CHAPTER-1
THE CONCEPTUAL FRAMEWORK

Statement of the Problem

Economic reforms of 1991 changed the entire scenario of Indian economy. The policy of liberalization was viewed as one of the major determinant in India’s economic growth and development. India was seen as an opportunity by the foreign promoters so that they can invest their surplus funds in order to grow themselves a trade giant. Investments can be of two types - Foreign Direct Investment and Portfolio Investment. FDI is one of the interesting topic to be discussed upon, particularly FDI in insurance sector. No doubt, over the last decade, share of foreign promoters has consistently increased but the percentage of FDI is restricted to 49%. Now, basically the problem is that inspite of increase in paid-up capital of foreign partners and enhancement in the gross direct premium constantly, the insurance sector in India could not make much headway. The variations or the fluctuations in the profits of life and non-life insurance sector can be seen significantly. This requires analytical study of the impact of FDI in the Indian Insurance Sector. Thus, basically this research is carried out in order to look at the causes that restrict the FDI to grow and how, if that limit is increased, it would affect the Indian Economy - Life Insurance and General Insurance sector in terms of its paid-up capital, its premium, its profits, number of agents, number of insurers, number of offices, claims paid, etc.

Before and at the time of Independence, the attitude of the Indian Government towards foreign capital was one of panic, qualm and haunch. But for this, the government cannot be raised fingers upon because this was quite natural and was built-in if thought about, of the previous exploitation and the role played by the foreigners in draining away the resources from this country. The suspicion and antagonism found articulation in the Industrial Policy of 1948 which, though acknowledged the part and role of private foreign investment in the country, but also emphasized and stressed that its regulation was essential in the national interest. Because of this perspective and approach expressed in the 1948 resolution, foreign capitalists got irked and as a result, the course of imports of capital goods got blocked and handicapped. Consequently, the prime minister had to affirm the foreign capitalists in 1949 through the following words:
No favoritism between foreign and Indian capital.

Full opportunities to earn profits.

Guarantee of compensation.

Although the Prime Minister asserted that the venture would be owned and effectively controlled by the Indians but at the same time, he also announced that there would be “no definite and incontrovertible rule regarding this business.” Through a bulletin issued on June 2, 1950, the government confirmed the foreign capitalists that the foreign investments can be remitted by them in the country after January 1, 1950. To supplement, they were also given the permission to draw away whatever amount of profits they have earned and accumulated.

Even after the following promises, foreign investors did not come up with the expected and required amount of capital into India during the period of the First 5-year plan. The environment of misbelief and cynicism still prevailed in Indian Economy. However, the policy statement of the Prime Minister which was issued in 1949, was constantly followed without any alterations and in the Industrial Policy Resolution of 1956, it advanced infinite areas and fields for the capitalists of the foreign countries to participate. Along with this, the inclination towards liberalization heightened casually and gradually and the pivotal role played by the foreign investors was recognized more significantly. In most of the cases, the government had to liberalize its policies and statements regarding control and ownership of enterprises and it also provided a number of tax concessions for foreign personnel. Pronunciation of liberalization by the government in the New Industrial Policy on 24th July 1991 opened up the doors of certain large number of industries for foreign capitalists. Before the announcement of this policy, foreigners were given permission to enter in those industries only where deficiency of Indian capital was felt and were not allowed to keep into those areas which were given protection by the government or which were considered to be of strategic importance to the country. As a result, this policy of the government was just to repress and discourage foreign investment in certain areas of essential consumer goods and service industries. However, this provision of the above said policy was periodically breached due to a number of collaborations by the Indian Government with the foreign partners in respect of cosmetics, toothpaste, lipstick etc. In addition to it, it was also confirmed and looked at that the foreign capital should help in the promotion of exports or substitution of imports.
The association between our country and the foreigners was monitored in such a way that it provided an image of a line of good fit into the overall framework of the plans and policies. In the industries where Indian technicians and managers with required skills, talents and experience were not available, foreign investors were allowed to operate and were asked to attach the required significance to the training and development of Indians in the quickest and appropriate manner.

Definitions of FDI

Foreign Direct Investment (FDI) is also called "direct foreign investment (DFI)", "direct investment", or "foreign investment." It may be defined as a process where investors go to other countries to set up all or/and any kind of business enterprise. Some of the oft quoted definitions of FDI are:

1. "Direct Investment refers to investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise." [IMF Balance of Payments Manual, 4th ed, 1977, p.136]

2. "The balance-of-payments accounts define direct investment as that part of capital flows that represents a direct financial flow from a parent company to an overseas firm that it controls." [E.M. Graham and P.R. Krugman, "The Surge in FDI in the 1980s"]

3. "Direct investment is intended to comprise investments involving a certain degree of control (by the investor) over the use of the funds invested, whereas portfolio investment lacks such control." [Rivera-Batiz & Rivera-Batiz, p.220] Broadly agreed to definition of FDI is that of Ohno, which also underscores FDI’s efforts to participate in the management of business enterprise if not to out-rightly control it.

4. FDI is an international financial flow with the intention of controlling or participating in the management of an enterprise in a foreign country. [K Ohno]

FDI is contrasted to "portfolio investment" where the intention or interest of foreign investor is not to own and control an undertaking. The main objective of portfolio investment is just to earn a good financial rate of return as the investments are being done in stocks, bonds, gold, objects de art, etc.
At the time of independence, India's technological base and domestic savings were both weak and stagnant. Therefore, India adopted import substitution and encouraged foreign private capital and technology as element of her strategy for industrial development in order to fill up the technological and production gaps and accelerate the development process.

Foreign investment is seen as a means to supplement domestic investment for achieving a higher level of economic development. It benefits domestic industry as well as the Indian consumers by providing opportunities for technological upgradation, access to global managerial skills and practices, making Indian industry internationally competitive, opening up export market, providing backward and forward linkages and access to international quality goods and services.

Investment in a country by individuals and organizations from other countries is an important aspect of international finance. This flow of international finance may take the form of portfolio investment, that is, acquisition of securities or direct investment creation of productive facilities.

Foreign Direct Investment is the outcomes of the mutual interest of multinational firms and host countries. According to the International Monetary Fund, FDI is defined as "investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of investor.” The investors propose being to have an effective voice in management of the enterprise. The essence of FDI is the transmission to the host country of a package of capital, managerial skills and technical knowledge.

The volume and direction of India’s offshore business exploded after the early 1990s. The buzzword of globalization developed a new approach to international business activities. The process of liberalization and privatization came up as elixirs to the health of globalization. Arthur Dunkels, in 1988, played very positive role in making the economies wall-less and adaptable to foreign investments. The inflow of foreign investments is practically very significant for the economic development and growth of a country in general and a developing state in particular. It was W.T.O. that fuelled the derive of global mechanisms. The new derive posed the challenges and threats before the Indian economy in many ways. The inflows of foreign investments, which started at faster rate after 1990-91 were divided into two categories: (i) Foreign Direct Investment as investments made for the purpose of actively controlling property assets, or companies located in host nations; and (ii) Foreign Portfolio
investments. These investments: create the sources for a receiving nation, link the host-nation with the global markets, faster the economic growth and capital markets and enhance the competitive advantage by value creation etc.

Foreign investment is motivated by private gain but it has many benefits for less developed countries if proper care and cautions are exercised while inviting foreign investment. Foreign investment should be supportive of the progress of the economy, development of the industry and prosperity of the people. It should not be destructive in any form. Foreign investment can fill the gap between desired investment and locally mobilized savings.

Foreign investment can supply a package of needed resources such as management experience, entrepreneurial abilities, organizational and technological skills. Foreign investment brings with it technological knowledge while transferring machinery and equipment to the developing countries. Under developed and developing countries require huge capital investment for the development of basic economic structure as their domestic capital is inadequate. In such a situation foreign investment plays a pivotal role in the development of basic infrastructure such as transport and communication system, generation and distribution of electricity, development of irrigation facilities, etc. Foreign investment can help the host country in improving its export performance. It has a positive impact on the host country's export competitiveness by raising the level of efficiency and the standard of product quality. Foreign investment provides to the host country better access to foreign markets. A number of under developed countries possess huge mineral resources, which avoid exploitation. They have to depend upon foreign capital to undertake the exploitation of their mineral wealth. In case of an adverse balance of payments situation in the host country, investment presents a short-run solution to the problem. Consumers in developing countries stand to gain from foreign investment through new products and improved quality of goods at competitive prices. Profit generation by foreign investment in the host country contributes to corporate tax revenue in the later.

Almost every developed country of the world in the initial stage of development had made use of foreign capital to make up the deficiency of domestic saving. In the seventeenth and eighteenth century, England borrowed from Holland and in the nineteenth and twentieth century England itself gave loans to many countries. USA, the richest country of the world, had borrowed heavily in the
nineteenth century and now in the 20\textsuperscript{th} century, USA has become the biggest lender country of the world. Foreign capital has played an important role in the economic development of India. Foreign capital had started flowing in India since the times of East India Company. However, the policy relating to foreign capital purchased by the British government was favourable for the foreign capitalist but against the interests of India. After independence foreign capital was used as a tool for promoting economic development to make balance of payment favourable.

FDI is made by foreign companies in order to establish wholly owned companies in another country and to manage them or to purchase shares of companies in another country for the purpose of managing such companies. The main characteristic of FDI is that native companies are managed by the foreign companies or new companies are set up in India by foreign companies. In this type of investment, it is the foreign investor who takes risk and is solely responsible for profit or loss of such companies. It also includes foreign collaboration of following types:

(i) Collaboration between Indian and foreign private companies;
(ii) Collaboration between Indian government and foreign private companies; and
(iii) Collaboration between Indian government and foreign government.

Insurance sector of India is a fast emerging sector in Indian capital market. After the promulgation of IRDA, the untapped insurance market of India attracted foreign players since 2000.

**Types of Foreign Direct Investment (FDI)**

There are these three types of FDI in operation:

- Equity acquisition--buying shares of an existing or a new business venture
- Profit re-investment--Re-investment of FDI profits in further expansion of their activities
- Advances and loans from a mother company to a daughter (subsidiary) unit in the host country

According to Chryssochoidis, Millar & Clegg, (1997) there are five different types of foreign direct investment (FDI). Given below is a brief discussion of major types of FDIs.

The first type of FDI can be explained as the one which is generally done to approach specific factors of production owned by a corporation in the host country, e.g. “resources, technical knowledge, material know-how, patent or brand names,
etc.” In case, the foreign company faces the scarcity of these factors of production in their domestic territory, and moreover, if these are immobile, then with no other option, the foreign company would like to contribute locally in order to gain access to these resources.

The second type of FDI is developed by Raymond Vernon in his product cycle hypothesis, adds to the typology given by various scholars discussed above. In this model, the company usually invests in order to get competitive advantage from these factors of production, e.g. low-cost labour. This type of FDI is generally applauded by the government of the host country if an export-oriented development strategy is ensued by it. The government may also bestow upon the foreign company certain relaxations and incentives in the form of subsidies, grants and concessions in taxes. But on the other hand, if the government is adopting an import-substitution policy, foreign corporations may only be allowed to invest in the host country to bring in new technical or managerial know-how, either in a wholly owned subsidiary or in a joint venture with a local partner. Moreover, Licensing is another tool to transmit such know-how.

The third type of FDI is described as one in which international competitors make mutual investments i.e. through cross-shareholdings or through establishment of joint ventures, so as to unbeatably strengthen their product line. Consequently, there increase the chances of competition among similar products and thus, specialization is activated by the R&D departments of the competitors. Thus in such cases, where these corporations fail to gain the competitive advantage, they resort to investing in each other's area of knowledge and contribute to sub-product specialization in production.

The fourth type of FDI is related with gaining access to customers in the host country market. Underlying shifts or even comparative advantage over the host country is almost irrelevant in this type of FDI, particularly when exports from the home base cannot happen for want of required services, or design having become somewhat dated. Growth of FDI in several services is usually ascribed and explained with reference to these factors.

The fifth type of FDIs relates to the regional integration of the trade diversionary aspects. It takes place when in their home country foreign companies have location advantages but due to the existing tariffs or some other trade barriers companies are restricted from exporting to the host country and, consequently access to the local market in the host country stands denied. To overcome this problem, the
foreign competitors cross the hurdles of trade by establishing a business venture within the host economy. This type of FDI in other words happens when the foreign company wants to maintain as much of the value-added capital in the host economy as much in its home economy.

Need for FDI
India need FDI due to following reasons such as:--

- **SUSTAINING HIGH LEVEL OF INVESTMENT**: As India is a developing country, it needs certain amount of saving to invest for its development. This gap between investment and saving is filled by foreign capital.
- **FULFILLING TECHNOLOGICAL GAP**: India has lower level of technology as compare to developed nations which is very necessary for industrial and other development so it need technology transfer which comes with FDI when it assumes the form of private foreign investment.
- **EXPLOITATION OF NATURAL RESOURCES**: India is full with natural resource but it has no required technical skill and expertise to exploit it so India need foreign capital to undertake the exploitation of its mineral wealth.
- **DEVELOPMENT OF ECONOMIC INFRASTRUCTURE**: Domestic capital of developing countries like India is too low to build up its economic infrastructure so it needs some foreign capital to develop its economic infrastructure.

Determinants of FDI in India

1. **Internal Determinants**
   - Huge size of the Indian market.
   - Large size of middle-income class.
   - Ready availability of cheap labour.
   - Availability of skilled & unskilled labour.
   - Diversified Industrial sector.
   - Neutral attitude of public towards foreign investment

2. **External Determinants**
   - Market saturation in home country.
   - Encouragement from home country.
   - Developing countries welcoming attitude towards FDI.
- Use of unused resources.
- Competition from other MNCs.
- GATT Round.
- Restrictions on further expansion in home country.
- High research and development expense in home country.

**Determinants of FDI in INDIA**

(1) **Internal Determinants**

- **Huge size of the Indian market:** The huge size of the Indian market is considered as one of the most important factors attracting FDI in India. In order to draw the benefits of the size of the economy of the host country and to cut down the production costs, all efficient international partners want to produce on a large scale. For the products of U.S.A., Indian Economy is viewed as titanic as it has a lot of untapped resources and thus, among the Asian countries, India is a perfect site to gain a toehold. Mr. Poneet, leader of the French delegation said, “India with its huge domestic market provided an excellent opportunity for French investors.” According to the chief executive of a US firm, “Despite the many challenges, India is a great emerging market. India is really a golden goose.” In comparison to other countries in Asia, India is much attracting and in a very beneficial position. The U.S. food major CPC international USA has recognized India as a major growth market in Asia in the near future.

- **Large size of Middle-Income Class:** The huge size of Indian middle class is also regarded as one of the significant determinants of foreign direct investment in India though the degree of significance assigned to this factor by different countries is statistically non-significant. This factor is of highest importance for U.K. based firms and of lowest for German firms. Large size of the middle-income class implies that there is an increasing demand for the standard products of international companies and this provides an awesome opportunity for the foreign capital.

- **Ready availability of Cheap Labour:** Another factor attracting FDI is the availability of cheap labour which reduces the cost of production that facilitates the prices to remain competitive and affordable, making this factor
the most significant factor having a strong and positive impact on FDI inflow in India. Direct investment from Japan is also perceived as their effort to escape from the domestic industrial stagnation brought about by increasing scarcities of natural resources and labour (Lee, 1980, 1984). Results of developing countries reveal that relatively lesser wage rates i.e. cheap labour cost is a significant determinant in FDI inflows.

- **Diversified Industrial Sector**: The level of significance of the Industrial Sector Diversification is viewed to be the highest by Japanese firms and lowest by many European firms. However, these differences in the degree of importance attached to this factor are statistically non-significant. India occupies the 4th rank in the Industrial Sector Diversification. Indian industry is diversified to a very large extent and the rate of growth is also remarkable and appreciable. This, as a result, opens up the market to a sharp rise in demand for various products. At the time of taking decision to invest abroad, this factor is considered to be of utmost importance by the foreign investors.

- **Availability of Skilled and Unskilled Labour**: This factor is also crucial factor to be considered but again, the degree of importance is varied among different sectors. This is shown to be of greatest importance for products like computers, electronics and electrical goods/industry and lowest for both the fuel and the power sectors. It is recognized as non-significant in textiles and metallurgy and almost neutral in food processing industry. According to John S. Clarkson, Boston Consulting Group President and CEO, there is terrific talent in India that needs to be unleashed, talent that needs to be polished and resources that need to be tapped. The skills and talent available in the people of India, if we talk about software, for example, are world class.

The availability of unskilled labour, on the other hand, is regarded as a less significant determinant of the international direct investment and consequently considered less significant as a determinant of FDI inflow in India in terms of ownership. There is hardly any variation in statistical terms in the importance assigned to this factor by some categories of FDI inflow. Availability of unskilled labour has got the last and the 7th rank as a factor under the features of Indian economy, influencing the flow of FDI in India.
Neutral attitude of the public towards Foreign Investment: The attitude of the public towards foreign investments is found to be neutral by more than 50% firms, approximately one-fourth firms showed it to be friendly and only 3 firms revealed it to be unfriendly. So no conclusions can be drawn about the importance of this factor.

(2) External Determinants

- Market Saturation in Home Country: Market saturation in the home country is considered as the most critical and important factor that affects the flow of FDI in India. 1st rank is accorded to this factor. MNCs are required to invest in other countries or in other words, to undertake FDI so as to overcome the limitations of the size of the market in their home country.

- Encouragement from Home Country: Foreign capitalists’ home government provides certain relaxations, subsidies and incentives in order to encourage them to go for investments in the other countries. For example, Japanese government has used various subsidies to encourage Japanese firms to invest in India.

- Developing Countries Welcoming Attitude towards FDI: Pre-liberalization and particularly, post-liberalization, the liberal attitude of the developing countries played a pivotal role in attracting foreign direct investment. This welcoming attitude resulted in increasing the proportion of FDI and this was seen as a factor playing a remarkable role.

- Use of Unused Resources: The decision to invest in India was taken by the foreign investors keeping in mind particularly, the untapped resources of India. They can optimally utilize these resources effectively just by incurring a low cost.

- Competition from other Multinational Companies: Another important factor influencing the flow of capital in India is the competition among the multinational Companies of the different countries. Many Multinational Companies have achieved success and have become giant corporations by investing in India. This automatically attracts other firms to invest here.

- GATT Round: In 1994, Uruguay round of GATT was an important step towards affecting the flow of FDI in India. It had been a positive step and was in favour of international direct investment. WTO advocated the removal of all
type of restrictions on imports and favoured free flow of goods and capital among member countries. So, this determinant also had been a major factor.

- **Restrictions on further Expansion in Home Country:** Certain restrictions were imposed on the firms of USA and Germany to further expand their market in their domestic territory. These restrictions on further expansion in home country forced them to invest abroad. Particularly, when they increase their profits to a great extent, they were not allowed to diversify further and thus, were forced to undertake investments abroad.

- **Higher Research and Development Expenses in Home Country:** Approximately 73% of the respondent firms stated that if they carry out the research and development activities in their home country, then the computed would be higher. On the other hand, this cost would be less in other countries, if research is carried out there. However, this determinant is fit for certain industries but does not hold good every time. Moreover, the significance attached to this factor varies from sector to sector.

**Deterrents to FDI Inflows in India**

- Foreign investment policy and procedure.
- Infrastructure bottlenecks.
- High Tax rate.
- Pro-labour laws or lack of exit policy.
- High import tariff.
- Political risk.
- Weak intellectual property regime.
- High rate of interest.

- **Foreign Investment Policy and Procedures:** Flaws and drawbacks in the foreign investment policy and procedures of India are the most significant obstacles in the inflow of foreign direct investment. Some of the drawbacks may be counted as the lack of transparency in the policy, bureaucratic delays and widespread corruption. A number of the sample firms when asked, stated that there is a huge time gap between giving proposal and getting the proposal cleared. And just due to this unnecessary delay in the commencement of the project, they experienced number of critical problems. According to NRI businessperson Mr. S.P. Hinduja, when a strange person goes to invest capital
in any foreign country, other than India, he is welcomed there as an investor but in India, even an overseas Indian and particularly, the foreigners are treated as if they are strangers. In the area of Foreign Investment Policy and procedures, widespread corruption in India is the second most dominant blockade to inflow of FDI. According to Peter Eingen, Chairman, Corruption not only falsifies the choice, the size and the timing of projects, but also distorts the choice of contractors and the quality of the work supplied. He also mentioned that the Indian laws are very vague, blurred, ill-defined and not clear. Thus, the interpretation of these laws varies from person to person.

**Infrastructure Bottlenecks:** Lack of developed infrastructure is another chunk in the journey of inflow of foreign direct investment in India. A lot may difficulties can be observed in different fields such as roads and railways, ports, power, telecommunication, water supply and sewerages system. But, the highly significant deterrent of FDI Inflow in India is present in the power sector. Around 92 % of the sample firms stated that railways and roads in India are not in adequate condition. If talk about the telecommunications system, they have reported the scarcity of technological and modern equipment and also mentioned the problem of delay in getting new connections and about inefficient service. India’s inability to implement infrastructure projects, electric power, roads and railways is further worsening the situation. If infrastructural constraints are not dislodged timely, India would not be able to grow as an industrialized country. Thus, to conclude, these infrastructural problems are putting hindrances in the path of progress of India.

**High Tax Rate:** As compared to the other Countries of Asia, Corporate Tax rates in India are quite higher. Thus, the Indian corp. tax structure needs to be altered appropriately in order to make it more definite and transparent and also the difference should be drawn between the nominal tax rates and effective tax rates.

**Pro- Labour Laws:** Another major obstacle or hurdle restricting the inflow of FDI in India is the presence of Pro-labour laws or the exit policy. The foreign countries wishing to contribute in India require the flexibility and dynamism in the labour market conditions.
• **High Import Tariff:** According to Mr. Chulsu Kim, Deputy Director General of WTO, India continued to be one of the most protected markets among the Asian countries. Tariffs still remain considerably higher in comparison to the East Asian counterparts. Quantitative restrictions still apply on 30% of the items imported into India.

• **Political Risk:** Political risk is yet another significant deterrent restricting the flow of foreign capital in India. According to UK investors, there is always the suspicion of govt. backtracking. It may take its step back and may send wrong signals to investors.

• **Weak Intellectual property regime:** For certain areas and sectors, patent protection plays a significant part. So, around 73% foreign investors do not consider the duration of patent protection satisfactory in India and that is why, this factor assumes a role of yet another hurdle in the flow of FDI in India.

• **High Rate of Interest:** Cost of capital is a very significant factor to be considered at the time of making investment in a certain project. In India, rate of interest charged for financing a project is very high as compared to other countries. This high rate of interest is one restriction being put on the inflow of capital into India.

**Policy Framework of FDI**

Although among the entire world, India is the largest democratic country but its political set up and administration has a number of defects, imperfections and limitations such as power shortage, corruption, bureaucratic hassles, political risk and uncertainty, social and economic infrastructural deficiencies and regional conflicts. Even though there are these countable limitations and problems, still India is regarded as an apple of eye and is viewed as an attractive and favourable destination for the foreign capital to be invested by the other Asian countries as well as by the European countries. And that is why, researchers consider this sector of FDI in India a more interesting and debatable topic to be discussed upon and they are interested in examining this area analytically. To a very large extent, policy framework of FDI does influence the trend, direction and the pattern of FDI inflow. Not only the benefits, incentives, schemes, relaxations or the threats are included in the policy framework of FDI but it is also comprised of foreign trade, technical know-how, foreign exchange and general aspects of the industrial policy. There has been a sea
change in India’s approach to foreign investment from the early 1990s when it began structural economic reforms encompassing almost all the sectors of the economy.

**Pre-Liberalisation Period**

Historically, for the formulation of the FDI policy in the light of the import-substitution strategy, India has always adopted a forethoughtful and calculating approach. So, basically the four phases of the FDI policy can be stated under:

i) **Cautious Welcome Policy (1948-1966).**

ii) **Selective and Restrictive Policy (1967-1979).**

iii) **Partial Liberalization Policy (1980-1990).**

iv) **Liberalization and Open Door Policy (since 1991 and onwards).**

**Policy developments during 1948-1966:** On the eve of Independence, foreign investment was permitted only in those areas where the scarcity of domestic capital and technical know-how was observed and that too with a lot of terms and conditions. FDI policy, in general sense, is nothing more than just a part of industrial policy. And therefore, EXIM policy formulated by the government would influence the success or failure of the FDI policy. On the onset of freedom, India needed to adopt a pragmatic and rational approach towards the foreign capital for its economic development. As per the industrial policy statement of April 1949, the following significant confirmations were provided to foreign capitalists:

i) No partiality and injustice would be done between domestic, local and foreign corporations.

ii) Required amenities would be provided to the foreigners so that they can remit their profits and repatriate their capital.

iii) Just, fair and equitable benefits and compensation would be allowed to foreign investors in case nationalization of enterprises takes place.

A new industrial policy resolution was formulated and was passed by the Indian parliament in April 1956 which enlisted a number of industries where in the scope of operation of local and foreign venture capitalists became immaterial. India witnessed catastrophe for the foreign currency in 1957-1958 and this came out to be a turning point when Indian government was forced to adopt a liberal attitude towards the foreign stockholders. As a result, Indian Government declared certain relaxations, incentives and concessions with a view to attract more and more inflows of foreign capital in India. Government of India in 1961, again stepped in with a list of industries
to welcome the foreign investments by eliminating the cleft between the capacity and targets. This first phase of the FDI policy was continued till the mid-sixties where the Government had the lenient attitude.

**Policy developments during 1967-1979:** In 1968, A board was established named as FIPB (Foreign Investment Promotion Board) and this board was specifically designed to handle the cases of FDI but with an exception of those areas in where total investment in share capital far exceeded Rs.20 million and where foreign equity surpassed the proportion of 40 percent. Prior approval of the Cabinet Committee was required in all such cases which did involve share capital worth more than Rs.20 million and also where more than 40% share was held by the foreign ventures.

Keeping the objective of ‘self-reliant’ in view, there observed a dual nature of policy intention – In the fields where high technical know-how was needed and where high priorities were accorded to the building of national capability, FDI was welcomed by the government through collaborations whereas in those areas where the government’s view was to protect and promote the Indian Industries, FDI was discouraged. A new act was formulated in 1973 i.e. Foreign Exchange Regulation Act (FERA) for the consolidation of the regulatory framework, wherein a joint venture, foreign capital was restricted only up to 40 percent. By and By, a number of privileges were elongated to foreign shareholders allowing them to have a share of more than 40 per cent in the holding if they are involved in export-oriented businesses and high technology and high priority areas. Moreover, learning from the experiences of other Asian countries, special economic zones (SEZs) were set up by the government and also rational, lenient and flexible policies were framed and concessions and incentives were provided just for promotion of exports and FDI. But due to the extremely protective attitude of Indian government, these measures did not contribute significantly to the export promotion. Considering the shortcomings again, Indian Government again came up with partial liberalization in the trade and investment policy in 1980s with the goal of increasing the export competitiveness, modernization and marketing of exports through Trans-national Corporations (TNCs).

**Policy developments during 1980-1990:** The declaration of Industrial Policy (1980 and 1982) and Technological Policy (1983) provided for a rational behavior of Indian Government towards foreign capital in the light of the modifications in the directions of the policy. One of the major features of the policy was de-licensing of few of the
industrial rules and regulations and promotion of export of goods manufactured in India as well as stressing upon the diversification and modernization of industries through liberalized imports of capital goods and technology. These measures of trade and investments were supplemented by the reduction of tariff barriers and by transferring a large number of products to Open General Licensing (OGL) from import licensing. In May 1983, concessions extended to the investments being done by the NRIs were subjected to a limit of 5 percent of the value of the total paid-up equity capital of the concerned enterprise.

In 1985-1986, Estate duty which was recognized as a significant obstacle in the path of capital inflow and remittances by the NRIs, was abolished by the Indian Government. In December 1986, the cabinet committee on economic affairs permitted the participation of foreign equity even in existing Indian companies just with a view to encourage the inflow of high technology. Even in the tourism sector, foreign investors were permitted to hold 51% equity capital.

It became easy for the new foreign companies to invest in existing Indian companies if they are possessing high technology and are supporting in the encouragement of exports. Foreign Currency (NR) Account Scheme was introduced with a view to supplement the remittances and also with effect from August 1, 1988 a differential interest rate scheme was introduced.

**Post-Liberalisation Period**

To balance and secure the India’s external sector and to monitor the sinking credit rating of the country, the Indian Government redefined the policy on foreign investment and consequently, the officials and the authorities signed in with the radical and dire alterations in the investment, trade and industrial policies and procedures. India’s deficit balance of payments situation and the preventive measures adopted to resist this difficulty specifically became an important affair to be taken care of. The measures adopted by the Indian Government to rectify the situation were of great concern since the nation borrowed a huge amount of money from IMF which ultimately led the Indian economy towards the debt trap, even the imports were curbed extensively and moreover the nation’s gold was pledged to different central banks of different countries. As a result, Indian government announced a new foreign trade policy with the wide range of liberalization of import controls across the board.
and also reduced import duties substantially and even the Indian rupee was devalued deliberately.

**Policy developments since 1991 and onwards:** Consequent upon economic liberalization and economic reforms 1991, Indian economy witnessed drastic radical changes which were implemented with a aim to heighten its rate of growth potential and in order to integrate the Indian economy with the world economy. On the one hand, Economic reforms substantially and gradually abolished certain restrictions which were placed on the foreign investment proposals and on the other hand, this Industrial policy also permitted business diversification and increased access to outside technology and funding. For liberalizing the foreign investment, a few of the following measures were adopted:

i) For the approval inflow of FDI, dual route was introduced i.e. RBI’s automatic route and Government’s approval (SIA/FIPB) route.

ii) In high priority industries, automatic approval was provided for technology agreements and in low technology areas, restrictions of FDI were removed and the technological imports were liberalized.

iii) In high priorities sectors, Non-resident Indians (NRIs) and Overseas Corporate Bodies (OCBs) were allowed to contribute investment up to 100 percent.

iv) The limits of foreign equity participation were enhanced to the extent of 51 percent for existing companies and the use of foreign brands’ name was liberalized.

v) In order to protect the foreign investments, the Convention of Multilateral Investment Guarantee Agency (MIGA) was signed and entered into.

Foreign Exchange Management Act (FEMA) 1999, which replaced foreign Exchange Regulation Act (FERA), further applauded these attempts made by the government. In addition to that, simultaneous introduction of the financial sector reforms laid down the path of success for greater capital account liberalization in India.

All the investment assignments of FDI that are a part of the automatic route and the matters concerning with FEMA are dealt with by RBI, while the government handles all those investment projects that fall under the approval route and issues that are related to FDI policy through its three institutions, viz., the Foreign Investment
Promotion Board (FIPB), the Secretariat for Industrial Assistance (SIA) and the Foreign Investment Implementation Authority (FIIA).

Inflow of FDI under the automatic route does not require any prior approval either by the Government or the Reserve Bank. Only the corresponding regional office of the RBI is required to be notified within 30 days of receipt of inward remittances and the required documents are also to be filed with that office within 30 days of issuance of shares to foreign stockholders. The foreign assignments that fall under the approval route are considered in a time-bound and transparent manner by the FIPB. And not only this, permission of composite projects involving foreign investment/foreign technical collaboration is also granted on the recommendation of the FIPB.

**Theories of FDI**
The theories of FDI can be categorized into two parts:-

- Macro-economic approaches
- Micro-economic approaches

**Macro-Economic Approaches:** Generally, in the Macro-Economic Approaches or the Neo-Classical Approaches, an undertaking would like to invest capital in the foreign country where it is assuming higher rate of return in spite of investing in the local organization in the home country. This is done due to the benefits that the investing organization is possessing in comparison to the advantages available to the foreign competitors. These benefits may take the form of a number of variables such as superior and updated technology, easy accessibility to markets, managerial expertise, economies of scale particularly integration and so on. Here, it is considered as higher the availability of the benefits is, higher would be the chances of a foreign company being allured due to the enhanced proportion of expected profits and earnings.

Thus, these theories are named as:-

1. Differential Rate of Return Approach
2. Portfolio Diversification Approach
3. Market Size Approach

**Micro-Economic Approaches:** The failure of the Neo-Classical Theories to state and forecast when, where and why foreign investment is being done gave birth to the
development of new theories of FDI at the micro level. These theories are basically concerned with the imperfections in the market structure and market failure. Thus, the assumptions of perfect market conditions are avoided and the potential of a firm to influence the market price level is considered.

Some of the approaches can be outlined as:-
1. Industrial Organization Theory
2. Transaction Cost Theory
3. Eclectic Theory of International Production
4. Product Cycle Theory
5. Oligopolistic Reaction Theory
6. Currency Capitalization Approach
7. IDP Paradigm

**Entry Routes for FDI**

Investments can be made by non-residents in the equity shares/fully, compulsorily and mandatorily convertible debentures/ fully, compulsorily and mandatorily convertible preference shares of an Indian company, through two routes;

- The Automatic Route: Here, the non-resident foreign capitalist or the Indian company does not need any prior approval from the RBI or Government of India for the investments to be made.
- The Government Route: Here, prior approval of the Government of India through Foreign Investment Promotion Board (FIPB) is required. Proposals under Government route for foreign investment are considered by the Foreign Investment Promotion Board (FIPB) in Department of Economic Affairs (DEA), Ministry of Finance from time to time as laid down in the FDI policy.

**Guidelines for Consideration of FDI Proposals by FIPB**

The guidelines that are laid down to enable the FIPB to review the proposals for FDI and to formulate its recommendations are as follows:

- Secretariat should place all the applications before the FIPB within 15 days and must also assure that the views, opinions and comments of the administrative ministries are placed before the Board either prior to/or in the meeting of the Board.
• Keeping in mind the time frame of thirty (30) days proposals should be analytically examined by the Board for communicating Government decision.
• In those situations where either the proposed assignment is not well-defined or further more information is needed so as to obviate time delay, then the more clarification and presentation by the applicant in the meeting of the FIPB can be asked for.
• FIPB should keep in view the requirements of the different sectors as well as their policies vis-à-vis the proposal(s), at the time of consideration of cases and making recommendations.
• Each and every proposed project is required to be deeply analyzed by FIPB in its totality.
• At the time of consideration of the proposals which are submitted to FIPB, the board should consider the following points carefully: (i) whether the industrial license is needed for the production of these certain items or for rendering certain services or not and if required, then the procedure for grant of industrial license must be gone through; (ii) whether any projection of exports is required by the proposal and if in case this is required, then the items of export and the projected destinations; (iii) Whether the proposed assignment has any strategic-related or any defense-related considerations.
• In addition to the above points, the following points must be prioritized at the time of consideration of proposals: (i) Consideration of items that are covered in infrastructure sector; (ii) Consideration of items which have an export potential; (iii) Consideration of items which are capable of providing large scale employment opportunities, especially for the people of rural areas; (iv) Consideration of items which have a direct/indirect or backward linkage with agro business/farm sector; (v) Consideration of items which do have greater significance and relevance in the social areas like hospitals, human resource development, life-saving drugs and equipment; (vi) Consideration of proposals which may lead to in induction of technical know-how or infusion of capital.
• Apart from everything, the following points should be especially checked at the time of scrutinizing and consideration of proposals. (i) The extent or limit of % of foreign equity capital that is proposed to be owned (keeping in view
sectoral caps if any); (ii) The extent of foreign equity capital from the point of view that whether the proposed project would amount to a holding company/wholly owned subsidiary/a company with dominant foreign investment (i.e. 76% or more) joint venture; (iii) Whether a new project would be set up by the proposed foreign equity capital (joint venture or otherwise) or whether it is made just for the extension and enlargement of foreign/NRI equity or whether it is actually invested for fresh introduction of foreign equity/NRI equity in an already existing Indian company; (iv) It must be checked that whether there is a resolution of the Board of Directors supporting the said induction/enlargement of foreign/NRI equity and whether there is a shareholders agreement or not in the cases of enlargement of foreign/NRI equity, and/or in the case of fresh induction offerings/NRI equity in already existing Indian companies; (v) In the situations of introduction of fresh foreign equity capital in the already existing Indian companies and/or in the cases of enlargement of foreign equity in existing Indian companies, the reasons must be checked that why the proposal has been made and how it has been done i.e. the modality for induction/enhancement (i.e. whether by increase of paid up capital/authorized capital, transfer of shares (hostile or otherwise) whether by rights issue; (vi) SEBI/RBI guidelines must be checked for monitoring the Issue/transfer/pricing of shares; (vii) Whether the proposal engages activities that are industrial activities or it involves service activities or it involves a combination of both the activities; (viii) Whether or not the items of activity are given any sort protection and does involve any restriction by way of reservation for the Micro & Small Enterprises sector; (ix) Whether there are any sectoral restrictions being put on certain types of activity; (x) Whether the proposal engages import of those certain items which are viewed as either hazardous/banned or detrimental to environment (e.g. import of plastic scrap or recycled plastics).

- No condition specific to the letter of approval issued to a non-resident investor would be changed or additional condition imposed subsequent to the issue of a letter of approval. This would not prohibit changes in general policies and, regulations applicable to the industrial sector.
Who Can Invest in India

- A non-resident entity (other than a citizen of Pakistan or an entity incorporated in Pakistan) can invest in India, subjected to the FDI Policy.

- A citizen of Bangladesh or an entity incorporated in Bangladesh can invest in India under the FDI Policy, only under the government route.

- NRIs resident in Nepal and Bhutan as well as citizens of Nepal and Bhutan are permitted to invest in the capital of Indian companies on repatriation basis, subject to the condition that the amount of consideration for such investment shall be paid only by way of inward remittance in free foreign exchange through normal banking channels.

- OCBs have been derecognized as a class of Investors in India with effect from September 16, 2003. Erstwhile OCBs which are incorporated outside India and are not under the adverse notice of RBI can make fresh investments under FDI Policy as incorporated non-resident entities, with the prior approval of Government of India if the investment is through Government route; and with the prior approval of RBI if the investment is through Automatic route.

  (i) An FII may invest in the capital of an Indian Company under the Portfolio Investment Scheme which limits the individual holding of an FII to 10% of the capital of the company and the aggregate limit for FII investment to 24% of the capital of the company. This aggregate limit of 24% can be increased to the sectoral cap/statutory ceiling, as applicable, by the Indian Company concerned by passing a resolution by its Board of Directors followed by passing of a special resolution to that effect by its General Body. The aggregate FII investment, in the FDI and Portfolio Investment Scheme, should be within the above caps.

  (ii) The Indian company which has issued shares to FIIs under the FDI Policy for which the payment has been received directly into company’s account should report these figures separately under item no. 5 of Form FC-GPR (Annex-1-A) (Post-issue pattern of shareholding) so that the details could be suitably reconciled for statistical/monitoring purposes.

  (iii) A daily statement in respect of all transactions (except derivative trade) have to be submitted by the custodian bank in floppy / soft copy in the
prescribed format directly to RBI to monitor the overall ceiling/sectoral cap/statutory ceiling.

- No person other than registered FII/NRI as per Schedules II and III of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations of FEMA, 1999, can invest/trade in capital of Indian Companies in the Indian Stock Exchanges directly i.e. through brokers like a Person Resident in India.