e-ISSN : 2347 - 9671, p- ISSN : 2349 - 0187

EPRA International Journal of Economic and Business Review | Vol - 4, Issue- 1, January 2016

Inno Space (SJIF) Impact Factor : 4.618(Morocco) ISI Impact Factor : 1.259 (Dubai, UAE)

FOREIGN DIRECT INVESTMENT IN INDIA

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ABSTRACT

Theories of international trade classify countries of the world mainly in two groups on the basis of availability of factors of production as labour abundant country and capital abundant country. In present world there is presence of intra and inter industry trade so these traditional notion of water tight compartment of labour and capital abundance have no place. Thus there is need of both Labour and capital for a country to develop. Similar is the case with India. Being capital deficient country India needs foreign capital whether in the form of FDI, loans or external commercial borrowings. With the wave of "Make in India" campaign it became necessary to understand everything about our foreign capital inflows and related policies.

Present paper is an attempt in this direction. Here I tried to describe different forms of foreign capital inflows in India, routes of their entrance into India, recent FDI limits in different sectors, Policy towards foreign capital and recent changes in FDI policy in realm of "Make in India" campaign.

KEYWORDS- *Make in India, FDI, FII, QFI, Foreign portfolio Investment, External Commercial Borrowings, and Foreign Investment Promotion Board.*

Section I
INTRODUCTION

Countries of the world are classified mainly as labour abundant and capital abundant in Theories of International Trade and production takes place according to that factor endowment. But in present scenario we see huge expansion of Inter and Intra industry trade. Thus both capital and labour along with other factors such as technology are important for the development of any country. India, a labour abundant country initially relied more on internal factors for development of the economy but later on in 1991 it liberalised its economy to allow foreign investment to come in. India was reluctant for any type of foreign help but later on it realised the unquestionable importance of foreign capital in the development of Indian economy. India needed foreign capital as there is (i) inadequate domestic capital (ii) difficulty in mobilising domestic saving for financing projects (iii) capital market is underdeveloped (iv) potential saving is used for investment only at higher level of economic activity and last but not the least reason is (v) foreign capital bring with it other scarce productive factors e.g. technical knowhow, business experience and knowledge which are equally essential for economic development. Thus for all these reasons foreign capital in India invited after a long restriction.

With the passage of time our governments' attitude towards foreign capital is becoming more and more liberalised and with the surge of make in India program FDI policy is liberalised further to help in ease of doing business.

Present paper is followed as objective of paper in Section II. Section III deals with forms of foreign capital in India then in next section sources or routes of foreign capital. Section V deals with different types of direct foreign investment in India and lists the limits of FDI in different sectors. Section VI deals with the government policy towards foreign capital and last Section deals with recent changes in FDI policy for ease of doing business in Make in India programme and then conclusion.

Section II
OBJECTIVE OF THE PAPER

- To highlight different forms of foreign capital in India
- To describe different routes for foreign capital in India
- To analyse the government policy towards Foreign capital
- To describe the recent changes in FDI policy in the wake of Make in India programme.

Section III
FORMS OF FOREIGN CAPITAL IN INDIA

There are mainly two sources of foreign capital viz. a) Official Channel that comprise of bilateral government system , multilateral financial institutions, debts, gifts and grants b) Private Channel comprising ECB, Equity capital, portfolio investment, Foreign institutional investors, FDI, NRI deposits. However foreign capital coming in India can be of following forms in India-

1. **Direct investment** –This can be either through direct establishment of companies, through subsidiary offices, branches and affiliates in India known popularly as FDI or through subscription of stocks and debentures of concerns in India known as FPI(Foreign Portfolio Investment).
2. **Foreign collaboration**- This is joint cooperation of domestic and foreign capital and can be of three types (i) joint participation between private parties (ii) between foreign firm and Indian government (iii) between foreign government and Indian government.
3. **Inter-governmental loans**- Loans from foreign governments such as Marshall aid that was a massive system of American aid given to war devastated countries. But often governments are reluctant towards this type of investment as it may hurt sovereignty of their nation.
4. **Loans from International Institutions**- International institutions like IMF provide loans to countries for correction of balance of payment problems. Other institutions such as World Bank, ADB and proposed BRICS Development Bank provide loans for various development activities.
5. **External Commercial Borrowings**- It is used for commercial borrowings from capital market. ADR GDR

Section IV
ROUTES OF DIRECT FOREIGN INVESTMENT IN INDIA

There are two routes of direct foreign investment in India. First is, Automatic Route also known as Mumbai Route and second is, FIPB Route also called Delhi Route.

a) **Automatic route**- There is no need of prior approval of RBI or Government for FDI coming through this route. This route is related to RBI because investors have to just inform regional office of RBI where this investment is coming within 30 days. Many sectors have been opened for 100% FDI through this route.

b) **Government or FIPB route**- FIPB was made in 1991 and since 2003 it is working under Finance Ministry. Except NRI deposits and Single Brand Retailing (these are accepted by DIPP Investment Policy and Promotion board of Commerce and Industry Ministry), all proposals are accepted by Department of Economic Affairs (MoF). FIPB is single window for approval of FDI, presided by Secretary of Department of Economic Affairs. Investment decisions up to 1200 crore rupees comes under jurisdiction of finance ministry and if investment is more than this limit approval of Cabinet committee of Economic Affairs is necessary.

Section V
TYPES OF DIRECT FOREIGN INVESTMENT

FDI (Foreign Direct Investment)-

Investment by foreign company in a national company in its capital assets, plant machinery, land, building, inventory etc. In it foreign company establishes a new company in the country or opens its subsidiary companies. Investor has control over invested capital. It leads to creation of physical assets that has a positive effect on production, income and employment of the country where investment takes place. These are of long term nature having no fear of capital flights with the fluctuation in business environment.

FPI (Foreign Portfolio Investment)-

Investor invests in financial assets like shares, bonds, investment funds or depositories. It is of short term nature. In India FII (Foreign institutional Investors) and QFI (Qualified Foreign Investors) comes under it. At present foreign individuals seeking to invest in Indian stocks has to be registered as a subaccount of an FII which inturn has to apply to SEBI on behalf of sub account holder. India allows only wealthy foreign individuals or high net worth individuals who have a minimum net worth of 50 million $. FII is very important for the Indian economy as RBI estimated says that 10% fluctuation in FII investment results in 35 % variation in stock prices. Recently FII pulled out money on account of growth falling below 7% net outflows exceeded 450 million $ last year. For many FII's economic woes in their own markets especially due to European debt crisis and a perceived policy paralysis in India following a string of scams exacerbated their pull out.

FII- It consist of those foreign companies or institutions that participate in Primary and Secondary financial markets in India. Hedge Fund, Insurance companies, pension funds, mutual funds comes under it. FII have to be registered with SEBI.

QFI- For attracting more foreign investors finance ministry allowed foreign individuals, group of foreign firms can directly invest in Indian stock market without requiring subaccount in FII. This should bring in some more investors who are interested in investment in India but feel turned off due to sub account and strict high net worth rule butQFI are required to open De-mat account and trade account with depository participants[1]. It means when any foreign investors purchase Indian shares, they do not get paper certificates but those shares get electronically transferred to their De-mat account in depository[2] like NSDL and CDSL.

Limits of FDI in different sectors:-

FDI is completely restricted in (i) Atomic Energy (ii) Lottery Trade (iii) Gambling and Betting (iv)Business of chit fund and Nidhi Company Trading in Transferable Development Rights (TDRs) (v) Activities/sector not opened to private sector investment; (vi) Agriculture (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms etc. under controlled conditions and services related to agro and allied sectors) and Plantations (Other than Tea Plantations); (vii) Real estate business, or construction of farm houses; (viii) Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco or of tobacco substitutes.

Note:

[1] Depository participants are like bank branches where shares in physical form are
deposited for converting them in electronic form like ICICI SBI HDFC etc.

[2] Depository is like a bank locker where securities are held in dematerialised form.

	Sectors	Limits of FDI
1.	Construction, NBFC's ,Single Brand Retail, National Highway, Science and technology magazine, Real estate Pharmaceutical industries, Doordarshan-channel, Mining , Alcohol- Distillation & Brewing, Coffee & Rubber processing & Warehousing, Hazardous chemicals and isocyanates , Industrial explosives Manufacture, Drugs and Pharmaceuticals 7. Power including generation (except Atomic energy) transmission, distribution and power trading, civil aviation. Publishing of scientific magazines/speciality journals/periodicals **Agriculture-**Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisciculture, Aquaculture, Cultivation of vegetables & mushrooms and services related to agro and allied sectors.Tea sector, including plantation.	100 %
2.	Telecommunication satellites, Mobile and TV, Private sector Banking, Atomic Minerals	74 %
3.	Multibrand retail, trading,	51 %
4.	Commercial banks, Broadcasting, Aviation, Stock Exchange, Assets and reconstruction companies, Petroleum and natural gas (PSU's)	49%
5.	Classifieds and adds, print and electronic media, insurance, Defence production	26%
6.	Commodity exchanges	23%
7.	FM radio	20 %

Section VI
GOVERNMENT POLICY TOWARDS FOREIGN CAPITAL

Pressure of economic development on the eve of independence led to realistic approach towards foreign capital and thus Nehru government made a statement in April 1949 giving 3 important assurance to foreign investors that no discrimination be made between foreign and local undertaking, foreign exchange position permitting reasonable facilities would be provided to foreign investors in terms of remittances of profits and repatriation of capital and in case of nationalisation of undertaking fair and equitable compensation would be given to foreign investors.

During congress rule it was decided that major ownership and effective control of undertaking was to be in Indian hands except few cases and government extended a number of tax concessions in favour of foreign enterprises. Government had to choose between pursuing policy of Indianisation of foreign subsidiary companies or to boost up exports through agency of foreign firms. The latter course which was chosen was beset with grave dangers of proliferation of influence of foreign concerns. During two year Janta rule two major decisions regarding MNC were taken 1) coco-cola company was asked to wind up its operations 2) government asked IBM to dilute its equity to 40 % so as to conform to norms of FERA. Despite these 2 decisions MNC's contributed to operate in non - priority areas.

Industrial policy 1991 regards foreign capital essential for modernisation, technology up gradation and industrial development. GOI liberalised its policy towards foreign investment in 1991 to permit automatic approval for foreign investment up to 51 % equity in 34 industries. FIPB was set up to process application for cases not covered by automatic approval. A series of measures that were undertaken to liberalise foreign investment such as (i) dual route of approval of FDI was introduced (ii) In case of technology agreements in high priority industries automatic permission was given and restriction of FDI in low technology areas was removed with the liberalisation of technology imports (iii) Non-resident Indians (NRIs) and Overseas Corporate Bodies (OCBs) were permitted to invest up to 100 per cent in high priorities sectors (iv) Convention of Multilateral Investment Guarantee Agency (MIGA) for protection of foreign investments was signed. These steps were further boosted by less stringent Foreign Exchange Management Act (FEMA), 1999 (that replaced the Foreign Exchange Regulation Act (FERA), 1973).

Foreign investment policy is changed to some extent in 2011 like **routes changes**: 100 % FDI through automatic route given to distillation and brewing, construction of industrial explosives, hazardous chemicals, airport programme (green field), investment in petroleum sector and cash trading & export trading. **Increase in equity limit:** equity limit of FDI increased to 100% through automatic route in mining, coal lignite for national consumption, infrastructure development for marketing of petroleum and natural gas, investigation and mining of diamond and precious metal. **FDI in new sectors:** 100% FDI through automatic approval provided in electronic trade and its process, storage of rubber and coffee. **Removal of restrictive conditions**: obligatory investment in BEBE commerce condition should be removed. **Process simplification:** FDI through automatic route if sectoral policy of FDI is not surpassed.

In 2012 certain policy changes were introduced like it was proposed that financing of current account deficit through FDI is best way. Only in commodity market approval of FIPB is necessary for FDI. Under leasing and finance process only financial leasing will come and for enhancing FDI limit in any sector above 24 % RBI should be informed, limit of FDI in single brand retail was enhanced to 100% and 51% FDI through FIPB route was proposed in multi-brand retail with certain conditions.

Most recently government's announcement that it would now treat all forms of foreign investment in Indian companies under a single, composite ceiling. Many sectors now have no limit on foreign direct investment (FDI). Foreign portfolio investment (FPI) refers to the positions that foreign institutional investors (FIIs) take in companies. Their boards have to decide whether this is to be taken above the default cap of 24 per cent. Consequently, sectors that would have directly been affected by the composite cap decision are banking, defence, single-brand retail, credit information and power and commodity exchanges, all of which have limits on FDI. When the announcement came, banking stocks rose sharply, based on the interpretation that bank boards could now vote to increase FPI limits up to the overall limit in the sector. But the government's position on banking and defence is now being made explicit; these two sectors will continue to operate under separate caps- one for foreign portfolio investment and the other for overall foreign investment. Consequently, foreign portfolio investment in banks could go up to only 49 percent within the overall sectoral foreign investment cap of 74 percent. For defence, the overall foreign investment cap will continue to be 49 per cent, within which FPI can be up to 24 per cent.

Section VII
CHANGES IN FDI POLICY IN THE REALM OF "MAKE IN INDIA" PROGRAMME

The "Make in India" campaign launched by Prime Minister Mr. Narendra Modi where leading businessmen and CEOs of about 3000 companies from 30 countries were present is an remarkable effort to boost investor confidence in the country. Moreover, Mr. Modi's recent US visit and meeting with CEOs of some of the top global firms like Goldman Sachs, Google, General Electric, Cargill, Boeing and many others unquestionably set the ground for investment in India. In make in India for manufacturing sector steps are undertaken to release restrictions impending the path of foreign investment in India with a view to improve ease of doing business. According to World Bank report, India ranks 142 out of 189 countries in the category for ease of doing business based on surveys conducted in the two major cities of India, Mumbai and Delhi prior to the new Government came to power. For increasing investor confidence, it is necessary that the Government need to improve the various constituents of Doing Business indicators like starting a business, trading across borders, getting electricity, getting credit, protecting minority investors, dealing with construction permits, paying taxes, registering property, enforcing contracts and resolving insolvency as these are the indicators being looked by the firm at before going forward with an investment decision in a country. Thus for improving over these indicators government of India as well as state governments have undertaken certain initiatives mentioned below-

- Requirement of minimum paid up capital for companies be removed.
- Requirement of common seal for companies removed.
- Requirement of filling declaration of commencement of business is removed.
- Single step incorporation of companies through INC 29 forms.
- Loans and guarantees to fully owned subsidiaries allowed.
- Process to approve related party transaction made simpler.
- Board's resolution taken off disclosure requirements.
- Orders to facilitate revival and rehabilitation of MSME's issued.
- Customs clearance facilitation committee constituted at ports for expeditious clearance of goods.
- Five services of companies incorporation, allotment of PAN and TAN and registration with ESIC and EPFO through a single process on eBiz portal
- Assessment framework for ranking of the states released.
- Investment by NRI to be deemed as domestic investment at par with investments by residents.
- Initial validity of industrial licence for defence sector revised for seven years extendable up to three years.
- FDI policy mapped with NIC code 2008.
- SEZ units allowed to remove goods for repair, replacement, testing, calibration, quality testing, and research and development of self-attestation.

CONCLUSION

For understanding recent changes in attitude of government towards foreign investment in the realm of Make in India campaign it was necessary to do in-depth study of foreign investment in India. The phase I of Make in India became successful to a great extent by increasing investment in considerable amount. Government is planning for phase II of this campaign. For a labour - abundant and capital deficient country like India it is necessary to have a sound foreign investment policy with a view to promote more and more foreign investment so that India be prepared for ripening the fruits of demographic dividend in future without having a mass unemployment situation.

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