CHAPTER 7

SUMMARY OF CHAPTERS,
BASIC FINDINGS, SUGGESTIONS
AND CONCLUSION
7.0 SUMMARY OF CHAPTERS:

Foreign capital supplements domestic savings for financing investment. External assistance and commercial borrowings from international capital market are two debt capital that supplement domestic savings for financing investment. Foreign investment in the form of equity capital is a non-debt capital involving neither interest payment nor any obligation for repayment of the principal. Equity capital comes in two forms – one is portfolio investment and the other is foreign direct investment (FDI). Portfolio investment usually invest in the shares of the companies motivated by short-term profit considerations, but foreign direct investors make their investments in the establishment of production facilities being motivated by the long-term prospects of making profits. Thus the foreign direct investors add to investible resources and capital formation. This form of capital is also a means of transferring organizational and managerial practices, as also marketing facilities world-wide. FDI usually results in managerial
control over the operation of the foreign equity. On the other hand, portfolio investment does not result in a managerial control over the operation of the foreign entity. Under this backdrop we have carried out empirically a research investigation to meet up the following objectives relating to FDI:

(a) To analyse statistically the impact of FDI on the growth of Indian Economy;

(b) To make a comparative study of the role of foreign and domestic firms across different industries in augmenting development process in post-reform India;

(c) To analyse FDI in certain select sectors in recent period;

(d) To study the overall impact of FDI on the foreign exchange reserve of India to address the various problems of foreign exchange management resulting from FDI;

(e) To make a comparative study of growth impact of FDI and EA (External Assistance).

In the Introductory Chapter (Chapter I) we have outlined in detail the problem undertaken for study along with the background of the problem, objectives of the study, sources of data and methodology
of study, interdisciplinary relevance of the problem of study, international and national status of the problem, significance of the study and structure of the thesis. After stating the problem under study we have reviewed some well known research works done on foreign direct investment. We have stated that none of the research works done on foreign direct investment that we have come across exactly resembles the research investigation undertaken by us and as such it is expected that our research investigation will add something new to the existing works on foreign direct investment.

In the Chapter II (FDI inflow as a supplement to Domestic Capital base), we have looked into the theoretical aspects of the FDI developed by John Dunning at the University of Reading (UK) and Rutgers University (USA) which is also the internationally accepted standards by most of the countries. Further, we have examined the different classifications of FDI in India. The prime classifications of FDI are (a) By Direction, (b) By Target, (c) By Motive. Under the first category we defined Inward and Outward FDI. Again in the second category we discussed Greenfield Investment, Brownfield Investment, Mergers and Acquisitions. In the final category we discussed the different motives behind the investment from the perspective of the
investing firm. Subsequently, we briefed up the history of FDI in India for both Pre-Reform and Post-Reform (1991 onwards) period. We have also examined the FDI Confidence Index prepared for 15 countries for different years. The FDI Confidence Index is based on the regular survey of global executives conducted by A. T. Kearney. The index depicts the present and future prospects for international investment flows. In this chapter we reviewed the different policy preference for FDI in India, the permitted and prohibited sectors of FDI, Approval Routes, procedure of entry of a foreign company in India, other modes of FDI, Investment by non resident Indians and overseas corporate bodies, procedure for receiving FDI in an Indian company, causes and reasons for low FDI in India. We have pointed out the probable measures may be taken for attracting more FDI in India. The chapter strongly suggests adoption of such measures to make India as an investment destination all over the globe.

Chapter III (FDI inflow in select sectors: A periodical insight) is devoted to the study of different types and forms in which the FDI is taking place in India. The periodic trend of inflow of FDI during the period 2001-02 to 2008-09 has been analysed elaborately. We examined FDI inflow in micro, small and medium (MSM) enterprises
in recent years. Further, industry wise FDI approvals and investment coming into the different industrial activities in the country are reviewed briefly. We also pointed out country wise flow of FDI for different corporate entities. The extent of FDI inflow in telecom and service sectors over different time periods has been discussed. We proposed to examine the mandate of some select Press Notes related from time to time.

In the Chapter IV (Impact of FDI on the growth of Indian economy – An empirical evidence) we have examined empirically the impact of FDI on the growth of Indian economy with the help of simple regression model. A comparative analysis of growth impact of FDI and External Assistance has also been studied with the help of multiple regression models. The regression models are constructed on the basis of chronological data of GDP, FDI and External Assistance for the period 1991-92 to 2009-10. In the simple regression model FDI is considered as independent variable and GDP as dependent variable. From the estimated model we obtained that FDI has positive impact on the growth of GDP and this impact is found significant. Moreover, the value of Co-efficient of Determination suggests that 37 percent variation in GDP is due to FDI and the remaining 63 percent is due to
other factors. Again, in the multiple regression model FDI and External Assistance are considered as independent and GDP as dependent variable. From the estimated model it is found that both FDI and External Assistance have positive impact on the growth of GDP and the impact in case of both FDI and External Assistance is significant. Both these together explain 68 percent of the total variation in GDP. Further, the growth impact of FDI is found to be slightly higher than that of External Assistance.

Chapter V (FDI and Economic Development: A firm level analysis of manufacturing sector in Post-Reform India) is devoted to study the role of foreign and domestic firms in augmenting economic development in post reform India. We have reviewed the empirical works relating to the comparative performance of foreign and domestic firms on the manufacturing sector. The research work done by Larry Willmore (1976), Byung Soo Chung and Chung H. Lee (1980), Larry N. Willmore (1986), Rhys Jenkins (1990) and Kumar N. (1990) have been reviewed briefly. The comparative study looks at both domestic and foreign firms across different industries. The predominance of foreign firms in Indian manufacturing sector is found across the following industries: Chemical, Electrical machinery, Non-Electrical
machinery and Electronics. The data set and methodology of the
comparative study have been mentioned. Moreover, the firms which do
not have data for at least three years are excluded from the study. The
comparative performance of domestic and foreign firms is analysed on
the basis of seven parameters namely export orientation, import
dependency, capital intensity, profit intensity, vertical integration,
product differentiation and effective tax rate. All the parameters are
also defined as well. The data on the variables like gross sales
(including excise duty), gross profit (net profit plus interest payment
plus depreciation), tax (corporate tax), gross fixed assets, total wage
bill, advertisement and value added (salary bills plus operating profits)
have been collected from CMIE (2001) on its publication entitled
"Statistical profiles of 500 Corporate Giants". Basically the study
relates to the period 1996 to 2000. The data collected for exports,
imports, value added, profits, advertisement, gross fixed assets; total
wage bills and corporate tax are first averaged for five years (1996-
2000) to avoid year to year fluctuation.

After carefully matching data of both domestic and foreign firms
we retain with 108 firms in Chemical, 36 firms in Electrical, 16 firms
in non-Electrical and 20 firms in Electronics. Altogether we take 180 firms of which 102 are domestic firms and 78 are foreign firms.

Of the 108 firms in Chemical, 62 are domestic firms and 46 are foreign firms. Of the 36 firms in Electrical, 21 are domestic firms and 15 are foreign firms. Of the 16 Non-Electrical firms, 9 are domestic firms and 7 are foreign firms and out of 20 firms in Electronic, 10 are domestic firms and 10 are foreign firms.

A comparative analysis is done between domestic and foreign firms by using the non-parametric test Wilcoxon Matched Pair Signed Rank test. The test is used for testing the statistical significance of the difference between foreign firms and domestic firms with respect to the seven variables (which are considered as development indicators) across the ten industries. The advantage of taking this test is that it does not assume normality of the population distribution. The test is rather a powerful one as it utilizes information on both direction and magnitude of the differences within the pairs. Further, performance of foreign and domestic firms in terms of the seven development indicators have been outlined with the help of tables prepared for ratios of the seven variables.
In chapter VI (Foreign inflow of capital and foreign exchange management) we devoted to study inflow of foreign capital in different periods in terms of dollar. We examined the sources of such inflow and its eventual impact on our domestic economy. Moreover, we explained the Government stand in changing policies to attract more capital to the country. The mechanism of put option and call option are elaborated with their relative features. We reviewed the implication of change in FDI rules consulting with the FDI guidelines that embodied in press note 4 of 2009. During the course of our research work we observed that currency management is not confined within the factors of domestic economy alone. There are some reasons attributed to externalities which have a direct bearing on domestic currency management. Some of the reasons are described briefly and inferences are also drawn.

7.1 MAJOR FINDINGS OF THE STUDY:

The major findings of the study are as under:

- It is found that a worth of huge amount have been struck in India till 2008 in the form of mergers and acquisitions
Among the top 10 M&A deals in India till March, 2009, Tata Steel’s mega takeover of European steel company Corus Group PLC for $14.85 billion is considered as biggest ever for an Indian company. This is the first great deal which marked the arrival of India Inc. on the global stage.

- As per FDI Confidence Index, it is observed that China remains the top-ranked destination by foreign investors, a title it has held since 2002. The United States (US) retakes second place from India, which had surpassed it in 2005. Along with China and US, India, Brazil and Germany complete the top five favoured investment destinations in 2010 FDI Confidence Index.

- It is seen from the analysis that large amount of FDI flows is confined to the developed economies. But there is a marked increase in the FDI inflows to developing economies from 1997-98 onwards. Developed economies rose in the FDI Confidence Index as investors looked for safety.

- India received a large amount of FDI from Mauritius (nearly 40 per cent of the total FDI inflows) apart from USA
(8.8 per cent), Singapore (7.2 per cent), U.K (6.1 per cent), Netherland (4.4 per cent) and Japan (3.4 per cent).

- It is found that India has increased its list of sources of FDI since 1991. There were 120 countries investing in India in 2008 as compared to 15 countries in 1991. Mauritius, South Korea, Malaysia, Cayman Islands and many more countries predominantly appears on the list of major investors in India after 1991. This broaden list of sources of FDI inflows shows that India is successful in restoring the confidence of foreign investors through its economic reforms process.

- It is also found that although the list of sources of FDI inflows has reached to 120 countries but the lion's share (66 per cent) of FDI flow is vested with just five countries viz. Mauritius, USA, UK, Netherlands and Singapore.

- Mauritius and United states are the two major countries holding the first and the second position in the investor's list of FDI in India. While comparing the investment made by both the countries, one interesting fact comes up which shows that there is a huge difference in the volume of FDI received from
Mauritius and the U.S. It is found that FDI inflows from Mauritius are more than double from that of the U.S. -

- FDI flow in India increases owing to return liquidity and strengthening of resources in the global financial markets. Sizable amount of FDI flowed into health and power sectors during 2009 which is an encouraging indication towards the sector put in our national priority list.

- Mauritius based companies made a significant contribution towards FDI inflows largely because of tax shield made available to them under the Indo-Mauritius double taxation avoidance agreement.

- Considering the vast potential user of telecom facilities in India, several global telecom service providers have widely invested in telecom sector. FDI in telecom sector got a big jump since 1998-99 and hiked to maximum in 2007-08.

- It has been noticed that the Service Sector has attracted the highest amount of FDI inflow. India attracted 2.48 billion dollar FDI in the service sector in the first five months of the fiscal 2009-2010, the highest among all sectors. The service
sector, including financial and non-financial segments, attracted 22 per cent of the total FDI inflows during April-August, 2009. The Service sector is followed by housing and real estate and telecommunications, attracting 1.79 billion dollar and 1.73 billion dollar respectively, during April-August 2009-2010.

• From the simple regression econometric model established for depicting the relationship between GDP and FDI we find that FDI has a positive impact on the growth of GDP and this impact is significant. The value of Co-efficient of determination reveals that 37 per cent variations in GDP are due to FDI and the remaining 63 per cent is due to other factors.

• From the estimated multiple regression econometric model designed to represent the relationship between GDP and FDI and External Assistance, it is obtained that both FDI and External Assistance have positive impact on the growth of GDP and the impact in case of both FDI and External Assistance is significant. Both these together explain 68 per cent of the total variation in GDP. Further, from the estimated regression coefficient we find that the growth impact of FDI is slightly higher than that of external assistance.
During the course of our research enquiry we have observed that currency management is not confined within the factors of domestic economy alone. There are number of reasons attributed to externalities which have a direct bearing on domestic currency management.

The study made on the performance of domestic and foreign firms in India in the manufacturing sector reveals the following:

- In firm level analysis we seen that foreign firms are relatively better export performer in comparison to domestic firms.
- Foreign firms are found to be less import dependent than domestic firms. Thus foreign firms save precious foreign currency for the country.
- In favour of the common belief we find that foreign firms are more capital intensive. Thus the employment generation capacity of foreign firms is less in comparison to domestic firms.
In respect of profit intensity, our analysis reveals that the profit intensity of foreign firms is significantly higher than that of the domestic firms.

So far as vertical integration is concerned we find that there is no significant difference between the two sets of firms.

In respect of product differentiation also we find that there is no significant difference between the two sets of firms.

The effective tax rate as defined by the ratio of tax provisions to gross profitability is found to be higher in respect of foreign firms in comparison to domestic firms. This contradicts the view that foreign firms are tax evaders and contribute less to the national exchequer.

During the course of our research enquiry we have also observed that the foreign direct investment brings in foreign capital and technology in investment in productive activities in plant and machineries and other manufacturing sectors. This inflow supplements our domestic capital requirement.
7.2 SUGGESTIONS:

It is found that FDI as a strategic component of investment is needed by India for its sustained economic growth and development. FDI is necessary for creation of jobs, expansion of existing manufacturing industries and development of the new one. Indeed, it is also needed in the healthcare, education, R&D, infrastructure, retailing and in long term financial projects. On the basis of our study we recommend the following suggestions:

- The study urges the policy makers to focus more on attracting diverse types of FDI.

- The policy makers should design policies where foreign investment can be utilised as means of enhancing domestic production, savings, and exports; as medium of technological learning and technology diffusion and also in providing access to the external market.

- It is suggested that the government should push for the speedy improvement of infrastructure sector's requirements which are important for diversification of business activities.
• Government should ensure the equitable distribution of FDI inflows among states. The central government must give more freedom to states, so that they can attract FDI inflows at their own level. The government should also provide additional incentives to foreign investors to invest in states where the level of FDI inflows is quite low.

• Government should open doors to foreign companies in the export- oriented services which could increase the demand of unskilled workers and low skilled services and also increases the wage level in these services.

• Government must target at attracting specific types of FDI that are able to generate spillovers effects in the overall economy. This could be achieved by investing in human capital, R&D activities, environmental issues, dynamic products, productive capacity, infrastructure and sectors with high income elasticity of demand.

• The government must promote policies which allow development process starts from within (i.e. through productive capacity and by absorptive capacity).
- It is suggested that the government endeavour should be on the type and volume of FDI that will significantly boost domestic competitiveness, enhance skills, technological learning and invariably leading to both social and economic gains.

- It is also suggested that the government must promote sustainable development through FDI by further strengthening of education, health and R&D system, political involvement of people and by ensuring personal security of the citizens.

- FDI should be guided so as to establish deeper linkages with the economy, which would stabilize the economy (e.g. improves the financial position, facilitates exports, stabilize the exchange rates, supplement domestic savings and foreign reserves, stimulates R&D activities and decrease interest rates and inflation etc.) and providing to investors a sound and reliable macroeconomic environment.

- Finally, it is suggested that the policy makers should ensure optimum utilization of funds and timely implementation of projects. It is also observed that the realisation of approved FDI into actual disbursement is quite low. It is also suggested that the
government while pursuing prudent policies must also exercise strict control over inefficient bureaucracy, red-tapism, and the rampant corruption, so that investor's confidence can be maintained for attracting more FDI inflows to India. Last but not least, the study suggests that the government ensures FDI quality rather than its magnitude.

Indeed, India needs a business environment which is conducive to the needs of business. Foreign investors do not look for fiscal concessions or special incentives but they are more of a mind in having access to a consolidated document that simplifies official procedures, rules and regulations, clearance, and opportunities in India. In fact, this can be achieved only if India implements its second generation reforms in totality and in the right direction. There is no doubt that the third generation economic reforms would make India not only favourable FDI destination in the world but also set an example to the rest of the world by achieving what is predicted by Goldman Sachs (in 2003, 2007) that from 2007 to 2020, India's GDP per capita in US$ terms will quadruple and the Indian economy will overtake France and Italy by 2020, Germany, UK and Russia by 2025, Japan by 2035 and US by 2043.
7.3 CONCLUSION:

Finally, it may be concluded that developing countries has made their presence felt in the economics of developed nations by receiving a descent amount of FDI in the last three decades. Although India is not the most preferred destination of global FDI, there has been a generous flow of FDI in India since 1991. It has become the 2nd fastest growing economy of the world. India has substantially increased its list of source countries in the post – liberalisation era. India has signed a number of bilateral and multilateral trade agreements with developed and developing nations. India as the founding member of GATT, WTO, a signatory member of SAFTA and a member of MIGA is making its presence felt in the economic landscape of globalised economies. The economic reform process started in 1991 helps in creating a conducive and healthy atmosphere for foreign investors and thus, resulting in substantial amount of FDI inflows in the country.

No doubt, FDI plays a crucial role in enhancing the economic growth and development of the country. Moreover, FDI as a strategic component of investment is needed by India for achieving the objectives of its second generation of economic reforms and maintaining this pace of growth and development of the economy.
On the whole, it can be concluded that the FDI inflows have the potential to give a boost to the Indian economy, but the flow of FDI should be high enough for a large economy like India. However, as of now, given the size and potential of the economy, the flow of FDI into India is very minimal. India's poor performance in terms of competitiveness, quality of infrastructure, skills and productivity of labour makes India a far less attractive ground for direct investment than the potential she has. Given that India has a huge domestic market which is fast growing, there is every reason to believe that with continued reforms resulting in improvement of institutions and economic policies would create an environment conducive for private investment and economic growth so that substantially large volumes of FDI will flow to India. It requires a judicious and sustained decision on the part of the policy makers to lure more foreign firms into India, which may bring positive effects on the Indian economy in the future.

7.4 SCOPE FOR FUTURE RESEARCH IN THE AREA

1. Foreign Direct Investment may be treated as one of the instruments of filling up the gap between savings and
investment in India. The growth impact of this savings and investment gap filling instrument on various sectors of Indian economy may be studied with the help of input-output analysis based on the latest Input-Output Table for India.

2. Our analysis relating to comparison between domestic and foreign firms in the manufacturing sector in respect of certain select parameters is a static one. A dynamic analysis may be made by making a comparison of domestic and foreign firms at more than one point of time in various sectors.