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Impact of Foreign Direct Investment on Economic Growth in India

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Abstract

The Foreign Direct Investment means "cross border investment made by a resident in one economy in an enterprise in another economy, with the objective of establishing a lasting interest in the investee economy. Foreign investment can play important role in development of any country by investing in different projects resulting in higher production and earnings from domestic and foreign market while using resources efficiently. Various factors are responsible for FDI includes stagnated market in home market, desire for growth, cheaper wages, special incentives by other country, emerging economy, tax benefits, innovation etc. FDI may have positive and negative impacts on home country and host country. But most of the time business multiplies between the trading countries and people of both the countries get benefits of scarce resources getting higher profit for their product and services on the one hand and getting beneficial products at the other hand.

Keywords: cross border investment, investee, FDI, emerging economy, stagnated market

Introduction

Foreign direct investment (FDI) is a direct investment into production or business in a country by an individual or company of another country, either by buying a company in the target country or by expanding operations of an existing business in that country. Foreign direct investment is in contrast to portfolio investment which is a passive investment in the securities of another country such as stocks and bonds.

Mechanism for setting A foreign company in India

A foreign company planning to set up business operations in India may

- Incorporate a company under the Companies Act, 1956, as a Joint Venture or a Wholly Owned Subsidiary.
- Set up a Liaison Office / Representative Office or a Project Office or a Branch Office of the foreign company which can undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office or Other Place of Business) Regulations, 2000.

Procedure for receiving Foreign Direct Investment in an Indian company

An Indian company may receive Foreign Direct Investment under the two routes as given under:

i. **Automatic Route**-FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.

ii. **Government Route**-FDI in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance. Application can be made in Form FC-IL Plain paper applications carrying all relevant details are also accepted. No fee is payable.

The Indian company having received FDI either under the **Automatic route** or the **Government route** is required to comply with provisions of the FDI policy including reporting the FDI to the Reserve Bank.

Instruments for receiving Foreign Direct Investment in an Indian company

Foreign investment is reckoned as FDI only if the investment is made in equity shares , fully and mandatorily convertible preference shares and fully and mandatorily convertible debentures with the pricing being decided upfront as a figure or based on the formula that is decided upfront. Any foreign investment into an instrument issued by an Indian company which:

- gives an option to the investor to convert or not to convert it into equity or
- does not involve upfront pricing of the instrument

as a date would be reckoned as ECB and would have to comply with the ECB guidelines.

The FDI policy provides that the price/ conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the extant FEMA regulations [the DCF method of valuation for the unlisted companies and valuation in terms of SEBI (ICDR) Regulations, for the listed companies.

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1. Impact on telecom sector-The government has raised the Foreign Direct Investment (FDI) cap in telecom to 100 percent from the earlier 74 percent. The decision will eliminate the need of a foreign player to partner with a local telco, and is an attempt to rescue the cash-strapped sector. It is expected to increase the much needed cash-flows for telcos to meet their expansion plans. The estimates by Cellular Association of India (COAI), suggests that the industry is marred into the debt of 1.86 Lakh Crore and could only attract less than 9 percent of total FDI that came in last twelve years in the country. And considering this, the move will act as a catalyst in reducing the debt. It is expected to open the route for fresh investments and would attract more overseas investors at a time when operators are struggling with their Capex-based investments. As required earlier, investments above 49 percent will need to take go-ahead from Foreign Investment Promotion Board (FIPB)—an approval which is dependent upon security clearances. **2. Impact on Insurance sector-**Only 6 per cent of Indians have insurance cover. Of this, 4.4 per cent have life insurance and 5 per cent have a reasonable health cover. Most small businesses (family-owned) have no insurance.

India is dolefully underinsured. We need capital to for our insurance industry which is critical and important.

According to the 12th Plan, India has to spend trillions on infrastructure and faces a gap of nearly in resources. Raising the FDI cap for the insurance sector will provide a strong momentum for meeting the long-term financial needs of infrastructure companies.

3. Impact on Railways- The Indian railway is lifeline of the country. Its infrastructure require a lot of funding and that may not possible with in-house investment. But the safety concerns are to be solved before allowing foreign investment in railways. The ministry of home affairs has finally given its green signal to the proposal of allowing foreign direct investment (FDI) in railways. Efficient operations of Indian railway are possible only with huge capital. The department of industrial policy and promotion (DIPP), which has already prepared a draft Cabinet note, was awaiting the go-ahead from the home ministry. By the final Cabinet note, India will allow foreign players to invest only in construction and maintenance of railway projects, not in operations.

4. Impact on Pharma sector-FIPB cleared Rs 6,400 crore FDI proposal of GlaxoSmithKline to acquire additional 24.33 per cent stake in its India arm on January 12, 2014. The Singapore subsidiary of the UK-based GlaxoSmithKline plans to buy 24.33 percent stake or 2.06 crore equity shares in GlaxoSmithKline Pharmaceuticals Ltd through an open offer. Reuters The acquisition will result in foreign exchange inflow of Rs 6,400 crore, as per the firm's proposal to FIPB. GlaxoSmithKline Pharmaceuticals is already majority owned and controlled by the GSK Group. After the purchase, holding of the promoter group firms in the Indian subsidiary will go up to 75 percent from the current level of 50.67 percent. The open offer for tendering of shares is scheduled to remain open from February 7-21. GSK Pharma makes, distributes and trades a variety of drugs. Its portfolio includes prescription medicines and vaccines across areas such as anti-infectives, dermatology, and gynaecology. The company employs more than 5,000 people and generated more than Rs 2,600 crore turnover in the financial year ended December 31, 2012. FDI inflow in the pharma sector during the April-October period totalled Rs 5,956 crore (USD 1.08 billion). In September, the government cleared the Rs 5,168-crore deal of the US-based Mylan Inc for acquiring Bangalore-based pharma firm Agila Specialties, a subsidiary of Strides Arcolab. In 2008, Japanese firm Daiichi Sankyo had bought out the country's largest drug maker Ranbaxy for USD 4.6 billion. US-based Abbot Laboratories had acquired Piramal Health Care's domestic business for USD 3.7 billion. India allows 100 percent FDI in pharma sector through automatic approval route in the new projects, but foreign investment in the existing companies is allowed only through the FIPB approval.

5. Impact on Online retailers- Consultancy Technopak estimates that e-retailing will grow to $56 billion (about Rs 3.5 lakh crore), accounting for 6.5% of overall retail sales, in 2023 from $1 billion (over Rs 6,000 crore) now. The scale of the opportunity has meant that the world's largest retailers are keen to begin operations in India and are lobbying hard with the government.

Many large domestic players feel they are already past the stage where the norms will impact them as they have turned into marketplaces rather than having their own inventory.

6. Likely Impact on defence-Asserting that the 26% FDI cap acts as a disincentive for foreign companies to invest in India's crucial defence sector, an Indian defence expert has called for increasing the investment limit. Increase in FDI in the defence sector becomes all the more important as India and the US are working to boost their defence ties and co-development under the Defence Trade Initiative (DTI).

All this can be achieved by India relaxing the 26% limit on FDI in the defence sector: a regulation that is widely attributed to have de-incentivized foreign companies' moves to invest in the Indian defence sector and transfer advanced technologies to it.

The United States, needs to regard the defence industrial capability gap between itself and India as an opportunity for collaboration rather than an obstacle.

Recent developments-

Government eases FDI norms in 15 major sectors.

□ Townships, shopping complexes & business centres – all allow up to 100% FDI under the auto route. Conditions on

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minimum capitalization & floor area restrictions have now been removed for the construction development sector.

□ India's defence sector now allows consolidated FDI up to 49% under the automatic route. FDI beyond 49% will now be considered by the Foreign Investment Promotion Board. Govt approval route will be required only when FDI results in a change of ownership pattern.

Private sector banks now allow consolidated FDI up to 74%.

□ Up to 100% FDI is now allowed in coffee/rubber/ cardamom/palm oil & olive oil plantations via the automatic route.

□ 100% FDI is now allowed via the auto route in duty free shops located and operated in the customs bonded areas.

□ Manufacturers can now sell their products through wholesale and/or retail, including through e-commerce without Government Approval.

□ Foreign Equity caps have now been increased for establishment & operation of satellites, credit information companies, non-scheduled air transport & ground handling services from 74% to 100%.

□ 100% FDI allowed in medical devices

□ FDI cap increased in insurance & sub-activities from 26% to 49%

□ FDI up to 49% has been permitted in the Pension Sector.

□ Construction, operation and maintenance of specified activities of Railway sector opened to 100% foreign direct investment under automatic route.

□ FDI policy on Construction Development sector has been liberalized by relaxing the norms pertaining to minimum area, minimum capitalization and repatriation of funds or exit from the project. To encourage investment in affordable housing, projects committing 30 percent of the total project cost for low cost affordable housing have been exempted from minimum area and capitalization norms.

□ Investment by NRIs under Schedule 4 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations will be deemed to be domestic investment at par with the investment made by residents.

□ Composite caps on foreign investments introduced to bring uniformity and simplicity is brought across the sectors in FDI policy.

□ 100% FDI allowed in White Label ATM Operations.

Conclusion

Foreign investment rescue India from the financial crisis of 1991. It provided investment for lot of industries and infrastructure. Standard of living is increased from 1991 onwards. Industry took a boost due to investment and customers got good variety of goods with better quality at affordable rates. But pros and cons of FDI should be carefully analyzed before making further decisions.

APPENDIX

FDI in India

Indicator Name	2005	2006	2007	2008	2009	2010	2011	2012
Imports of goods and services (BoP, current US$)	181858367951	225086027162	278785752272	379479380179	328257176213	439059034248	553062186680	579908579784
Insurance and financial services (% of service imports, BoP)	7	8	9	9	10	10	12	9
Goods imports (BoP, current US$)	134692007368	166571862854	208610899982	291740328015	247907713474	324320487288	428021232155	450249366550
Service imports (BoP, current US$)	47166360582	58514164307	70174852290	87739052164	80349462739	114738546960	125040954524	129659213234
Charges for the use of intellectual property, payments (BoP, current US$)	671829366	845949436	1159824391	1528826913	1860070100	2438302981	2819291079	3990055617
Imports of goods, services and primary income (BoP, current US$)	194154269869	239530781131	297951343494	400437066914	349528915346	464622088118	579252729072	610650438039
Transport services (% of service imports, BoP)	44	43	45	49	44	41	46	47
Travel services (% of service imports, BoP)	13	12	12	11	12	9	11	10
Foreign direct investment, net outflows (% of GDP)	0	1	1	2	1	1	1	0
Secondary income, other sectors, payments (BoP, current US$)	475507398	857016413	1233747716	2894628689	1652988824	2270102083	2522897385	3135735444
Personal remittances, paid (current US$)	1348282858	1561865362	2059330846	3812363581	2889988305	3828678498	4077745356	4963082154
Current account balance (BoP, current US$)	-10283543308	-9299060317	-8075694484	-30971987181	-26186435957	-54515877624	-62517637222	-91471245846
Current account balance (% of GDP)	-1	-1	-1	-3	-2	-3	-3	-5
Net financial account (BoP, current US$)	-10824559421	-8399404999	-6737296326	-29826228672	-26172856384	-56436079497	-64390527321	-90237732678
Net primary income (BoP, current US$)	-6649958332	-6245325788	-6515811031	-5364336274	-7538933229	-15601985068	-16043262742	-20842871438
Net trade in goods and services (BoP, current US$)	-27276336271	-31769964257	-38703712439	-74360043516	-67410018791	-91023662479	-106686782609	-136063399026
Net trade in goods (BoP, current US$)	-32288927608	-42695648388	-55081319693	-92675230456	-79950042234	-93353427193	-120173743750	-151928782350
Net errors and omissions (BoP, current US$)	-541016113	899655318	1338398158	1145758509	-279420427	-1969864183	-1940805909	1830745984
Foreign direct investment, net (BoP, current US$)	-4628652265	-5992285935	-8201628958	-24149749830	-19485789183	-11428785746	-23890659988	-15442447343
Portfolio Investment, net (BoP, current US$)	-12144114068	-9545718947	-33016300605	15074790314	-17756860244	-36875471079	-2664809742	-29285240146
Reserves and related items (BoP, current US$)	14554075998	29169924815	87488219956	25372728203	17035954559	14126806367	-4138567645	-4022754897
Exports of goods and services (BoP, current US$)	154582031680	193316062904	240082039834	305119336663	260847157422	348035371769	446375404071	443845180758
Foreign direct investment, net inflows (BoP, current US$)	7269407226	20029119267	25227740887	43406277076	35581372930	27396885034	36498654598	23995685014
Foreign direct investment, net inflows (% of GDP)	1	2	2	4	3	2	2	1

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