AN ANALYTICAL STUDY OF FDI AND ITS IMPACT ON INDIAN ECONOMY

Dr Sowmya KethiReddi

Assistant Professor, School of Management Studies, Chaitanya Bharathi Institute of Technology, Hyderabad, Telangana, India.

Abstract

Foreign direct investment (FDI) is always a positive contribution towards the growth of an economy. It is the investment made by one country in another country which aids in the economic development of a nation. A country's technology level and sectoral development is depending upon the level of FDI inflows. Foreign direct investment (FDI) is an important component, tool or source of investment which is needed by India for achieving the economic reforms and maintaining the pace of growth and development of the economy at which it has to. The main purpose of the study is to analyse the impact of FDI on economic growth in India, from the period of 2010 to 2019. For this we have two models out of which the first will constitute the four variables that we have considered in this paper as factors affecting FDI and the second model examines the economic growth of the country in the decade and how much FDI has contributed towards the same.

Keywords: Foreign direct investment (FDI), Indian economy, Growth rate, Single brand retail, Gross Domestic Product, Exchange rate, financial position, Foreign Exchange Reserve.

INTRODUCTION

Indian economy is termed as the developing economy of the world. Some features like low per capita income, higher population below poverty line, poor infrastructure, agriculture based economy and lower rate of capital formation, tagged it as a developing economy in the world.

FDI is a tool for economic growth through its strengthening of domestic capital, productivity and employment. FDI also plays a vital role in the up gradation of technology, skills and managerial capabilities in various sectors of the economy. Foreign Direct Investment as seen as an important source of non-debt inflows and is increasing being sought as a vehicle for technology flows and as a means of attaining competitive efficiency by creating a meaningful network of global inter-connections.

Today, FDI is not only about capital, but also about one of the most important aspects technology and know-how. Today FDI has become part of the process of international production, by which investors locate one country to produce a good or a service that is part of a broader platform. Investors then have become traders now and vice-versa. Moreover, FDI is now not only carried out by only big MNEs, but also from relatively smaller firms from developing countries that are investing in countries beyond their home countries. International patterns of production are leading to new forms of cross-border investment, in which foreign investors share their intangible assets such as know-how or brands in conjunction with local capital or tangible assets of domestic investors. This is the case of non-equity modes of investment (NEMs) –such as franchises, outsourcing, management contracts, contract farming or manufacturing.

Foreign Direct Investment or FDI is a major driver of economic growth and is largely a matter of private business decisions. FDI inflows depend on a number of factors sub as availability of natural resources, infrastructure, market size, general investment climate etc. Government of India has put in place a liberal and transparent policy for FDI with most sectors open to FDI under the automatic route. To further attract more investors the department for promotion of Industry and Internal trade and the investment promotion agency Invest India have joined hands to put in place a new mechanism under which those looking to invest 500 million dollars or more will have a designated person to facilitate all clearances.

Foreign direct investment (FDI) is always contributing in the positive growth toward the economy of one country due to the investment by another country or country's personnel's. The effectiveness and efficiency of Global economy depends upon the investor's perception, if investment seen with the purpose of long terms investment in the social-economical development then it is said that the investment contributes positively towards global economy, if it is short term for the purpose of making profit then it may be less significant than that long term and disinvestment leads negative effect. The FDI may also be affected due to the governmental trade barriers and policies for the foreign investments and leads to less or more effective toward contribution in economy as well as GDP and GNP of the country.

LITERATURE REVIEW

Deepak Kumar (2019) FDI plays a critical part in financial improvement of a country. The main objective of their study was to analyze the trend of FDI equity inflows in different sectors and regional offices. From their study it was found that there were high variations in the inflows of FDI equity. The results also revealed that maximum contribution (18 percent) of FDI inflows in service sector and the Maharashtra, Dadra &Nagarhavali, Daman & Diu got the highest inflows which are 31% of total FDI.

QayoomKhachoo& Ruchi Sharma (2016) Their study observed closely the behavior of Indian and foreign Manufacturing firms for the research and development (R&D) when the FDI flows in. Their results indicate a remarkable increase in the investment budgets of both domestic and foreign firms on R&D and further suggests opening of the domestic economy for higher FDI.

Dierk Herzer (2017) The main contribution of this article was to re-examine the FDI-growth nexus in developing countries by emphasizing productivity spillover effects from FDI. They have found that trade appears to have a detrimental effect on TFP growth in India.

Murugesan Ramasamy, Dominic Dhanapal, Poovendhan Murugesan (2018) The objective of this study is to analyze the regional productivity across 28 Indian states from 1993 – 2013 with respect to FDI spill over. Using a panel data, they found that factors like research and development, technology import, human capital, and various specifications of FDI have a substantial effect on the regional productivity in India except technology gap.

Zafar, S.M.Tariq& Waleed Hemdat (2017) have found that FDI flow in India has increased to a great extent when compared to the past. They have also found the connection between FDI inflow and GDP of the nation through which they conclude that the former has an influence on the later and also that both were moving with a matching pace having a positive impact on the economy. In their study it was also found that FDI has generated a balanced growth and development which has engaged manpower across the nation.

Dimple Goyal &Ritu Jain (2014) The purpose of this study is to analyze the trend of FDI equity inflows in different sectors and regional offices. Through this paper they could also find the share of top investing countries in FDI equity inflows in India. In order to obtain the objectives of this study, they used secondary data for the periods of 2000-2013. The secondary data has been collected from various journals, books, Newspapers and websites etc. they have observed that the maximum FDI inflows can be seen in the Service and construction sector while telecommunication, computer hardware and drugs sector attract the equal FDI equity inflows i.e. 6% of total FDI inflows. The finding from their study was that India has received maximum FDI inflows from the Mauritius and followed by the Singapore.

Jiang et.al. (2012) the main purpose of the study was to know the impact of FDI on Chinese culture. To give the results, data has been collected from the major Chinese cities and found that FDI has significant effects on the degree of future orientation, performance orientation and group collectivism. In their study it was found that FDI from Japan, Singapore, USA and UK has significantly negative effects on the degree of performance orientation. The study has concluded that FDI from Japan and Singapore has a significantly positive effect on the degree of in-group collectivism.

RESEARCH METHODOLOGY

FDI has been an important aspect in the building of Indian Economy from what is was to what it is, despite so many years of independence we still continue to be a developing economy one of the factors contributing to this could be not allowing enough FDI. Has FDI really seeped into all the sectors as effectively as its numbers sound? Analysis of the study is done based on secondary data.

OBJECTIVES OF THE STUDY

1. To analyze the foreign direct investment, its overall impact and contribution towards nation's economic growth.

2. To study the technological and skill upgradation FDI has been bringing in post economic reforms.

HYPOTHESIS

H0: FDI does not have a significant impact on the economic growth of the country.
H1: FDI has a significant impact on the economic growth of the country.

TOOLS FOR ANALYSIS

Trend Analysis and Regression Analysis (y=a+bx). Where, y= predicted value of the dependent variable a = y – axis intercept, b = slope of the regression line (or the rate of change in y for a given change in x), x = independent variable.

Further, to study the impact of foreign direct investment on economic growth, we have two models:
The foreign direct investment model shows the factors influencing the foreign direct investment in India.

FDI = f [TRADEGDP, RESGDP, FIN. Position, EXR.]
The economic growth model depicts the contribution of foreign direct investment to economic growth.
GDPG = f [FDIG] where, FDIG = Foreign Direct Investment Growth.

Where, FDI= Foreign Direct Investment
GDP = Gross Domestic Product
FIN. Position = Financial Position
TRADEGDP= Total Trade as percentage of GDP.
RESGDP= Foreign Exchange Reserves as percentage of GDP.
FIN. Position = Ratio of external debts to exports
EXR= Exchange rate GDPG = level of Economic Growth.

DATA ANALYSIS and INTERPRETATION

MODEL 1:this model consists of 4 independent variables; one dependent factor i.e. Foreign Direct Investment (FDI). The FDI is the flow of capital from the multinational corporations and foreign countries that brings capital formation advantage, technological advancement and skilled human capital in less developed countries.Gross Domestic Product (GDP) is the measure of economic growth of any country. It drives from the technological advancement, growth in the physical capital stock, growth in employment, growth in the skilled human capital and progress in institutions –Education & Health. We have analyzed the constitution of FDI from the 4 variables that we have considered (Trade GDP, Foreign Exchange Reserve, Financial position which includes export and debt, Exchange rate). There are various factors that influence FDI out of which we have considered the above four to find out the impact they have on FDI. For any country foreign investments constitute a major part as they help in the overall development of the economy which includes giving an exposure for the local market to land into the global market which benefits the domestic sector immensely. This can happen mainly by increasing our trade that is proper dealing or import and export, improving our financial position by reducing debt and encouraging exports, attracting more of foreign investments and maintaining adequate foreign reserves and having a constant check on our exchange rate not to go low. The below table gives a description of the relation between how all the above four factors have had an impact on FDI and how it has in turn reflected on the GDP which will be useful for us in the next model. The FDI inflows have decreased when compared to the preceding years only on two occasions, financial year 2010-11 and Financial year 2012-13 where during this time they fell by almost 8 percent and a sharp 26% respectively. It may also be noted that the highest annual increase over these years particularly the decade we have considered was recorded in the year between these two which are financial years 2011 and 2012, where the FDI inflows have showed an annual increase of 34 percent. After an annual growth in the years 2014-15 and 2015-16, it has been observed that the FDI inflows only increased by single digit percentage points annually over the last three years which is 8 percent during 2016 – 2017, 1 percent during 2017-2018 and 6 percent during 2018-19). The FDI inflows recorded during the financial year 2009-10 were $37,745 (data in the table below) million and over the ensuing decade, however the FDI inflows have recorded a considerably constant but progressive growth every year. For the financial year 2018-2019, the inflows were $64,375 million which is 70.55 percent higher than the annual inflows in 2009-10.

Table: 1 GDP and FDI inflow

YEARS	GDP RATE	FDI (USD Mn)
2010	8.5	37,745
2011	5.24	34,847
2012	5.46	46,556
2013	6.39	34,298
2014	7.41	36,046
2015	8	45,148
2016	8.17	55,559
2017	7.17	60,220
2018	6.98	60,974
2019	4.8	64,375

Table: 2 Descriptive statistics of GDP and FDI Inflow

GDP RATE		***FDI***	
Mean	6.812	Mean	47576.8
Median	7.075	Median	45852
Standard Deviation	1.297183	Standard Deviation	11832.96
Sample Variance	1.682684	Sample Variance	1.4E+08
Skewness	-0.33857	Skewness	0.232301
Kurtosis	-1.29268	Kurtosis	-1.82491
Range	3.7	Range	30077
Minimum	4.8	Minimum	34298
Maximum	8.5	Maximum	64375
Sum	68.12	Sum	475768
Count	10	Count	10
Standard Error	0.410205	Standard Error	3741.909

MODEL 2

The second model is called the economic growth model because GDP is a tool that helps determine the status of economy of a country as a whole. In this model GDP is the dependent factor that is dependent on FDI which is the independent factor. By this it is to convey that FDI could have an impact on GDP i,e have an impact on the economic growth of the nation. However it is not necessary that a significant impact is observed because there are various factors that could influence the economic growth. Foreign direct investment refers to the direct investment equity flows in the reporting economy. It is the sum of equity capital, reinvestment of earnings, and other capital. Direct investment is a category of cross-border investment that is associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy. Direct investment relationship is determined based on the criteria that ownership of 10 percent or more of the ordinary shares of voting stock. Currently the Data is in U.S. dollars. Indian foreign direct investment for 2017 was $ 60,220M, an increase from the previous 2016. For the year 2016 it was $55,559M, a 1.22% increase from 2015, the foreign direct investment for 2015 was $45,148M, a 25.28% increase from 2014 and foreign direct investment for 2014 was $36046M, a 5.82% increase from 2013. The deceleration to growth rates that went below 7 percent between Quarter 3 of 2016–17 and Quarter 2 of 2017–18 was an aberration, attributed to temporary disruptions in economic activity because the economy adjusted to one of the most significant changes which was demonetization and businesses prepared for the implementation of GST.
Table:3 Regression analysis of the GDP and FDI

SUMMARY OUTPUT					
Regression Statistics					
Multiple R	0.112657				
R Square	0.012692				
Adjusted R Square	-0.11072				
Standard Error	1.367112				
Observations	10				
ANOVA					
	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	0.192203	0.192203	0.102838	0.756667117
Residual	8	14.95196	1.868995		
Total	9	15.14416			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	7.39957165	1.882562063	3.930586	0.004353	3.058375752	11.740768	3.05837575	11.7407675
FDI	-1.235E-05	3.85114E-05	-0.32068	0.756667	-0.00010116	7.646E-05	-0.00010116	7.6458E-05

FINDINGS

From the above study it is observed that the macroeconomic variable factors that we have considered have a profound impact on the inflows of FDI in India. The appreciation in the value of Indian Rupee provides an opportunity to the policy makers to attract FDI inflows in Greenfield projects rather than attracting FDI inflows in Brownfield projects. Further, the above analysis helps in identifying the major determinants of FDI in the country.Foreign investments are highly beneficial for any country and ours is no exception. To increase the flow of FDI there are few changes that we could make in order to have good benefits they are:

- We should start focusing on diverse types of FDI and frame policies in a similar manner. FDI should be a means of enhancing domestic production, savings, and exports which results in providing access to the external market.
- Improvement for things like infrastructure facilities should happen at a rapid pace which is important for diversification of business activities
- Government should also see to the equitable distribution of FDI inflows among all the states.
- Freedom of decision making must be given at a state level so that each state can contribute as much as it can and also attract as much FDI as it can in their own level.
- There are a lot of unrecognized skilled sectors in our nation which if given equal significance can contribute and also increase their wage level in few services
- Government should start investing much more in human capital and R&D activities that help in determining specific types of FDI that generate a spillover effect in the overall economy.
- Most importantly education, health and political system of our nation must strengthen to promote sustainable development through foreign investments as it determines the future of our nation.

CONCLUSION

There are various factors that influence the Foreign Direct Investments of a country; among so many factors for this study four factors/variables have been considered: Trade GDP, foreign exchange reserves, exchange rates, financial position of the country. The result of the first model was that all of the variables considered have adequate averages and will fare better if proper support is executed by the government for the betterment and development. The hypothesis that we have considered in this case is H0: FDI does not have a significant impact on the economic growth of the country.H1: FDI has a significant impact on the economic growth of the country.Through this study it has been found that though FDI has independently increased its value and efficiency towards the development of the Indian economy through the years, however it has not been the sole factor to enhance the GDP as we find the null hypothesis of our study is accepted which implies that FDI does not have a significant impact on the economic growth of the country.

REFERENCES:

1. Deepak Kumar (2019)- FDI Outflows Trends and Patterns of Indian CompaniesVol.7, No.2, February 2019 E-ISSN: 2321-9637

2. QayoomKhachoo& Ruchi Sharma (2016) FDI and Innovation: An Investigation into Intra and Inter industry Effects Volume 45, 2016 - Issue 4

3. Dierk Herzer(2017) In search of FDI-led growth in developing countries IAI Discussion Papers, No. 150

4. Murugesan Ramasamy, Dominic Dhanapal, Poovendhan Murugesan: (2018) FDI spillover on regional productivity Evidence from panel data analysis using stochastic frontier analysis International Journal of Emerging Markets 12(3):447-463

5. Zafar, S.M.Tariq& Waleed Hemdat (2017)An analytical study on foreign direct investment and its relative impact on Indian economy Volume-3, Issue-12, ISSN No: 2348-9510

6. Dimple Goyal1 &Ritu Jain (2014) Impact of fdi on Indian economy Volume III.

7. Jiang et.al (2012) State ownership effect on firms' FDI ownership decisions under institutional pressure: A study of Chinese outward-investing firms.Journal of International Business Studies 43(3):264-284.