

# **DETERMINANTS OF FDI PATTERNS IN INDIA: A CASE STUDY OF POLITICAL ORIENTATION**

**Poonam Kumari**

Research Scholar, Department of Commerce, Central University of Rajasthan, Ajmer

**Pushpender**

Research Scholar, Department of Commerce, Central University of Rajasthan, Ajmer

## **ABSTRACT**

*Foreign Direct Investment is the key factor for development of every country. It is a developmental tool which helps for accelerating growth in number of countries. Foreign Direct Investment helps a country in numerous ways to grow like by raising productivity, improvement in infrastructure, increasing employment opportunities and also develop competitive nature in domestic industries. In every five years, new government came up with new ideas, strategies and policies to grab higher investment in the country. There can be many factors which affect the inflows of investment in a country like inflation rate, interest rate, policies of the government etc. Since 1991, with the introduction of LPG policies there is huge increase in the growth rate of India in almost every sector.*

*This paper seeks to provide a rationale for changing of trend in inflow of foreign direct investment during the period of 2013-17. The study examines five sectors that are financial services, insurance, real estate, manufacturing and education, research and development. The study is based on secondary sources of data. The paper then provides empirical support to identify the variables which cause high or low inflow of foreign direct investment in the specific period in India.*

**Keyword:** Foreign Direct Investment, Policies, Factors, India.

## **1. INTRODUCTION**

Foreign direct investment refers to an investment made to acquire lasting interest in enterprises operating outside the economy of the investor. The main feature of FDI is taken to be the lasting interest of investor in an enterprise. Investors are able to directly influence the management of enterprise; it does not mean that they have absolute control in the enterprise. FDI is having two components: Portfolio investment and direct investment. Portfolio investment means investing securities like equity, ventures and bond holdings. Foreign Portfolio Investment does not provide long lasting control over the business entity as Foreign Direct Investment do but Foreign Portfolio Investment provides liquidity, which FDI don't. According to Luiz De Mello FDI is "a form of international inter-firm co-operation that involves equity stake in the company as well as effective management decision power and control in the company."

Integration of India's economy with the world economy gained momentum since 1991 which ultimately results in change in the attitude of host countries toward India. Chandan Chakraborty and Peter Nunnenkamp (2008) "*talked about India's growth after 1991 reforms is very impressive, although the growth potential of FDI inflows are still high.*" Foreign Direct Investment helps to integrate the domestic country with world and along with this it also plays important part for upgrading in the balance of payments position. From past few years, governments of underdeveloped and developing countries are focusing on potential of private FDI in their economies. From 1991, when LPG policies were introduced; there is huge increase of investment in various sectors like insurance, banking, real estate, manufacturing etc. FDI helps in capital formation as well as to fill the gap between domestic investment and savings. Measures undertaken by government effects the FDI inflows as well as outflows in the country. The pattern of new FDI varies across different sectors, depending on the required entry strategy. Foreign investment raises productivity, lower prices, improvement in foreign exchange reserves, enhancement of employment opportunities, increase domestic savings and government receives more taxes.

Thus, it is very important to encourage FDI in the country because it ultimately affects the real income of the residents of country. To make appropriate FDI policies, government must aware about the limitations of existing policies on FDI as well as the possible negative impact of new policies. Foreign Direct Investment is considered as better than importing and licensing because through FDI country acquire the industrial technology that is not available through import and licensing.

According to Reenu Kumari and Anil Kumar Sharma "Policy makers are more able to understand the determinants of foreign direct investment and take steps to encourage FDI in a country." Government policies play a vital role in the inflows of investment in the country. Some policies have positive impacts on investment inflows in various sectors and negative impacts on the other sectors, so FDI inflows are dependent upon policies formation of the government. FDI pattern needs to be examined through macro perspective for a realistic analysis, as there are some factors which are responsible for increase in FDI in particular region. In this study we will examine these factors that result in increase or decrease in FDI pattern in India during 2013 to 2017. This paper analyses the determinants of Foreign Direct Investment patterns in India and talks about the variables that causes inflows of FDI in India during 2013-2017.

The structure of the paper is as follows; Section 2 discussed literature on foreign direct investment and its determinants. Section 3 presents the objectives of the study. Section 4 talks about the research methodology of the study. Section 5 gives a brief of political factors that leads to foreign direct investment during 2014-2018. Section 6 talks about the findings and conclusion of the study. Section 7 lays down the suggestions for improvement of foreign direct investment in the country. Section 8 describes the limitations of the study and section 9 gives a brief scope for further future research.

## **2. LITERATURE REVIEW**

Although, it is generally accepted hypothesis that there is positive relationship between foreign direct investment and economic growth and development, but there is no symmetry between the variables that lead to positive relationship between foreign direct investment and growth of the country. Some of the prior studies talked about the FDI inflows after 1991 policy reforms, while some focused on the effect of FDI on different sectors in the economy. Different studies used different models to see the effect of foreign direct investment on various factors like employment, exchange rate, GDP etc.

Author	Title of the Paper	Findings and Conclusion
Nagesh Kumar (1998)	Liberalisation and Changing patterns of foreign direct investment	This paper summarised the emerging patterns and trends of FDI inflows in India from arouse of policy (liberalisation, privatisation and globalisation) reforms initiated since 1991. Compared to a near total concentration in manufacturing, the bulk of new inflows have come in the energy and service sector.
Raghbendra Jha (2002)	Recent trends in FDI flows and prospects for India	This paper emphasizes the view that an enlightened FDI policy is to be seen as part of a general policy of enhancing investment in this economy under production conditions of sustained efficiency and describes the trends of FDI.
D. S. Sethi & SE Guisinger (2003)	Trends in FDI inflows: a theoretical and empirical analysis	This study presents a generic and holistic conceptualization, bringing together both macro-economic and firm strategy factors and arguing that both aspects need consideration in tandem in order to explain the changing trends of FDI flows.
Nagesh Kumar (2007)	Emerging TNCs: trends, patterns and determinants of outward FDI by Indian enterprises	This paper concluded that Indian enterprise draw their ownership advantages from their accumulated production experience, the cost effectiveness of their production process and other adaptation to imported technology made with their technology effort and sometimes with their ability to differentiate the product
R. Anitha (2012)	Foreign Direct Investment and economic growth in India	It was found out that even though there has been increased flow of FDI into the country during the Post-liberalisation period, the global share of FDI in India is very less when it is compared to other developing countries. Lack of proper infrastructure, instable government and political environment and limited export processing zones are considered to be major problems for low FDI into the country.
R. B. Teli (2013)	A Critical Analysis of Foreign Direct Investment inflows in India	It is found that FDI inflows in India shows positive trend over the period under study. Gross inflows of FDI include 63% share of direct investment in equity and 37% share of portfolio investment. And correlation analysis results indicated that there is a very high correlation between the FDI inflows and other related economic indicators.
Malla Reddy (2014)	Foreign Direct Investment in Indian Banking Sector: A study	It is observed that service sector is one of the dominating sector in attracting more FDI inflows. FDI in banking sector provide benefits of technology transfer better risk management.
Justin Paul & Niti Bhasin (2015)	Exports and outward FDI: are the compliments or substitutes? Evidence from Asia	The authors find evidence of long-run causality from exports to OFDI. Further, exports and OFDI are found to be substitutes. There is no long-run causality from OFDI to exports, implying that MNEs are not “connecting” with home country

Author	Title of the Paper	Findings and Conclusion
		firms through backward and forward linkages in the production process.
Reenu Kumari and Anil Kumar Sharma (2015)	Determinants of Foreign Direct Investment in developing countries: A Panel Data Study	The study used unbalanced panel data, applied on the data of 20 developing countries and the objective of this paper is to find the determinants that cause inflows of FDI in the country during 1990-2012. The study finds that interest rate, inflation rate, market size, international trade favourable policies etc. are the key determinants that cause inflows of FDI in a developing country.
Pooja Sen Gupta & Roma Puri (2018)	Exploration of Relationship between FDI and GDP: A Comparison between India and Its Neighbouring Countries	This study explores the pattern of FDI into India's neighbour countries and made comparison with Indian FDI. Fixed-effect model has been used and findings of the study said that India is having largest R-square value. This study concluded that there is strong association between FDI and GDP of every country and we can say that FDI is a tool for economic growth for every country except Pakistan. This study also suggests that developmental policies of every country should focus on both the domestic as well as international capital inflows and outflows.

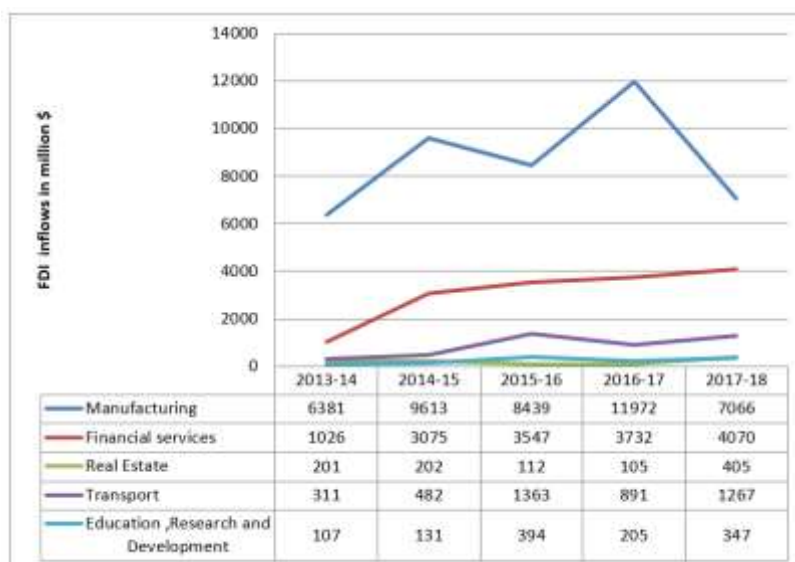
### 3. OBJECTIVES

The present study mainly focuses on the trend of Foreign Direct Investment in India in 5 years (2003-17) and find out the main factors which cause the change in the trend. Therefore, the objectives of the study are:

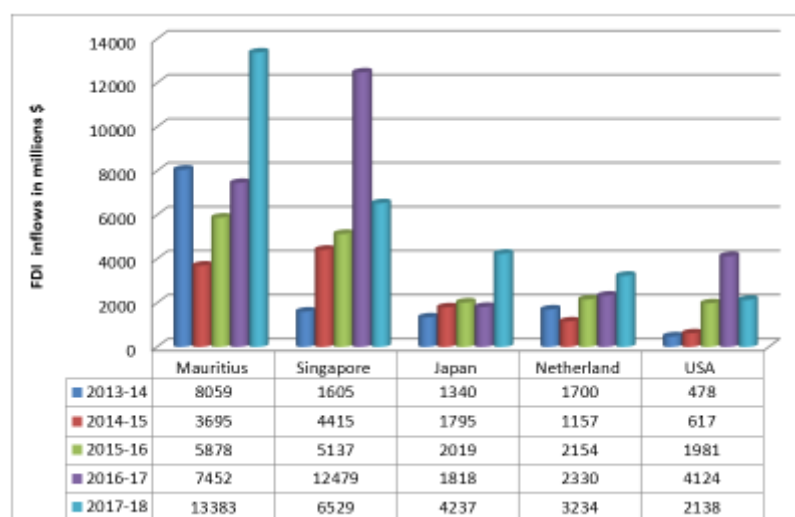
- To review FDI pattern in India.
- To identify the variables responding for FDI growth.
- To analyse the pattern of FDI with political interference.
- To suggest the measures for FDI improve.

### 4. RESEARCH METHODOLOGY

The present research article is descriptive in nature and the target population is total FDI inflows in India. FDI inflows in financial services, real estate, manufacturing, transport and research and development sector has been taken as sample. The study conducted with the help of secondary data collected from past literature, government reports and any other reliable published data related to foreign direct investment. The interpretation and conclusion are based on previous studies as well as published data on foreign direct investment patterns.



**Figure 1** Sector-wise trends of FDI inflows in India (2013-2017)



**Figure 2** Top 5 countries investing in India

## 5. FACTORS THAT LEAD TO CHANGE IN FDI TRENDS

There are numerous factors that lead to change in foreign direct investment inflows like economic factors, political factors, technological factors, social factors, legal factors, environmental factors; among those only political factors are taken for our study that lead to change in FDI inflows during 2013-2017.

**In 2013-2014**, FDI reduced concerns around industrial growth persist as slowdown in the industry continued due to deceleration in mining and quarrying and a disappointing performance of the manufacturing sector. Persistent uncertainty in the global outlook, caused by the crisis in the euro area and general slowdown in the global economy impacting the demand for exports, compounded by domestic structural constraints such as low manufacturing base, delays in projects approvals among others and inflationary pressures, has resulted in a protracted slowdown.

**In 2014-2015**, all sectors shows upward trend. This may be due to the political change in India as Mr. Narendra Modi took oath as 14<sup>th</sup> Prime Minister of India, and his government took

various steps to attract the foreign investors in India. Apart from this, Commonwealth games were held in Glasgow and India finished with 5<sup>th</sup> rank at the Commonwealth Games. Swachh Bharat Abhiyan launched by Government of India. The measures taken by the government are directed to open new sectors for foreign direct investment and increase the sectoral limit in existing sectors. Some of policy measures were:

- 49% FDI under automatic route permitted in insurance and pension sector.
- 100% FDI under automatic route permitted in Brownfield Airport projects.
- 100% FDI allowed in asset reconstruction companies.

**In 2015-16**, financial services, education, research and development and transport shows upward trend. Concept of Digital India introduced in year 2015, which can transform the whole IT landscape in the country. 2015 financial services trends also included mobile-first strategies. Along with the various financial amendments made the financial services more attractive. Example: The ITL provides for a concessional tax rate for non-residents on income earned by way of dividends. With a view to liberalise this investment avenue, the government of India notified a new Depository Receipts Scheme, 2014. SEBI encourages mutual funds to consolidate various schemes that have same features, so the schemes become simpler. In 2015 itself Government of India declared 106 National Waterways, thus the investment in transport increased.

**In 2016-17**, Manufacturing, financial services and transport sector shows upward trend. Government of India increased export incentives available to labour intensive MSME sectors by 2%. Government of India has launched a phased manufacturing programme aimed at adding smarter phone components under Make in India initiative. For economic growth services sector is the key driver. In foreign trade policy (2015-2020) central government increase incentives and working to remove many trade barriers to services. Real Estate sector shows decline because of decline in the number of people buying residential properties. Main reason is that the property prices remain high compared to the average income of Individuals. In Education, research and development sector, top issues impacting higher education in 2016 are presidential elections; Higher education act reauthorisation has become the topic that refuses to go away, quality assurance, cyber security etc. Intel India plans to invest ₹1100 crores. To expand its research and development centre in Bangalore.

**In 2017-18**, Industrial production pick up growth again as the goods and services tax has finally been implemented. In august 2017, the government announced a new consolidated FDI policy. The policy allows start-ups to raise money from foreign ventures capital investors by issuing instruments such as convertible notes. RERA (Regulation and Development) Act, 2016 was passed by parliament, which seeks to protect home buyers as well as boost the investment in real estate industry.

## **6. SUGGESTIONS FOR FDI INFLOWS IMPROVEMENT**

In today's world, a country's growth is depending upon its FDI inflows. It contains large proportion in the growth and development of country. To attract FDI, a country should have favourable environment which consists of inflation rate, interest rate, political stability, exchange rate, transportation, infrastructure, natural resources etc.

1. Exchange rate stability plays a very vital role in attracting foreign direct investment. It builds confidence in investors to invest in a particular country.
2. A country which is having strong banking system attracts more FDI compared to those countries which don't have strong banking system. So, a country should focus on making its banking system strong.

3. Through better monetary and fiscal measures, a country can improve its foreign direct investment flows. Strong political measures are needed for international integration and improving regulatory system.
4. Through favourable economic environment a country can improve its foreign direct investment inflows. Favourable economic environment includes subsidies, good infrastructure, good transportation facilities, tax rebates, political stability, employment, improving standard of living etc.
5. There should be proper law and order in the country; otherwise no country would invest in a country where there are no laws and orders.
6. By setting up co-operative and business friendly financial system, foreign direct investment can be attracted. Strong financial system provides access of credit to foreign firms who are investing internationally.
7. India is having strong potential for improvement in capital formation; it leads to foreign direct investment inflows in the country. Capital formation can be raised through including domestic industries in the competition by supporting them to compete with foreign firms.

## **7. LIMITATIONS OF THE STUDY**

1. Only few political factors have been taken into consideration which majorly affects the inflows of foreign direct investment into country, for better analysis more variables could have been considered.
2. Sample size of the study is small, as only five sectors are considered for analysis. For better analysis more sectors could have been taken.
3. Non-availability of information on some factors like corruption.

## **8. CONCLUSION**

The status of FDI inflows has improved a lot during the period 2014-18, but still there are many areas in which there is lots to go. During Modi's Government, FDI inflows improved greatly because of launching of various programme and policies. Financial sector shows great growth because of digitalisation, GST etc., although FDI in manufacturing sector does not shows that much increase because of deceleration in mining and quarrying. Various ups and downs can be seen in real estate sector in past five years. Education, research and development sector shows good increase but this is also not satisfactory, so there should be more focus on education, research and development sector along with manufacturing sector. Lack of proper political environment can be a big hindrance in upliftment of foreign direct investment in the country; so government should take initiatives like increasing sectoral caps, increasing the rate of subsidies for those who are investing in education sector, increasing the number of sector under automatic route, signing bilateral agreement with more number of countries, improving monetary and fiscal policies etc. Therefore, we can say that political sector of a country can affect its economic, social, legal and environmental sector also. There is urgent need in India to adopt the new strategies and corporate governance practices in accordance with international standard so that more foreign direct investment can be attracted in the country.

## **9. SCOPE FOR FURTHER RESEARCH**

There is wide scope for further research in foreign direct investment. Impact of foreign direct investment on balance of payments by taking micro as well as macro variables can be investigated. Further research can be undertaken on impact of foreign direct investment on growth and development of India since 1991 by increasing variables from political factors to

economic and legal factors. At international level also, there is huge scope of research like foreign direct investment inflows in various developing, under-developed and developed countries by taking both regulatory and non-regulatory variables during a specified period of time; comparison can be made between foreign direct investment inflows of various Asian countries and its impact on growth and development within a specified time period.

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