

# Changes in FDI policy for smoothening of investment

Shubhra Suman

MA (Economics), Delhi School of Economics, Delhi University, Delhi

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## ABSTRACT

*The Foreign Direct Investment (FDI) scenario in India is currently witnessing a gradual shift with liberalized reforms over the last few years and an attractive investment climate making a positive impact on the inflow. With a steady increase in volume of FDI, India has attracted more than 90 countries till 2010 (29 countries in 1991) across the globe to invest in India, making it one of the top investment destinations in the world. Investment into India could mostly follow the automatic route with no licenses or permissions required bypassing the current practice of many investments needing to be approved by Foreign Investment Promotion Board. The policy of FDI liberalisation has proved beneficial to provide diversification and sustainable development to the Indian economy and specifically retail sector, which is considered to be one of the significant pillars of economy. Furthermore, for continuous growth of the economy, it seems vital to encourage more investment in other sectors by liberalising the restrictive policies. This paper tries to identify the historical and current situation of FDI inflows to India. Also, some areas which need improvement are also highlighted so that it can open gates for more and more investors to invest in India through FDI two that India could become and remain as a favourite destination of FDI investment across the globe.*

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## 1. Introduction

Foreign Direct Investment (FDI) is an investment from a party in one country into a business or corporation in another country with the intention of establishing a lasting interest. Lasting interest differentiates FDI from foreign portfolio investments, where investors passively hold securities from a foreign country.

An FDI can be made by obtaining a lasting interest or by expanding one's business into a foreign country. A lasting interest is established when an investor obtains at least 10% of the voting power in a firm. The key to FDI is the element of control. Control represents intent to actively manage and influence a foreign firm's operations. For this reason, a 10% stake in the foreign company's voting stock is necessary to define FDI.

## 2. Methods of Foreign Direct Investment

There are various ways in which foreign direct investment can be done. The foreign direct investor may obtain voting power of an enterprise in an economy through any of the following methods:

By the means of including a fully owned subsidiary or firm anywhere, by obtaining shares in an associated company, via a merger or an acquisition of a firm that is not related, by taking part in an equity joint venture with another investor or company.

## 3. Benefits of FDI

Foreign direct investment offers advantages to both the investor and the foreign host country. These incentives encourage both parties to engage in and allow FDI. FDI is beneficial for business well as for the host country. It benefits business in these numerous ways . It gives market

diversification, tax incentives, lower labor costs, preferential tariffs, Subsidies. For businesses, most of these benefits are based on cost-cutting and lowering risk. For host countries, the benefits are mainly economic. The benefits which FDI gives to the host country are - economic stimulation, development of human capital, Increase in employment , access to management expertise, skills, and technology.

As pointed out by the Corporate Finance Institute (n.d.) FDI plays an important role in the economic development of a country. The capital inflow of foreign investors helps in strengthening infrastructure, increasing productivity and creating employment opportunities in India. FDI also acts as a medium to acquire advanced technology and mobilise foreign exchange resources. The availability of forex reserves helps RBI in its activities like intervening in the foreign exchange market and controlling any adverse movements to stabilise the foreign exchange rates. Thus it helps create a favourable economic environment for the development of the Indian economy.

## 4. Advent of FDI in India

After the independence of India in 1947, the makers of new India realised the need of foreign investment for development, and designed FDI policies aiming it as a medium for bringing in advanced technology and gaining valuable foreign exchange resources.

FDI was introduced in the year 1991 under Foreign Exchange Management Act (FEMA), by then Finance Minister Dr. Manmohan Singh. It started with a baseline of \$1 billion in 1990.

India is considered as second most important destination for foreign investment. The major sectors that attracted FDI are services, telecommunications, construction activities and computer software and hardware.

## 5. FDI in present times

Apart from being a critical driver of economic growth, FDI has been a major non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges like tax exemptions etc.

For a country where foreign investment is being made, it also means achieving technical know-how and generating employment. The Indian government's favourable policy regime and robust business environment has ensured that

foreign capital keeps floating 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.

## 6. Size of foreign direct investment in India

The Table 1 shows FDI inflows over the period 2000 to 2018 and the FDI inflows in the last quarter of 2019-2020.

**Table 1 Cumulative FDI Flows into India**

| <b>Total FDI Inflows (April, 2000 to March 2018)</b>  |                     |                      |
|---|---------------------|----------------------|
| Cumulative Amount of FDI Inflows (Equity inflows+ Re-invested earnings+ Other capital)          | -                   | US\$ 546,452 Million |
| Cumulative Amount of FDI equity Inflows (Excluding, amt remitted through RBIs NRI schemes)      | Rs. 2,075,911 Crore | US\$ 376,848 Million |
| <b>FDI Inflows during fourth quarter of Financial Year 2017-18 (January 2018 to March 2018)</b> |                     |                      |
| Total FDI Inflows into India (Equity inflows + Re-invested earnings+ Other capital)             | -                   | US\$ 14,076 Million  |
| FDI Equity Inflows  | Rs. 95549 Crore     | US\$ 8,916 Million   |

Source: Government of India, Quarterly Fact Sheet March 2018

According to DIPP's FDI data base, FDI equity inflow in India stood at US\$ 2,463 Million in 2000-01 which went up to 30,931 Million in 2014-15, indicating that Government's effort to improve ease of doing business and relaxing FDI norms has yielded results.

FDI inflow in India stood at US\$ 376,969.14 Million from April 2000 TO March 2018. With an inflow of US\$ 66,185 Million, the services sector attracted the highest FDI equity inflow followed by computer software and hardware at US\$ 30,822 Million, telecommunications sector at US\$ 30,157 Million, and construction at US\$ 24,832 Million.

During this period, India received the maximum FDI equity inflow from Mauritius (US\$ 127,578 Million), followed by Singapore (US\$ 66,770 Million), Japan (US\$ 27,285 Million), United Kingdom (US\$ 25,438 Million) and Netherlands (US\$ 23,438 Million).

## 7. Government Initiatives

Indian government has taken a number of steps to encourage foreign investment by relaxing regulation and clarifying ambiguities pertaining to investments. This has improved the ranking in terms of ease of doing business. The government has taken various initiatives to accelerate the growth of FDI in country. The Ministry of External Affairs has provided information on many such schemes. Some of which are :

- i) In January 2018, the government allowed investment up to 49 percent from foreign airlines in Air India.
- ii) FDI up to 100 percent has been permitted in Real Estate Broking Services.
- iii) In September 2017, the government encouraged the states to develop and strengthen single window clearance system for fast-tracking approval processes.

- iv) Government of India had been planning 100 percent FDI in insurance intermediaries in India to give a boost to the sector and attract more funds, as well as permit investment in defence sector telecommunications sector etc.

## 8. Road ahead

India is going to be the most attractive emerging market for global partners (GP) investment for the coming years. FII investments have been strong in the preceding period and the trend is expected to continue.

Annual FDI inflow in the country is expected to rise to US\$ 75 billion over the next five years. The Government of India aims to achieve US\$ 100 billion worth of FDI inflow in the next two years.

## 9. Conclusion

The recent FDI initiatives in changes in FDI policies reflect the commitment of the Indian government at liberalizing the FDI of the country to boost employment opportunity and improve the economy. It is expected that the government will further improve the policies to accommodate the sectors that are presently restricted to bring further liberalisation in the FDI.

To maintain a steady rise in the global ease of doing business index, the FDI policies must be more business oriented to appeal to the interest of the investors and the economy. The policy should follow a systematic stand-point for smooth implementation and benefit for both Indians and foreigners.

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