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FDI Impact on Indian Economy

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Abstract

FDI has a huge share and a key motivator of growth in the Indian economy. India opened up to foreign direct investments in the year 1991 and since then the foreign investments have been pouring in the country immensely.

The government of India has been making regulations in the foreign policies in order to make the FDI process liberal and more streamlined in-order to attract more foreign investments in various sectors of India. Prime Minister Narendra Modi does not leave any stone unturned in order to promote India in various global platforms and also bring major reforms in the business environment of India.

The factors that attract foreign investors to India are the low wage rate, skilled human resources, an abundance of natural resources, and liberal policies. India has gradually made its place in the international market and as a key investment destination that provides promising returns. The position of India has also improved in the global club of Ease of Doing Business and tops the Greenfield FDI ranking.

Introduction

UNCTAD, 1999 defines FDI as "an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise, affiliate enterprise or foreign affiliate)."The distinguishing feature of FDI, in comparison with other forms of international investment, is the element of control over management policy and decisions; the element of control gives direct investors an informational advantage over foreign portfolioinvestors and over domestic savers.

Apart from being a critical driver of economic growth, Foreign Direct Investment (FDI) has been a major non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges like tax exemptions, etc. For a country where foreign investment is being made, it also means achieving technical know-how and generating employment.

The Indian Government's favourable policy regime and robust business environment has ensured that foreign capital keeps flowing into the country. The Government has taken many initiatives in recent years such as relaxing FDI norms across sectors such as defence, PSU oil refineries, telecom, power exchanges, and stock exchanges, among others.

FDI India Entry Routes

The government of India has established two routes through which foreign investors can make investments into the Indian economy. The routes for FDI are the automatic route and the government route. A thorough understanding of the two routes is required in terms of foreign investments as the government has divided the various sectors amongst them.

I. Government Route: As the name suggests, the route for foreign investments that has government involvement is known as the government route. To make foreign investments in the sectors that come under the government route, the foreign investors are required to first take approvals from the government as without approvals the foreign entities would not be able to make the investments in India. The foreign investors have to submit a proposal to the respective administrative ministry department who is responsible for granting permissions and then the investments can be made.

II. Automatic Route: The sectors that come under the automatic route of FDI do not require any approvals from the government. The foreign investors can make the investments without taking any approvals from the government through the automatic route but the revised policies must be checked before making the investments to avoid any confusion.

Types & Methods in FDI

A. Types in FDI –

To further understand the nuances of FDI in India, let us have a look at the types of foreign direct investments.

1. Horizontal FDI

- In this type of FDI the parent company initiatives the same business model in another country.
- The goods and services that are manufactured abroad are mostly similar to the products/services that are manufactured in the home country of the company.
- The term horizontal is given to this type of FDI because the similar operations of a company are carried out in another country

2. Vertical FDI

- This type of FDI is known as the export platform foreign direct investment in which the exports are sent back to the home market.
- The main contributor to this type of FDI is the increase of the trade blocks that have low internal trade barriers but have higher external barriers.

3. Platform FDI

- In the case of platform FDI, a business gets expanded to another country but the aim of this expansion is to take the output from the foreign country and export it to the third country.

B. Methods of FDI –

Foreign investors have the opportunity of expanding their business into other countries through the means of foreign direct investment. The following are the various methods of foreign direct investment:

1. Mergers and acquisitions.
2. Joint Ventures with foreign companies
3. Starting subsidiary in an abroad country of the domestic company
4. Getting voting stocks in a foreign company

India & FDI

One of the significant factors that make India an attractive destination for foreign direct investments is the market size. India has a vast customer base that foreign investors want to make the best use of. The buying capacity of the consumers is enormous, and India provides a good market for foreign goods.

Due to the high return on investments, foreign investors want to invest in Indian companies and launch their products. The government of India plays its role rightfully in enhancing the number of foreign investments coming into the country by making time to time reforms in the FDI policy that increase the ease of doing business in the country.

According to the World Bank data, India is currently in the 63rd position in the Ease of Doing Business Rankings. It is a very positive thing for the country and aims to attract a high volume of foreign investments.

Table1. FDI EQUITY INFLOWS (MONTH-WISE) DURING THE FINANCIAL YEAR 2019-20:

Financial year 2019-20 (April - Feb)	Amt of FDI Equity Inflows	
	(In Rs. Crores)	(In US $mn)
Apr-19	36463	5252
May-19	26481	3795
Jun-19	50567	7282
Jul-19	30774	4472
Aug-19	18164	2553
Sep-19	19551	2741
Oct-19	22808	3211
Nov-19	20036	2804
Dec-19	33166	4659
Jan-20	39719	5570
Feb-20	24025	3361

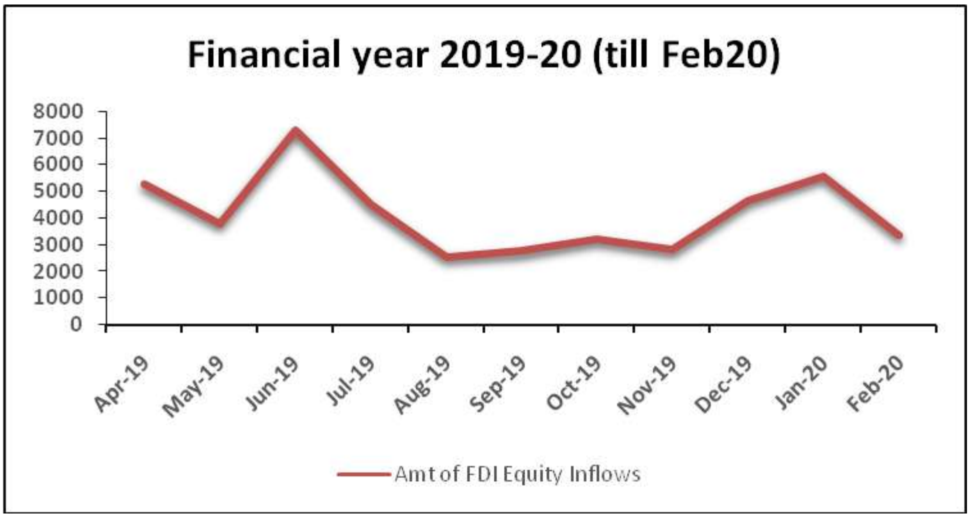

Table 2. SECTORS ATTRACTING HIGHEST FDI EQUITY INFLOWS

Amt in Rs. Crores (in US $ mn)

Rank	Sector	2017-18	2018-19	2019-20
1	SERVICES SECTOR	43,249 (6,709)	63,909 (9,158)	55,429 (7,854)
2	COMPUTER SOFTWARE & HARDWARE	39,670 (6,153)	45,297 (6,415)	54,250 (7,673)
3	TELECOMMUNICATIONS	39,748 (6,212)	18,337 (2,668)	30,940 (4,445)
4	TRADING	28,078 (4,348)	30,963 (4,462)	32,406 (4,574)
5	CONSTRUCTION DEVELOPMENT	3,472 (540)	1,503 (213)	4,350 (617)
6	AUTOMOBILE INDUSTRY	13,461 (2,090)	18,309 (2,623)	19,753 (2,824)
7	CHEMICALS (OTHER THAN FERTILIZERS)	8,425 (1,308)	13,685 (1,981)	7,492 (1,058)
8	CONSTRUCTION (INFRASTRUCTURE) ACTIVITIES	17,571 (2,730)	15,927 (2,258)	14,510 (2,042)
9	DRUGS & PHARMACEUTICALS	6,502 (1,010)	1,842 (266)	3,650 (518)
10	HOTEL & TOURISM	7,279 (1,132)	7,590 (1,076)	21,060 (2,938)

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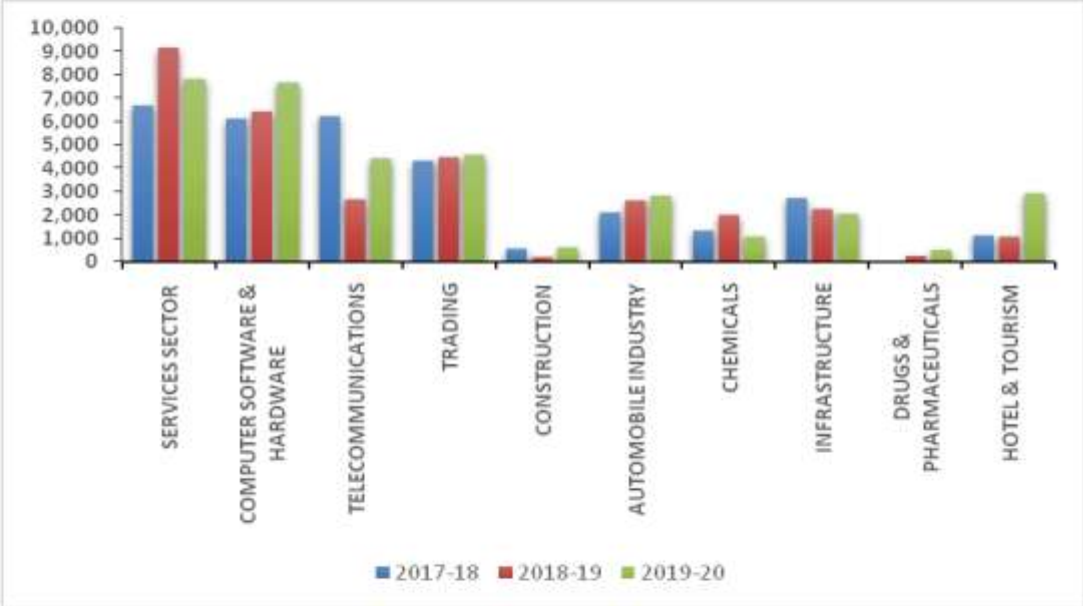

FDI: Good or Bad?

A. Benefits of FDI

FDI brings in many advantages to the country. Some of them are discussed below.

1. Brings in financial resources for economic development.
2. Brings in new technologies, skills, knowledge, etc.
3. Generates more employment opportunities for the people.
4. Brings in a more competitive business environment in the country.
5. Improves the quality of products and services in sectors.

B. Disadvantages of FDI

However, there are also some disadvantages associated with foreign direct investment. Some of them are:

1. It can affect domestic investment, and domestic companies adversely.
2. Small companies in a country may not be able to withstand the onslaught of MNCs in their sector. There is the risk of many domestic firms shutting shop as a result of increased FDI.
3. FDI may also adversely affect the exchange rates of a country.

Road Ahead

India is expected to attract foreign direct investments (FDI) of US$ 120-160 billion per year by 2025, according to CII and EY report. Over the past 10 years, the country witnessed a 6.8% rise in GDP with FDI increasing to GDP at 1.8%.

In terms of attractiveness, investors ranked India #3; ~80% investors have plans to invest in India in the next 2-3 years, while ~25% reported investments worth >US$ 500 million, the Economic Times reported.

FDI provides India with stability in inflow of funds, access to international markets, export growth, Technological transfer, and skills to improve the balance of payment. But FDI doesn't guarantee a high growth rate. Host countries should enforce environmental regulations. FDI must be monitored and nurtured in such a way that it will bring more skills and resources.

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