ISSN No. : 2456-7477 (Print)

Pacific University Journal of Social Sciences

Vol. 5 Issue 1 November, 2020 Udaipur

Indexed in : Scientific Indexing Services | Scientific Journal Impact Factor (4.729)

INTERNATIONAL INVESTMENTS: INDIA'S GROWTH PERSPECTIVE

Dr. Pragya Dheer
Assistant Professor
Department of Commerce and Management,
University of Kota, Kota
Rajasthan

Abstract

A number of significant economic changes in countries all over the world are encouraging results of liberalisation measures which were introduced in 1980's by different countries. The precarious economic situation in India encouraged and forced by the then Congress government to take some bold measures to rejuvenate the economy and to accelerate the pace of development. The policy changes initiated by the then Congress government are termed as Liberalisation, Privatisation and Globalisation and collectively known as LPG model.

The economic liberalisation that swept across the world particularly since the late 1980's, have very significantly changed the environment for international investments. At the same time, the surging international capital flow, in its turn, are substantially impacting the business environment. The massive flow of international investment has resulted in a substantial increase in their role in global production, employment generation and trade. The ratio of world FDI (Foreign Direct Investment) inward stock to world GDP increased from about 5% in 1980 to about 30% in recent times. As renowned management guru Peter Drucker in his Managing for the future observes that, "increasingly world investment rather than world trade will be driving the international economy. Exchange rates, taxes and legal rules will become more important than wage rates and tariffs."

Keywords: International Investment, Foreign Direct Investment, Foreign Institutional Investors, GDR, ADR

Introduction and Meaning

International foreign investment has been subject to upgrading within and without other areas closely associated with it, especially with respect to the constant changes in international economic activities. International Monetary Fund (IMF) and its affiliated institutions, which have, since their inception, played a cardinal role in developing and promoting international foreign investment.

According to the International Monetary Fund (IMF) Balance of Payment Manual 5th Edition, International Investments refers to investments done to acquire easy interests in the enterprises operating outside the home country (economy) of the investor, where the investor's motive is to acquire an effective management for the enterprise, either incorporated or unincorporated. This definition reflects current and future trends in international foreign investment activities, as it addresses specifically the general ambits of what can and eventually will constitute a foreign investment. The term international foreign investments has undergone and is still undergoing a thorough evolution of its essential elements, as far as the definition of the foreign investors, a foreign investment, the treatment of the investment within host economies and finally its general protection are concerned.

Additionally, the definition is identified in three principal segments of investment activities. These are the entrance thru which a foreign investor can came into an economy other than his own national economyin which he has interested via an incorporated or unincorporated enterprise. Finally but not exclusively, his acquisition can be completed with an effective voice in the management of the affairs of the enterprise, thereby influencing its operations. These segments are generalised in the nature of international foreign investments, leaving out enough room for current or future specific aspects of international foreign investment activities to fit in.

Factors Affecting International Investments

There are number of factors, broadly economic and government/political, which influence foreign investments.

1. **Rate of Interest :** One of the most important stimuli to international capital movements is the difference in the rate of interest prevailing at different places. Capital has a tendency to move from a country with a low rate of interest to a country where it is higher.

2. **Speculation:** Short term capital movements may be influenced also by speculation pertaining to anticipated changes in the interest rates or foreign exchange rates.

3. **Profitability:** Private foreign capital movement is influenced by the profit motive.

4. **Cost of Production:** Private capital movements are encouraged by lower costs of production in foreign countries. As Kreinin points out, we may distinguish between two types of cost – reducing movement. The first arises when there is the need to obtain raw materials from abroad. The second type of cost reducing investment pertains to costs of commodities other than material, primarily labour.

5. **Economic Conditions:** It is particularly the market potential and infrastructural facilities, influence private foreign investment. The size of the population and the income level of a country have an important bearing on the market opportunities.

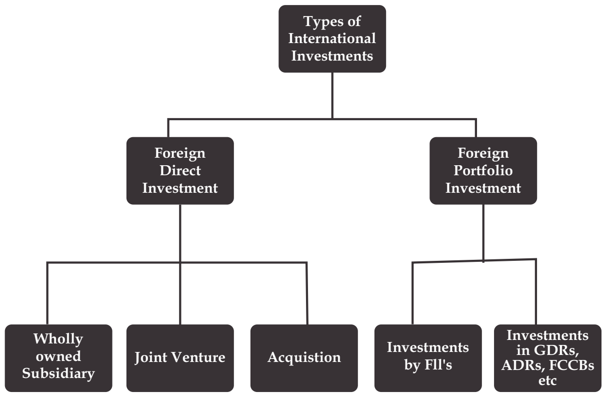
6. **Government Policies:** It is particularly towards foreign investments, foreign collaboration, remittances, profits, taxation, foreign exchange control, tariffs and monetary, fiscal and other incentives, are important factors that may influence foreign investment in a country.

7. **Political Factors:** Political factors like political stability, nature of important political parties and relations with other countries also influence capital movement.

Types of International Investment

Mainly, International investments are categorised into two types viz. foreign direct investment (FDI) and foreign portfolio investment (FPI)

Figure 1 : Types of International Investments



1. **Foreign Direct Investment (FDI):** It refers to an investment internationally or cross - borders where the investor retains control over the investment. It typically takes the form of starting a subsidiary, acquiring a stake in an existing firm or starting a joint venture in the foreign country. Direct investment and management of the firms concerned normally go together. FDI may take the form of:

   - **Green –** Field Investment i.e. establishing an entirely new enterprise in the foreign market.
   - **Mergers and Acquisition (M&A)** i.e. merging or acquiring an existing firm in the foreign country. In recent years, cross – border merger and acquisition has been the major driver of FDI.

2. **Foreign Portfolio Investment (FPI) :** Where investors has interest in mere property only and to fulfil his interest he invest the capital like: equities, bonds or other securities abroad, it is referred to as portfolio investment. In the portfolio investments, the investor uses his capital to get good returns over its investment, but has no control over the usage of the capital. Foreign Portfolio Investment (FPI), thus, is investment by individuals, firms or public bodies (like governments or government organisations) in financial instruments (such as stocks and government bonds).

   There are mainly two routes of portfolio investments in India viz. by Foreign Institutional Investors (FIIs) like mutual funds and through Global Depository Receipts (GDRs), American Depository Receipts (ADRs) and Foreign Currency Convertible Bonds (FCCBs)

   GDRs/ADRs and FCCBs are instruments issued by Indian companies in the foreign markets for mobilising foreign capital by facilitating portfolio investment by foreigners in Indian securities. Since 1992, Indian companies, satisfying certain conditions are allowed to access foreign capital markets by Euro – issues.

Thus, UNCTAD's World Investment Report states that foreign direct investment (FDI) is along term investment which reflects a long lasting interest and control made by a resident entity in one's economy (foreign direct investors or parent enterprises) other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate). FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy.

Role and Function of FDI in Developing Countries

FDI plays an important role for the developing economies like India. It is a long – term source of capital as well as a source of advanced and developed technologies. The investors bring best global practices of management in the country along with the investment. Through this large amount of capital which comes in country through FDI can be helpful to establish more and more industries in the country. This also helps in increasing employment and in promoting international trade. This investment is a non – debt, non – volatile investment and returns received on these are generally spent on the host country itself, thus helping in the development of the country.

1. **Capital Formulation :** FDI is an important source of private external finance for developing countries. It is different from other forms of external private capital flows.

2. **Offset Volatility :** FDI can offset the volatility created by 'hot money'. Short – term lenders and currency traders can create an asset bubble in a country and then selling their investments just as quickly. This can create a boom – bust cycle that can wreak economies. On the contrary, FDI takes longer to set up and has a more permanent presence in a country.

3. **Economic Growth :** The impact of FDI on economic growth is two folds. Firstly, through capital accumulation. Secondly, through knowledge transfer as it includes skill acquisition and training.

4. **Forex Reserves :** One of the important arguments in favour of FDI is that they improve the foreign exchange position of the host country. Not only this, FDI brings in valuable foreign currency through export promotion but also saves the foreign currency through import substitution.

5. **Technology Transfer :** In addition to the direct capital financing, FDI can serve as a source of valuable technology and know – how to the host developing countries. These technological innovations by foreign investment companies serve as a catalyst to the growth in developing countries.

6. **Employment Generations :** It is another positive effect of FDI. As who entered in the FDI, has to recruit people from the host country and impart necessary training to them. This leads to employment generation and human resource development in the host country.

7. **Standard of Living :** FDI may bring in new goods and services, produced using sophisticated technology and at a competitive cost which uses aggressive promotion strategy to promote their goods which create new needs in society. It resulted in enhancing the standard of living of consumers in the host country.

8. **Spread Effect :** The operations of the foreign investors generate employment and income in other related sectors of the host country through spread effect. They also give boost to the service sector like banking, transportation, communications, advertising and sales promotion.

9. **Revenue for the Government :** The monetary value of operations and turnover of foreign companies is very huge and so does their profit. Although foreign investment is taxed at a lower rate in the host countries, whatever moderate amount of tax they pay is huge which generate revenue for the government. This revenue can be invested by the government for infrastructural and development projects in the economy.

10. **Other Benefits:**

- Use of professional management and sophisticated management techniques.
- Increase exports and reduce import requirements
- Healthy competition in host country may develop domestic industries.

FDI Policy and Operations in India

The Department of Industrial Policy and Promotion (DIPP) is the nodal department for formulation of the policy of the government on Foreign Direct Investment (FDI). It is also responsible for maintenance and management of data on inward FDI into India, based upon the remittances reported by the Reserve Bank of India. The department plays an active role in the liberalisation and rationalisation of the FDI policy.

The FDI policy is reviewed as an ongoing basis, with a view to making it more investor friendly, in keeping with national interest. With a view to attracting higher levels of FDI, government has liberalised the policy of FDI, under which FDI can be up to 100%, which is permitted under the automatic route, in most of the sectors/activities as per the consolidated FDI Policy.

The Indian government has significantly simplified and streamlined the policy and procedures governing foreign investment and technology transfer as a part of the economic reform programme. Today, foreign investment is freely allowed in all the sectors including service sector except in cases where there are sectoral ceilings.

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

a). **Automatic Route:** Where FDI is allowed automatically in the country without any prior approval either of the government or the Reserve Bank of India in all activities/sectors as specified in consolidated FDI Policy, issued by government of India from time to time is known as Automatic Route.

b). **Government Route:** Other activities, which are not covered under the automatic route is known as Government Route.It requires prior approval of the government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs and Ministry of Finance.

Table 1: FDI Equity Inflows in India from 2000 – 01 to 2019 – 20

Financial Year (April to March)	**FDI Inflow** (in US$ billion)	**% Change over** Previous Year
2000 – 01	4.029	--
2001 – 02	6.130	(+) 52%
2002 – 03	5.035	(-) 18%
2003 – 04	4.322	(-) 14%
2004 – 05	6.051	(+) 40%
2005 – 06	8.961	(+) 48%
2006 – 07	22.82	(+) 155%
2007 – 08	34.84	(+) 53%
2008 – 09	41.87	(+) 20%
2009 – 10	37.74	(-) 10%
2010 – 11	34.84	(-) 8%
2011 – 12	46.84	(+) 34%
2012 – 13	22.40	(-) 38%
2013 – 14	24.30	(+) 8%
2014 – 15	30.93	(+) 27%
2015 – 16	40.00	(+) 23%
2016 – 17	43.48	(+) 9%
2017 – 18	44.80	(+) 3%
2018 – 19	44.36	(-) .98%
2019 – 20	49.97	(+) 13%
Cumulative Inflow (April 2000 to March 2020)	469.99	

Source: Various tables released by Department of Industry Policy and Promotion (DIPP) in its official website.

According to Department for Promotion of Industry and Internal Trade (DPIIT), FDI equity inflow in India stood at US$ 469.99 billion during the period from April 2000 to March 2020, indicating that the government's effort to improve the ease of doing business and relaxing FDI norms has given a great results.

In 2019 – 20, India's FDI equity inflow stood at $49.97 billion. This data clearly indicates that service sector had attracted the highest FDI equity inflow i.e. US$ 7.85 billion, which is followed by computer software and hardware production houses i.e. by US$ 7.67 billion and telecommunication sector by US$ 4.44. billion, and trading (secondary market) by US$ 4.57 billion.

Significant changes have been made in the FDI policy regime in recent times, to ensure that India remains an increasingly attractive investment destination. Some significant changes in 2019 – 20 related to FDI policy in India are as follows:

1. Government of India has reviewed the extant FDI policy on Insurance Sector and has made following amendments in the consolidated FDI Policy of 2017:

(a) No Indian Insurance company shall allow the aggregate holdings by way of total foreign investment in its equity shares by foreign investors, including portfolio investors, to exceed 49% of the paid up equity capital of such Indian Insurance company.

(b) The foreign investment up to 49% of the total paid up equity of the Indian Insurance company shall be allowed on the automatic route subject to approval/verification by IRDAI (Insurance Regulatory and Development Authority of India).

(c) Any increase in foreign investment in an Indian Insurance company shall be in accordance with the pricing guidelines specified by RBI (Reserve Bank of India) under the FEMA Regulations.

(d) The foreign equity investment cap of 100% shall apply on the same terms as above to insurance brokers, re – insurance brokers, insurance consultants, corporate agents, third party administrator, surveyors and loss assessors and such other entities as may be notified by the IRDAI from time to time.

2. Foreign Direct Investment (FDI) policy on Civil Aviation:

(a) Air transport services would include Domestic Scheduled Passenger Airlines, Non – Scheduled Air transport services, helicopter and seaplane services.

(b) Foreign airlines are also allowed to invest in the capital of Indian companies, operating scheduled and non – scheduled air transport services, up to the limit of 49% of their paid up capital. Such investments would be subject to the following conditions:

- It would be made under the government approval route.
- The 49% limit will subsume FDI and FII/FPI investment.
- The investments so made would need to comply with the relevant regulations of SEBI.

(c) In addition to the above conditions, foreign investment in M/s Air India Ltd. shall be subject to the following conditions:

- Foreign investment(s) in M/s Air India Ltd, including that of foreign airline(s) shall not exceed 49% either directly or indirectly except in case of those NRI's, who are Indian Nationals, where foreign investment(s) is permitted to 100% under automatic route.
- Substantial ownership and effective control of M/s Air India Ltd shall continue to be vested in Indian Nationals as stipulated in Aircraft Rules, 1937.

(d) FDI in Civil Aviation is subject to provisions of Aircraft Rules, 1937, as amended from time to time.

3. The Government of India has reviewed the extant FDI policy for curbing opportunistic takeovers/acquisitions of Indian companies due to the current COVID 19 pandemic and amended para 3.1.1 of extant FDI policy as contained in Consolidated FDI Policy, 2017 as under:

Para 3.1.1.

3.1.1 (a) A non – resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited. However, an entity of a country, which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, can invest only under the government route. Further, a citizen of Pakistan or an entity incorporated in Pakistan can invest, only under the government route, in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment.

3.1.1 (b) In event of the transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership failing within the restriction/purview of the para 3.1.1 (a), such subsequent change in beneficial ownership will also require government approval.

Foreign Institution Investors (FIIs)

Foreign Institutional Investments were opened in 1992 – 93 to operate in Indian stock market. Since the date there has been a significant increase in the portfolio investment through FIIs.

On 14th November, 1995, a Regulations on Foreign Institutional Investors were notified which contains various provisions relating to definition of FIIs, eligibility criteria, investment restrictions, procedures of registration and general obligations and responsibilities of FIIs.

According to the Regulations of Foreign Institutional Investors, investors may invest only in:

(a) Securities either from primary market or secondary markets which includes shares, debentures and warrants of particular companies listed on a recognised stock exchange in India, and,

(b) Units of floated domestic mutual funds like

Unit Trust of India, which were either listed on a recognised stock exchange or not.

Thus, as per regulation, FII's are permitted to invest in a company up to a limit of 24% of equity, which can be increased to 40% with the subject to receive approval from the Board of Directors and a special resolution from the General body.

Conclusions

Encouraged by the favourable business environment fostered by the global liberalisation, the international private capital flows have been increasingly rapidly. Cross – border M&A have been the major driver of the recent surge in the FDI. Foreign capital now contributes a significant share of the domestic investment, employment generation, industrial production and exports in a number of economies.

Although India has substantially liberalised its foreign investment policy, the FDI has been much below the targets. India had not been getting even 1/10th the size of FDI flow as and when compared with other economies. Bureaucratic problems, certain unfavourable government attitudes, poor infrastructure, labour factors, high input cost etc. are regarded as its major reasons.

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