

Flow of Foreign Investment into India : Myths and Realities

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ABSTRACT

Since the implementation of 'New Economic Policy' 1991 the flow of foreign investment continues to be the most discussed topic. Foreign Direct investment (FDI) and Foreign Portfolio Investment (FPI) have been the most important sources. It is observed that the flow of FDI during 1991-97 has been \$ 7.0 billion. Although the SIA/FIPB have approved 5742 FDI Proposals of Rs. 956.9 billion during 1991-96, the actual flow is only 22 percent, i.e. Rs. 210.0 billion. Similarly, in FPI category, FII is the largest constituent and till March '97 \$ 7.5 billion has come to India through this route. These investors usually take interest in the secondary capital market and very volatile in nature. Portfolio investments through Euro-issues like GDRS contribute more than one-fifth of the total flow during the last six years. However, as the other constituted of FPI, the flow through off-shore funds has not been impressive. It is marked that during the last six years (1991-97) India has attracted a sizable foreign investment but it is considered much less than the desired. Important questions like flow of much of the current foreign exchange reserve (\$ 20 billion) has been on account of the growth of exports? How much it has been on account of inflow of hot funds in quest of short-term gains? etc. have been raised. It is thus important that India should emphasise more on real export growth and vigorously sell the "Product India" in the world of FDI market. It is also necessary to speed up the official procedure and to bring transparency in their operations. To attract more FPI it is also important to reduce settlement period, introduce good depository system and efficient custodial services in the stock market.

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Since the beginning of planning process in India, the importance of self-reliance has never been sidelined. And that to the socialist justice has been given priority over the capitalist objectives. Although the trend is reflected in different industrial policies and economic programmes, the New Economic Policy, 1991 is to a great extent unique in its character and contents. It seems that planners could not restrain themselves but to open the economy through the process of liberalisation and globalisation. The policy measures brought massive restructuring in every sector of economy. This metamorphosis thus demanded a large amount of capital investment which is scarce in a developing country like India. Thus it is realised that the control and regulations on capital flow from foreign countries is to be monitored in such a manner that the dual objective of social equality and growth will be maintained.

The flow of foreign capital into India is not a new phenomenon. But the earlier flows were very much limited in its scope and that to mainly through import of foreign technology in form of investments in plant and machinery. The present scenario of foreign capital flow consists of varied constituents. The official source usually comprises the grants and loans on concessional and non-concessional term from bilateral and multi-lateral agencies. While the private source consists of foreign direct investments (FDI) coming through Reserve Bank of India (RBI) / Secretariat of Industrial Approvals (SIA) / Foreign Investment Promotion Board (FIPB) / Non-resident Indians (NRI) route; foreign portfolio investments (FPI) coming through Foreign Institutional Investments (FIIs), Euro-issues, Offshore funds and others; loans from foreign financial institutions and usual trade credits. Among all these sources FDI & FPI are prominent. In this article attempt has been made to highlight the myths and realities associated with these two important sources along with their pattern of flow.

THE FLOW PATTERN

(A) FOREIGN DIRECT INVESTMENT (FDI)

Flow of FDI to developing economies from developed markets is an age old phenomenon. The flow of surplus fund to traditional investment centres of developed countries become sluggish due to slow down in their economies on the one hand, and the better yields in developing countries on the other. This inspired many foreign countries to bring their money to different emerging markets including India. The 95 crore population with more than 15 crore potential consumers, the vast technical expertise in its work force, the well diversified industrial base, the wide network of financial institutions and many others put India among one of the top ten emerging economics of the world. Table - 1 depicts the total foreign capital flows into India through FDI and FPI. The FDI which was only \$ 0.15 billion in 1991-92 financial year has increased to \$ 2.6 billion during 1996-97. But in comparison to total FDI flow to developing countries as presented in Table-2, this meagre \$ 2.6 billion flow is less than 5 percent. This indicates the lacuna in our

system and in its development process which has failed to attract higher FDI despite 5 years of economic liberalisation.

Among the FDI category the SIA/FIPB route is working well to approve large number of proposals from various countries. During the last 5 years they have approved 5742 FDI proposals with a total worth of Rs. 956.86 billion (Table-3). On the contrary, the actual inflow is very slow that it has even not reached 25 percent of the total approvals, where the worldwide figure is more than 50 percent. This may be attributed to the political instability in India associated with delay in decision making process and poor credit rating by international agencies. Another observation of International Finance Corporation (IFC) can be cited here that the policy of privatisation adopted by the Govt. of India (GOI) during the period of 1985-94 yielded \$ 4.4 billion revenue through 57 privatisation cases but FDI due to these was nil. Hopefully the successive opening up different industries for foreign equity participation through automatic approvals ranging from 51 percent to 74 percent may yield some result in future.

Another constituent of FDI is investment through NRI route. This investment has increased manifold during this liberalisation period, from \$ 63 million in 1991-92 to \$ 435 million in 1995-96. The change in Foreign Exchange Regulation Act (FERA) governing NRI investment and proliferation of new NRI schemes by RBI/GOI has yielded impressive result. The recommendation of Sodhani Committee which has done away with many complicated operational procedures in this area also attracted NRI investment in recent years.

The country-wise flow of FDI into India in term of approvals given during 1991 to Nov. 1996 (Table-4) indicates out of total FDI approvals of Rs. 925.6 crore. USA constitutes 26 percent followed by UK, Mauritius, Japan and others. It is interesting to note here that despite of 6 years of economic restructuring the developed countries have not shown adequate interest in India as their investment destination.

(B) FOREIGN PORTFOLIO INVESTMENT (FPI)

In this category of capital flow, FII constitutes the important segment. It came into existence with the 1992-93 Budget Speech of Dr. Monmohan Singh and the Finance Ministry issued a set of guidelines in September 1992 FIIs are portfolio managers like pension funds, mutual funds etc. investing their fund in Indian capital market. Although they are allowed to operate in both primary and secondary market, their interest till date remain in the later due to high return in Indian stock market. At present more than 250 FIIs have been registered with SEBI with more than 300 funds. The net investments by FIIs till March 1997 is around \$7.5 billion which constitute near about 1/3rd of total investment funds. Table-1 portrays that the share of FIIs has increased rapidly during the last 6 years. Among the FPI, FII constitute 80 percent and rest is contributed by Euro-issues and Offshore funds. The level of response from FIIs clearly indicates their confidence in India's future growth prospects. But it is a well known fact that these funds are

opportunistic in nature and any reshuffle in political scenario with changes in economic policies would prompt them to withdraw from Indian capital market. So these are volatile in nature and their activities now-a-days determine the moods of the market. The recent announcement by our Finance Minister in his Budget Speech, to increase the investment limit of FIIs in a single company to 30 percent would have a salutary effect in the FII flow but the gradual decline of interest rates in Indian financial market may force them to rethink over their strategies.

Euro-issues are also another significant part of portfolio investment. Global Deposit Receipt and Euro-Convertible Bonds are the two routes through which money usually come to India. These routes were opened in 1992-93 year and recorded high growth during the first three years. In 1996-97 year it constitute nearly 23 percent of total foreign investment flow (Table-1). So far Indian companies have landed more than 50 GDR issues worth of more than \$ 3.5 billion during the last five years. The abolition of Controller of Capital Issue and liberalisation of FERA rules opened the door for such issues to get high premium for their share in European market. Secondly, the settlement and trading problem faced by international fund managers through investment in rupee nominated share also props the markets for GDRs. But every company in India can not go for such issues and the choice is limited among the international investors. So the current healthy appetite for GDRs in European market may not last long

As the third category in FPI, the track record of foreign investment mobilisation by offshore funds is not encouraging. This route was first tapped by UTI in 1986 in the collaboration with Merrill Lynch International and since then more than 20 foreign offshore funds are operating in the country. However, the response of these funds is not adequate in comparison to the size and potential of Indian market. So far, it contributed only 5 percent of total foreign investment flows (Table - 1) amounting nearly \$ 1.0 billion. This relatively poor raisings through these funds is largely on account of insufficient trade settlements in the market and poor registration system for securities.

SOME CRITICAL ISSUES

India in recent years has been enjoying a comfortable foreign exchange reserve of around \$ 20 billion. But how much of it has been on account of the growth of exports ? How much of it has been on account of inflow of hot funds in quest of short term gains ? These questions are still unanswered. There are nagging doubts about the persistence of adverse balance of trade even in the midst of comfortable foreign exchange reserve. Thus, it is foolish to relax when our export earnings are always less than import payments and when in recent years the trade gap is widening more and more. Apart from it, the FDI flow into India in real term is still unimpressive in comparison to other growing economies of Asia-Pacific region. Again, much of the FDI has come into non-essential consumer products. Contrary to expectations there is not very much FDI in heavy investment or technological difficult areas.

The Foreign Institutional Investors have accounted for about \$ 7.5 billion, but they are essentially interested in short-term capital gains. Any surge in US interest rates or dislocation in the settlement period of the Indian stock exchange would shift their interest and in any moment they can flee. Thus it will not be judicious to prepare any long term strategy on the basis of hot money alone. No doubt FIIs have flattened the foreign exchange kitty, but it is important that the RBI, GOI and SEBI has to exercise strategic vigilance on the impact to their operations. Again the growing FII's stake in unlisted companies not coming under SEBI regulations would create problem for SEBI once they go in for listing.

CONCLUSION

The ongoing liberalisation programme has been responded well by international investing class which is evident from the growing FDI and FPI. But it is essential that we must think in real term export growth and a narrow trade gap. The government both at the Central and at the State level should aggressively sell the "product India" in the world of FDI market. For this transparency in procedures and promptness on the part of officials shall play a crucial role. In addition to the basic ingredients India possess, to attract FDI, the political stability would be important. On the other hand, a good depository system, shorter settlement period, efficient custodial services and transparent stock market trading would also attract more FIIs and offshore funds. So to compete with other emerging economies for attracting foreign investment the path should be cleared from each and every hurdle which will instill confidence among investing community about the irreversibility of reform programme in India.

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