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   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

   ACKNOWLEDGMENTS

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   APPENDIX/ANNEXURE

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- Bowersox, Donald J., Closs, David J., (1996), "Logistical Management." Tata McGraw, Hill, New Delhi.
- Hunker, H.L. and A.J. Wright (1963), "Factors of Industrial Location in Ohio" Ohio State University, Nigeria.

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**ONLINE RESOURCES**

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**WEBSITES**

- Garg, Bhavet (2011): Towards a New Natural Gas Policy, Political Weekly, Viewed on January 01, 2012 http://epw.in/user/viewabstract.jsp

# FDI IN INDIA: TREND, ISSUES AND CHALLENGES

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## ABSTRACT

*Foreign Investment is considered to be the life blood and an important vehicle of for economic development as far as the developing nations are concerned. Its global popularity and positive output in augmenting the domestic capital, productivity and employment; has made it an indispensable tool for initiating economic growth in countries. But there are some controversies and challenges regarding FDI in India and there is a need to reflect upon the question that will high growth and inflows of FDI be able to solve structural imbalances of Indian economy and whether it will succeed in improving the lot of bottom section of the Indian economy, which are living in abysmally poor socio-economic conditions. The employment elasticity in the agriculture and industrial sector has gone down in the post-reform period, therefore, the creation of employment opportunities will be a gigantic task for the policy makers. FDI has come in the most capital-intensive sectors; therefore, the required employment opportunities could not be created especially for the manual and the semi skilled labor while high skilled workforce gained substantially. That is why high growth is called urban centric and thus has developed a wedge between the urban and rural economy. This paper focuses on such issues and challenges.*

## KEYWORDS

Foreign Direct Investment (FDI), Growth, flow of FDI, policy recommendation.

## INTRODUCTION

Before 1991, the Indian financial system was isolated from the international financial markets. Indian companies could only access the Indian capital markets which means their sources of finance were restricted with in India. After the economic liberalization, the openness was introduced in the Indian financial system and option of global market was opened for Indian business entrepreneur. They can tap international sources for both debt and equity and global depository receipts (GDR) and American Depository Receipts (ADR) were the main market instruments used by the Indian companies. At the same time international finance also comes in the form of foreign direct investment (FDI), under this source direct equity contribution by MNC's are made to expand their operation beyond their national boundaries in the form of new enterprises as a branch or as subsidiary, expansion of overseas branch or subsidiary and acquisition of an overseas business. A tremendous change has occurred in the Indian financial system with regard to its integration with the global financial markets.

Foreign direct investment (FDI) has become an integral part of national development strategies for almost all the nations globally specially for developing countries. Its global popularity and positive output in augmenting of domestic capital, productivity and employment; has made it an indispensable tool for initiating economic growth for countries. In India, FDI is considered as a good source of flow of foreign capital as it not only adds value to the domestic resources but also an important source of technology and global best practices. Foreign direct investment is done for many reasons including to take advantage of cheaper wages in the country, special investment privileges such as tax exemptions offered by the country as an incentive to gain tariff-free access to the markets of the country or the region.

Now there is a need to reflect upon the question that will high growth and inflows of FDI be able to solve structural imbalances of Indian economy and whether it will succeed in improving the lot of bottom section of the Indian economy, which are living in abysmally poor socio-economic conditions. The employment elasticity in the agriculture and industrial sector has gone down in the post-reform period, therefore, the creation of employment opportunities will be a gigantic task for the policy makers. FDI has come in the most capital-intensive sectors; therefore, the required employment opportunities could not be created especially for the manual and the semi skilled labor while high skilled workforce gained substantially. That is why high growth is called urban centric and thus has developed a wedge between the urban and rural economy. There is urgent need to solve this problem.

## OBJECTIVES OF THE STUDY

The main objective of the study is to discuss Current issues and challenges related to FDI in India. The other objectives are:

1. To review FDI Policy framework in India.
2. To discuss the FDI limits of various sectors in India.
3. To study the country wise FDI inflows in India.
4. To address various issue and concern relating to FDI.

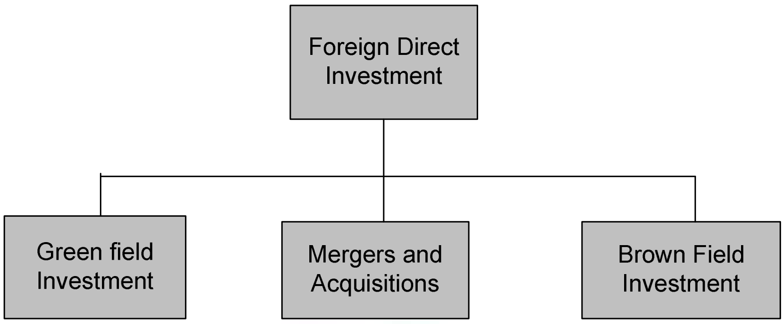
## RESEARCH METHODOLOGY

The present study is of analytical and descriptive nature. For this study data and information has been gathered through secondary sources including Magazines, Newspapers, and reports of RBI, department of Industrial Promotion and Policy, Centre for Monitoring Indian Economy, books on Foreign Investment, Research Journals, and articles written by eminent authors.

## FDI POLICY FRAMEWORK IN INDIA

FDI is the process whereby resident of one country acquires ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country. In other words FDI is characterized as any form of long-term investment that earns interest in an enterprise which functions outside the domestic territory of the investor. FDI can of following types: -

Foreign Direct Investment (FDI) has been classified in a following manner:




1. **Green Field Investment**. It involves starting from scratch means constructing new infrastructure for the purpose of business or investment abroad through opening of the branches
2. **Mergers and acquisitions** are either outright purchase of running company abroad or an amalgamation with a running foreign company.
3. **Brown field investment** involves just maintenance of existing one or cosmetic additions to the existing one.

**1.1 ROUTES OF FOREIGN DIRECT INVESTMENT**

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

- **Automatic Route**: FDI under the automatic route does not require any prior approval either by the Government or the Reserve Bank. The investors are only required to notify the concerned regional office of the RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issuance of shares to foreign investors.
- **Government Route/FIPB Route**: Under this Route, FDI approval is made by three institutions, viz., the Foreign Investment Promotion Board (FIPB), the Secretariat for Industrial Assistance (SIA) and the Foreign Investment Implementation Authority (FIIA).Under the approval route, the proposals are considered in a time-bound and transparent manner by the FIPB. Approvals of composite proposals involving foreign investment/ foreign technical collaboration are also granted on the recommendations of the FIPB.

**AUTHORITIES DEALING WITH FOREIGN INVESTMENT**

(a) Foreign Investment Promotion Board (popularly known as FIPB)**:** The Board is responsible for expeditious clearance of FDI proposals and review of the implementation of cleared proposals. It also undertakes investment promotion activities and issue and review general and sectoral policy guidelines;
(b) Secretariat for Industrial Assistance (SIA): It acts as a gateway to industrial investment in India and assists the entrepreneurs and investors in setting up projects. SIA also liaison with other government bodies to ensure necessary clearances;
(c) Foreign Investment Implementation Authority (FIIA): The authority works for quick implementation of FDI approvals and resolution of operational difficulties faced by foreign investors;
(d) Investment Commission
(e) Project Approval Board
(f) Reserve Bank of India

**REPATRIATION OF PROFITS EARNED ON FOREIGN INVESTMENT CAPITAL IN INDIA**

All foreign investments are freely repatriable except for the cases where NRIs choose to invest specifically under non-repatriable schemes. Dividends declared on foreign investments can be remitted freely through an authorized dealer. Non-residents can sell shares on stock exchange without prior approval of RBI and repatriate through a bank the sale proceeds if they hold the shares on repatriation basis and if they have necessary NOC/tax clearance certificate issued by Income Tax authorities. For sale of shares through private arrangements, regional offices of RBI grant permission for recognized units of foreign equity in Indian company in terms of guidelines indicated in Regulation 10.B of Notification No. FEMA.20/2000 RB dated 3rd May 2000. The sale price of shares on recognized units is to be determined in accordance with the guidelines prescribed under Regulation 10B (2) of the above Notification. Profits, dividends, etc. (which are remittances classified as current account transactions) can be freely repatriated.

## FDI LIMITS FOR VARIOUS SECTORS

Foreign Direct Investment (FDI) in India is subject to certain Rules and Regulations and is subject to predefined limits ('Limits') in various sectors which range from 20% to 100%. There are also some sectors in which FDI is prohibited. The FDI Limits are reviewed by the Government from time to time and as and when the need is felt and FDI is allowed in new sectors where the limits of investment in the existing sectors are modified accordingly. In order to revise the FDI Limits to attract more foreign investment in India, the Union Government constituted a committee named, Arvind Mayaram Committee headed by the Economic Affairs Secretary. On 16th July, 2013, the Government approved the recommendations given by the Arvind Mayaram Committee to increase FDI limits in 12 sectors out of the proposed 20 sectors, including crucial ones such as defense and telecom.

| SECTOR SPECIFIC LIMITS OF FOREIGN INVESTMENT IN INDIA | | | |
|---|---|---|---|
| **Sector** | **FDI Cap/Equity** | **Entry Route** | **Other Conditions** |
| **A. Agriculture**<br>1. Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisciculture, Aquaculture, Cultivation of vegetables & mushrooms and services related to agro and allied sectors. | 100% | Automatic | |
| 2. Tea sector, including plantation | 100% | FIPB | |
| *(FDI is not allowed in any other agricultural sector /activity)* | | | |
| **B. Industry**<br>1. Mining covering exploration and mining of diamonds & precious stones; gold, silver and minerals. | 100% | Automatic | |
| 2. Coal and lignite mining for captive consumption by power projects, and iron & steel, cement production. | 100% | Automatic | |
| 3. Mining and mineral separation of titanium bearing minerals | 100% | FIPB | |
| **C. Manufacturing**<br>1. Alcohol- Distillation & Brewing | 100% | Automatic | |
| 2. Coffee & Rubber processing & Warehousing. | 100% | Automatic | |
| 3. Defence production | 26% | FIPB | |
| 4. Hazardous chemicals and isocyanates | 100% | Automatic | |
| 5. Industrial explosives –Manufacture | 100% | Automatic | |
| 6. Drugs and Pharmaceuticals | 100% | Automatic | |
| 7. Power including generation (except Atomic energy); transmission, distribution and power trading. | 100% | Automatic | |
| *(FDI is not permitted for generation, transmission & distribution of electricity produced in atomic power plant/atomic energy since private investment in this activity is prohibited and reserved for public sector.)* | | | |
| **D. Services**<br>**1. Civilaviation (Greenfield projects and Existing projects)** | 100% | Automatic | |
| **2. Asset Reconstruction companies** | 49% | FIPB | |
| **3. Banking (private) sector** | 74% (FDI+FII).<br>FII not to exceed 49% | Automatic | |
| 4. **NBFCs** : underwriting, portfolio management services, investment advisory services, financial consultancy, stock broking, asset management, venture capital, custodian, factoring, leasing and finance, housing finance, forex broking, etc. | 100% | Automatic | s.t.minimum capitalisation norms |
| **5. Broadcasting**<br>a. FM Radio<br>b. Cable network; c. Direct to home; d. Hardware facilities such as up-linking, HUB.<br>e. Up-linking a news and current affairs TV Channel | 20%<br>49% (FDI+FII)<br><br>100% | FIPB | |
| **6. Commodity Exchanges** | 49% (FDI+FII) (FDI 26 % FII 23%) | FIPB | |
| **7. Insurance** | 26% | Automatic | Clearance from IRDA |
| **8. Petroleum and natural gas :**<br>a. Refining | 49% (PSUs).<br>100% (Pvt. Companies) | FIPB (for PSUs).<br>Automatic (Pvt.) | |
| **9. Print Media**<br>a. Publishing of newspaper and periodicals dealing with news and current affairs<br>b. Publishing of scientific magazines / speciality journals/periodicals | 26%<br><br>100% | FIPB<br><br>FIPB | S.t.guidelines by Ministry of Information & broadcasting |
| **10. Telecommunications**<br>a. Basic and cellular, unified access services, national / international long-distance, V-SAT, public mobile radio trunked services (PMRTS), global mobile personal communication services (GMPCS) and others. | 74% (including FDI, FII, NRI, FCCBs, ADRs/GDRs, convertible preference shares, etc. | Automatic up to 49% and FIPB beyond 49%. | |

Source: Reserve Bank of India

**SECTORS WHERE FDI IS BANNED**

1. Retail Trading (except single brand product retailing);
2. Atomic Energy;
3. Lottery Business including Government / private lottery, online lotteries etc;

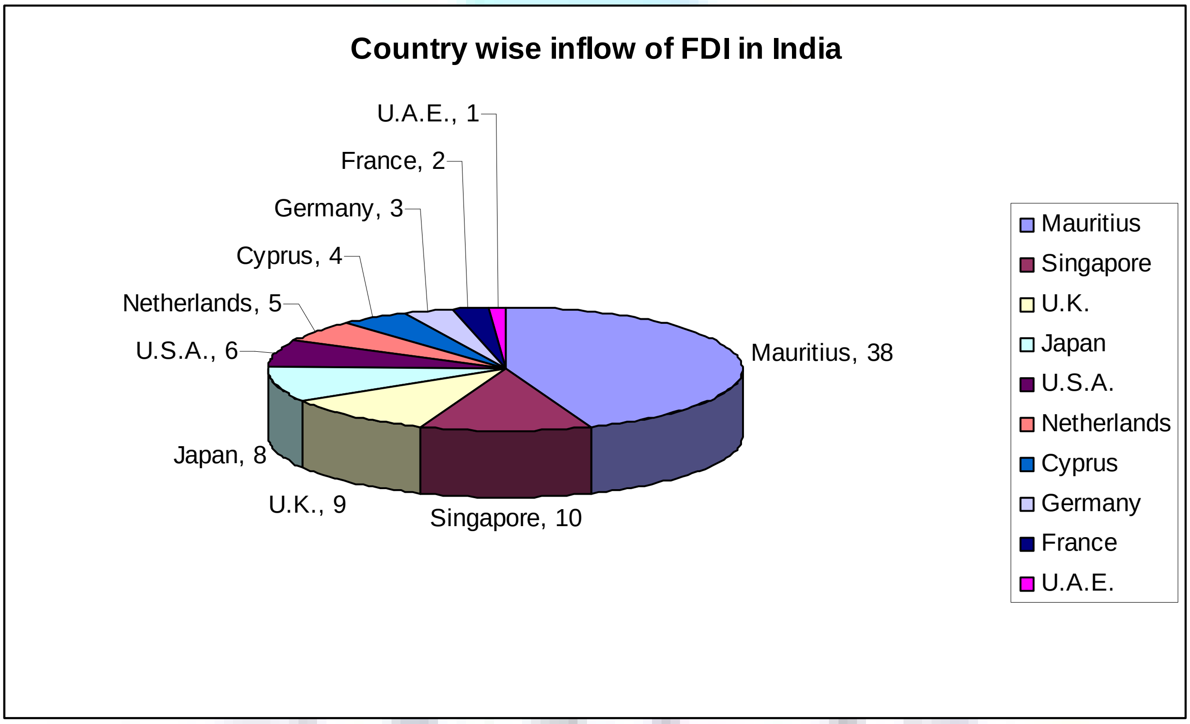
4. Gambling and Betting including casinos etc.;
5. Business of chit fund;
6. Trading in Transferable Development Rights (TDRs);
7. Activities/sector not opened to private sector investment;
8. Agriculture (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms etc. under controlled conditions and services related to agro and allied sectors) and Plantations (Other than Tea Plantations);
9. Real estate business, or construction of farm houses; Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco or of tobacco substitutes.

## COUNTRY WISE INFLOW OF FDI IN INDIA

It is proposed to analyse the country wise inflow of foreign direct investment in India during 2001 to 2013. The data relevant to the analysis is presented in table.

| Ranks | Country | Amount (in US$ Million) | % |
|---|---|---|---|
| 1 | Mauritius | 73666 | 38 |
| 2 | Singapore | 19460 | 10 |
| 3 | U.K. | 17549 | 9 |
| 4 | Japan | 14550 | 8 |
| 5 | U.S.A. | 11121 | 6 |
| 6 | Netherlands | 8965 | 5 |
| 7 | Cyprus | 6889 | 4 |
| 8 | Germany | 5480 | 3 |
| 9 | France | 3573 | 2 |
| 10 | U.A.E. | 2422 | 1 |

**Source**: RBI Bulletin 2013




Above table portrays the country-wise FDI equity inflows in India. It shows the total amount of inflows from 2000 to 2013 in terms of US $. Table discloses that the Mauritius country has the highest foreign investment in India with 38.14%. Mauritius is at top in investing FDI in India followed by Singapore, UK, Japan and so on. U.S.A also gets 5th position in this category with 5.84%.

India is the fourth largest economy in terms of purchase power parity. India have the second largest road network in the world, spanning 3.3 million kilometers, easy availability of labour at cheap rates, raw materials supplied abundantly and fully developed banking system. These are the reasons which facilitate the flow of FDI from different countries in India.

## FDI: CURRENT ISSUES AND CHALLENGES

### ISSUES

- **Predatory pricing issue-** Threat of MNC's using predatory pricing policies to wipe out competition from the market. Thus a possibility of unfair trade war can't be wiped out.
- The promise of back end sourcing within tunes of 30% might not materialize as seen in case of IKEA- the furniture giant refusing to be bound to source from local manufacturers over quality issues.
- FDI promises to provide jobs to people but the jobs will mostly be high end and lots of jobs lost to unskilled employees.
- Recent controversy of Wal-Mart allegedly paying bribe to secure FDI in several nations like China, India and Brazil cast shadows over the transparency of the whole idea of FDI.
- FDI investment implementation decision is left to states but recently Delhi and now Rajasthan with changed non-Congress regime have decided to not implement it while first agreeing when ruled by Congress govt. The whole unpredictability and lack of firm guidelines make it a shoddy investment for foreign companies as it involves huge investment to begin with.
- **High Entry Barriers might be erected**-Issue of Hypermarkets being promoted or MNC/ mall culture being promoted might lead discourage small entrepreneurs from entering the market.

- Drastic shift in crop patterns might affect food security as MNC's promote mono crop large scale cultivation with contract farming..
- 26% Cap in FDI in defense is called to be insufficient according to industry experts who think the low cap is a disincentive for foreign firms to invest in this crucial sector. Increase in FDI in the defense sector becomes all the more important as India and the US are working to boost their defense ties and co-development under the Defense Trade Initiative (DTI). But issues underlying this crucial decision are many. Typical concerns that make foreign investments in the defense sector important from a national security perspective are:

(i) Foreign owners could eventually restrict defense supplies to host governments;
(ii) Foreign owners could use acquired technologies to harm host government's security interests;
(iii) Foreign-acquired domestic firms could be used for surveillance, infiltration and sabotage against the host governments and
(iv) Particularly from a developing country perspective, foreign ownership could result in widespread infusion of low-end technologies that could wipe out nascent defense industrial bases in the host countries.

- Though FDI permitted in telecommunications with a large share but it's mired in controversy with privacy and security concerns.

**CHALLENGES**

India is focusing on maximizing political and social stability along with a regulatory environment. In spite of the obvious advantages of FDIs, there are quite a few challenges facing FDIs in India, such as:

1. **Resource challenge**: India is known to have huge amounts of resources. There is manpower and significant availability of fixed and working capital. At the same time, there are some underexploited or unexploited resources. The resources are well available in the rural as well as the urban areas. The focus is to increase infrastructure 10 years down the line, for which the requirement will be an amount of about US$ 150 billion. This is the first step to overcome challenges facing larger FDI.
2. **Equity challenge**: India is definitely developing in a much faster pace now than before but in spite of that it can be identified that developments have taken place unevenly. This means that while the more urban areas have been tapped, the poorer sections are inadequately exploited. To get the complete picture of growth, it is essential to make sure that the rural section has more or less the same amount of development as the urbanized ones. Thus, fostering social equality and at the same time, a balanced economic growth.
3. **Political Challenge**: The support of the political structure has to be there towards the investing countries abroad. This can be worked out when foreign investors put forward their persuasion for increasing FDI capital in various sectors like banking, and insurance. So, there has to be a common ground between the Parliament and the foreign countries investing in India. This would increase the reforms in the FDI area of the country.
4. **Federal Challenge**: Very important among the major challenges facing larger FDI is the need to speed up the implementation of policies, rules, and regulations. The vital part is to keep the implementation of policies in all the states of India at par. Thus, asking for equal speed in policy implementation among the states in India is important. Federal legislation is another perverse impediment for India. Local authorities in India are not part of the approval process and the large bureaucratic structure of the central government is often perceived as a breeding ground for corruption. Foreign investment is seen as a slow and inefficient way of doing business, especially in a paperwork system that is shrouded in red tape.
5. **Investment challenges**: India must also focus on areas of poverty reduction, trade liberalization, and banking and insurance liberalization. Challenges facing FDI are not just restricted to the ones mentioned above, because trade relations with foreign investors will always bring in new challenges in investments.
6. **Inadequate and region specific infrastructure**: Physical infrastructure is the biggest hurdle that India currently faces, to the extent that regional differences in infrastructure concentrates FDI to only a few specific regions. While many of the issues that plague India in the aspects of telecommunications, highways and ports have been identified and remedied, the slow development and improvement of railways, water and sanitation continue to deter major investors. Public transport is a particular infrastructure challenge; in Bangalore, for example, Infosys Technologies spends US$5 million a year to transport its 18,000 employees to their place of work.
7. **Other challenges** include income disparities, bureaucracy, environmental impact of development, and corruption.

## POLICY RECOMMENDATIONS

- FDI can be instrumental in developing rural economy. There is abundant opportunity in Greenfield Projects. But the issue of land acquisition and steps taken to protect local interests by the various state governments are not encouraging. Government of India has enacted an act to address this issue named **Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013** to replace the 120 year old Land Acquisition Act 1894. But the new act still is lacking in certain policy areas. Early addressal of lacuna will strengthen confidence among investors and will be a key to attracting more FDI in several areas in India.
- India has a huge pool of working population and a favorable edge as in large number of youth i.e. **Demographic Dividend**. However, due to poor quality primary education and mismatch between education and skills; there is still an acute shortage of employable working population. This factor has negative repercussion on domestic and foreign business. FDI in Education Sector is less than 1%. Given the status of primary and higher education in the country, FDI in this sector must be encouraged. However, appropriate measure must be taken to ensure quality. The issues of commercialization of education, regional gap and structural gap have to be addressed on priority.
- Indian economy is largely agriculture based. There is plenty of scope in food processing, and investment in agriculture services and agriculture machinery. FDI in this sector should be encouraged but the issue of food security, interest of small farmers and marginal farmers need cannot be ignored for the sake of mobilization of foreign funds for development. Thus a balance needs to be achieved for sustainable and all round development.
- India has a well developed equity market but does not have a well developed debt market. Steps should be taken to improve the depth and liquidity of debt market as many companies may prefer leveraged investment rather than investing their own cash. Looking for debt funds in their own country invites exchange rate risk.
- In order to improve technological competitiveness of India, FDI into R&D should be promoted. Various issues pending relating to Intellectual Property Rights, Copy Rights and Patents need to be addressed on priority. Special package can be also instrumental in mobilizing FDI in R&D.
- Though service sector is one of the major sources of mobilizing FDI to India, plenty of scope exists. Still we find the financial inclusion is missing. Large part of population still doesn't have bank accounts, insurance of any kind, underinsurance etc. These problems could be addressed by making service sector more competitive. Removal of sectoral cap in insurance is still awaited.

## CONCLUSION

Despite a surge in foreign investments, rigid FDI policies resulted in a significant hindrance. However, due to some positive economic reforms aimed at deregulating the economy and stimulating foreign investment, India has positioned itself as one of the front-runners of the rapidly growing Asia Pacific Region. FDI might prove to be an important source of financing the economic development of our nation. However, we must not forget that FDI alone can't be a solution for poverty eradication, unemployment and other economic ills. Thus India while holding on to its current policy of sector selective FDI, must be on lookout for broadening its base while keeping in mind our nation specific socio-economic constraints so that an all beneficial FDI may lead our nation to the path of progress.

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