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A study on FDI equity inflows in Indian economy

Dr. Hamsalakshmi R

Assistant Professor, Department of Commerce, LRG Government Arts College for Women, Palladam Road, Tirupur, Tamil Nadu, India

Abstract

Government of India embarked upon major economic reforms since mid-1991 with a view to integrate with the world economy and to emerge as a significant player in the globalization process. 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 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 favourable policy regime and robust business environment have ensured that foreign capital keeps flowing into the country. The present government has taken many initiative schemes "Make in India" in recent years such as relaxing FDI norms across sectors and it is observed at the end of Dec 2015 a significant contribution were made in different sectors namely trading, services, automobile, telecommunications and computer software and hardware segments. In this background this paper makes an empirical analysis of most attracting FDI destinations and its trends. By applying trend analysis, trend equations and ANOVA it is observed that a significant mean difference of selected segments during the study period.

Keywords: Foreign Direct Equity Inflows, Phases of FDI policy, Equity caps, Entry route, Approved investments, Automatic route, Foreign Investment Promotion Board

1. Introduction

India has already marked its presence as one of the fastest growing economies of the world. It has been ranked among the top 3 attractive destinations for inbound investments. Since 1991, the regulatory environment in terms of foreign investment has been consistently eased to make it investor-friendly. Government of India embarked upon major economic reforms since mid-1991 with a view to integrate with the world economy and to emerge as a significant player in the globalization process. Reforms undertaken include de-control of industries from the stringent regulatory process; simplification of investment procedures, promotion of foreign direct investment (FDI), liberalization of exchange control, rationalization of taxes and public sector divestment.

As per the extant policy, FDI up to 100% is allowed, under the automatic route, in most of the sectors. FDI under the automatic route does not require prior approval either by the Government of India or the Reserve Bank of India (RBI). Investors are only required to notify the Regional office concerned of RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issue of shares to foreign investors. Under the Government approval route, applications for FDI proposals, other than by Non- Resident Indians, and proposals for FDI in 'Single Brand' product retailing, and Multi Brand Retail Trading are received in the Department of Economic Affairs, Ministry of Finance. Proposals for FDI in 'Single Brand' product retailing and by NRIs are received in the Department of Industrial Policy & Promotion, Ministry of Commerce and Industry. These proposals are then considered by the Foreign Investment Promotion Board (FIPB) which is housed in the Department of Economic Affairs.

Foreign investments in equity capital of an Indian company under the Portfolio Investment Scheme are governed by separate regulations of RBI/Securities & Exchange Board of India. The FDI policy has been liberalized progressively through review of the policy on an ongoing basis and allowing FDI in more industries under the automatic route. Three major reviews were undertaken in the year 2000, 2006 and 2007-2008. A major policy stance defining indirect foreign investment was taken in 2009 which elaborated the counting of indirect foreign investment and guidelines for downstream investments by foreign owned or controlled companies as also guidelines for transfer of ownership from residents to non residents in sensitive sectors.

2. Statement of the Problem

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 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 favourable 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 FDI norms across sectors such as defence, PSU oil refineries, telecom, power exchanges, and stock exchanges, among others. From this point of view this paper makes an empirical analysis of FDI Equity Inflows in Indian economy during recent times.

3. Objectives of the Study

This paper deals with a review of FDI policy, important phases of FDI policy evolution, highest sectors attracting FDI destination, analysis of trend pattern of FDI inflows in different sectors and estimation of FDI equity inflows for the forthcoming periods and to examine the mean significance of selected sectors.

4. Methodology

The current study is based on secondary data and required data were collected from RBI websites. Period of study covers financial year from 2010-11 to 2014-15. Trend Analysis, fitting linear trend equation and one way ANOVA were used to analyse the data. To carry out the study top ten highest sectors which were attracting FDI equity inflows (based on RBI fact sheet) during 2015 namely services sector, construction and development, computer software and hardware, telecommunications, automobile, drugs and pharmaceuticals, chemicals (other than fertilizers), trading, power and hotel and tourism industry were considered.

5. Theoretical Review

5.1 Important Phases of FDI Policy

The evolution of FDI policy in India has broadly gone through four phases.

The first phase, between 1948 and 1969, was characterized by a cautious welcome to foreign investment, as outlined in the Industrial Policy Statement of 1948, which observed that the 'participation of foreign capital and enterprise will be of value to the rapid industrialization of the country.' It, however, noted that 'the conditions under which it may participate be carefully regulated in the national interest. As a rule, majority interest in the ownership and effective control should always be in Indian hands.' During this phase, foreign firms were encouraged to invest in protected industries, such as fertilisers and machine tools and extensive concessions and tax advantages were offered to attract multinational oil companies.

The *second phase*, between 1969 and 1991, was marked by the coming into force of the Monopolies and Restrictive Trade Practices Commission (MRTP) in 1969, which imposed restrictions on the size of operations, pricing of products and services of foreign companies. The Foreign Exchange Regulation Act (FERA), enacted in 1973, limited the extent of foreign equity to 40%, though this limit could be raised to 74% for technology-intensive, export-intensive, and core-sector industries. A selective licensing regime was instituted for technology transfer and royalty payments and applicants were subjected to export obligations. The year 1977 witnessed a reversal of the policy, when Coca Cola was asked to move out of the country.

The third phase, between 1991 and 2000, witnessed the liberalisation of the FDI policy, as part of the Government's economic reforms program. Under the 'Statement on Industrial Policy' (July, 1991), FDI was allowed on the automatic route, up to 51%, in 35 high priority industries. Foreign technical collaboration was also placed under the automatic route, subject to specified limits. A dividend-balancing condition was imposed for all sectors. This was later restricted to 22 notified consumer items (Press Note 12 of 1992). In 1996, the automatic approval route for FDI was expanded, from 35 to 111 industries, under four distinct categories (Part A–up to 50%, Part B–up to 51%, Part C–up to 74%, and Part D-up to 100%). Press Note 18 of 1998 limited the scope of foreign companies starting new joint-ventures, using the same technology as an existing Joint Venture. A Foreign Investment Promotion Board (FIPB) was constituted to consider cases under the government route.

The fourth phase of FDI policy, between 2000 till date, has reflected the increasing globalisation of Indian economy. In the year 2000, a paradigm shift occurred, wherein, except for a negative list, all the remaining activities were placed under the automatic route (Press Note 2 of 2000). The dividend-balancing condition was removed (Press Note 7 of 2000). Caps were gradually raised in a number of sectors. The NBFC Sector was placed on the automatic route (Press Note 2 of 2001). The insurance and defence sectors were opened up to a cap of 26% (Press Notes 10 of 2000, 4 of 2001 and 2 of 2002). The cap for telecom services was increased from 49% to 74% (Press Note 5 of 2005). FDI was allowed up to 51% in single brand retail (Press Note 3 of 2006). In the year 2009, the next significant shift took place, with the differentiation between 'ownership' and 'control', for the purpose of calculating the total foreign investment-direct and indirect-in an Indian company (Press Note 2 of 2009). Indian companies having FDI, owned and controlled by Indian residents were allowed downstream investments without government approval (Press Notes 2 and 4 of 2009). Limits on payment of royalty were removed (Press Note 8 of 2009).

The year 2010 saw the continuation of the rationalization process. All existing regulations on FDI were consolidated into a single document for ease of reference (Circular 1 of 2010). Downstream investment through internal accruals was specifically permitted (Circular 2 of 2010). Circular 1 of 2011 allowed issue of shares against non-cash considerations (in respect of import of capital goods/ machinery/ equipment and pre-operative/ pre-incorporation expenses) and also provided flexibility in fixing pricing of convertible instruments through a formula, rather than upfront fixation. The requirement of Government approval for establishment of new joint ventures in the 'same field' was also done away with. As a result, non-resident companies were allowed to have 100% owned subsidiaries in India. Government has since allowed FDI, in Limited Liability Partnerships (Press Note 1 of 2011).

The evolution of the FDI policy, towards more rationalization and liberalization, has narrowed down the instruments regulating FDI policy broadly to three:

(i) **Equity caps:** restricting foreign ownership of equity capital.
(ii) **Entry route:** requiring prior Government oversight, including screening and approval.
(iii) **Conditionalities:** comprising of operational restrictions/ licencing conditions, such as nationality criteria, minimum-capitalisation and lock in period etc.

5.2 FDI Inflows

The cumulative FDI inflows from April 2000 to January 2015 aggregate US $ 361,320 Million. The cumulative FDI equity inflows from April 2000 to January 2015 aggregate to US $ 243,107 million (Rs. 11,99,386 crores). In the financial year 2014-2015, the FDI equity inflows from April 2014 to January 2015 are US $ 25,526 million compared to US $ 18,749 million during the corresponding period in 2013-14. In the current calendar year 2015, the FDI equity inflows for January, 2015 are US $ 4,481 million (Rs. 27,880 crores) compared to US $ 2,189 million (Rs. 13,589 crores) during the corresponding period in 2014 representing a increase of 105 % in dollar terms and an increase of 105 % in rupee terms. During 2015-16 an increased FDI inflow of 3,753cr was observed, whereas in 2012-13 it was 2,242 cr only.

5.3 Market size

According to Department of Industrial Policy and Promotion (DIPP), the total FDI investments India received in April-December period of 2015 was US$ 40.82 million, indicating that government's effort to improve ease of doing business and relaxation in FDI norms is yielding results. Data for April-December 2015 indicates computer hardware and software segment attracted the highest FDI equity inflow of US$ 5.31 billion, followed by services sector – US$ 4.26 and trading business- US$ 2.72 billion. The total FDI equity inflows for the month of December 2015 touched US$ 4.64 billion as compared to US$ 2.16 billion in the same period last year. During FY2015, India received the maximum FDI equity inflows from Singapore at US$ 10.99 billion, followed by Mauritius (US$ 6.12 billion), USA (US$ 3.51 billion), Netherlands (US$ 2.15 billion) and Japan (US$ 1.08 billion). Healthy inflow of foreign investments into the country helped India’s balance of payments (BOP) situation and stabilised the value of rupee. FDI in India witnessed an increase of 40 per cent and reached US$ 29.44 billion during April-December, 2015 as compared to US$ 21.04 billion in the same period last year.

Budget 2016-17 has proposed several reforms in Foreign Direct Investment Policy in the areas of insurance and pension, asset reconstruction companies and stock exchanges, such as easier governing and fund raising norms, clarification of tax related matters and higher FDI limits.

The Government of India has recently relaxed FDI policy in 15 sectors, such as raising the foreign investment limit for some sectors, easing the conditions for others and putting many on the automatic route for approval and relaxed the FDI policy norms for Non-Resident Indians (NRIs). Under this, the non-repatriable investments made by the Persons of Indian Origin (PIOs), Overseas Citizens of India (OCI) and NRIs will be treated as domestic investments and will not be subject to FDI caps.

The Cabinet Committee on Economic Affairs (CCEA) has raised the threshold for foreign direct investment requiring its approval to Rs 3,000 crore (US$ 440.15 million) from the present Rs 1,200 crore (US$ 176.06 million). This decision is expected to expedite the approval process and result in increased foreign investment inflow. India is likely to grant most favoured nation treatment to 15 countries that are in talks regarding an agreement on the Regional Comprehensive Economic Partnership, which would results in significant easing of investment rules for these countries. The Government of India plans to further simplify rules such as increasing FDI investment limits in sectors and include more sectors in the automatic approval route, to attract more investments in the country.

Table 1: Financial Year- Wise FDI Equity Inflows (As per DIPP's FDI data base- Equity capital components)

S. No	Financial Year (April-Mar)	Amount of FDI Inflows		% growth over previous year (in $)
		(In Cr.)	(in US $ millions)	
1	2000-01	10733	2463	-
2	2001-02	18654	4065	65%
3	2002-03	12871	2705	-33%
4	2003-04	10064	2188	-19%
5	2004-05	14653	3219	47%
6	2005-06	24584	5540	72%
7	2006-07	56390	12492	125%
8	2007-08	98642	24575	97%
9	2008-09	142829	31396	28%
10	2009-2010	123120	25834	-18%
11	2010-2011	97320	21383	-17%
12	2011-12	165146	35121	64%
13	2012-13	121907	22423	-36%
14	2013-14	147518	24299	8%
15	2014-15	189107	30931	27%
16	2015-16 (April-Dec 15)	191063	29443	
Cumulative Total		1424600	278076	

Source: RBI Fact sheet- including amount remitted through RBI’s-NRI Schemes (2000-2002).

(ii) FEDAI (Foreign Exchange Dealers Association of India) conversion rate from rupees to US dollar applied, on the basis of monthly average rate provided by RBI (DEPR), Mumbai. # Figures for the years 2010-11 to 2015-16 are provisional subject to reconciliation with RBI.

^ Inflows for the month of March, 2012 are as reported by RBI, consequent to the adjustment made in the figures of March, ‘11, August, ’11 and October, ‘11.

5.4 Approved Investments

Based on the recommendations of Foreign Investment Promotion Board (FIPB) in its 231st meeting held on January 22, 2016, the Government has approved ten FDI proposals involving FDI of Rs 607 crore (US$ 89.06 million), and recommended one proposal for approval of Cabinet Committee on Economic Affairs (CCEA) involving FDI of Rs 5,856.51 crore (US$ 859 million).

Some of the recent significant FDI announcements are

- E-commerce giant Amazon plans to set up its second largest global delivery centre outside the United States, in Hyderabad,
- Global beverage company Pepsi plans to invest Rs 500 crore (US$ 72.84 million) to set up another unit in Maharashtra to make mango, pomegranate and orange-based citrus juices, while biotechnology giant Monsanto plans to set up a seed plant in Buldhana district of

Maharashtra.

- Apple will build its first technology development centre outside the US in Hyderabad with an investment of $25 million, likely employing about 4,500 people.
- Japan has won the right to construct India's first bullet train, while offering a loan of US$ 8.11 billion to India for the same.
- Chinese mobile handset maker, Coolpad Group Limited, has committed US$ 300 million for setting up a research and development (R&D) centre and its own assembly line in India by 2017.
- Amazon India expanded its logistics footprint three times to more than 2,100 cities and towns in 2015, as Amazon.com invested more than US$ 700 million in its India operations since July 2014.
- Indian Railways has issued a Letter of Award (LOA) to US-based General Electric (GE) for a Rs 14,656 crore (US$ 2.15 billion) diesel locomotive factory project at Marhowra, and to French transport major Alstom for Rs 20,000 crore (US$ 2.93 billion) electric locomotive project in Madhepura, Bihar.
- Kellogg Co, world's largest cereal maker, is making large investments in manufacturing and plans to set up its first Research and Development (R & D) facility in India at Taloja, near Mumbai.
- The Government of Karnataka has signed an agreement with the Taiwan Electrical and Electronic Manufacturers Association for the purpose of creating a Taiwanese electronic manufacturing cluster near the Bengaluru airport, with an investment expectation of Rs 3,200 crore (US$ 469.5 million).
- Posco Korea, the multinational Korean steel company, has signed an agreement with Shree Uttam Steel and Power (part of Uttam Galva Group) to set up a steel plant at Satarda in Maharashtra.
- Foxconn has signed a Memorandum of Understanding (MoU) with Maharashtra state government to invest US$ 5 billion over the next three years for setting up a manufacturing unit between Mumbai and Pune.
- Global giants such as Bombardier, Hyundai-ROTEM, TALGO and CAF have queued up to manufacture semi high-speed train sets in India, which will be used for faster inter-city travel.
- Germany-based ThyssenKrupp group is aiming to double its revenue from India to US$ 1 billion in next three-four years while the group's elevator unit, Thyssen Krupp Elevator, plans to invest EUR 44 million (US$ 50.5 million) to set up a manufacturing plant in Chakan, Pune.
- Swedish home furnishing brand Ikea has made a long-term plan of opening 25 stores in India by making an investment worth Rs 12,500 crore (US$ 1.83 billion).
- Google plans to invest Rs 1,500 crore (US$ 220 million) for a new campus in Hyderabad which will be focused on three key areas- Google Education, Google Fibre broadband services and Street view.
- Warburg Pincus, a US based Private Equity (PE) firm, has planned to invest Rs 850 crore (US$ 124 million) in Ecom Express- an India based logistics solutions provider.

5.5 Roads ahead

According to United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2015, India acquired ninth slot in the top 10 countries attracting highest FDI in 2014 as compared to 15th position last year. The report also mentioned that the FDI inflows to India are likely to exhibit an upward trend on account of economic recovery. India also jumped 16 notches to 55 among 140 countries in the World Economic Forum's Global Competitiveness Index that ranks countries on the basis of parameters such as institutions, macroeconomic environment, education, market size and infrastructure among others. India will require around US$ 1 trillion in the 12th Five-Year Plan (2012–17), to fund infrastructure growth covering sectors such as highways, ports and airways. This would require support from FDI flows. During 2014, foreign investment was witnessed in sectors such as services, telecommunications, computer software and hardware, construction development, power, trading, and automobile, among others.

6. Analysis and Interpretations

This section deals with analysis of FDI equity inflows during the study period.

Following table 2 explains about the trend pattern of FDI equity inflows from 2000-01 to 2014-15. To examine the data linear trend equation was applied and the trend equation of $y = 13282x - 24016$ was fitted and the following trend values were observed.

Table 2: Trends of FDI Equity Inflows during 2000-01 to 2014-15 (Amount in Rupees. Cr)

Year	Trends of FDI inflows	Year	Trends of FDI inflows
2000-01	-10734	2008-09	95522
2001-02	2548	2009-2010	108804
2002-03	15830	2010-2011	122086
2003-04	29112	2011-12	135368
2004-05	42394	2012-13	148650
2005-06	55676	2013-14	161932
2006-07	68958	2014-15	175214
2007-08	82240		

Source: computed

From the above table it is observed that a continuous increasing trend of FDI inflows from 2000-01 to 2014-15.

Table 3: Actual Trends in FDI Equity Inflows from 2010-11 to 2014-15

Year	Services sector	Construction	Computer S/W and H/W	Tele communications	Automobile	Drugs & pharmaceuticals	Chemicals	Trading	Power	Hotel & Tourism
2010-11	18681	11168	1351	4985	3582	5810	13124	-599	6274	5306
2011-12	20004	9808	3782	6848	6229	6687	10565	2976	5858	5792
2012-13	21327	8448	6213	8711	8876	7563	8006	6551	5442	6279
2013-14	22650	7088	8644	10574	11523	8440	5447	10126	5026	6765
2014-15	23973	5728	11075	12437	14170	9317	2888	13701	4611	7252

Source: Computed (Amount in Rupees. Cr)

From table 3 it is observed that a remarkable growth of FDI equity inflows in services sector followed by automobile industry, trading, telecommunications and computer software and hardware industry. More over a decreasing trend is observed in Power, Chemical and construction industries.

Table 4: Trend Projections of FDI Equity Inflows from 2015-16 to 2019-2020

Year	Services sector	Construction	Computer S/W and H/W	Tele communications	Automobile	Drugs & pharmaceuticals	Chemicals	Trading	Power	Hotel & Tourism
2015-16	25296	4368	13506	14300	16817	10194	329	17276	4195	7738
2016-17	26619	3008	15937	16163	19464	11071	-2230	20851	3779	8225
2017-18	27942	1648	18368	18026	22111	11947	-4789	24426	3363	8711
2018-19	29265	288	20799	19889	24758	12824	-7348	28001	2947	9198
2019-2020	30588	-1072	23230	21752	27405	13701	-9907	31576	2531	9684

Source: computed (Amount in Rupees. Cr)

Table 4 explains the trend projections of FDI equity inflows from 2015-16 to 2020 in various industries. It is found that a continuous increasing trend of FDI equity investments in trading followed by services industry, automobile, computer software and hardware and telecommunications. Negative trend projections were observed from chemicals and construction industry. Power sector attracts a very least proportion of FDI inflows during the study period.

To test the mean significance one way ANOVA has been applied and the following null hypothesis was framed.

Ho: There is no significant mean difference between the selected sectors.

Table 5: One way ANOVA

Source of variation	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	947284045.667	9	105253782.852	3.896	.001
Within Groups	1080716885.512	40	27017922.138		
Total	2028000931.179	49			

Source: computed F value at 5% level of significance is 2.12

It is observed from table 5 the calculated value is 3.89, hence the null hypothesis is rejected and the alternate hypothesis is accepted. It is concluded that there is a significant mean difference is observed between the selected industries during the study period.

7. Findings

From the analysis it is found that the most attracting FDI destinations are Trading, Services, Automobile, Computer software and hardware and telecommunications. Remaining sectors are found a least attracting destination of FDI equity inflows during the study period. It is expected that Prime Minister’s “Startup India” scheme could contribute a remarkable growth rate in forth coming years.

8. Conclusion

Foreign Direct Investment, as distinguished from portfolio investment, has the connotation of establishing a ‘lasting interest’ in an enterprise that is resident in an economy other than that of the investor. This paper envisages that the most attracting destination on FDI equity inflows in recent years and emphasis that the other concentrating sectors where policies to be revamped.

In order to make India a more attractive foreign investment destination, the Ministry of Finance is planning to introduce the residency permit policy, which will allow key executives of foreign companies making investments worth US$ 2 billion or more in India, to avail various facilities such as special package on upscale housing, residency permits allowing long stay in the country, and cheap rates for utilities. It is the intent and objective of Government of India to attract and promote foreign direct investment through the scheme 'Make in India 'in order to supplement domestic capital, technology and skills, for accelerated economic growth.

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