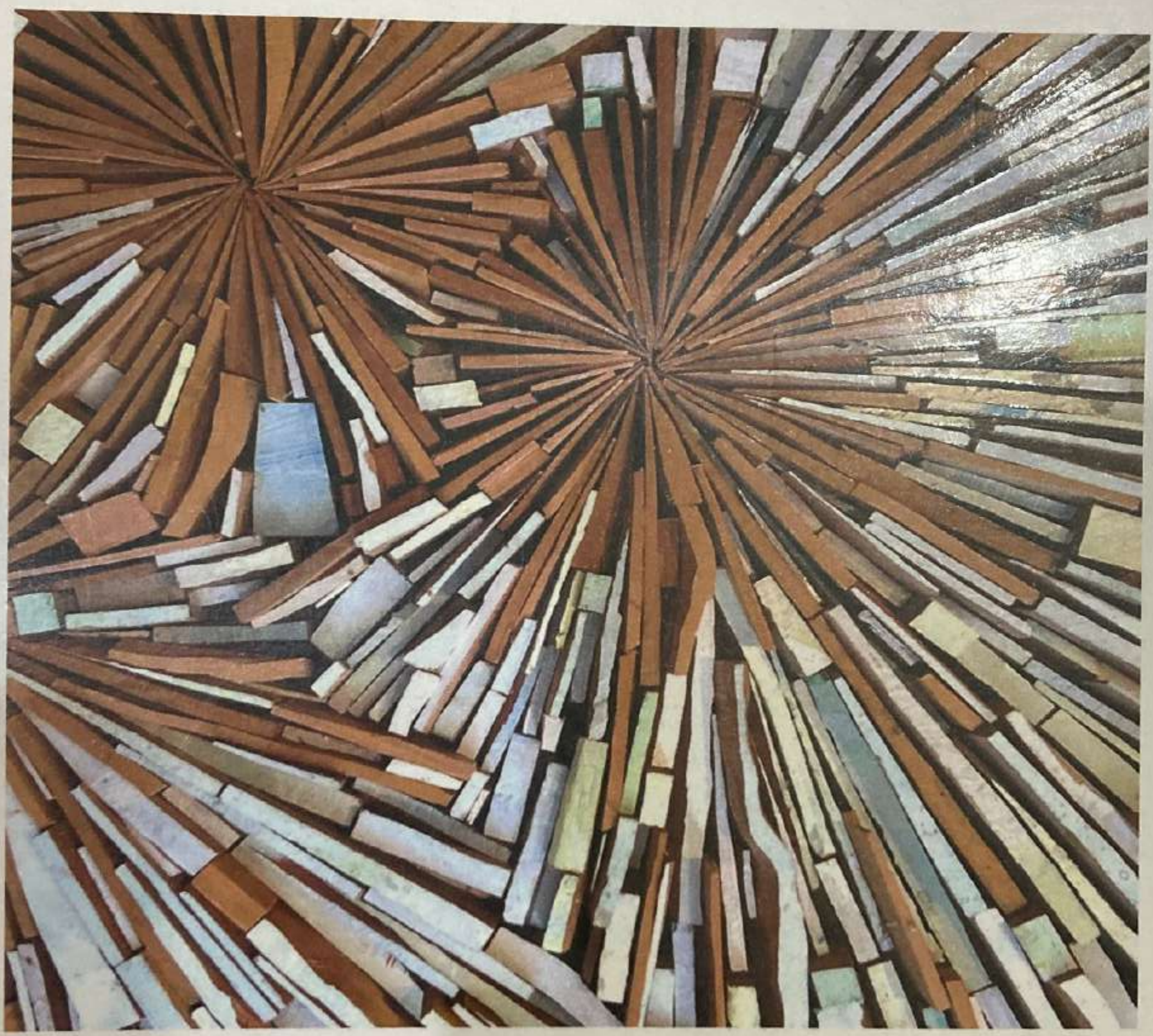
Assemblage

An Anthology of Business and Management Research



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Delhi

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Foreign Direct Investment in India: A Critical Analysis of Route-Wise FDI Inflows

Vinod Kumar* and Jaiparkash**

ABSTRACT

Foreign Direct Investment (FDI) is an important source of non-debt financial resources for developing countries for economic development and growth. FDI helps to transfer the technology from developed to developing countries. India has continuously sought to attract investment from the world's major investors. With the advent of globalization and liberal policies of Indian government in 1991, foreign investment has helped the Indian economy grow tremendously. These investments have been a key driver for accelerating the economic growth through employment generation, improved access to managerial expertise and competing internationally with higher efficiency. The task of transforming India is proceeding on an unprecedented scale, noting that more than 90 per cent FDI sectors are on automatic approval route. This paper has made an attempt to analyse the trend of FDI inflow into the country along with route-wise inflows from August 1991 to March 2017. The study is diagnostic and exploratory in nature and makes use of secondary data. The study finds and concludes that the foreign direct investment in India have very volatile annual growth trends both positive and negative direction. The study finds a compound annual growth rate of 29 per cent in FDI inflows during study period from August1991 to March 2017 and further concludes that the highest rank (1st rank) is attained by RBI route followed by reinvested earnings (2nd rank), acquisition of shares (3rd rank), government route (SIA/FIPB) (4th rank), while NRI route has (7th rank) lowest rank in the cumulative FDI inflows in India.

Keywords: *Foreign Direct Investment, Foreign Institutional Investment, Liberalisation, GDP, Investment.*

INTRODUCTION

Since the latter half of the 1990s, FDI has played a fundamental role in India's economic integration worldwide. Globally, FDI has been the most dynamic macro-determinant

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in industrial restructuring. However, the bulk of FDI over the past 25 years since economic reforms in India corresponds to acquisitions i.e. to transfer of ownership rather than creation of new businesses or expansion of the capacities of existing firms. The scope of inward direct investment depends on a host of factors i.e. size of the domestic market, skills of workforce, quality of infrastructure, labor costs, taxation, the level of technology and the development of the banking and financial system.

FDI involves the movement of factors of production into operating facilities abroad. It may be either in the form of investment in foreign branches or in subsidiaries, or in the form of a merger with and acquisition of a foreign firm. There are a number of views explaining why a firm moves abroad. Firstly, capital moves from a capital abundant economy to capital scarce economy and it continues moving until the marginal productivity of capital in the two countries becomes equal. Both the countries gain from this movement. Secondly, firms having some sort of ownership advantage find themselves in an oligopolistic position and move abroad in order to reap advantages from their oligopolistic position. Thirdly, it is believed that firms move to a foreign country to take the advantage of cheap raw material or cheap labour there so as to minimize the cost of production. Most developing countries consider FDI as an important channel for accessing resources for economic development. With the liberalization of capital account and initiation of structural reforms India has also opted for inflow of FDI in the country. It needs FDI not just to revamp its pitifully inadequate infrastructure but even more urgently to become part of the global network. Greater global trade would also bring new ideas, technology and economies of scale. Several policy measures have been announced during the post-reform period for encouraging FDI. India has brought a paradigm shift in its FDI policy by gradually removing restrictions on FDI flow. Now, India has one of the most liberal policy frameworks for FDI and foreign technology transfer.

LITERATURE REVIEW

A good number of studies have investigated on FDI issues. There is an enormous theoretical and empirical literature dealing with the relationship between FDI and growth. Chopra (2002) examined the effect of policy reforms on the FDI in India during the study period from 1980 to 2000. The study observed many policy related variables such as the degree of openness of the economy, debt-service ratio, foreign exchange rate and GDP as the explanatory variables of FDI inflows in India. The empirical result revealed that GDP was an important factor which motivates FDI in the country. Banga (2003) concluded that FDI is found to be attracted to large market size, low labour cost, high productivity of labour, and financial health of the economy and higher availability of electricity in the economy. Kathuria and Das (2005) analyzed the effect of increased FDI flows on the innovation strategies of the domestic manufacturing firms in the Indian context using post liberalization data. The results showed that in the post-liberalization era, the relationship between FDI and domestic R&D had undergone a change, with substitution coming out strongly in the later period when the effects of FDI were deemed to have been absorbed. Sharma *et al.* (2007) analyzed the trends and patterns of FDI inflows in India and found that FDI was more stable component of all kinds of capital inflows and gained great importance in recent times. Top five states constitute around 65 per cent and top 10 sectors constitute nearly 72 per cent of total FDI inflows in the country. There seems a large gap between approvals and inflows in different sectors. The states which are good in infrastructure and well developed have attracted much of the FDI. Kamath (2008) established the relationship between FDI inflows, exports and GDP in the Indian economy. The results indicated that a greater inflow of foreign capital has lead to growth in the exports of goods and services and also growth of the economy over the period of study from 1991-2005. Rameshkumar and Alagappan (2008) examined the trends and patterns in the FDI inflows into India during the post-liberalization period of 14 years from 1991 to 2004. The results reveal that the actual flows of FDI into Indian economy maintained a fluctuating and unsteady trend during the study period. It is found that the approvals were slow in materializing themselves into actual inflows. Of the total amounts of the FDI flows into India through the different approval routes, the SIA or the FIPB route topped the list followed by the acquisition of shares route, the RBI automatic route and the NRI route. It is interesting to note that more than 50 per cent of the total FDI inflows received by India came only from Mauritius and the USA. Among the different sectors, the electrical equipment had received the larger proportion of the FDI inflows followed by transportation industry, telecommunications, fuels and service sector. Gupta (2009) attempted to give an overall picture of FDI in India and evaluates the positive and negative aspects of FDI on Indian economy since the inception of New Economic Reforms measures. The study found that the major source of FDI in India is through both the equity route which accounted for 82 per cent of the total FDI inflows in India. Reinvested earnings of FDI companies accounted for 15 per cent of the total Direct Investments. Acquisitions accounted for 32 per cent of total FDI. Kumar and Dhingra (2011) concluded that FDI inflows have shown significant growth in the post liberalization period. The compound annual growth rate of actual FDI inflows during this period was 29.56 per cent. The analysis of structure of FDI in India reveals that there definitely has been a shift in favor of service sector and a steep fall in the share of manufacturing sector in post-liberalization era. Teli (2014) found Mauritius and Singapore tops in FDI inflows and the FDI inflows in service sector were in highest position. They have positive impact on the related economic indicators on Indian Economy. GOI should attract more FDI through favourable policies and avoid uncertainties.

Vyas (2015) study highlights country wise approvals of FDI inflows to India and the FDI inflows in different sector for the period April 2000 to June 2015. The study concluded that Mauritius emerged as the most dominant source of FDI contributing. It is because the India has Double Taxation Avoidance Agreement (DTAA) with Mauritius and most of the foreign countries like to invest in service sector. Sirisha and Malyadri (2015) study analyzed the sector wise and country wise inflows of FDI during the period 2009-2014. This study began by reviewing possible sources of FDI and then provides a comprehensive evaluation of the empirical evidence on sector wise FDI. The study concludes that the Government should design the FDI policy in such a way where FDI inflows can be utilized as means of enhancing domestic production, savings and exports through the equitable distribution among states so that they can attract FDI inflows at their own level. As per the study, the sectors that attracted higher inflows were Communication services as per the CAGR and as per the share it is manufacture sector. The Luxembourg was at highest FDI inflows as per the CAGR and as per the share it is from Mauritius. Samal and Raju (2016) study focused on the center of Foreign Direct Investment (FDI) on manufacturing Industries of India. By investing more FDI it facilitates the economic development & as well as increase the growth of the domestic Product (GDP) of the country and found its positive impact in every sector of industrial life and Human life in order to maintain a sustainable & moderate life style. Kumar and Sharma (2017) study dealt with the effect of FDI inflows on the Indian economy over the period of 2011 to 2014.This analysis has revealed that Foreign Direct Investment has positive and significant impact on GDP. The importance of the FDI was increased after the new economic policy 1990-1991. The results found that foreign direct investment had a good and positive impact on the GDP.

OBJECTIVES OF THE STUDY

The present study is concerned with the following objectives:

(1) To study the trends and patterns of FDI inflow and

(2) To analyze the FDI inflows route-wise from August 1991 to March 2017.

RESEARCH METHODOLOGY

Research methodology is the conceptual structure within which research is conducted. It constitutes the blueprint for the collection, measurement and analysis of the data.

Period of the Study

The present study covers a period of 26 years from the year August 1991 to March 2017.

Data Collection

The study is carried out on the basis of secondary data collected from Reserve Bank of India (RBI), Department of Industrial Policy and Promotion (DIPP) and Secretariat of Industrial Assistance newsletter (SIA). The secondary data has been used as input to attain the objectives of the study.

Tools of Analysis

To analyze the data the study employs annual growth rate estimates and compound annual growth rate of FDI inflows during study period using MS-Excel 2010 software. MS-Excel is a comprehensive and flexible statistical analysis and data management solution. It can take data from almost any type of file and uses them to generate tabulated reports, charts, descriptive statistics and statistical analysis.

RESULTS AND DISCUSSION

Table 1 reveals the trends and patterns of FDI inflows in India during the post-liberalization period from 1991 to 2017. During 1991-92, FDI inflows in India was recorded to $129 million, which had tremendously increased to the level of $315 million, with 144 per cent annual growth rate in 1992-93 over the previous year. In 1993-94, a growth rate of 86 per cent was recorded in FDI inflows over 1992-93 and reached to the level of $586 million. FDI inflows in India increased considerably in 1994-95 and reached to $1314 million, with 124 per cent annual growth rate.

Table 1: FDI Inflows in India (August 1991-March 2017)

Year	Amount of FDI Inflows	Annual Growth Rate
1991-92	129	NA
1992-93	315	144%
1993-94	586	86%
1994-95	1314	124%
1995-96	2144	63%
1996-97	2821	32%
1997-98	3557	26%
1998-99	2462	-31%
1999-00	2155	-12%
2000-01	4029	87%
2001-02	6130	52%
2002-03	5035	-18%
2003-04	4322	-14%
2004-05	6051	40%
2005-06	8961	48%
2006-07	22826	155%
2007-08	34835	53%
2008-09	37838	9%
2009-10	37763	0%
2010-11	30380	-20%
2011-12	46553	53%
2012-13	34298	-26%
2013-14	36046	5%
2014-15	45148	25%
2015-16	55457	23%
2016-17	60082	8%
Gross Total	491240	-
Compound Annual Growth Rate (CAGR)		29%

Source: Secretariat for Industrial Assistance, various FDI Fact Sheets.

FDI inflows increased from the level of $129 million in 1991-92 to the level of $2144 million in the year 1995-96, with a growth rate of 63 per cent over 1994-95. During the period from 1991-92 to 1995-96, the highest FDI inflows in India had amounted to $2144 million in 1995-96, whereas the highest annual growth rate of 144 per cent was recorded in 1992-93. The increase was largely due to the expanded list of industries or sectors which were opened up for foreign equity participation. However, through the new economic policy and the new industrial policy of 1991, a series of policy measures were announced to liberalize the FDI environment in the country.

Policy towards foreign investment was liberalized in 1991 to permit automatic approval for foreign investment upto 51 per cent equity in 34 industries. The foreign investment promotion board was also established to process applications in cases, which were not covered by automatic approval. During 1992-93 several measures were taken to encourage investment flows in the economy through FDI, portfolio investment, NRI investment and deposits and investment in global depository receipts. FDI has been allowed in exploration, production and refining of oil and marketing of gas. Under the new industrial policy of July 1991, approvals for FDI upto 51 per cent of equity in specified high-priority industries were given automatically subject to the condition that the dividend payments should be balanced by export earnings over a specified period of time (Economy Survey, 1992-93).

During 1996-97, FDI inflows increased to $2821 million, with 32 per cent annual growth rate over the previous year. In the next year, a growth rate of 26 per cent was recorded in FDI inflows and reached to the level of $3557 million in absolute terms. During the period from 1991-92 to 1997-98, the total amount of the FDI inflows had amounted to $10866 million and it was found that there had been a continuous increase in FDI inflows.

The Foreign Investment Promotion Board (FIPB) had permitted FDI in the area of financial services in 1997-98. During 1998-99, FDI inflows in India declined to $2462 million by 31 per cent annual growth rate and it was found that FDI inflows had declined for the first time since 1991-92 due to unfavorable international economic environment.

There was a decline in FDI inflows from $2462 million during 1998-99 to $2155 million (12 per cent decrease) during 1999-2000 which could be partly on account of sluggish domestic investment demand. The most important reasons for the declining trend included several restrictions imposed on India by the USA on account of the nuclear test carried out by India at Pokhran, the political instability, slowdown of the Indian economy, the restrictions imposed on the FDI inflows regarding Trade Related Investment Measures (TRIMS), the poor domestic industrial environment and the unfavorable external economic factors such as the financial crisis of South-East Asia. A number of FDI policy initiatives were taken in the year of 1999-2000 to further facilitate inflows of FDI in India. In August 1999, Foreign Investment Implementation Authority (FIIA) was set up for speedy conversion of approvals to actual flows.

Table 2: FDI Inflows in India – Equity and Other Components (August 1991-March 2017)

(US$ million)

Government (SIA/FIPB) Route (a)	RBI Route (b)	NRI Route (c)	Acquisition of Shares (d)	Equity capital of unincorporated bodies (e)	Total FDI (Equity) (a+b+c+d+e) = I	Reinvested Earnings II	Other Capital III	Total FDI Inflows (I+II+III)
66	-	63	-	-	129	-	-	129
222	42	51	-	-	315	-	-	315
280	89	217	-	-	586	-	-	586
701	171	442	-	-	1314	-	-	1314
1249	169	715	11	-	2144	-	-	2144
1922	135	639	125	-	2821	-	-	2821
2754	202	241	360	-	3557	-	-	3557
1821	179	62	400	-	2462	-	-	2462
1410	171	84	490	-	2155	-	-	2155
1456	454	67	362	61	2400	1350	279	4029
2221	767	35	881	191	4095	1645	390	6130
919	739	-	916	190	2764	1833	438	5035
928	534	-	735	32	2229	1460	633	4322
1062	1258	-	930	528	3778	1904	369	6051
1126	2233	-	2181	435	5975	2760	226	8961
2156	7151	-	6278	896	16481	5828	517	22826
2298	17127	-	5148	2291	26864	7679	292	34835
4699	17998	-	4632	702	28031	9030	777	37838
3471	18990	-	3148	1540	27149	8669	1945	37763
1945	12994	-	4491	874	20304	9424	652	30380
3046	20427	-	11360	1021	35854	8205	2494	46556
2319	15967	-	3539	1059	22884	9880	1534	34298
1185	14869	-	8245	975	25274	8978	1794	36046
2219	22530	-	6189	978	31912	9988	3249	45148
3574	32494	-	3933	1042	41043	10049	4365	55457
5900	30417	-	7161	1227	44705	12176	3201	60082

Source: RBI Monthly Bulletins

In 2000-01, FDI inflows in India increased to the level of $4029 million with 87 per cent annual growth rate over the previous year. The share of equity capital, re-invested earnings and other capital was $2400 million, $1350 million and $279 million respectively in total FDI inflows (Table 2). The Gujarat earthquake (January 2001), the terrorist attack on the Indian Parliament (December 2001), and the terrorist attack on the World Trade Centre (WTC) (September 2001) brought about a temporary dislocation in FDI inflows in India. The highest FDI inflows of $4029 million and the highest annual growth rate of 87 per cent were recorded in 2000-01. Hence, it may be concluded that equity capital component of FDI inflows was the sole component of FDI inflows till 2000-01.

In the year 2001-02, FDI inflows in India increased to the level of $6130 million, a growth rate of 52 per cent was recorded over the previous year. This was due to liberalization of the FDI policy. The inflows of the FDI decreased to the level of $5035 million (decrease of 18 per cent) in 2002-03, which further declined to $4322 million (decrease of 14 per cent) in 2003-04. The overall decline in 2002-03 and 2003-04 was principally due to the sharp fall in the net equity inflows through SIA/FIPB route mainly in electronics, electrical and service sectors (RBI, Annual Report 2002-03). Table 2 reveals that the share of equity capital, re-invested earnings and other capital was $2229 million, $1460 million and $633 million respectively in total FDI inflows in 2003-04. FDI inflows grew steadily through the first half of the 90s but stagnated between 1996-97 and 2003-04. The year-on-year fluctuations until 2003-04 make it difficult to identify a clear trend.

During 2004-05, FDI inflows in India increased by 40 per cent and reached to the level of $6051 million in absolute terms. FDI inflows in India had amounted to $8961 million in absolute terms, which were increased by 48 per cent during 2005-06 on the back of positive investment climate, improved growth prospects and initiatives aimed at rationalizing and liberalizing the FDI policy and simplifying the procedures. The highest FDI inflows of $8961 million were recorded in 2005-06, while the highest annual growth rate of 52 per cent was recorded in 2001-02. In view of bringing the FDI compilation of India, in line with international best practices, coverage of data on FDI has been expanded from 2000-01 by including certain new items, viz., equity capital of unincorporated bodies, reinvested earnings and inter-corporate debt transactions between the related entities (RBI, Annual Report 2002-03).

The growth in FDI has been significant after the launch of Make in India initiatives in September 2014, with 48 percent increase in FDI equity inflows during October 2014 to April 2015 over the corresponding period last year. In 2014-15, country witnessed unprecedented growth of 717 percent, to US $ 40.92 billion of Investment by Foreign Institutional Investors (FIIs). The FDI inflow under the approval route saw a growth of 87% during 2014-15 with inflow of US$ 2.22 billion despite more sectors having been liberalized during this period and with more than 90 percent of FDI being on automatic route. These indicators showcases remarkable pace of approval being accorded by the government and confidence of investors in the resurgent India.

The increased inflow of Foreign Direct Investment (FDI) in India especially in a climate of contracting worldwide investments indicates the faith that overseas investors have imposed in the country's economy and the reforms initiated by the Government towards ease of doing business. The Make in India initiatives of the Government and its outreach to all investors have made a positive investment climate for India which is evidenced in the results for the last financial year especially the second half.

Table 2 presents the revised inflows of FDI in India from the year 2000-01. The revised practice of reporting FDI statistics addressed the issue of underestimated FDI inflows in India. The equity inflows have been differentiated under equity inflows of incorporated bodies and equity inflows of unincorporated bodies. In absolute terms, the share of reinvested earnings in total FDI inflows in India was $1350 million (33.51 per cent) in 2000-01, $1645 million (26.83 per cent) in 2001-02, $1833 million (36.41 per cent) in 2002-03, $1460 million (33.78 per cent) in 2003-04, $1904 million (31.47 per cent) in 2004-05 and $2760 million (30.80 per cent) in 2005-06, whereas the share of other capital i.e. inter-corporate debt transactions was $279 million (6.92 per cent) in 2000-01, $390 million (6.36 per cent) in 2001-02, $438 million (8.70 per cent) in 2002-03, $633 million (14.65 per cent) in 2003-04, $369 million (6.10 per cent)in 2004-05 and $226 million (2.52 per cent) in 2005-06.Therefore, it may be concluded that the share of reinvested earnings and other capital in total FDI inflows accounted significant share. From the increase in FDI inflows since 2004-05 and particularly in 2006-07 when total FDI inflows in India crossed the $20 million mark for the first time, India has emerged as one of the leading FDI destinations in Asia in recent years.

Table 1 reveals that FDI in India increased sharply from $8961 million during 2005-06 to $22826 million in absolute terms during 2006-07 on the strength of expansion in domestic activity, the rising pace of mergers and acquisitions in sectors such as financial services, manufacturing, banking services, information technology, and construction. The inflows of FDI in India stood at $34835 million in absolute terms and a growth rate of 53 per cent was recorded during 2007-08. The pick-up in FDI inflows reflected investor's interest in the Indian economy due to the rationalization and liberalization of the FDI policy. FDI was largely driven by equity and reinvested earnings during the year 2008-09. Further measures were taken to support and strengthen the equity route by widening access of foreign firms to local equity markets had the beneficial effect of helping in reducing the market volatility experienced under the impact of global financial crisis.

Table 1 reveals that in 2008-09, FDI inflows in India were recorded to $37838 million, which declined to $37763 million in 2009-10 and reached to the level of $30380 million in 2010-11. The highest FDI inflows in India had amounted to $37838 million in 2008-09, whereas the highest annual growth rate of 155 per cent was recorded in 2006-07. Further, it is found that FDI inflows reached to the level of US$ 36046 in 2013-14.

It is concluded that, during the period under study, annual growth rate in FDI inflows was positive from 1991-92 to 1997-98, but thereafter, it was negative in 1998-99, 1999-00, 2002-03, 2003-04, 2009-10 and 2010-11 and positive in 2000-01, 2001-02 and from 2004-05 to 2008-09. **Table 2** depicts that the cumulative FDI inflows in India from August 1991 to March 2017 were $491240 million. It is also found that total FDI inflows (equity components only) was $357225 million and share of incorporated bodies i.e. government (SIA/FIPB route), RBI route, NRI route and acquisition of shares were $50949 million, $218107 million, $2616 million and $71515 million respectively, whereas share of equity capital of unincorporated bodies was $14042 million. Further, it is also found that the share of reinvested earnings and other capital in total FDI inflows in India was $110858 million and $23155 million respectively. The NRI route of equity capital of incorporated bodies was switched off after 2002-03.

Table 3: Cumulative FDI Inflows in India (August 1991-March 2017)

(US$ million)

Rank	Route of FDI inflows into India	Amount of FDI inflows	Share as % of total FDI inflows
1	RBI Route	218107	44.40
2	Reinvested Earnings	110858	22.57
3	Acquisition of Shares	71515	14.56
4	Government (SIA/FIPB)	50949	10.37
5	Other Capital	23155	4.71
6	Equity Capital of Unincorporated bodies	14042	2.86
7	NRI Route	2616	0.53
	Gross Total	491242	100

Source: Compiled by the author.

Table 3 depicts that RBI route accounted for 44.40 per cent, reinvested earnings 22.57 per cent, Government route (SIA/FIPB) 10.37 per cent, acquisition of shares route 14.56 per cent, equity capital of unincorporated bodies 2.86 per cent, other capital 4.71 per cent and NRI route 0.53 per cent share of total FDI inflows in India. Thus, it is concluded that the highest rank (1st rank) is attained by RBI route followed by reinvested earnings (2nd rank), acquisition of shares (3rd rank), government route (SIA/FIPB) (4th rank), while NRI route has (7th rank) lowest rank in the cumulative FDI inflows in India from August 1991 to March 2017.

FUTURE RESEARCH DIRECTIONS

FDI is an important mode through which investment takes place in India. The importance of FDI extends beyond the financial capital that flows into the country. In addition, FDI can be a tool for bringing knowledge and integration into global production chains, which are the foundation of a successful exports strategy. FDI into India has been on the rise because Indian economy is still growing faster than the rest of the world. India witnessed several big-ticket economic reforms like liberalized FDI policy in which 90 per cent investment comes through automatic route in various sectors, demonetization, introduction of Goods and Services Tax from July 2017 will hopefully attract absolute FDI inflows in the future. India stands committed to have a FDI policy and regime which is investor friendly and also promotes investment leading to increased manufacturing, job creation and overall economic growth of the country.

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