

## **Role of Foreign Direct Investment and Economic Growth in India**

**Dr. S. Archana Bai**

Assistant Professor in Commerce  
Sir Theagaraya College  
Chennai 600021

### **ABSTRACT**

Foreign direct investment (FDI) has played an important role in the process of globalization during the past two decades. The rapid expansion in FDI by multinational enterprises since the mid-eighties may be attributed to significant changes in technologies, greater liberalization of trade and investment regimes, and deregulation and privatization of markets in many countries including developing countries like India. In the era of volatile flows of global capital, the stability of FDI emerges as an effective channel to faster growth in developing countries. It plays an important role in the long-term development of a country not only as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities. FDI inflows are considered to be a vital source of economic growth or development for any economy and it plays big role in growth in gross domestic product (GDP), improvement in infrastructure, employment creation, export and trade performance. The paper tries to examine the various set of factors which influence the flow of FDI and economic growth of India. The main purpose of this research study is to investigate the impact of FDI on the economic growth of India, from the period of 2014 to 2018.

**Keywords:** Investments, Economy, Infrastructure, Investments

### **1. INTRODUCTION**

FDI is an important source of development financing and contributes to productivity gains by producing new investment, better technology, management expertise and export markets. FDI promotes economic growth by increasing the volume of investment and efficiency. This paper revisits the FDI and economic growth relationship by examining the role FDI inflows play in promoting growth in the main economic sectors, namely primary, manufacturing, and services. Often-mentioned benefits, such as transfers of technology and management knowhow, introduction of new processes, and employee training tend to relate to the manufacturing sector rather than the agriculture or mining sectors. Therefore all the countries try to attract FDI for the package of benefits. The relationship between FDI and economic growth has generated a voluminous empirical literature focusing on developing and industrial nations. Foreign Direct Investment is one of the major factors that decide a country's integration with the global economy. Global FDI flows grew considerably at the rate of 18% on an average during 2001-2015 which is higher than global economic growth. Foreign Direct Investment (FDI) plays an important role in global business. It can provide a firm with new marketing channels, cheaper production facilities, access to technology transfer, product, skills and financing. With the

advent of globalization and strong governmental support, foreign investment has helped the Indian economy grow tremendously.

India has continuously sought to attract investment from the world's major investors. In 1998 and 1999, the Government of India announced a number of reforms designed to encourage and promote a favorable business environment for investors. Foreign investments in the country can take in the form of investments in listed companies i.e., Foreign Institutional Investors' (FIIs) investments, investments in listed/unlisted companies other than through stock exchanges i.e., through the foreign direct investment or private equity/foreign venture capital investment route, investments through American Depository Receipts (ADR), Global Depository Receipts (GDR), or investments by Non-Resident Indians (NRIs) and Persons of Indian Origin (PIOs) in various forms. This paper attempts to review the importance of foreign direct investments in Indian economy, particularly after a decade of economic reforms and analyze the role played by the FDI in the economic development of the country. The study is diagnostic and exploratory in nature and makes use of secondary data. The study finds and concludes that the foreign direct investment in India have significantly improved and developed the economy as well.

The need for foreign capital for a developing country like India could arise on account of the following reasons are Domestic capital is inadequate for purpose of economic growth and it is necessary to invite foreign capital. For want of experience, domestic capital and entrepreneurship may not flow into certain lines of production. Foreign capital can show the way for domestic capital. There may be potential savings in a developing economy like India but this may come forward only at a higher level of economic activity. It is, therefore, necessary that foreign capital should help in speeding up economic activity in the initial phase of development. It may be difficult to mobilize domestic savings for the financing of projects that are badly needed for economic development; the capital market is itself underdeveloped. During the period in which the capital market is in the process of development, foreign capital is essential as a temporary measure. Foreign capital brings with it other scarce productive factors, such as technical know-how, business experience and knowledge which are equally essential for economic development.

## **2. REVIEW OF LITERATURE**

The empirical findings as reflected in the survey of de Mello (1997) on two channels through which FDI can stimulate growth can be adoption of new technology and knowledge transfer. This mechanism accelerates spill over effects with the accumulation of human capital (Borensztein et al.1998; Chakarbarti, 2001; Asicdu, 2002; Durham, 2004). As regards developing countries the empirical studies focus on FDI growth relationship Journal of International Relations and Foreign Policy, Vol. 2(2), June 2014 Stanley Morgan (2002) has examined in his paper that FIIs have played a very important role in building up India's Forex Reserves, which have enabled a lot of economic reforms. Lin et al. (2006) concluded that the investment performance of FIIs high holding stocks is significantly better than that of FIIs low holding stocks. They presented the evidence that FIIs trading behavior has generated better returns and portfolio performance since the stock market's full liberalization.

Douma, Pallathiatta and Kabir (2006) in their study investigated the impact of foreign institutional investment on the performance of emerging market firms and found that there is

positive effect of foreign ownership on firm performance. They also found the impact of foreign investment on the business group affiliation of firms.

Krishna Prasanna (2008) in his study examined the relationship between foreign institutional investment and firm specific characteristics in terms of ownership structure, financial performance and stock performance.

### **3. STATEMENT OF THE PROBLEM**

The study observes that FDI is a significant factor influencing the level of economic growth in India. It provides a sound base for economic growth and development by enhancing the financial position of any country. No doubt, India can improve its economic performance and can achieve its target of double digit growth rate by creating conditions conducive to investment. For this, the policy makers should ensure optimum utilization of funds and timely implementation of projects. The study also urges the policy makers to focus much more on attracting diverse types of FDI. Foreign investment is an important economic process during which foreign state and private companies and enterprises invest capital, technology and innovations into the companies of another country. As usual, the capital flows from developed countries to developing countries. Modern world economy cannot develop successfully without foreign investment. A great number of countries invest their funds to the economy of other countries having a certain income and developing certain branches of industries of such countries. Due to received capital the country receives an opportunity to renew and develop all necessary branches of industries, to increase the effectiveness of production and produce competitive goods and services.

### **4. OBJECTIVES OF THE STUDY**

- To appreciate the importance of foreign direct investment for the Indian economy
- To review the Foreign Direct Investments secured by the country;
- To analyze the trends of Foreign Direct Investment;
- To offer suggestion for the improvement of the FDI for the economic development.

### **SOURCES OF DATA**

This paper is a part of the comprehensive study undertaken by the author on the status and prospects of onward FDI in India. Analytical research design was developed and secondary data sources were explored to draw inferences. The conclusions drawn from empirical data analysis and information gathered from various secondary data sources listed in the references section have been presented in this paper. Based on the inferences and experience of the researches a conceptual model consisting of strategic approaches to attract more FDI into India had been presented. The present study is of analytical nature and makes use of secondary data. The relevant secondary data are collected from the following sources: Publications of Government of India; Publications of Reserve Bank of India; Handbook of Statistics on the Indian Economy, RBI, etc Various FDI related journals have also been referred to. Tools Used for Analysis The analysis of the data forms the core part of the research. In order to analyze the data and draw conclusions on this study, various statistical tools like growth rates, regression and correlation

have been used through EXCEL and SPSS Software. The study period starting from the year 2014 to 2018

## ANALYSIS AND INTERPRETATION

### 1. Inflow of FDI and Exports

The year wise inflow of FDI secured by the country along with the amounts of exports are furnished in Table 1

#### YEAR WISE INFLOW OF FDI AND EXPORTS (IN MILLIONS)

YEARS	FDI	%	EXPORT	%
2014-2015	37745	52.64	162904.30	28.87
2015-2016	41873	20.17	185295	13.78
2016-2017	46556	33.66	305963	40.49
2017-2018	36860	20.82	200570	11.76

Source: DIPP and Reserve Bank of India

**TABLE NO 1**

The above Table-1 reveals that the FDI inflows and the Exports made by the country are increasing year after year. The highest growth rate has been observed (40.49%) in 2016-17 and the lowest growth rate (11.76%) in the year 2017-18

#### CORRELATION

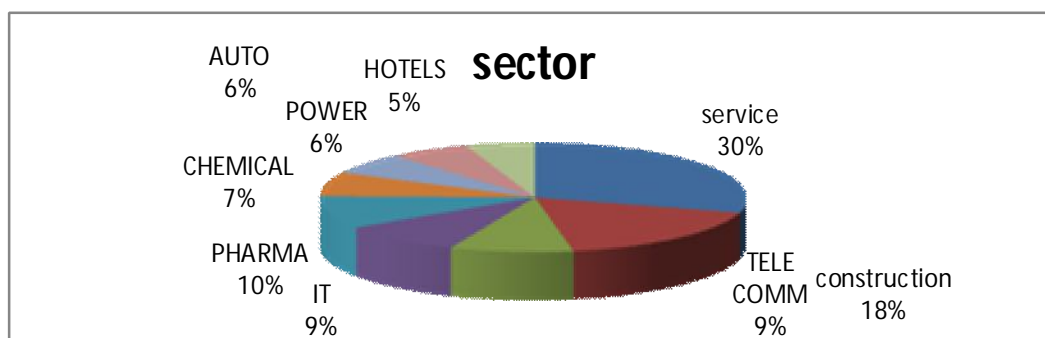
	FDI	EXPORT
FDI Pearson Correlation	1	.851
Sig (2 tailed)		.002
N	10	10
Export Pearson Correlation	.851	1
Sig (2-tailed)	.002	
N	10	10

**TABLE NO 2**

Correlation analysis was carried out to find out the relationship between the variables (Foreign Direct Investment. and Exports). Table 2 exhibits the relationship between the variables (Foreign Direct Investment and Exports). Correlation value is 0.851 which is significant at 0.01 levels. It indicates that as the FDI inflow of the country increases the export also increases.

The above figures shows that Make in India is growing eventually but these few years is just not enough to comment on the impact of FDI due to Make in India policy.

**INDIA'S SECTOR WISE INVESTMENT CLASSIFICATION**



**FIGURE 3**

From the above figure, it is clear that highest 19.51% of FDI in India is found in Service sectors, 11.56% in Construction development, 6.66% in Telecommunication, 6.13% Computer Software and hardware, 5.37% in Drugs and Pharmaceuticals, 4.66% in Chemical (other than fertilizers), 4.12% in Power, 4.03% in Automobile industry, 3.45% in Hotel and Tourism, 2.83% Petroleum and natural gas.

**5. FINDINGS AND SUGGESTIONS**

Foreign investment is a predominant and vital factor in influencing the global economic development. Foreign investment has been defined as “a transfer of funds or materials from one country (called capital exploring country) to another country (called host country) in return for a direct or indirect participation in the earnings of that enterprise. Hence, this study is pertinent to analyze the impact of FDI inflows in the economic development of India. FDI inflow has a positive relationship with exports made by the country. It is found that the compound annual growth rate of GDP of the country was 18% which is a welcome trend. It is found that the trend of GDP was better because of the steady increase in the flow of FDI during the study period. The FDI inflow of the country increases which in turn; the amount of foreign exchange reserve is also increased. The increase over the period of the foreign exchange reserve was 3.88 times. FDI inflow has a close relationship with the increasing amount of foreign exchange reserve of the country. There has been a growing presence of Foreign Direct Investment in Indian capital market evidenced by an increase in their net sizable investments. This indicates that Indian capital markets have become vibrant in terms of their composition of various constituents of the market. In India foreign capital helps in increasing the productivity of labour and to build up foreign exchange reserves to meet the current account deficit. Foreign investment provides a channel through which the country can have access to foreign capital. FDIs have significant impact on the Indian economic growth in terms of Export, Gross Domestic Product and Foreign Exchange Reserves. Government should encourage industries to grow to make FDI an attractive avenue to invest.

**6. CONCLUSION**

The study reflects that economic growth can stimulate FDI in majority of the countries mentioned above. This is because growth-led FDI is more evident than FDI-led growth. This

happens due to increased economic activity which expands market size offering opportunities for foreign investors and to reap economies of scale in a larger market economy. Us Foreign Direct Investment (FDI) is a form of long-term international capital movement, made for the purpose of productive activity and accompanied by the intention of managerial control or participation in the management of foreign firm. Foreign investment is necessary not only to supplement domestic capital but also to secure scientific, technical and industrial knowledge. In view of this, the government adopted a liberal attitude by allowing more frequent equity participation to foreign enterprises, and to accept equity capital in technical collaboration in India. In 1998 and 1999, the Government of India announced a number of reforms designed to encourage and promote a favorable business environment for investors. The government also provides many incentives such as tax concessions, simplification of licensing procedures and de-reserving some industries such as drugs, aluminum, heavy electrical equipments, fertilizers, etc in order to further boost the FDI inflows in the country. Thus, foreign investments provide opportunities to host countries to enhance their economic development and opens new vistas opportunities to home countries to optimize their earnings by employing their ideal resources Thus, it was concluded that FDI contributes in stimulating the economic growth and development of our country. FDI has invested largely to the service sectors of India. There has been a positive impact of Make in India Policy towards FDI in India. It also reduces brain-drain from the host countries and provides to work for better market with upgraded techniques and handsome revenue generation

### **FURTHER RESEARCH**

In the past two decades nations around the globe have witnessed huge flow of private capital flow in the form of Foreign Direct Investment (FDI). FDI is functioning as an instrument in enhancing the phase of economic growth of developing economies. it is an important source of development finance which contributes to multiple gains by providing new investments, better technology, management expertise, export markets, creates forward and backward linkage, a phenomenon has been widely accepted in the literatures of international business. With the prevailing resource constraints accompanied with lack of investment, market forces, private sectors and governments also rely upon FDI as an engine for sustaining economic growth.

### **8. REFERENCES**

- [1] Shleifer A. & Vishny R.(1997) ‘ A survey of Corporate Governance’, Journal of Finance, Vol.52, Issue.2, pp. 737-783.
- [2] Vachani, Sushil. 1997. “Economic liberalization’s effect on sources of competitive advantage of different groups of companies: The case of India,” International Business Review, vol. 6, no. 2 (April), pp. 165-184.
- [3] Sarbapriya Ray, (2012) ‘Impact of Foreign Direct Investment on Economic Growth in India: A Co integration Analysis’,
- [4] Advances in Information Technology and Management (AITM), Vol.2 No.1, pp.187-201. Rahul Dhiman, (2012) ‘Impact of Foreign Institutional Investor on the stock Market’, International Journal of Research in Finance & Marketing, Vol.2 Issue 4, pp.33-46.
- [5] Yew Siew Youg.(2007) ‘Economic Integration, Foreign Direct Investment and Growth in ASEAN five members’, psarir.upm.edu.my/5038.

- [6] Borensztein, E., J. de Gregorio, and J.-W. Lee (1998):How Does Foreign Investment Affect Economic Growth? ,Journal of International Economics, Volume 45, pp. 115-35.
- [7] Chakraborty, C, and Basu, P. (2002): Foreign direct investment and growth in India: A cointegration approach ,Applied Economics , Volume 34, No. 9,pp.1061–1073.
- [8] Chowdhury, A ., and Mavrotas , G.,(2005):FDI and Growth : A Causal Relationship , United Nations University , WIDER Research Paper No. 2005/25. Duasa,J.(2007):
- [9] Dutt, A.K. (1997):The Pattern of Direct Foreign Investment and Economic Growth, World Development ,Volume 25,No. 11,pp. 1925-1936.
- [10] Gerald M. Meier(1997):Leading Issues in Economic Development, Oxford University Press,New Delhi Kumar, Nagesh (2002):Globalization and Quality of Foreign Direct Investment:Oxford University Press, New Delhi .
- [11] Kumar, N and Pradhan, J.P .,(2002):Foreign Direct Investment, Externalities and Economic Growth in Developing Countries:Some Empirical Explorations and Implications for WTO Negotiations on Investment, RIS Discussion Papers No.27/2002.