



A study on FDI policies and objective analysis in developing and developed countries -India

Sohrab Karami and Mahshad Alizadeh

University College of Commerce and Business Management, Osmania University, India.

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ABSTRACT

The objective of this study was to analyze the country-specific attributes that either motivate or determines foreign direct investment (FDI) in a nation. A review of the literature on foreign direct investment revealed specific location attributes that tend to motivate direct investment in a particular location. In order to measure the impact of each of these attributes on foreign direct investment I created a database including each key attribute as a variable and measuring it across countries over a period of five years (2009-2013). The database contains all countries; the primary regions include USA, INDIA as well as a group of "Other" developed and developing nations. Analysis of the countries and variables and their affect on FDI flows. Unfortunately, I found GDP to be the only significant pull factor for U.S. foreign direct investment which indicates that large market size is a major investment determinant for multinational corporations. Other research on an industry-specific basis is necessary to gain a more in-depth analysis of specific variables. Foreign direct investment (FDI) in all over the world in general and in India in particular after the opening up of our market with the adoption of the policies namely globalization, privatization and liberalization has no doubt emerged as one of the most significant source and contributor of external inflow of resources and is one of the most crucial contributors to the capital formation despite their share in the world arena still catching up. When we talk about the term FDI we are talking about a bundle of resources that usually flow into a country including besides capital, production technology, global managerial skills, innovative marketing strategies and access to new markets. A cumulative and an exhaustive study of the overall scenario of FDI in India, FDI in USA in perspective of India investments of FDI in the country, share of top investing countries, sectors attracting highest FDI flows, sector wise technology transfer and approvals. We will also look at the determinants for attracting FDI in the country and also the causes for low flow of FDI and the mechanisms that can be undertaken to make our country attractive enough for investors and vice versa (for USA). This study entirely relies on secondary data collected after a thorough and exhaustive study of various websites, text books, journals, newspapers, magazines and great inputs form various professors and professionals specializing in this area.

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Introduction

Foreign direct investment (FDI) is defined as "investment made to acquire lasting interest in enterprises operating outside of the economy of the investor." The FDI relationship consists of a parent enterprise and a foreign affiliate which together form a Multinational corporation (MNC). In order to qualify as FDI the investment must afford the parent enterprise *control* over its foreign affiliate. The UN defines control in this case as owning 10% or more of the ordinary shares or voting power of an incorporated firm or its equivalent for an unincorporated firm; lower ownership shares are known as portfolio investment.

Objectives:

1. To study the trends in the inflow and outflow of foreign direct investment all over the world, comparing the investment share of India Vs USA
2. To study the share of top investing countries of FDI during the period 2009-2013.
3. To study the objectives and analyse the risk of FDI
4. The sector attracting highest FDI equity inflow

5. To study the causes and reasons for low FDI inflow in the country
6. To study the determinants for attracting the FDI
7. To study the FDI policy in brief and a certain the main causes why investor likes investment outside the home country.
8. Key business objectives behind FDI decisions;
9. Countries and regions of the world that are most attractive to investors; and
10. Key factors and considerations that influence companies' location strategies.

Methodology:

This study is entirely based on freelance work done by the student and therefore no organization has been taken as a base for doing the study. AN exhaustive amount of data available on the internet, from the text books, newspapers, and various magazines and suggestions from a few experts in the field has been taken in doing this study. As this is a freelance study, the data has been entirely collected from secondary sources and therefore its authenticity can be vouched for only by going through the same literature which has been used.

Scope Of The Study:

As this study is aimed to analyze the trends in the FDI inflows and outflows, the main focus is given on the recent trends in the inward of both India and USA FDI, sectors attracting highest FDI, and the share of top investing countries; it covers only equity capital components. The scope is limited to the availability of the secondary data.

Limitations of the study:

The study is conducted in a short period, which was not detailed in all aspects.

It was conducted a sample of only two nations India and America

Non-availability of accurate data to FDI

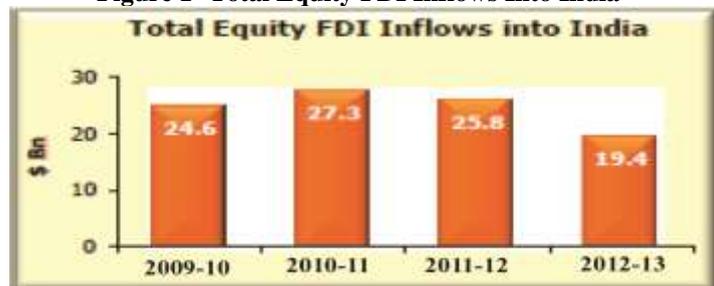
Data in one secondary source do not match with that of another source.

Data Analysis

India FDI Inflows:

The decade gone by would be considered as the golden year for foreign direct investment (FDI) in India. Between year 2003-13, India attracted cumulative FDI inflow of USD 237 Bn. 70% of this FDI constituted equity inflows, rest being re-invested earnings and other Capital. Over the last decade, FDI in India grew at CAGR 23%

Figure 1 -Total Equity FDI Inflows Into India



The Bull Run in India FDI started in FY 2009-10 when it grew at 146% over the previous year. FDI peaked in year FY2008-09 and only marginally declined in the following years of economic crisis. For the eight months of FY 2012-13 (Apr-Nov 2012), India has already garnered USD 33 Bn. of FDI matching the full year FDI of the previous year.

Country Cumulative Inflows:

Table 1. Country Cumulative Inflows In India

Sl.no	Country	Cumulative inflows 2003-2013
1	Mauritius	41%
2	Singapore	10%
3	USA	7%
4	UK	6%
5	Japan	5%
Top 5		69%

Share of top five investing countries in India stood at 69%. Mauritius was the top country of origin for FDI flows into India primarily driven by the tax haven status enjoyed by Mauritius. Services sector (Financial & Non-financial) attracted the largest FDI equity flows amounting USD 31 Bn. (20.5% share). Other high share sectors in top five were -Telecom (8%), Computer Software & Hardware (7%), Housing & Real Estate (7%) and Construction (7%).

Over the years, Automatic route has become the most used entry route for FDI investments in India indicating the gradual liberalization of FDI policy. In FY 2012-13, 64% of Equity FDI inflows in India came via "Automatic Route" almost trebling from 22% share in FY 2003-04. "Acquisition of shares" constituted 25% and "FIPB/SIA" constituted 11% of equity inflows in 2012-13. India's FDI policy has progressively

liberalized since nineties and only a few sectors, primarily in services sector now has FDI cap on investment. India's inward investment regime is now be considered most liberal and transparent amongst emerging economies.

Figure 2. Cumulative services sector FDI inflows



Financial Sector FDI:

Over the last decade, BFSI (Financial, Insurance & Banking services) was the most preferred destination for FDI in India. FDI in the BFSI sector accounted for over 12% of the total cumulative FDI inflows into India, and over 59% of the FDI in Services sector. Between 2003-13, Services sector (BFSI and Non-Financial) attracted FDI of USD 31 Bn.

Table 2. Key deals that took in FY 2003-2013

Sl.no	company name	value in \$mn
1	Housing Development Finance Corp	654
2	DSP Merrill Lynch	484
3	AAA Global Ventures	368
4	South Asia Communications	370
5	Kotak Mahindra	406
6	Tata Capital	291
7	Morgan Stanley Securities	275
8	Morgan Stanley Securities	347
9	National Stock Exchange of India	258
10	HSBC Securities & Cap Market	185
Total		4224

With a 59% share, BFSI FDI share amounted to USD 18 Bn. The subsectors with BFSI attracted the following FDI equity inflows - Financial : USD 13 Bn., Banking: USD 2.9 Bn and Insurance: USD 2.3 Bn. Mauritius had the largest share of FDI investment at 43% amongst top countries investing in Indian Financial services sector. Singapore (14%), UK (11%), USA (8.5%) and Cyprus (3%) were the other countries in the top five list. Top 10 BFSI FDI Equity inflows in India over the last decade amounted USD 4.2 Bn. Key US investors in Indian BFSI sector included Merrill Lynch, Morgan Stanley, Bank of New York Mellon, JP Morgan, Citibank Overseas, Franklin Templeton, New York Life, Metlife, AIG, Pramerica and PE/VC firms like Warburg, Blackstone, Carlyle, KKR & Co. and Apollo. Development of Indian capital markets (especially corporate bond markets) and further policy liberalization in commercial banking will be the key for future investments in Indian BFSI segment.

FDI Inflows from United States:

United States of America has been one of the top FDI investors in India. Reported cumulative FDI Equity Inflows from USA into India between 2003 -2013 were \$9.8 Bn, placing it at rank 3rd after Mauritius & Singapore. If we account for the US FDI equity inflows into India routed through tax havens, the FDI number will be considerably higher. Keeping up with overall trend, the Services sector (Financial & Non-Financial) accounted for the highest share of cumulative FDI equity inflows from USA with share of 22% amounting

USD 2.1 Bn. USA FDI equity inflows in services sector represented 7% of the total FDI equity inflows in Indian services sector and in Financial services sector represented 8.5% of the total FDI equity inflows from all countries amounting USD 2.6 Bn.

Figure 3. FDI Equity inflow From USA



Following were the top FDI inflows from USA in Indian financial services:

- #1 Citibank Overseas Investment Corp. into E-serve International: USD 112 Mn.
- #2 Bank of New York Mellon into Kotak Mahindra Bank: USD 102 Mn.
- #3 JP Morgan International Finance into JP Morgan Securities India Ltd.: USD 75Mn.

Figure 4- Top Sectors For USA FDI Equity Inflows



FDI in Insurance sector:

Indian insurance sector got liberalized in 2003. Since then the sector has grown at 20% annually and have seen entry of 41 private insurance companies (Life: 23, General: 18) with many of them choosing to enter with a foreign joint venture partner. Investment through the FDI can be a maximum of 26%. In 2013, India was ranked 9th in life insurance business and 19th in general insurance business globally. The insurance density stood at USD 64.4 (USD 9.9 in 2003) and insurance penetration was 5.2% (2.3% in 2003). India has 49 life and general insurance companies with total investment of USD 6 Bn. as of March 2013. There are 24 companies operating each in the life insurance and general insurance with an investment of USD 4.7 Bn. and USD 1.3 Bn. respectively. One company operates in re-insurance sector.

FDI in Indian insurance sector stood at USD 1.36 Bn of which life insurance comprised USD 1.1 Bn and general insurance comprised USD 0.2 Bn of FDI. American companies have been investing in the Indian insurance sector since it opened up in 2003. As of March 2013, there are four American insurance players operating in India as joint venture partners namely - New York Life, Metlife, AIG and Pramerica Financial. In 2013, Berkshire Hathway announced its entry into India Life insurance segment and Libery Mutual Group also got necessary approvals from IRDA for entry into general insurance business

with an Indian partner. Besides insurers, US based brokers like Marsh & McLennan and Aon corp have also entered Indian markets. The total investment by American insurance companies in India is USD 315 Mn contributing 26% equity capital of USD 1.2 Bn. share capital of the entities they were joint venture partners of. American origin FDI constituted 23% of FDI.

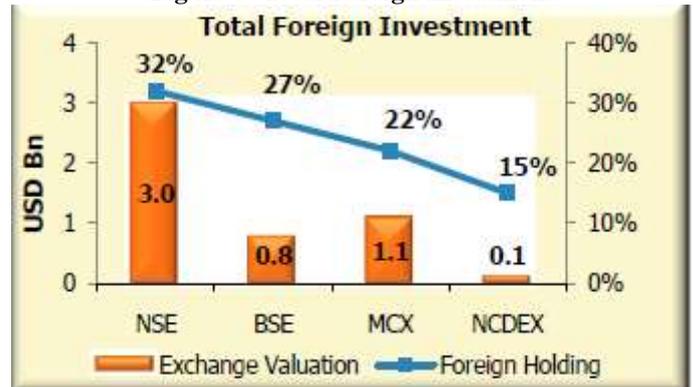
India’s insurance industry is expected to reach USD 350-400 Bn. in premium income by 2020 making it among the top 3 life insurance markets and amongst top 15 general insurance markets. Its estimated the Indian insurance sector would attract USD 15-20 Bn. of investments in next couple of years. Liberalization of foreign investment in insurance sector thereby permitting up to 49% FDI will accelerate this flow of investments putting Indian insurance sector on a fast track to the top of the global insurance market

FDI in Financial Inclusion:

Indian Financial Inclusion sector is predominantly characterized by rural retail banking, Non-Banking Financial Corporations & Micro Finance Institutions (MFIs). For over a decade now, the Indian microfinance industry has been a poster child of Indian Financial Inclusion. As of 2010, microfinance institutions had a client base of 26 million borrowers and the total loan outstanding was in excess of \$3 Bn. The number of clients is expected to increase to 64 million in 2012. Investments in NBFCs & MFIs not traded on the stock exchange fall under the purview of Foreign Investment Promotion Board (FIPB). FIPB has set the following rules for FDI in start-up companies. From a slow start in 2006, equity investments in the Indian Microfinance sector skyrocketed in the 3 years from 2006 to 2009. The sector saw a total of 32 deals with a total capital of ~\$230 mn between 2006 to 2009. Private equity investments constitute ~70% of the total investments in Indian Micro Finance sector. 30% is constituted by Microfinance focused funds and private investors.

US based private equity firms, Sequoia capital, Silicon Valley Bank & Sandstone capital have invested ~\$150 mn in the Indian Microfinance sector. Another area within Financial Inclusion which has attracted private equity investors is technology services for microfinance institutions. US based Private equity firms like Blackstone, Intel Capital have invested ~\$50 mn in Financial Information Network & Operations (FINO), a technology services company in the Financial Inclusion sector.

Figure 5- Total Foreign Investment



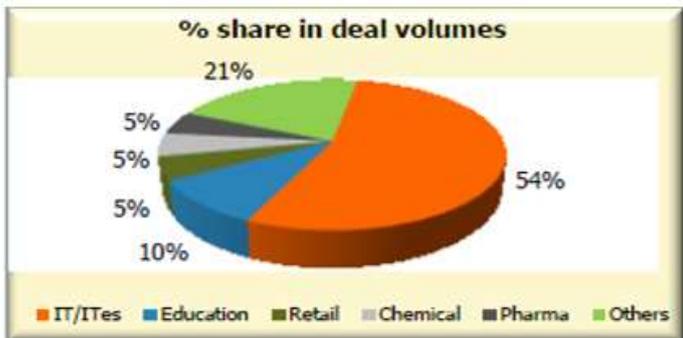
In 2012, NSE had 12 foreign investors with a total foreign investment of 32% compared to BSE which had 8 foreign investors with share of 27% investments. In the same period, MCX had 22% foreign holding & NCDEX 15% foreign investments. Some of the key US investors active in Indian exchanges are NYSE group, Atlantic LLC, Goldman Sachs, Morgan Stanley, Citigroup, Northwest Venture Partners,

George Soros, Argonaut ventures, Fidelity, Intel Capital, Merrill Lynch, and Bessemer Capital are some of the US investors. Most of the transactions involving these exchanges have been secondary in nature. The change in regulations (restricting the single investor holding to 5%) also added to the spurt in secondary deals. The lucrative exchange space continues to attract more players who are looking to increase their market shares.

India outward FDI in USA:

Strong economic growth and progressive liberalization has induced Indian companies to expand their presence into new markets and USA is the largest recipient of Indian outbound investments. During 2006-11, India invested USD 5.5 Bn. in US across 127 greenfield projects. 80% of this investment went into five sectors – Metals, Software & IT services, Leisure & Entertainment, industrial machinery, equipment & tools and financial services.

Figure 6. %Share In Deal Volumes



The top three states for Indian investments were Minnesota, Virginia and Texas. 10 Indian companies accounted for more than 70% of the US \$5.5 Bn invested in greenfield initiatives in US. In the same period, Indian companies invested USD 21 Bn. in mergers & acquisitions in United States. 83% of M&A investments from India were in the following sectors – Manufacturing, IT & IT enabled services, Biotech, Chemicals & Pharmaceuticals, Automotive and Telecom. As of FY2011, US accounted for 6.5% of India’s outward FDI flows making India the second largest investor in USA. As far as Indian Financial services sector investments in US goes, Only a few public and private sector banks have expanded in USA by providing niche services (e.g. remittances). Indian outbound deals in the US are predominantly majority stakes paid in cash and financed with debt. In future, the nature of collaboration is likely to evolve with Indian companies seeking more alliances and transactions involving minority stakes & joint ventures rather than focusing on majority stakes. US offers Indian companies many benefits for investment notably - abundant natural resources, large consumer markets and access to innovation. Reciprocally, India’s investments in this world’s largest recipient of FDI bring new skills, strengthen manufacturing and will create jobs in the US.

Figure 7- Flow Of Fdi Inflow (Us\$ Billions)

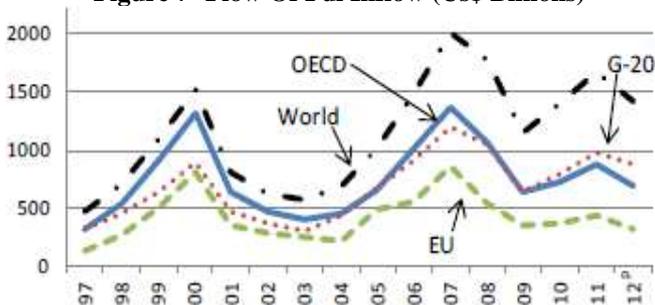
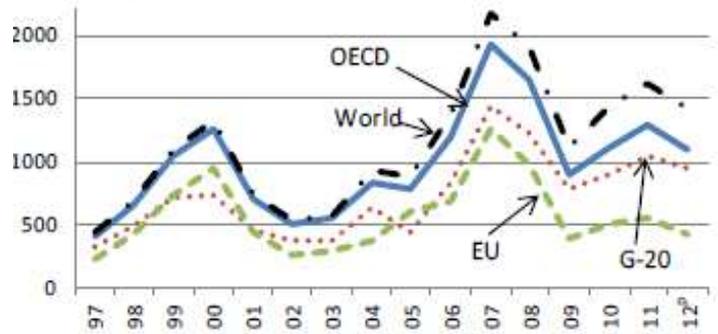


Figure 8- Flow Of Fdi Outflows(Us\$ Billions)



According to preliminary estimates, global FDI flows have declined in 2013 by 14% from 2012 to USD 1.4 trillion in spite of the 22% increase in the last quarter but remain comparable to global FDI flows in 2011.

OECD investments abroad declined by 15% to USD 1100 billion in 2013 accounting for 77% of global FDI (80% in 2012) and OECD attracted only USD 686 billion of FDI (or 48% of global FDI) representing an annual decrease of 21%. Investment to and from the European Union, in aggregate, declined by around 25%. China became the first FDI destination in 2013 and the United States maintained its position as the leading investing economy.

In 2013, 44% of global **FDI inflows** were hosted by only five countries. China attracted the lion’s share by USD 253 billion (or 18% of total) followed by the United States USD 175 billion), Brazil (USD 65 billion), the United Kingdom (USD 63 billion) and France (USD 62 billion).

In spite of the 25% drop from USD 234 billion in 2012, accounting for the decrease in both equity and intercompany loans, the United States remains the first FDI destination within the OECD area. FDI in Germany, which ranked as the 5th largest host economy within the OECD in 2012, declined by 87% in 2013 to USD 6 billion, ranking at the 20th position. This development is due to disinvestments (in equity) by foreign investors and reimbursements of intercompany debt. On the other hand, inflows to Japan recovered modestly in 2013 increasing from USD -1.8 billion in 2012 to USD 2.1 billion in 2013, well below the inflows recorded in 2009 and 2010 (USD 24 billion and USD 12 billion, respectively).

Some EU countries recorded negative inflows such as Belgium at USD -1.6 billion (declining drastically from USD 103 billion in 2012 as a result of major disinvestments in the fourth quarter of 2012). However, the impact of some of the decreases recorded in the OECD area in 2013 was offset, in part, by significant increases. FDI inflows to France increased by 52%, to USD 62 billion (ranking as 3rd OECD recipient). Due to historically high levels of intercompany loans, inflows to Luxembourg reached USD 58 billion, excluding investments in special purpose entities hosted in this country.

While China and Argentina received respectively 11% and 25% more FDI as compared to 2012, inflows to India, Russia and South Africa’s decreased by more than 15%. Indonesia recorded its highest level of FDI inflows at USD 19.9 billion and Saudi Arabia received USD 13.7 billion in the first three quarters of 2013, while Brazil maintained the same level of FDI inflows at USD 65 billion.

At USD 1100 billion, OECD’s **FDI outflows** represented 77% of global outflows for 2013, representing a 15% decrease from 2012. In the same period, the United States, the largest single investing economy world-wide, recorded USD 351 billion outward FDI which accounted for 25% of global outflows (or 32% of OECD or 37% of G20 economies). Other significant

investing countries in 2013 were Japan (USD 122 billion), Belgium (USD 85 billion), the United Kingdom (USD 72 billion), Germany (USD 67 billion), China (USD 62.4 billion) and France (USD 62.2 billion).

The FDI scenario in India has changed drastically in the last decade. For the first time in 15 years, the government has simplified and rationalized FDI procedures while liberalizing the existing sectors such as retail, television, diamond and coal mining, airports, wholesale and export trading, and opening new ones such as power trading, processing and warehousing of coffee and rubber to foreign investment.

Notwithstanding the upturn, India's capital account in recent years has gained far more strength from short-term portfolio flows than from long-term FDI flows. This probably necessitates revisiting the FDI policy and identifying constraints impeding higher FDI inflows. Procedural simplifications are likely to encourage much greater FDI flows.

The sectors attracting highest FDI were Equipments (including computer software & electronics), services sector (financial and non-financial) and Telecommunications (radio paging, cellular mobile, basic telephone services)

While Mauritius is the top most investing country followed by USA, UK, Netherlands, Japan, Singapore, and Germany. In case of no. of technological transfers USA is at first position with share of 21.98% followed by Germany, Japan, and UK.

Conclusion

The Global Business Location Survey provides insights into the decision-making processes of the responding companies and the basis on which such decisions are made. The findings with regard to the motivations of the investors, the form and mode of planned investment, locations of interest, and the factors influencing site selection should be useful both to countries seeking to attract foreign direct investment and to companies wishing to assess the current mood of their market and potential investment strategies in their sector of the economy.

While the data and analysis presented in this report reflect the views of the companies that responded, the themes that emerge also echo within the broader population of transnational corporations.

There is clear evidence that companies worldwide continue to look beyond their national boundaries when considering near-term investment opportunities. They are that provide the most favorable market access as a top priority. Locations that stand out will be those that combine market advantages and stable social and political settings. While global economic uncertainty is leading some companies to become more conservative, they are nevertheless still committed to foreign investment as an appropriate strategy for market development.

This is particularly true of companies based in developing countries that are seeking to develop new operations and markets abroad. More generally, companies doing business around the world have signaled that they will look to balance the need for access to new markets with a desire to minimize risk.

As companies try to assess and react to the implications of the events of financial crisis, achieving an acceptable balance is undoubtedly the biggest strategic challenge they face. The most important determinants for attracting FDI are the Cost Factors, Market Size, Real Exchange Rates, Macro Economic Stability, Rate of Inflation, Overall Economic Stability, National FDI Policy, Investment Incentive, and Removal of Restrictions like Access to few industries, foreign ownership restrictions, ease of entry performance requirements.

The policy on Foreign Direct Investment has been reviewed on a continuing basis and several measures announced from

time to time for rationalization/ liberalization of the policy and simplification of procedures.

As a result, a number of rationalization measures have been undertaken which, inter alia include, dispensing with the need to multiple approvals from Government and/or regulatory agencies that exist in certain sectors, extending the automatic route to more sectors and allowing FDI in new sectors.

The Government should take a series of steps to further liberalize and streamline the procedures and mechanism for approval of both domestic and foreign direct investment.

In fulfillment of its commitment to provide greater transparency in decision making. It announces a set of guidelines for the consideration of foreign direct investment proposals by the Foreign Investment Promotion Board.

1. Investors look to invest in more market accessible place either in developing countries or developed countries irrespective risk n economic factors sub to constrain w.rto sample of India and USA

2. Indian invest abroad to diversify risk and lure high potential technologies

3. The centre has divested some of its own powers of approving foreign investments that it exercised through the Foreign Investment Promotion Board and has handed them over to the general permission route under the RBI.

4. The FDI cap for telecommunications has been increased to 74%, up from prevailing ceiling of 49 percent.

5. It has set up an Investment Commission that will garner investments in the infrastructure sectors among other sectors, and plans to increase the limit for investment in the infrastructure sector.

6. The Government approved sweeping reforms in FDI with a first step towards partially opening retail markets to foreign investors. It will now allow 51% FDI in single brand products in the retail sector. Besides retail, other sectors are being opened.

7. 100% is allowed in new sectors such as power trading, processing and warehousing of coffee and rubber.

8. FDI limit raised to 100% under automatic route in mining of diamonds and precious stones, development of new airports, cash and carry wholesale trading and export trading, laying of natural gas pipelines, petroleum infrastructure, captive mining of coal and lignite.

9. Subject to other regulations, 100 percent FDI is allowed in distillation and brewing of potable alcohol, industrial explosives and hazardous chemicals.

10. Indian investor is allowed to transfer shares in an existing company to foreign investors.

11. The Government is looking at reviewing regulation involving foreign investments into the country. Aimed at simplifying the investment from foreign institutional investors (FII) and FDI in the same light.

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