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Role of Foreign Direct Investment in the Indian Economy

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Abstract: *International Economic Integration plays a crucial role in the country's economic development. It creates an arrangement between different regions which is marked by the elimination of trade barriers and the coordination of monetary and fiscal policies. Foreign Direct Investment is one of the major instruments of attracting International Economic Integration in an economy. Many developing countries like India are facing the deficit of savings. This problem can be solved with the help of Foreign Direct Investment because it acts as a bridge to fulfill the gap between saving and investment. FDI not only helps to cover the domestic saving constraint but also provide access to the new and updated technologies that in turns helps to promote the efficiency and productivity of the economy. The main purpose of the study is to investigate the impact of FDI on economic growth in India, from the period of 2000 to 2016. The present study deals with the objectives (a) to assess the amount of FDI inflows from 2000 – 2016, (b) to access the FDI equity inflow in India and (c) to explore the sector wise distribution of FDI inflows in order to point out the dominating sector, that has attracted the major share. To analysis the above mentioned objectives, data has been gathered through secondary sources like reports and publications of RBI, reports and journals related to foreign investment, magazine and internet. This paper recommends that India should welcome the inflow of foreign investment because it enables us to achieve our goals like favourable balance of payment, rapid economic development, removal of poverty, and internal personal disparity in the development of Indian economy.*

Keywords: *Foreign direct investment, Indian economy, International Economic Integration, economic growth, trade barriers.*

I. INTRODUCTION

The foreign direct investment (FDI) by multinational corporations helps in stimulating the dynamic growth of an economy. Except employment opportunities, FDI will bring knowledge that indirectly effect in building skill and technological capacities of local firms. Fast growing economies like Singapore, China, and Korea etc have shown incredible growth at onset of FDI. Though US capture most of the FDI inflows-, developing countries still account for significant growth of FDI. FDI offers an exclusive opportunity to enter into the international or global business, new markets and marketing channels, exclusive access to new technology and expertise, expansion of company with new or more products or services, and cheaper production facilities. Indian economy has shown a favorable business environment after 1991, when the government of India opened the door for foreign capital in the way of direct investment and through foreign institutional investors. A foreign investment includes both foreign portfolio investments and foreign direct investments (FDI).

FDI means cross-border investment by a resident entity in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy. Or 'capital inflows from abroad that is invested in or to enhance the production capacity of the economy'. FDI is considered to be the life blood for developing nations. It provides opportunity for technological transfer and up gradation and others. It helps in broaden the market accessibility for both host and home countries. It helps in invention and innovation of international markets.

FDI can be categorized into three parts, i.e. horizontal, vertical and conglomerate direct investment. A horizontal direct investment can be defined as investing the same type of business operations in a foreign country as it operates in its home country. A vertical direct investment is the one in which the companies separates their production process by outsourcing some production stages geographically. The main reason behind this type of FDI is that if the input prices vary across the different countries, it becomes profitable for the firm to split the production chain. A conglomerate direct investment is the one in which a company or an individual makes a foreign investment in a business which is totally unrelated to its existing business in its home country.

India is a developing country and it needs certain amount of saving to invest for its development. This gap between saving and investment can be filled by foreign investment. Moreover, India has lower level of technology as compared to developed nations. So, in order to meet them, it is necessary for India to have new and updated technology which can be possible with the help of technology transfer.

II. REVIEW OF LITERATURE

Aggarwal and Khan (2011) ^[1] in their study found that 1% increase in FDI would result in 0.07% increase in GDP of China and 0.02% increase in GDP of India. The study also found that China's growth is more affected by FDI, than India's growth. Kumar and Karthika (2010) ^[2] found out in their study that Foreign Direct Investment has a major role to play in the economic development of the host country. Many countries are using foreign investment and foreign technology to accelerate the pace of their economic growth. FDI ensures a huge amount of domestic capital, production level and employment opportunities in the developing countries, which a major step towards the economic growth of the country.

John Andreas ^[3] in his work "The Effects of FDI Inflows on Host Country Economic Growth" discusses the potential of FDI inflows to affect host country economic growth. The paper argues that FDI should have a positive effect on economic growth as a result of technology spillovers and physical capital inflows. A cross section and panel data analysis on a dataset covering 90 countries during the period 1980 to 2002, finds that FDI inflows enhance economic growth in developing economies only but not in developed economies. This paper has assumed that the direction of causality goes from inflow of FDI to host country economic growth. However, economic growth could itself cause an increase in FDI inflows.

Chopra ^[4] examines the effect of policy reforms on the FDI in India. The analysis has been carried out with the help of annual data from 1980-2000. The research includes 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. Empirical result shows that GDP is an important factor which motivates FDI in the country.

Jayachandran and Seilan ^[5] investigate the relationship between trade, Foreign Direct Investment (FDI) and economic growth of India over the period 1970-2007. The results of Granger causality test show that there is a causal relationship between the examined variables. The direction of causality relationship is from FDIs to growth rate and there is no causality relationship from growth rates to FDIs.

Sharma Reetu and Khurana Nikita (2013) ^[6] in their study on the sector-wise distribution of FDI inflow to know about which has concerned with the chief share, used a data from 1991-92 to 2011-2012 (post-liberalization period). This paper also discusses the various problems about the foreign direct investment and suggests the some recommendations for the same. In this study found that, Indian economy is mostly based on agriculture. So, there is a most important scope of agriculture services. Therefore, the foreign direct investment in this sector should be encouraged.

III. OBJECTIVE OF THE STUDY

- To assess the amount of FDI inflows from 2000 – 2016.
- To access the FDI equity inflow in India

To explore the Sector wise distribution of FDI inflows in order to point out the dominating sector, that has attracted the major share.

IV. RESEARCH METHODOLOGY

The data is collected with the help of secondary sources like reports and publication of Govt. and RBI relating to foreign Investment, economic journals, books, magazines and internet etc.

V. DATA ANALYSIS

Financial year wise FDI inflows data:

A. AS PER INTERNATIONAL BEST PRACTICES:

(Data on FDI have been revised since 2000-01 with expended coverage to approach International Best Practices)

(Amount US\$ million)

S.No	Financial Year (Apr- Mar)	FOREIGN DIRECT INVESTMENT (FDI)						Investment by FII's (net)
		EQUITY		Reinvested earnings	Other capital	FDI FLOWS INTO INDIA		
		FIPB route/RBI's Automatic Acquisition Route	Equity capital of unincorporat ed bodies			Total FDI flows	% age growth over previous year (US \$ terms)	
FINANCIAL YEAR 2000-01 TO 2015-16								
1	2000-01	2,339	61	1,350	279	4,029	-	1,847
2	2001-02	3,904	191	1,645	390	6,130	(+)52%	1,505
3	2002-03	2,574	190	1,833	438	5,035	(-)18%	377
4	2003-04	2,197	32	1,460	633	4,322	(-)14%	10,918
5	2004-05	3,250	528	1,904	369	6,051	(+)40%	8,686
6	2005-06	5,540	435	2,760	226	8,961	(+)48%	9,926
7	2006-07	15,585	896	5,828	517	22,826	(+)155%	3,225
8	2007-08	24,573	2,291	7,679	300	34,843	(+) 53 %	20,328
9	2008-09	31,364	702	9,030	777	41,873	(+) 20 %	(-) 15,017
10	2009-10	25,606	1,540	8,668	1,931	37,745	(-)10%	29,048
11	2010-11	21,376	874	11,939	658	34,847	(-)8%	29,422
12	2011-12	34,833	1,022	8,206	2,495	46,556	(+)34%	16,812
13	2012-13	21,825	1,059	9,880	1,534	34,298	(-)26%	27,582
14	2013-14	24,299	975	8,978	1,794	36,046	(+)5%	5,009
15	2014-15	30,933	952	8,983	3,423	44,291	(+)25%	40,923
16	2015-16	40,001	1,042	10,049	4,365	55,457	(+)23%	(-)3,516
	CUMULATI VE TOTAL (Apr2000- Mar2016)	290,199	12,816	101,197	19,955	424,167		1,87,075

Source: (i) RBI's Bulletin May, 2016 dt.10.05.2016 (Table No. 34 – foreign investment inflows).
(ii) Figures updated by RBI up to March, 2016.

The above table depicts the route –wise FDI inflows in India from 2000 to 2016. It shows that FIPB, RBIs, Automatic and Acquisition have the maximum contribution in total FDI in India. FDI through Automatic Acquisition Route is increasing year by year. FDI through equity was maximum in year 2007-08 (2,291) and minimum in year 2000-01 (61). FDI through Re-

invested was at peak in the year 2010-11 (11,939). The total inflow was 34,847 million dollars in year 2010-11 which has increased to 55,457 million dollars in 2015-16. The FDI flow in India has shown an incredible growth.

B. DIPP'S – FINANCIAL YEAR-WISE FDI EQUITY INFLOWS:

As per Department of Industrial Policy & Promotion- FDI data base – equity capital components only):

Financial Year 2000-01 To 2015-16		Amt Of FDI Inflows		%Age Of Growth Over Previous Year (In Terms Of Us \$)
S.NO	Financial Year (Apr-Mar)	In Rs Crores	In Us\$ Millions	
1	2000-01	10,733	2,463	
2	2001-02	18,654	4,065	(+)65%
3	2002-03	12,871	2,705	(-)33%
4	2003-04	10,064	2,188	(-)19%
5	2004-05	14,653	3,219	(+) 47 %
6	2005-06	24,584	5,540	(+) 72 %
7	2006-07	56,390	12,492	(+)125 %
8	2007-08	98,642	24,575	(+) 97 %
9	2008-09	1,42,829	31,396	(+) 28 %
10	2009-10	1,23,120	25,831	(-) 18 %
11	2010-11	97,320	21,383	(-) 17 %
12	2011-12	1,65,146	35,121	(+) 64 %
13	2012-13	1,21,907	22,423	(-) 36 %
14	2013-14	1,47,518	24,299	(+) 8%
15	2014-15	1,89,107	30,931	(+) 27%
16	2015-16	2,62,322	40,001	(+) 29%
CUMULATIVE TOTAL (from April, 2000 to March, 2016)		1,495,860	288,635	

Source: Department of Industrial Policy & Promotion, Government of India, Ministry of commerce and Industry <http://dipp.nic.in/English/Default.aspx>

The above table shows the equity components of FDI flows in India. It shows the fluctuations in the equity FDI in India. Year 2006-07 has marked an incredible increase in the inflows of equity FDI by 125%. The total amount of inflows amounts to Rs 1,495,860 crores, which makes it clear that equity, is the most important route for investment in India.

STATEMENT ON SECTOR-WISE FDI EQUITY INFLOWS

FROM APRIL 2000 TO MARCH 2016

S.No	Sector	Amount of FDI Inflows		%age of Total Inflows
		(In Rs crore)	(In US\$ million)	
1	SERVICES SECTOR	258,354.22	50,792.42	17.6
2	CONSTRUCTION DEVELOPMENT: Townships, housing, built-up infrastructure and construction-development projects	113,936.35	24,187.94	8.38
3	COMPUTER SOFTWARE & HARDWARE	112,183.92	21,017.77	7.28
4	TELECOMMUNICATIONS	92,728.71	18,382.35	6.37
5	AUTOMOBILE INDUSTRY	81,394.21	15,064.59	5.22
6	DRUGS & PHARMACEUTICALS	70,097.36	13,849.50	4.8
7	CHEMICALS (OTHER THAN FERTILIZERS)	59,555.37	11,900.29	4.12
8	TRADING	68,836.54	11,872.47	4.12
9	POWER	52,613.34	10,476.15	3.63
10	HOTEL & TOURISM	49,709.68	9,227.33	3.2
11	METALLURGICAL INDUSTRIES	43,427.34	8,890.34	3.08
12	CONSTRUCTION (INFRASTRUCTURE) ACTIVITIES	47,897.17	7,956.75	2.76

13	FOOD PROCESSING INDUSTRIES	40,264.87	6,815.69	2.36
14	PETROLEUM & NATURAL GAS	32,659.51	6,675.76	2.31
15	INFORMATION & BROADCASTING (INCLUDING PRINT MEDIA)	26,336.17	4,977.02	1.73
16	NON-CONVENTIONAL ENERGY	24,260.55	4,397.94	1.52
17	ELECTRICAL EQUIPMENTS	21,864.52	4,336.72	1.5
18	INDUSTRIAL MACHINERY	22,042.84	4,064.57	1.41
19	HOSPITAL & DIAGNOSTIC CENTRES	19,783.21	3,592.11	1.25
20	CONSULTANCY SERVICES	17,619.11	3,356.58	1.16
21	CEMENT AND GYPSUM PRODUCTS	14,776.62	3,109.11	1.08
22	MISCELLANEOUS MECHANICAL & ENGINEERING INDUSTRIES	15,182.50	3,068.10	1.06
23	FERMENTATION INDUSTRIES	12,894.51	2,376.96	0.82
24	MINING	12,026.96	2,216.09	0.77
25	RUBBER GOODS	11,772.91	2,084.26	0.72
26	SEA TRANSPORT	10,435.27	1,977.50	0.69
27	TEXTILES (INCLUDING DYED,PRINTED)	9,610.46	1,852.47	0.64
28	AGRICULTURE SERVICES	9,275.85	1,844.31	0.64
29	PORTS	6,730.91	1,637.30	0.57
30	ELECTRONICS	8,171.00	1,636.03	0.57
31	PRIME MOVER (OTHER THAN ELECTRICAL GENERATORS)	7,914.27	1,451.29	0.5
32	EDUCATION	6,870.77	1,256.08	0.44
33	SOAPS, COSMETICS & TOILET PREPARATIONS	6,086.00	1,111.32	0.39
34	MEDICAL AND SURGICAL APPLIANCES	5,971.26	1,097.13	0.38
35	PAPER AND PULP (INCLUDING PAPER PRODUCTS)	5,498.68	1,093.82	38
36	AIR TRANSPORT (INCLUDING AIR FREIGHT)	5,184.29	931.05	0.32
37	MACHINE TOOLS	4,346.88	837.96	0.29
38	DIAMOND,GOLD ORNAMENTS	4,183.70	772.05	0.27
39	CERAMICS	3,617.40	744.72	0.26
40	RAILWAY RELATED COMPONENTS	3,925.80	710.98	0.25
41	VEGETABLE OILS AND VANASPATI	3,165.41	589.06	0.2
42	PRINTING OF BOOKS (INCLUDING LITHO PRINTING INDUSTRY)	3,208.09	581.49	0.2
43	FERTILIZERS	3,060.09	564.8	0.2
44	RETAIL TRADING	3,275.28	537.61	0.19
45	GLASS	2,623.90	499.77	0.17
46	AGRICULTURAL MACHINERY	2,259.34	433.99	0.15
47	COMMERCIAL, OFFICE & HOUSEHOLD EQUIPMENTS	1,761.39	346.03	0.12
48	EARTH-MOVING MACHINERY	1,799.11	337.16	0.12
49	SUGAR	1,110.62	188.51	0.07
50	SCIENTIFIC INSTRUMENTS	1,002.49	178.27	0.06
51	LEATHER,LEATHER GOODS AND PICKERS	883.07	164.91	0.06
52	TIMBER PRODUCTS	838.15	147.46	0.05
53	BOILERS AND STEAM GENERATING PLANTS	823.55	141.24	0.05
54	TEA AND COFFEE (PROCESSING & WAREHOUSING COFFEE & RUBBER)	505.49	109.62	0.04

55	DYE-STUFFS	438.88	77.71	0.03
56	INDUSTRIAL INSTRUMENTS	363.8	75.34	0.03
57	PHOTOGRAPHIC RAW FILM AND PAPER	273.76	67.29	0.02
58	GLUE AND GELATIN	211.52	37.78	0.01
59	COAL PRODUCTION	119.19	27.73	0.01
60	MATHEMATICAL,SURVEYING AND DRAWING INSTRUMENTS	39.8	7.98	0
61	DEFENCE INDUSTRIES	25.48	5.12	0
62	COIR	22.05	4.07	0
63	MISCELLANEOUS INDUSTRIES	47,474.61	9,747.04	3.38
	Sub Total	1,495,326.10	288,512.78	
64	RBI's- NRI Schemes (2000-2002)	533.06	121.33	
	Grand Total	1,495,859.16	288,634.11	

Source: FDI Statistics, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, Government of India.

It is to be noted that Services sector includes Financial, Banking, Insurance, Non-Financial / Business, Outsourcing, R&D, Courier, Tech. Testing Analysis. The inflow of FDI in service sector, from Apr 2000 to 2016, has attained significant economic growth. The highest amount of FDI has gone to service sector, followed by construction development and computer software & hardware.

VI. FINDINGS

On the basis of the present study, following are the findings-

- The study reveals that the saving rate is less than investment rate in the study period.
- The foreign investment increased in both term i.e. FDI and FIIs.
- Equity is the important route of FDI inflow that is 3, 03,015 million Dollars in India.
- Second important route of foreign indirect investment is FIIs. Through this route inflow of foreign investment found 1, 87,075 million Dollars (US Dollar).
- As per Department of Industrial Policy & Promotion, of equity FDI, from Apr 2000-2016 is Rs 1,495,860 crores.
- The highest amount of FDI has gone to service sector, followed by construction development and computer software & hardware.
- The total amount of inflows from all the sectors is Rs 1,495,859.16 crores.

VII. CONCLUSION

FDI in India has always played a very significant role in the economic development of the country. Foreign investments are helping in meeting the scare domestic investments in developing countries. In India, through FDI, many of the sectors have attained sustained economic growth and development because of increase in number of jobs, expansion of manufacturing industries, exclusive access to new technology and new markets and marketing channels. The inflow of FDI in service sector, from Apr 2000 to 2016, has attained significant economic growth. The other two sectors that have shown incredible inflow of FDI are construction development, computer software & hardware. India should provide better environment for attracting the foreign investment. They should welcome inflow of foreign investment in such way that it should help in achieving our cherished goal like rapid economic development, removal of poverty, internal personal disparity in the development and making our Balance of Payment favorable.

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