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Review Article

Foreign Direct Investment in India: Status, Challenges and Opportunities

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ABSTRACT

With the initiation of economic process, developing countries, notably those in Asia, are witnessing a high surge of FDI inflows throughout the past two decades. Although Republic of India has been a comer to the FDI scene compared to alternative East Asian countries, its hefty market potential and a liberalized policy regime has sustained its attraction as a favourable destination for foreign investors. This analysis paper aims to look at the impact of FDI on the Indian economy, notably when 20 years of economic reforms, and analyzes the challenges to position itself favourably in the global competition for FDI. The paper provides the foremost policy implications from this analysis, besides drawing attention on the complexities in deciphering FDI information in Republic of India.

Key Words: Foreign Direct Investment; Investment; Globalization; Economic Development; Investment Sectors

INTRODUCTION

Apart from being a critical driver of economic growth, Foreign Direct Investment (FDI) has been a major non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of the relatively lower wages, special investment privileges like tax exemptions, etc. When foreign investment is being made in India, it also helps the country achieve technical know-how and generate employment. The Indian Government's favourable policy regime and robust business environment has 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. According to the Department for Promotion of Industry and Internal Trade (DPIIT), FDI equity inflow in India stood at US$ 572.81 billion between April 2000-December 2021, indicating that the government's efforts to improve ease of doing business and relaxing FDI norms have yielded results.

FDI is a kind of investment into an enterprise in a country by the other enterprises situated in another country by purchasing a company in the target country or by widening operations of an existing business in that country. In the period of globalization, FDI takes an important part in the development of both developed and developing countries. It has been connected with improved economic development and growth in the host countries which has led to the emergence of global competition to attract FDI. It provides a number of benefits like innovative products, the overture of new technology, opportunities of employment, an extension of new markets, and introduction of new skills etc., which reflect in the growth of income of any country. FDI is one of the measures of growing economic globalization. Investment has always been a matter for developing nations such as India. The world has been globalizing and all the countries are liberalizing their policies for welcoming investment from nations which have ample capital resources. The nations which are developed are concentrating on new markets where there is the availability of a huge number of labours, the scope for products, and high profits are attained. Therefore, in emerging markets, FDI has become a battleground.

FDI INFLOW ROUTES

An Indian company may accept Foreign Direct Investment under the two routes which are as under :

1. ***Automatic Route*:** In this route, Foreign Direct Investment is enabled without prior consent either of the Reserve Bank of India or the Government Of India in all activities or sectors as prescribed in the consolidated FDI Policy, issued by the Indian Government from time to time.
2. ***Government Route:*** Government Route where Foreign Direct Investment in sectors or activities not covered under the automatic route requires the prior consent of the Indian Government which is considered by the Department of Economic Affairs, Foreign Investment Promotion Board (FIPB) and Ministry of Finance.

TYPES OF FDI

1. ***Greenfield Investment:*** It is the type of direct investment in new facilities or the expansion of existing facilities. It is the primary method of investing in developing countries like India.
2. ***Mergers and Acquisition:*** It takes place when a transfer of existing assets from local firms takes place.

Foreign Direct Investment is prohibited in the following industrial sectors which are as under

1. Arms and ammunition.
2. Atomic Energy,
3. Railway Transport.
4. Coal and lignite.
5. Mining of iron, manganese, chrome, gypsum, sulphur, gold, diamonds, copper, zinc.
6. Lottery Business
7. Gambling and Betting
8. The business of Chit Fund
9. Agricultural (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 activities (other than Tea Plantations).
10. Housing and Real Estate business.
11. Trading in Transferable Development Rights (TDRs).

12. Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or tobacco substitutes.

IMPORTANCE OF FDI IN INDIA

The Indian economy stood at the 11th position in the world regarding to the nominal gross domestic product (GDP) for the financial year 2011-12 observed a year low growth of the Indian economy (grew at a rate of 6.5%) and reasons traced could be the weak financial policy, cut in investments and inflation issues. India is one of the most pleasing destinations for foreign investment. Since liberalization, when FDI were permitted to enter India, our economy has grown by manifolds. Foreign investments play a very important role in the Indian economy. The importance could be attributed to the following reasons which are as under :

1. Increased Investment in the country
2. Improvement in Technology
3. Infrastructure Increased productivity
4. Enhanced Flow of Equity Capital
5. Improved Corporate Governance
6. Increased Employment Opportunities.

FDI through the Automatic Route

The sector, where 100% Foreign Direct Investment is permitted through the automatic route, are as follows :

1. Agriculture & Animal Husbandry including Floriculture, Horticulture, Apiculture and Cultivation of Vegetables & Mushrooms under controlled conditions[2], Development and Production of seeds and planting material, Animal Husbandry(including breeding of dogs), Pisciculture, Aquaculture and Services related to agro and allied sectors
2. Single Brand Retail Trading
3. Plantation Sector including Tea sector including tea plantations, Coffee plantations, Rubber plantations, Cardamom plantations, Palm oil tree plantations and Olive oil tree plantations.
4. Mining and Exploration of metal and non-metal ores, Mining of Coal & Lignite and Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities.
5. Broadcasting
6. Exploration of Petroleum and Natural Gas.
7. Defence Manufacturing
8. Civil Aviation both for airports and air transport services
9. Construction Development: Townships, Housing, Built-up Infrastructures
10. Industrial Parks (new & existing)
11. Satellites– establishment and operation, subject to the sectoral guidelines of Department of Space/ISRO

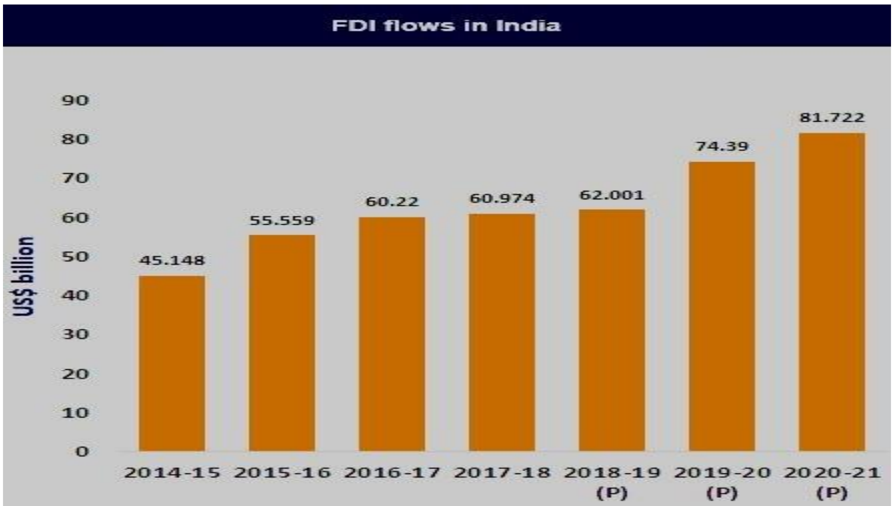
HISTORICAL TRENDS IN FDI IN INDIA

The historical background of FDI in India can be traced back with the establishment of East India Company of Britain. British capital came to India during the colonial era of Britain in India. After Second World War, Japanese companies entered Indian market and enhanced their trade with India, yet U.K. remained the most dominant investor in India. Further, after Independence issues relating to foreign capital, operations of MNCs, gained attention of the policy makers. Keeping in mind the national interests the policy makers designed the FDI policy which aims FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resources. With time and as per economic and political regimes there have been changes in the FDI policy too. The industrial policy of 1965, allowed MNCs to venture through technical collaboration in India. Therefore, the government adopted a liberal attitude by allowing more frequent equity participation to foreign enterprises, and to accept equity capital in technical collaborations. But due to Significant outflow of foreign reserves in the form of remittances of dividends, profits, royalties etc, and the government has to adopt stringent foreign policy in 1970s. During this period the government adopted a selective and highly restrictive foreign policy as far as foreign capital, type of FDI and ownerships of foreign companies was concerned. Government setup Foreign Investment Board and enacted Foreign Exchange Regulation Act in order to regulate flow of foreign capital and FDI flow to India. The soaring oil prices continued low exports and deterioration in Balance of Payment position during 1980s forced the government to make necessary changes in the foreign policy. Thus, resulting in the partial liberalization of Indian Economy. The government introduces reforms in the industrial sector, aimed at increasing competency, efficiency and growth in industry through a stable, pragmatic and non-discriminatory policy for FDI flow. In this critical face of Indian economy the government of India with the help of World Bank and IMF introduced the macro – economic stabilization and structural adjustment program. As a result of these reforms India open its door to FDI inflows and adopted a more liberal foreign policy in order to restore the confidence of foreign investors. Further, under the new foreign investment policy Government of India constituted FIPB (Foreign Investment Promotion Board) whose main function was to invite and facilitate foreign investment through single window system from the Prime Minister’s Office. The foreign equity cap was raised to 51 percent for the existing companies. Government had allowed the use of foreign brand names for domestically produced products which was restricted earlier. India also became the member of MIGA (Multilateral Investment Guarantee Agency) for protection of foreign investments.

FDI INFLOWS INTO INDIA

Total FDI inflow into India in the third quarter of FY22 stood at US$ 17.93 billion, while the FDI equity inflow for the same period stood at US$ 12.02 billion. Data between April-December 2021 indicates that the computer software and hardware industry attracted the highest FDI equity inflow of US$ 10.25 billion, followed by the automobile sector at US$ 5.96 billion, services sector at US$ 5.35 billion, trading sector at US$ 2.99 billion, construction activities at US$ 1.59 billion, and drugs and pharmaceuticals at US$ 1.21 billion. Between April-December 2021, India recorded the highest FDI equity inflow from Singapore (US$ 11.69 billion), followed by the US (US$ 7.52 billion), Mauritius (US$ 6.58 billion), the Cayman Islands (US$ 2.74 billion), the Netherlands (US$ 2.66 billion), and the UK (US$ 1.44 billion). In the same period, Karnataka registered the highest FDI equity inflow of US$ 17.25 billion, followed by Maharashtra (US$ 9.69 billion), Delhi (US$ 6.39 billion), Tamil Nadu (US$ 2.38 billion), Gujarat (US$ 2.06 billion), and Haryana (US$ 2.03 billion). During the third quarter of FY22, foreign owned assets in India stood at US$ 926.2

billion, up from US$ 852.4 billion in the third quarter of FY21. Figure 1 shows the inflow of the FDI into India from 2014 to 2020.



Source: www.ibef.org

India has received Foreign Direct Investment (FDI) inflows worth USD 339.55 billion in the last five years. There has been a continuous increase in the inflow of FDI in recent years. It increased from USD 45.15 billion in 2014-15 to USD 81.97 billion in 2020-21. During the year 2019-20, the FDI inflows to India stood at USD 74.39 billion. In 2018-19, it stood at USD 62 billion. In 2017-18, it was USD 60.97 billion and in 2016-17, the FDI inflow to India stood at USD 60.22 billion. India received USD 64 billion in Foreign Direct Investment in 2020, the fifth largest recipient of inflows in the world, according to a UN report which said the COVID-19 second wave in the country weighs heavily on the country's overall economic activities but its strong fundamentals provide "optimism" for the medium term.

STATUS OF FDI IN INDIA

The World Investment Report 2021 by the UN Conference on Trade and Development (UNCTAD), global FDI flows have been severely hit by the severely hit by the pandemic and they plunged by 35 per cent in 2020 to USD 1 trillion from USD 1.5 trillion the previous year. Lockdowns caused by COVID-19 around the world slowed down existing investment projects and prospects of a recession led multinational enterprises (MNEs) to reassess new projects. The report said in India, FDI increased 27 per cent to USD 64 billion in 2020 from USD 51 billion in 2019, pushed up by acquisitions in the information and communication technology (ICT) industry, making the country the fifth largest FDI recipient in the world. The pandemic boosted demand for digital infrastructure and services globally. This led to higher values of greenfield FDI project announcements targeting the ICT industry, rising by more than 22 per cent to USD 81 billion. Major project announcements in the ICT industry included a USD 2.8 billion investment by online retail giant Amazon in ICT infrastructure in India.

The report noted that the second wave of the COVID-19 outbreak in India weighs heavily on the country's overall economic activities. Announced greenfield projects in India contracted by 19 per cent to USD 24 billion, "and the second wave in April 2021 is affecting economic activities, which could lead to a larger contraction in 2021," it said, adding that the outbreak in India severely hit main investment destinations such as Maharashtra, which is home to one of the biggest automotive manufacturing clusters (Mumbai-Pune-Nasik-Aurangabad) and

Karnataka (home to the Bengaluru tech hub), which face another lockdown as of April 2021, exposing the country to production disruption and investment delays. "Yet India's strong fundamentals provide optimism for the medium term. FDI to India has been on a long-term growth trend and its market size will continue to attract market-seeking investments. In addition, investment into the ICT industry is expected to keep growing," the report said.

The country's export-related manufacturing, a priority investment sector, will take longer to recover, but government facilitation can help. India's Production Linkage Incentive scheme, designed to attract manufacturing and export-oriented investments in priority industries including automotive and electronics can drive a rebound of investment in manufacturing. The report said FDI in South Asia rose by 20 per cent to USD 71 billion, driven mainly by strong M&As in India. "Amid India's struggle to contain the COVID- 19 outbreak, robust investment through acquisitions in ICT (software andhardware) and construction bolstered FDI," it said adding that cross-border M&As surged 83 per cent to USD 27 billion, with major deals involving ICT, health, infrastructure and energy. Large transactions included the acquisition of Jio Platforms by Jaadhu, a subsidiary of Facebook for USD 5.7 billion, the acquisition of Tower Infrastructure Trust by Canada's Brookfield Infrastructure and GIC (Singapore) for USD 3.7 billion and the sale of the electrical and automation division of Larsen & Toubro India for USD 2.1 billion. Another megadeal - Unilever India's merger with GlaxoSmithKline

Consumer Healthcare India, a subsidiary of GSK United Kingdom) for USD 4.6 billion - also contributed, it said. FDI outflows from South Asia fell 12 per cent to USD 12 billion, driven by a drop in investment from India. India ranked 18 out of the world's top 20 economies for FDI out�ows, with 12 billion dollars of outflows recorded from the country in 2020 as compared to 13 billion dollars in 2019. "Investments from India are expected to stabilise in 2021, supported by the country's resumption of free trade agreement (FTA) talks with the European Union (EU) and its strong investment in Africa," the report said.

The report cautioned that while the Asian region has managed the health crisis relatively well, the recent second wave of COVID-19 in India shows that significant uncertainties remain. "This has major impacts on prospects for South Asia. A wider resurgence of the virus in Asia could significantly lower global FDI in 2021, given that region's significant contribution to the total," the report said. FDI inflows to developing Asia grew by 4 per cent to USD 535 billion in 2020, making it the only region to record growth and increasing Asia's share of global inflows to 54 per cent. In China, FDI increased by 6 per cent to USD 149 billion. While some of the largest economies in developing Asia such as China and India recorded FDI growth in 2020, the rest recorded a contraction, it said. The report added that FDI inflows in Asia are expected to increase in 2021, outperforming other developing regions with a projected growth of 5-10 per cent. Signs of trade and industrial production recovering in the second half of 2020 provide a strong foundation for FDI growth in 2021. Yet, substantial downside risks remain for the many economies in the region that struggle to contain successive waves of COVID-19 cases and where capacity for recovery spending is limited. "Economies in East and South-East Asia, and India, will continue to attract foreign investment in high-tech industries, given their market size and their advanced digital and technology ecosystem," the report said.

CHALLENGES RESTRICTING FDI IN INDIA

The challenges facing larger FDI in India are in spite of the fact that more than 100 of Fortune 500 companies are already investing in India. These FDIs are already generating employment opportunities, income, technology transfer and economic stability. 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 larger FDIs in India, such as:

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.

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.

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.

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. India must also focus on areas of poverty reduction, trade liberalization, and banking and insurance liberalization. Challenges facing larger FDI are not just restricted to the ones mentioned above, because trade relations with foreign investors will always bring in new challenges in investments.

OPPORTUNITIES TO FDI IN INDIA

A combination of scale and breadth of investable opportunities across asset classes as diverse as toll roads and office blocks, renewable energy, ecommerce and fintech, and a constructive environment for foreign direct investment are the top draws for deploying capital in India. As we continue to scale, it is important for us to build capabilities and infrastructure to invest in one of the world’s largest economies and also among the fastest growing to be able to participate in global growth. Graham, CEO of the Canadian pension colossus CPP Investment Board (CPPIB), told ET in an exclusive interaction. CPPIB manages more than $500 billion of assets worldwide, but only 3.06% of the corpus has been deployed in India so far. “For us, it’s important to have a portfolio that is diversified by geography and diversified in terms of asset class. India offers both the breadth of scope and sophistication of the market. During the five-day maiden trip to the country since taking over CPPIB early last year following the controversial exit of his predecessor Mark Machin, Graham met Prime Minister Narendra Modi and Finance Minister Nirmala Sitharaman, dined with corporate captains and even soaked in the "high energy vibe and excitement" of young entrepreneurs and VCs, breaking bread with them over breakfast. Machin had to step down following his trip to the United Arab Emirates to receive a coronavirus vaccine despite federal rules banning inessential travel, and a long line of older and immune compromised citizens waiting for their shots. That resulted in the elevation of Graham, a former physical chemistry doctorate who spent almost a decade as a research scientist at Xerox before becoming an asset manager at CPPIB in 2008 and subsequently building its sprawling credit business for close to a decade.

Since 2018-19, CPPIB has been building its exposure to emerging economies and China in particular in the hunt for juicier returns. More than 85% of its funds are invested outside of Canada with Asia Pacific being the second largest geographical cluster, after the US. Plans to increase exposure to Asia's biggest economy and allocate up to 20% of its assets to the country by 2025 are still on track, Graham said. "It's really important to be global and diversified. We have said we will deploy up to a third of our assets into emerging markets, including China," Graham. "That's different from a third. But even then, if we see a great scope to deploy capital we will. We do not have a fixed allocation. This diversified, global spread and flexibility also helps dealing with big swings or shocks like the Covid pandemic and the ongoing war in Ukraine that has taken a big toll on global macroeconomic prospects. "Early in Covid around March 2020, there was an opportunity to invest in credit markets that were dislocated. As liquidity came back, that opportunity went away. So we have been agile in adjusting," Graham said. Globally, pricing across global capital markets also became attractive but Graham said "the swiftness and magnitude of fiscal and monetary interventions by various central banks and governments" also made these prospects very short-lived. But with global interest rates tightening, does he see the need to tweak his investment thesis? "We have been navigating inflation and interest rate hikes in the past fiscal year and our strategy is built in a way that it stays robust against any macro-economic backdrop Covid or geopolitical uncertainties triggered by Russia-Ukraine…It's really important to have long term investing beliefs, not make strategic decisions in terms of crisis or be too dogmatic".

Real Assets, Tangible Returns

But in times of flux bets on real assets – airports, real estate, infrastructure and even equities provide some protection against inflation and volatility. Graham, though, acknowledges that pockets of real estate, especially the commercial segment, will get impacted as hybrid workplace models become commonplace as people gradually come back to their offices. "Some sectors have been beneficiaries of Covid, some have been affected". one of the tenets of investing is we are a bottom-up, detail-oriented, deep diligence, deal-by-deal investor and our office portfolio has typically leaned toward high quality, tier-1 assets with pedigree partners and tenants. This has proved to be largely resilient even as hybrid models tend to become more popular post-Covid, compared with Tier 2, tier 3 cities and assets". This statement comes on the very same day CPPIB announced a Rs 5,300 crore joint venture with Tata Group arms to develop commercial real estate. Far smaller than mega asset managers such as BlackRock, Blackstone, Brookfield or Vanguard, CPPIB banks on steady quarterly inflows from the more than 20 million Canadian workers who put their pension money into the fund a key plank of the country's retirement savings system. Thus, it becomes an even bigger fiduciary responsibility to "leverage the breadth of our investment capabilities to deliver the best returns".

Spotting Unicorns

In that context, CPPIB's big bets in high risk, digital and tech startups across the world, including Indian unicorns or soonicorns like Byju's, Flipkart, Delhivery or news aggregator Dailyhunt, have raised eyebrows. Technology usage was arguably the one bright spot during the health crisis, spurring development and uptake of things such as grocery delivery and online education. CPPIB opened an office in San Francisco in 2019, its second in the US after New York, bringing it closer to Silicon Valley. It was one of the anchor investors in the Paytm IPO just days before the issue imploded, thereby highlighting the volatile nature of backing early-stage companies. Different assets play different roles within our overall portfolio. "We have exposure to low volatility, cash generating assets and there is an important place within our portfolio for growth and we strive to have a balance between growth and value within our portfolio. It’s important to size it properly within the broader portfolio and then even more important is we pick the right companies to invest in." Talking specifically about Paytm, Graham said he was not too fussed about "short-term events but was focused on the intrinsic value of a company over a longer-term horizon," which could last for even multiple decades. Drawing comparisons with Asian tigers South Korea or China, Sujeet Govindaraju, CPPIB’s head of India, highlighted the internet economy has a massive potential to stimulate domestic and household consumption that in turn creates large, valuable companies in sub sectors. "We look for such sub-sectors and how they are trending. Ecommerce penetration is 5.5% in India versus China where it is 27-28%," he said. "Even if the Indian market doubles, there is room for large companies." This is especially true in fintech, the CPPIB leadership believes. "Instead of sharp volatility in stock prices, we worry about management capability to monetise the customer base that they are building," added Govindaraju. A digital moat, according to him, based on value addition, convenience and consumer data is far more robust for the long term. The other area of focus for the is sustainability and assisting old-economy cement, chemicals, steel and manufacturing companies to wean away from fossil fuels and make the transition to net zero. "India is definitively a target market for our Sustainable Energies Group and our investment in ReNew Power is an indication of that. We are excited about ESG and the transition to net zero," said Graham. CPPIB’s current renewable portfolio is C$7.67 billion ($6.08 billion) and represents 1.54% of the total fund. "But the plan is to double that exposure in the green transitioning of assets by 2030.

CONCLUSION

Foreign Direct Investment plays a significant role in the long-term progress of a country not only as a source of capital but also for increasing competitiveness of the domestic economy through strengthening infrastructure, transfer of technology, generating new employment opportunities and raising productivity. India emerges as the 5th largest recipient of FDI across the globe and 2nd largest among all other developing countries (World Investment Report 2010). Foreign Direct Investment always helps to create employment in the nation and also provides support to the small scale industries and helps countries to put an impression on the worldwide level through globalization and liberalization. Government should design the FDI policy such a way where FDI inflows can be utilized as means of enhancing domestic production, savings and exports through the equitable distribution among states so that they can attract FDI inflows at their own level. FDI can help to raise the output, production and export at the sectored level of the Indian economy. It is advisable to open up the export oriented sectors and higher growth of economy could be achieved through the growth of these sectors. Keeping in mind the humble beginning of India and the stage at which it is right now goes to show how much potential is present in this country and if the Indian government works on the areas for improvement mentioned above and continues to support and assist the encouragement of FDI into India, there is no stopping India into becoming the number one destination for FDI in the world, far beyond China.

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