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ROLE OF FOREIGN DIRECT INVESTMENT IN THE ECONOMIC DEVELOPMENT OF INDIAN ECONOMY

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Abstract:

This paper presents the role of Foreign Direct Investment in the economic development of Indian economy. Foreign direct investment (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 company. Foreign direct investments are distinguished from portfolio investments in which an investor merely purchases equities of foreign-based companies. Foreign investment involves capital flows from one country to another, granting extensive ownership stakes in domestic companies and assets. Foreign investment denotes that foreigners have an active role in management as a part of their investment. A modern trend leans toward globalization, where multinational firms have investments in a variety of countries.[1]

Key words: Foreign direct investment, economic development, Indian economy, growth, investment etc.

Introduction:

Foreign Direct Investment is expected to bring needed capital to developing countries. The developing countries need higher investment to achieve increased targets of growth in national income.[2]

Foreign Direct Investment provides inflow of foreign exchange resource and removes the constraints on balance of payment. It can be seen that a large number of developing countries suffer from balance of payments deficits for their demand for foreign exchange which is normally far in excess of their ability to earn. Foreign Direct Investment inflows by providing foreign exchange resources remove the constraint of developing countries seeking higher growth rates.

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Types of Foreign Direct Investment (FDI)

1. **Horizontal FDI** arises when a firm duplicates its home country-based activities at the same value chain stage in a host country through Foreign Direct Investment.
2. **Platform FDI** Foreign directs investment from a source country into a destination country for the purpose of exporting to a third country.
3. **Vertical FDI** takes place when a firm through Foreign Direct Investment moves upstream or downstream in different value chains i.e. when firms perform value-adding activities stage by stage in a vertical fashion in a host country.[3]

Methods:

The foreign direct investor may acquire voting power of an enterprise in an economy through any of the following methods:

- by incorporating a wholly owned subsidiary or company anywhere
- by acquiring shares in an associated enterprise
- through a merger or an acquisition of an unrelated enterprise
- Participating in an equity joint venture with another investor or enterprise.

In the context of foreign direct investment, advantages and disadvantages are often a matter of perspective. A Foreign Direct Investment may provide some great advantages for the MNE but not for the foreign country where the investment is made. On the other hand, sometimes the deal can work out better for the foreign country depending upon how the investment pans out. Ideally, there should be numerous advantages for both the MNE and the foreign country, which is often a developing country. We will examine the advantages and disadvantages from both perspectives, starting with the advantages for multinational enterprises (MNEs).[4]

- **Access to markets**: FDI can be an effective way for you to enter into a foreign market. Some countries may extremely limit foreign company access to their domestic markets. Acquiring or starting a business in the market is a means for you to gain access.

- **Access to resources**: FDI is also an effective way for you to acquire important natural resources, such as precious metals and fossil fuels. Oil companies, for example, often make tremendous FDIs to develop oil fields.

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- **Reduces cost of production**: FDI is a means for you to reduce your cost of production if the labor market is cheaper and the regulations are less restrictive in the target foreign market. For example, it's a well-known fact that the shoe and clothing industries have been able to drastically reduce their costs of production by moving operations to developing countries.

Foreign Direct Investment also offers some advantages for foreign countries. For starters, FDI offers a source of external capital and increased revenue. It can be a tremendous source of external capital for a developing country, which can lead to economic development.

Importance of Foreign Direct Investment (FDI)

Foreign direct investment is critical for developing and emerging market countries. Their companies need the sophisticated investors' funding and expertise to expand their international sales. In 2015, they received 43 percent of total global Foreign Direct Investment. Developing Asia attracted more foreign investment than either the European Union or the United States.[5]

The developed world also needs cross-border investment, but for different reasons. Most of these countries' investment is via mergers and acquisitions between mature companies. These global corporations' investments were for either restructuring or refocusing on core businesses.

In 2015, world Foreign Direct Investment rose 38 percent to $1.76 trillion. There was a surge in cross-border mergers and acquisitions. Once the merger and acquisition activity was subtracted from the calculations, Foreign Direct Investment only gained 15 percent. (Source: Annual 2016 FDI Report, UNCTAD, June 24, 2016.)

In 2014, FDI declined 16 percent to $1.2 trillion. That unusual drop-off was investment in the developed world declined 28 percent. Most of it was a single massive U.S. divestment. In 2013, FDI was up 9 percent to $1.45 trillion. (Source: Annual 2015 FDI Report, UNCTAD, June 24, 2015.)

Foreign enterprises by employing the nationals of developing countries provide employment. In the absence of this investment, these employment opportunities would not have been available to many developing countries.

Further, these employment opportunities are expected to be in relatively higher skill areas. Foreign Direct Investment not only creates direct employment opportunities but also through backward and forward linkages, it is able generate indirect employment opportunities as well.

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Role of Foreign direct investment in India

Foreign direct investment (FDI) in India is the major monetary source for economic development in India. Foreign companies invest directly in fast growing private Indian businesses to take benefits of cheaper wages and changing business environment of India. Economic liberalization started in India in wake of the 1991 economic crisis and since then FDI has steadily increased in India. It were Manmohan Singh and P. V. Narasimha Rao who brought FDI in India, which subsequently generated more than one crore jobs. According to the *Financial Times*, in 2015 India overtook China and the US as the top destination for the Foreign Direct Investment. In first half of the 2015, India attracted investment of $31 billion compared to $28 billion and $27 billion of China and the US respectively [6]

Foreign Investment in India is governed by the FDI policy announced by the Government of India and the provision of the Foreign Exchange Management Act (FEMA) 1999. The Reserve Bank of India (RBI) in this regard had issued a notification, which contains the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000. This notification has been amended 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 cap. The FDI policy is notified through Press Notes by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP).The foreign investors are free to invest in India, except few sectors/activities, where prior approval from the RBI or Foreign Investment Promotion Board ('FIPB') would be required.

The ability to attract large scale Foreign Direct Investment into India has been a key driver for policy making by the Government. Prime Minister Modi seems to be going along the right track, with India receiving FDI inflows worth USD 60.1 billion in 2016-17, which was an all-time high. Hence, the FDI policy of India has always been closely watched and carefully amended over the years.

On August 28th, 2017, the Department of Industrial Policy and Promotion (**DIPP**) had issued the updated and revised Foreign Direct Investment Policy, 2017 – 2018 (**FDI Policy 2017**). The FDI Policy 2017 incorporated various notifications issued by the Government of India over the past year.

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India has become the fastest growing investment region for foreign investors in 2016, led by an increase in investments in real estate and infrastructure sectors from Canada, according to a report by KPMG.

Some of the recent significant FDI announcements are as follows:

- In September 2017, 15 Japanese companies including Moresco, Toyoda Gosei, Topre and Murakami, signed memorandums of understanding (MoUs) with an intention to invest in the state of Gujarat.
- Singapore's Temasek will acquire a 16 per cent stake worth Rs 1,000 crore (US$ 156.16 million) in Bengaluru based private healthcare network Manipal Hospitals which runs a hospital chain of around 5,000 beds.
- France-based energy firm, Engie SA and Dubai-based private equity (PE) firm Abraaj Group have entered into a partnership for setting up a wind power platform in India.
- US-based footwear company, Skechers, is planning to add 400-500 more exclusive outlets in India over the next five years and also to launch its apparel and accessories collection in India.
- The government has approved five Foreign Direct Investment (FDI) proposals from Oppo Mobiles India, Louis Vuitton Malletier, Chumbak Design, Daniel Wellington AB and Actoserba Active Wholesale Pvt. Ltd., according to Department of Industrial Policy and Promotion (DIPP).
- Cumulative equity foreign direct investment (FDI) inflows in India increased 40 per cent to reach US$ 114.4 billion between FY 2015-16 and FY 2016-17, as against US$ 81.8 billion between FY 2011-12 and FY 2013-14.
- International Finance Corporation (IFC), the investment arm of the World Bank Group, is planning to invest about US$ 6 billion through 2022 in several sustainable and renewable energy programmes in India.
- Warburg Pincus, a Private Equity firm based in New York, has invested US$ 100 million in Clean Max Solar, a rooftop solar development firm, which will be utilized to fund growth opportunities outside India and to improve product offerings.

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- Soft Bank is planning to invest its new US$ 100 billion technology fund in market leaders in each market segment in India as it is seeks to begin its third round of investments.
- The Government's Make in India campaign has attracted investment across sectors from various Chinese companies, as is evident from cumulative Foreign Direct Investment (FDI) inflows of Rs 9,933.87 crore (US$ 1.54 billion) between 2014 and December 2016.

Government of India has decided to allow 26% FDI and 23% FII investment in commodity exchange, subject to the provision that no single entity will hold more than 5% stake.

• Although India`s share in global FDI has increased considerably, but the pace of FDI inflows has been slower than China, Singapore, Brazil and Russia

• Due to continued economic liberalization since 1991, India has seen a decade of 7 plus percent of economic growth. In fact, India`s economy has been growing more than 9 GYANPRATHA – ACCMAN Journal of Management, Volume 5 Issue 1 2013 percent for three consecutive years since 2007 which make country make a proficient performer among global economies. [7]

At present India is the 4th largest and 2nd fastest growing economy in the world. It is the 11th largest economy in terms of industrial output and has the 3rd largest pool of scientific and technical manpower.

There has been a generous flow of Foreign Direct Investment in India since 1991 and its overall direction also reminded the same over the years irrespective of the ruling party. India has considerably decreased its fiscal deficit form 4.3% in 2002-03 to 2.7% in 2007- 08 and 1.15 in year 2009-11. Foreign Direct Investment plays a crucial role in enhancing the economic growth and development of the country. Moreover, FDI as a strategic component of investment is needed by India for achieving the objectives of its second generation of economic reforms and maintaining the pace of growth and development of the economy.

Conclusion:

Thus it is concluded that apart from being a critical driver of economic growth, foreign direct investment (FDI) is a major source of non-debt financial resource for the economic development of

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India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions, etc. For a country where foreign investments are being made, it also means achieving technical know-how and generating employment.

The Indian government's favorable policy regime and robust business environment have ensured that foreign capital keeps flowing into the country. The government has taken many initiatives in recent years such as relaxing Foreign Direct Investment norms across sectors such as defense, PSU oil refineries, telecom, power exchanges, and stock exchanges, among others.

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