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FACTORS AFFECTING FOREIGN DIRECT INVESTMENT IN INDIA

Shreshtha Sharma*

Abstract

Foreign Direct Investment has emerged as an upcoming parameter to assess the development of Indian Economy. For the growth and development of any nation FDI inflows can be taken as key factor. India needs foreign investment for improving Infrastructure, capital formation, employment, economic stability, and utilization of productive resources etc.

Several studies reveal the inflow of Foreign Direct Investment in India. The objective of the present work is to examine the different factors responsible for FDI inflows in India. Keeping in view of the stated, the current research paper will be a foundation to any further efforts in the direction of promoting or hindering foreign direct investment in India.

Keywords:Foreign Direct Investment; India;Factors;Reform in policy.

* **Assistant Professor, Babu Banarasi Das Engineering College, Lucknow.**

1. Introduction

Investing directly in production activities of another country, either by buying a company there or establishing new operations of an existing business, is known as Foreign Direct Investment (FDI). Foreign Direct Investment is done mostly by companies as opposed to financial institutions, which prefer indirect investment abroad such as buying small parcels of a country's supply of shares or bonds. In India, Foreign direct investment grew rapidly during the 1990s before slowing a bit, along with the global economy, in the early years of the 21st century. Most of this investment went from one country to another, but the share going to developing countries increased gradually. Therefore, many multinational companies also started making a beeline to enter India. Recent reports have shown that Foreign Direct Investment is on an increasing rise and is expected to follow the same trend in future.

2. Objectives of the Study

- To study the factors affecting foreign direct investment in India.
- To study the current trends associated with the foreign direct investment in India.
- To study the major challenges to the global players for foreign direct investment in India.

3. Research Methodology

The present study aims to examine the role of foreign direct investment in India and to identify factors affecting FDI inflows in the Indian economy. Secondary data have been used. Various government reports were analyzed. FDI Guidelines for this sector was also analyzed to find out the implications on the growth of this industry. The research methodology also includes compilation of research article of the experts in the field and reflections of the various books on FDI.

4. Foreign Direct Investment

Foreign direct investment plays a pivotal role in the development of any nation. It becomes significant if the country is under-developing or developing. Foreign Direct Investment inflows provide financial resources to a country for long-term development, a sustainable growth of the economy and at the same time increasing the income and savings level.

Contextual Background

The historical background of Foreign Direct Investment in India can be traced back with the establishment of East India Company of Britain. British capital came to India during the colonial era of Britain in India. However, researchers could not depict the complete history of Foreign Direct Investment inflows in India due to lack of abundant and authentic data. Before independence major amount of Foreign Direct Investment came from the British companies. British companies setup their units in mining sector and in those sectors that suits their own economic and business interest. After Second World War, Japanese companies entered Indian market and enhanced their trade with India, yet U.K. remained the most dominant investor in India[2].

Post independence, the MNCs operations gained attention of the policy makers and they planned Foreign Direct Investment policy which was aimed as a medium for acquiring advanced technology and to mobilize foreign exchange resources[2].

Foreign Direct Investment and India

FDI is ascribed as a source of economic growth, modernisation and employment creator where the policies of the government decides the overall benefits and stimulates technological overflow to help capital formation, thereby, contributing to international trade practices. Moreover, it helps to create a higher level of competitive business environment and consequently improve the efficiency of the resources used[14].

India opened its door for Foreign Direct Investment after introducing the liberalized economic policy in July'24, 1991 under Foreign Exchange Management Act (FEMA), driven by the then finance minister Dr. Manmohan Singh[14].

An Indian corporation may receive Foreign Direct Investment under the two routes:

i. Automatic Route

Foreign Direct Investment is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/sectors except

ii. Government Route

Foreign Direct Investment in activities not covered under the automatic route requires prior approval of the Government which is considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance.

The Indian company having received Foreign Direct Investment either under the Automatic route or the Government route is required to comply with provisions of the Foreign Direct Investment policy including reporting the Foreign Direct Investment to the Reserve Bank[11].

In addition to the above stated Foreign Direct Investment is prohibited under the Government Route as well as the Automatic Route in Atomic Energy, Lottery Business, Gambling and Betting, Business of Chit Fund, Nidhi Company, Trading in Transferable Development Rights (TDRs), Real Estate Business or Construction of Farm Houses, Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes, and Railway operations (other than permitted activities)[8].

5. Factors affecting Foreign Direct Investment in India

Foreign direct investment becomes important in India after the 1991 policy reform. It is the aim and purpose of the Government of India to attract and promote foreign direct investment in order to enhance domestic capital, technology and skills, for speedy economic growth.

The numerous factors affect FDI in India. Particular action of investor or government is responsible for any change in the investment for a given period is taken as factor for it. A set of variables influence investment to rise or fall as suggested by existing literature, some of them are:

Investor-friendly policy: The government has put in place an investor-friendly policy on foreign direct investment, under which FDI up to 100% is permitted under the automatic route in most sectors/activities. Under this route, no permission from the Central Government is required for

FDI inflow, but the same is subject to applicable laws/regulations, security and other conditions[8].

National political framework: Changes in the national political climate have impulsive and noticeable trend towards greater acceptability of FDI. The present government has introduced many initiatives to attract FDI inflows as well as has paid attention to liberalize FDI policy. It includes improving infrastructure, reforming the land-acquisition law, revisiting the labour law, and improving coordination between central-state governments for project clearances process[5].

Market size and Economic Growth: This is among the most important factor of FDI inflow. Market size can be measured by gross domestic product, GDP per capita, or the population of middle-income group etc. Countries having more GDP growth rate can attract more FDI inflows[13]. As per the Central Statistics Office (CSO), the growth rate of the gross domestic product (GDP) has been 7.6 per cent in fiscal year 2015-16, as against the 7.2 percent growth recorded in the previous year[9]. Larger the market size more appealing to the FDI inflows. This growing GDP will be able to attract more inflows.

Infrastructure: Infrastructure is the basis of economic growth and development. The synergic effect of infrastructure development on the economy is important and its role as a stimulator of economic growth is unquestionable. The availability and reliability of infrastructure is a most important factor for profit. Infrastructure development can be measured by roads, ports, railways and telecommunication development as well as institutional development (banks)[3].

Availability of quality human capital and public investment: Availability of quality human capital and public investment in development is more significant. FDI can have a positive impact on growth, especially when the host country has a highly educated workforce, allowing it to use FDI spill-over. Availability of export orientation of economy, technical manpower is more significant for FDI inflows[1].

Resources: Resources are the reason of reducing cost of production hence it attracts more investors to invest in India. Natural resources protected by imposing high tariffs or quotas from international competition. The theoretical investigation reveals that policy related variables and economic factors jointly explain the variations in the FDI inflows. Empirical analysis reveals that the long term debt is a key factor in attracting FDI as compare to Foreign exchange reserves and Sum of exports and imports (Exim). These inflows will be unfavourably affected if the natural resources are highly protected[6].

International Image: One of the most promising destinations for FDI investment is India for sure. The United Nations Conference for Trade and Development said that FDI into India had nearly doubled in 2015 and the country remains a top destination.

India receives the major share of FDI inflows in South Asia. Inward FDI stock stood at $202 billion, making India one of the largest FDI recipients in the developing world[15].

Make in India Movement: Make in India inititative was launched on September 25, 2014, with aim of promoting manufacturing and attract foreign investment. The major objectives behind the Make in India initiative are job creation and skill enhancement in 25 sectors of the economy, including automobiles, aviation, biotechnology, chemicals, construction, defence manufacturing, electrical machinery, electronic systems and mining. As per Economic survey, there was an almost 40% increase in FDI inflows from October 2014 to June 2015 after the launch of the initiative[12].

According to the Department of Industrial Policy and Promotion, FDI inflows under the approval route (which requires prior government permission) increased by 87% during 2014-15 with an inflow of $2.22 billion. More than 90% of FDI was through the automatic route[8].

6. Conclusion

As evidenced by analysis and data, FDI trends are taken more sincerely and the importance of FDI flows for the economy to grow has been identified whereby the government recognised that lots of simplifications of procedures are still needed. It is true that with reforms in policies maximum global investors are getting attracted to India. India now has a large number of sectors open for FDI inflows under 100% automatic route or closer to 100%. But still there are some sectors having lots of restrictions, where even government approval will not permit foreigners to own up to 100% of companies they invest in. Policies of FDI have affected various sectors in different speed and effectiveness.

The goal for upcoming years would link gain and restore the government capacity for generating employment, removing poverty and promoting equality.

There are many diverse factors that decide FDI inflows and it is really a hard deal to isolate them as it also depends on the type of industry.

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