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A Study on Factors Affecting Foreign Direct Investment Inflows in India

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Abstract
Foreign direct investment is one of the most essential tools for growing the economy of a country. Economic growth of a nation is dependent on many factors such as growth in agriculture and manufacturing sector, exchange rate and international investment. In spite of different factors affecting the growth, the growth of foreign direct investment in different sectors is considered to be an essential factor which controls all other factor. Foreign direct investment is very useful in growth of a country particularly in the capital scarce country by way of improving their infrastructure, technical skills, entrepreneur abilities and financial resources in terms of government revenue and foreign exchange. Foreign direct investment has played a very important role in the economic development of India also. FDI has solved the several problems of India i.e. lack of capital, modern technology and capital goods etc. In last two years, Government has brought major FDI policy reforms in a number of sectors viz. Defence, Construction Development, Insurance and Pension Sector etc. This paper is an attempt to identify the recent trend in the FDI and various factors which affect the foreign direct investment inflows in India.

Keywords: Foreign Direct Investment, Economic Development, Foreign Exchange

Introduction

Foreign investment can be in the form of foreign portfolio investment or as foreign direct investment. FDI occurs when an investor based in one country acquires asset in another country with the aim of managing the assets. FDI usually involves the ownership, whole or partial, of a company in a foreign country. Firms that provide FDI referred to as MNCs. FDI helps the investors to earn major profits and returns that's why investors invest in the growing economy to earn major share of profits. One of the economic problems of Less Developed Countries (LDCs) is the growing shortage of official loans from the international financial institutions and aid from the developing countries. They are in constant need of foreign capital in forms of both direct and indirect investments. FDI appeared to be one of the easiest ways to get foreign capital without undertaking any risks linked to the debt. The foreign direct investment (FDI) is more significantly related to the GDP growth of the nation. The incremental growth of FDI is the good sign of economic growth. The Indian attitude regarding foreign direct investment at the time of independence was one of fear and suspicion. This suspicion and hostility was clearly visible in the industrial policy of 1948 in which the role of foreign capital was kept to minimal and was relegated to import of capital goods, which faced lots of restrictions also. The new industrial policy announced on 24th July, 1991 brought about a drastic change in the attitude of the government regarding FDI. Economic liberalization started in India in wake of the 1991 economic crisis and since then FDI has steadily increased in India. Foreign direct investment in India is the major monetary source for economic development. The foreign direct investments in India have two channels of entry (a) the automatic route (b) Foreign Investment Promotion Board (FIPB). Investments in some sectors need the prior permission of the government which is obtained through FIPB. Government of India has taken many steps to promote the foreign direct investment from time to time. There are so many factors that are availability of skilled manpower with lower wage rates, growing GDP rates and permission of 100% FDI in some sectors which attract the investors for investing in the India. Union Government liberalized the FDI system on 20th June, 2016 with the objective of providing major momentum to employment and job creation in India. This was the second major reform after the last radical

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changes announced in November, 2015. FDI norms were relaxed for 25 sectors in September 2014 (retail, insurance, service). In 2016, FDI norms for 15 sectors including construction, civil aviation, banking, and broadcasting were further liberalized. The government of India took several initiatives such as "Make in India" and "Digital India" to promote foreign investment. FDI reforms will give a boost to employment, job creation and benefit the Indian economy.

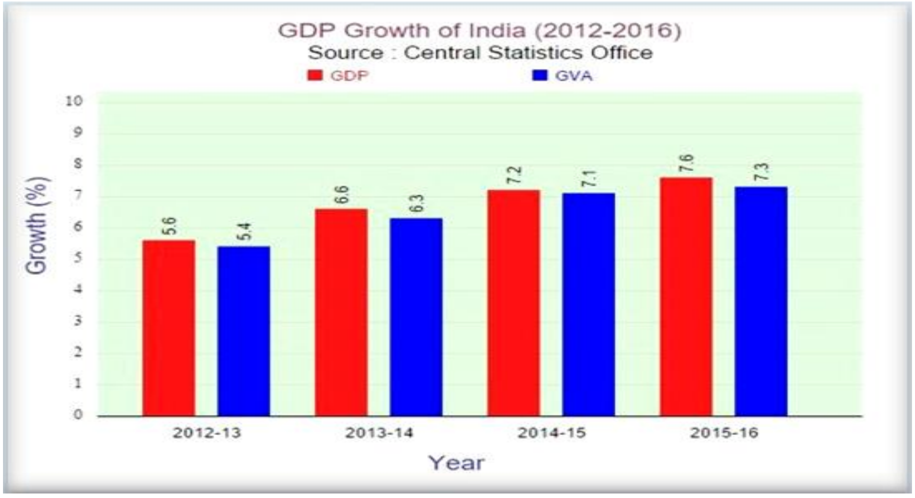
Objectives of the study

1. To examine the factors which affect the foreign direct investment inflows in India
2. To study the recent trends in FDI inflows in India
3. To study the recent policy measures taken by government for promoting FDI inflows

Factors Affecting Foreign Direct Investment in India

There are different factors which influence the FDI inflows in a country. The investors consider and assess various aspects of a country before investing in it. Following are the many factors which affects the foreign investment inflows in India:

- **Economic Growth:** Foreign direct investment is often targeted to selling goods directly to the country involved in attracting the investment. Therefore, the size of the population and scope for economic growth will be important for attracting investment. The Indian economy has grown by more than 7 % for a number of years in the last decade. This has contributed to making India the fourth largest economy in the world in purchasing power parity terms. With a GDP of 7.6% for 2015-16, India has overtaken China as the fastest growing economy.



- **Lower Wages Rates:** A major incentive for a multinational to invest abroad is to outsource labour intensive production to countries with lower wages. Companies which are more labour intensive will often invest in poor countries with high populations because of the easily availability of cheap labour. In India, wage rates are less because of huge population in comparison to other countries. This is why many Western firms have invested in clothing factories in the Indian sub-continent.
- **Transport and Infrastructure:** Foreign direct investment is also affected by availability of trade facilitation instruments such as proper infrastructure. Different transport facilities with a proper coordination between land, rail and air should be available for attracting the multinational companies to invest in India. Number of initiatives has taken by government of India in this regard. Development of national highways, creation of smart cities, improving road connectivity with villages has been allocated specific funds in the budge
- **Relaxation in Tax Rates:** Big multinationals, such as Apple, Google and Microsoft invest in those countries which have lower corporation tax rates. Tax regulations are also very important factor which encourage or discourage foreign investors. India introduced the special economic zones in 2006 which provided a more favorable atmosphere for carrying out foreign investment and business because companies which are operating their business in these zones has given high tax incentives. Government of India in order to attract the FDI has extended incentives in the form of tax holiday, investment tax allowances etc.
- **Skilled Labour Force:** A country with high numbers of skilled and educated personnel that are readily available will attract companies in need of skilled human resource. Some industries required skilled and semi-skilled labour. Many developing countries have large reserves of skilled and semi-skilled workers that are available for employment at wages significantly lower than in developed countries. For example, India has attracted much investment in call centers, because a high percentage of the population speaks English, but wages are low. This makes it an attractive place for outsourcing and therefore attracts investment.
- **Strong Financial Sector:** The robust financial sector also influences the decisions of foreign investors to venture into specific foreign markets. India has a robust, well regulated financial system which has allowed it to weather the global financial crisis without any major difficulties and present an image of quality, resilience and transparency. India's banking sector is very strong, with top quality balance sheets, high levels of competition and strong corporate governance. India has large number of financial institutions and banks.

- **Ease of Doing Business**: The ease of starting and running a business is a very vital factor in attracting foreign direct investment. The Ease of Doing Business Index is normally used to rank the ability of countries to facilitate and expedite opportunities for the investors. Government of India has made efforts to smoothen the process of FDI entry into India through adoption of automatic route. Foreigners can directly invest in India either on their own or as a joint venture, with a few exceptions with regard to investment limits and sectors.
- **Favourable Labour Laws:** India has around 250 labour laws including both at central and state level. These laws have always been considered as a restraint to FDI. These laws make the operations of the firms in labour intensive industries very restrictive. But government of India has brought reforms in these laws from time to time for promoting the foreign direct investment. For example, in Rajasthan, it is now permissible for firms having less than 300 workers to hire and fire labourers without prior government approval.
- **Investor-Friendly Market:** Policies that are favorable to both local and foreign investors determine the amount of foreign direct investment that a country receives**.** The government of India has amended FDI policy to increase FDI inflows. The government of India took several initiatives such as "Make in India" and "Digital India" to promote foreign investment. FDI norms were liberalized for 25 sectors in September 2014 under the "Make in India" initiative (retail, insurance, service).

Recent Trends in FDI Inflows

Foreign Direct Investment in India increased by 4739 USD Million in July of 2016. Foreign Direct Investment in India averaged 1176.30 USD Million from 1995 until 2016, reaching an all-time high of 5670 USD Million in February of 2008. Recently the government cleared three Foreign Direct Investment (FDI) proposals worth Rs 0.35 crore." Based on the recommendations of Foreign Investment Promotion Board (FIPB) in its 239th meeting held on 30th August 2016, the Government of India has approved three FDI proposals," the Ministry of Finance said in a statement. According to the statement, proposals of Dr. Willmar Schwabe India, SAET India and Bugworks Research India were approved. According to Department of Industrial Policy and Promotion (DIPP), the total FDI inflows soared by 24.5 per cent to US$ 44.9 billion during FY2015, as compared to US$ 36.0 billion in FY2014. FDI into India through the Foreign Investment Promotion Board (FIPB) route shot up by 26 per cent to US$ 31.9 billion in the year FY2015 as against US$ 25.3 billion in the previous year, indicating that government's effort to improve ease of doing business and relaxation in FDI norms is yielding results. During 2014-15, India received most of its FDI from Mauritius, Singapore, Netherlands, Japan and the US. The following table shows month –wise FDI inflows during the calendar year 2016

FDI Equity Inflows (Month-Wise) During the Calendar Year 2016

Calendar Year 2016 (Jan.-Dec.)		Amount of FDI Equity Inflows (In Rs. Crore)	Amount of FDI Equity Inflows (In US$ mn)
1.	January, 2016	33,461	4,975
2.	February, 2016	21.268	3,117
3.	March, 2016	16,530	2,466
Year 2016 (up to March, 2016) #		71,259	10,559
Year 2015 (up to March, 2015) #		61,499	9,886
%age growth over last year		(+)16%	(+)7%

(Source: http://dipp.nic.in/English/Publicaton/FDI-Statistics/FDI-Statistice.aspx)

Recent Policy Measures Taken by Government for Promoting FDI Inflows

The government of India made some changes to the FDI policy on June 20, 2016 at a meeting chaired by PM Narendra Modi. This is the second biggest reform in FDI since those announced in November 2015. The measures taken by the Government are directed to open new sectors for foreign direct investment, increase the sectoral limit of existing sectors and simplifying other conditions of the FDI policy. Some new changes in various sectors for attracting the FDI are as follow:

- To attract the investment in the broadcasting carriage services like Teleports, Direct to Home, Cable Networks, Mobile TV etc., the government has permitted 100% FDI through automatic route.
- In Private Security Agencies, FDI limit was raised to 74% from 49% earlier. FDI beyond 49% and up to 74% is permitted through Government approval route. Now FDI up to 49% has been allowed under automatic route in this sector.
- Under the new FDI policy, 74% FDI under automatic route has allowed in the Brownfield pharmaceuticals. FDI beyond 74% will be allowed through government approval route
- The changes in the policy include allowing 100% FDI for trading including through e-commerce, in respect of food products manufactured and/or produced in India under automatic route.
- Foreign investment in access of 49% has now been allowed through government approval route wherever it is likely to result in access to modern technology or for other reasons to be recorded.FDI limit for defence sector made applicable to Manufacturing of Small Arms and Ammunitions covered under Arms Act 1959.
- For establishment of branch office, liaison office or project office or any other place of business in India if the principal business of the applicant is Defence, Telecom, Private Security or Information and Broadcasting, approval of Reserve Bank of India would not be required in cases where FIPB approval or license/permission by the concerned

Ministry/Regulator has already been granted

- As per new FDI Policy 2016, FDI in Animal Husbandry (including breeding of dogs), Pisciculture, Aquaculture and Apiculture is permitted 100% under Automatic Route under controlled conditions. The requirement of 'controlled conditions' for FDI in these activities has now been done away with under the new policy.
- FDI limit for Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline and regional Air Transport Service raised to 100%, with FDI up to 49% permitted under automatic route and FDI beyond 49% through Government approval
- FDI on airport up to 100% has been allowed in Greenfield Projects and 74% FDI in Brownfield Projects under automatic route and FDI in access of 74% for Brownfield Projects is under government route according to earlier policy. Now 100% FDI under automatic route has been permitted in Brownfield Airport projects.

Conclusion

In nutshell, it can be stated that FDI plays a major role in the growth of the capital market of developing and developed countries like India. Foreign direct investment helps to cover the domestic saving constraint and provide access to the modern technology that encourage efficiency and productivity of the existing production capacity and produce new production opportunities. Government of India has gave so many incentives to foreign investors to promote the foreign direct investment in India form time to time, the biggest example of this , new reforms in FDI policy on June 2016 by PM Narendra Modi. FDI has so many positive effects on growth of a economy but there are also negatives impacts i.e. negative impact on balance of payments, exploitation of resources of host country and increase completion for domestic companies etc. Therefore, when a country promote the FDI, it is necessary to monitor the direction of FDI rather than volume of FDI.

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