A Study of Impact of FDI and Investment by FII on Economic Growth of India

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Abstract

The role of investment in promoting economic growth has received considerable attention in India since independence. India opened up to investments from abroad gradually over the past two decades, especially since the landmark economic liberalization of 1991. Apart from helping in creating additional economic activity and generating employment, foreign investment also facilitates flow of technology into the country and helps the industry to become more competitive. FDI and FII are equally connected to investment in a foreign country. FDI or Foreign Direct Investment is an investment that a parent company builds in a foreign nation. On the different, FII or Foreign Institutional Investor is an investment prepared by an investor in the markets of a foreign country. The objective of this research paper is to study the impact of FDI and investment by FII on economic growth of India and also give the recommendations for improving FDI inflows and investment by FII in India.

Keywords: *Foreign Direct Investment Inflows in India, investment by Foreign Institutional Investors Inflows in India, Correlation, Regression.*

Introduction

In today's wealth driven world, capital is the powerhouse of economic growth of a country. Countries, especially developing ones, strive to generate capital through various sources, that is, by exporting their output (raw material) to industrialized countries, receiving foreign aid, raising loans from foreign banks, etc. But in a reversal of trend in recent years, the tendency to generate capital by means of routes as mentioned above are steadily declining and Foreign Direct Investment (FDI) has gained importance as a preferred source.

FDI has proven to be an 'engine of growth' of a country in the modern era. In today's liberalized and globalized world economy, a growing number of countries have received significant capital flows, mainly in form of FDI. Foreign Direct Investment can be defined basically as an investment of foreign assets into domestic structure, equipment and organization. In exchange for this ownership, the investing company usually transfers some of its financial, technical, managerial, trademark and other relevant resources to the recipient country.

A Foreign Direct Investment (FDI) is an investment made by a company or entity based in one country, into a company or entity based in another country. FDI is distinguished from portfolio foreign investment, a passive investment in the securities of another country such as public stocks and bonds by the element of control. Entities making direct investments typically have a significant degree of influence and control over the company into which the investment is made.

Open economies with skilled workforces and good growth prospects tend to attract larger amounts of foreign direct investment than closed, highly regulated economies.

Objectives of the Study

- To study the impact of FDI and investment by FII on economic growth of India.
- To give the recommendations for improving FDI inflows and investment FII by in India.

Research Hypotheses

The study has been taken up for the period 1991-2015 with the following hypotheses:

- **H_{01}:** The association between total FDI and investment by FII in India is insignificant.
- **H_{11}:** The association between total FDI and investment by FII in India is significant.
- **H_{02}:** Regression coefficient of investment by FII in India on total FDI is insignificant.
- **H_{12}:** Regression coefficient of investment by FII in India on total FDI is significant.

Data base and Research Methodology

The study is descriptive and analytical in nature. Various statistical and mathematical techniques such as Correlation, Regression, Trend analysis, simple growth rate, compound growth rate have been used in the research paper to provide analytical results of the data. The study is secondary based.

Analysis and Interpretation

Foreign Direct Investment (FDI)

A Foreign Direct Investment (FDI) is an investment in a business by an investor from another country for which the foreign investor has control over the company purchased. FDIs are commonly made in open economies, as opposed to tightly regulated economies, that offer a skilled workforce. It frequently involves more than just a capital investment and it may include provision of management or technology as well.

Investment by Foreign Institutional Investors (FII)

An investment by foreign institutional investors is an investment fund by an investor registered in a country outside of the one in which it is investing. Institutional investors most notably include hedge funds, insurance companies, pension funds and mutual funds. The term is used most commonly in India and refers to outside companies investing in the financial markets of India. Market regulator SEBI has over 1450 foreign institutional investors registered with it.

Foreign Direct Investment in India

Economies like India, looks at FDI as a source of filling the savings, foreign exchange reserves, revenue, trade deficit, management and technological gaps. FDI is considered as an instrument of international economic integration as it brings a package of assets including capital, technological, capacity and access to foreign markets. As a result, FDI has a wide range of impact on the country's economic policy.

India, today, is a vibrant economy and is recognized as a leader among the emergent countries with a huge potential for growth. FDI in India is the main source for the economic development in India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions, etc. For a country where foreign investments are being made, it also means achieving technical know-how and generating employment. India has been ranked among the top 10 attractive destinations for inbound investments. Since 1991, the regulatory environment in terms of foreign investment has been consistently eased to make it investor-friendly.

Investment by Foreign Institutional Investors in India

Economies like India, which offer relatively higher growth than the developed economies, have gained favour among investors as attractive investment destinations for foreign institutional investors. All Investments by Foreign Institutional Investors are allowed to invest in India's primary and secondary capital markets only through the country's portfolio investment scheme (PIS). This scheme allows FIIs to purchase shares and debentures of Indian companies on the normal public exchanges in India.

Countries with the highest volume of investments by foreign institutional investors are those that have developing economies. These types of economies provide investors with higher growth potential than in mature economies. This is why these investors are most commonly found in India, all of which must register with the securities and exchange board of India to participate in the market. Ever since FIIs allowed investing in Indian financial markets since September 1992, there have been extensive deliberations on the impact of such flows. It has said that portfolio flows from FIIs inject global liquidity into the capital markets, raise the price-to-earnings ratios, thereby reducing the cost of capital. This, in turn, leads to further issues of equity capital and stimulates investment growth in the host economy, apart from bringing in best international corporate governance practices.

Impact of FDI on Indian Economy

FDI creates the employment opportunity for domestic country and it is also impacts the modern technology. FDI provides the goods and services at best suitable price. Through FDI government earns in the form of licenses fees, registration fees, taxes which is spend for public expenditure and backward area can be developed. FDI is also creating good capital market in India and creates the competition among the domestic company and MNC in this way domestic company can increase their efficiency. FDI aids to maintain a proper balance amongst the factors of production by the supply of scarce resources thereby accelerating economic growth.

Impact of FII on Indian Economy

FIIs promote financial innovation and development of hedging instruments. FIIs not only enhance competition in financial markets, but also improve the alignment of asset prices to fundamentals. By increasing the availability of riskier long term capital for projects, and increasing firm's incentives to supply more information about them, the FIIs can help in the process of economic development. FIIs can help in supplementing the domestic savings for the purpose of development projects like building economic and social infrastructure and also help in growth of rate of investment; it boosts the production, employment and income of the host country.

Analysis and Interpretation of FDI and FII Inflows in Indian Economy

Foreign Direct Investment in India (FDI): FDI refers to foreign direct investment. Economic growth has a profound effect on the domestic market as countries with expanding domestic markets should attract higher levels of FDI inflows.

The generous inflow of FDI (Table-1 and Chart-1) is playing a significant and contributory role in the economic growth of the country. In 2008-09, India's FDI touched Rs. 142829 crore against Rs. 98642 crore in 2007-08 and FDI touched a new high of Rs. 189107 crore in 2014-15. As a result, growth rate of India's FDI inflows has averaged 28.19 % during 2015 over 2014. During 1991-2015 the compound annual growth rate was 30.36 %.

Investment by Foreign Institutional Investors in India (FII)

FII refers to foreign institutional investment by an investor. A Foreign Institutional Investment is an investment in securities, real property and other investment assets by one country in another country. Investment by Foreign Institutional Investors helps in promoting good governance and improving accounting.

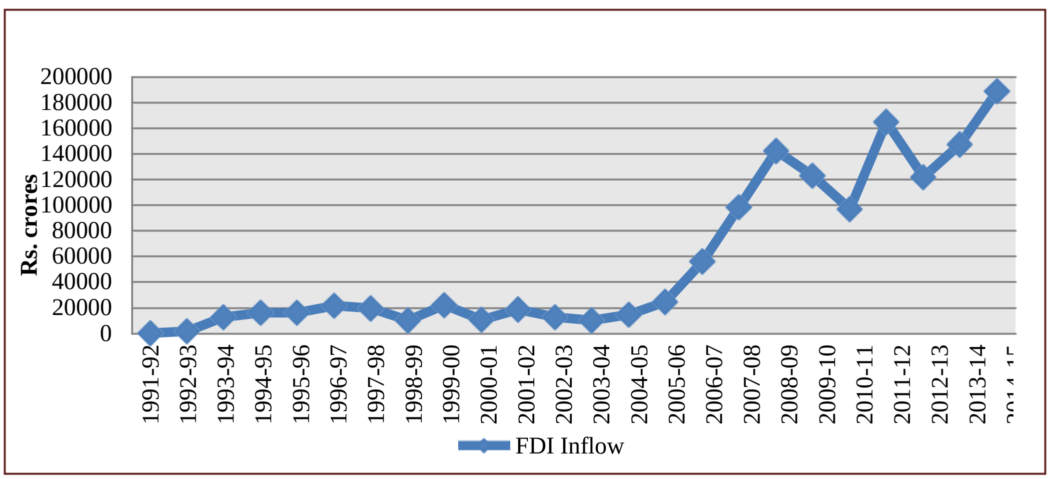
The foreign institutional investment in India (Table-2 and Chart-2) is playing a significant and contributory role in the economic growth of the country. In 2010-11, India's FII touched US$ 29422 million against US$ 29048 million in 2009-10 and FII touched a new high of US$ 40923 million in 2014-15. As a result, growth rate of India's FII inflows has averaged 716.99 % during 2015 over 2014. During 1991-2015 the compound annual growth rate was 55.66 %.

Table 1: FDI Inflow in India (Rs. Crore)

Years	FDI Inflow in India	Growth Rate (%)
1991-92	326	---
1992-93	1713	425.46
1993-94	13026	660.42
1994-95	16133	23.85
1995-96	16364	1.43
1996-97	21773	33.05
1997-98	20014	-8.079
1998-99	10101	-49.53
1999-00	22450	122.25
2000-01	10733	-52.19
2001-02	18654	73.8
2002-03	12871	-31.001
2003-04	10064	-21.81
2004-05	14653	45.60
2005-06	24584	67.77
2006-07	56390	129.38
2007-08	98642	74.93
2008-09	142829	44.79
2009-10	123120	-13.80
2010-11	97320	-20.95
2011-12	165146	69.69
2012-13	121907	-26.18
2013-14	147518	21.009
2014-15	189107	28.19
CAGR (%)	---	**30.36 %**

Source: Various issues of Economic Survey, RBI Bulletin.

Chart1: FDI Inflow in India (1991-92 to 2014-15



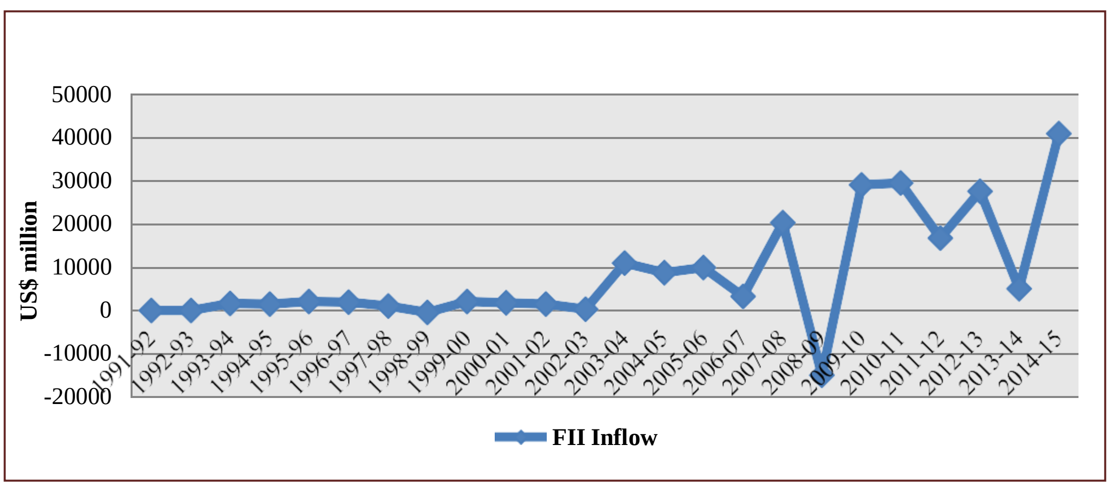
Source: Various issues of Economic Survey, RBI Bulletin.

Table 2: FII in India (US$ million)

Year	Investment by Foreign Institutional Investor	Growth Rate (%)
1991-92	---	---
1992-93	1	---
1993-94	1665	166400
1994-95	1503	-9.73
1995-96	2009	33.67
1996-97	1926	-4.13
1997-98	979	-49.17
1998-99	-390	-139.84
1999-00	2135	-647.44
2000-01	1847	-13.49
2001-02	1505	-18.52
2002-03	377	-74.95
2003-04	10918	2796.02
2004-05	8686	-20.44
2005-06	9926	14.28
2006-07	3225	-67.51
2007-08	20328	530.33
2008-09	-15017	-173.87
2009-10	29048	-293.43
2010-11	29422	1.29
2011-12	16812	-42.86
2012-13	27582	64.06
2013-14	5009	-81.84
2014-15	40923	716.99
CAGR (%)	---	**55.66**

Source: Various issues of Economic Survey, RBI Bulletin.

Chart 2: FII Inflow in India (1991-92 to 2014-15)



Source: Various issues of Economic Survey, RBI Bulletin.

Testing of Hypothesis

Association between FDI and Investment by FII

H_{01}: The association between total FDI and investment by FII in India is insignificant.
H_{11}: The association between total FDI and investment by FII in India is significant**.**
H_{02}: Regression coefficient of investment by FII in India on total FDI is insignificant.
H_{22}: Regression coefficient of investment by FII in India on total FDI is significant**.**

Table 3: Correlation coefficient between FDI and Investment by FIIs

		FDI	Investment by FII
FDI	Pearson Correlation	1	0.579
	Sig. (2-tailed)		0.004
	N	24	23
FII	Pearson Correlation	0.579	1
	Sig. (2-tailed)	0.004	
	N	23	23

Correlation is significant at the 0.01 level (2-tailed)
Source: Calculated values

Table 3 shows that Karl Pearson coefficient of correlation between total FDI and investment by FII in India is 0.579 which is moderate but positive. Since significant value 0.004 for two tailed is less than the level of significance 0.01, therefore, null hypothesis no.1 is rejected which means there is significant relationship between total FDI and investment by FIIs in India.

Table 4: Regression coefficient of Investment by FIIs on total FDI

	Unstandardized Coefficients		Standardized Coefficients	t	R Square	Sig.
	B	Std. Error	Beta			
Constant	1477.407	3164.772		0.467	0.335	0.645
Investment by FII	0.123	0.38	0.579	3.250		0.004

Source: Calculated values

Table 4 clearly shows that the regression equation of investment by FII in India is Y = 1477.407 + 0.123X and the regression coefficient of investment by FII on total FDI in India is also significant because the significant value is 0.004 which is less than the level of significance 0.01, therefore, null hypothesis no.2 is rejected which means the dependence of investment by FII on total FDI in India is significant. Clearly R square is 0.335 which is using more indicating that around 34 % of the changes in investment by FII in India are due to changes in total FDI in India and rest 66 % changes are due to some other factors. Thus, there is significant relationship between total FDI and investment by FII in India. Hence investment by FII does not only depend

Upon FDI, rather, it depends upon so many other economic factors including interest rate, savings, inflation rate, governance etc.

Conclusions

From the above analysis, the study concluded that both Foreign Direct Investment and Investment by Foreign Institutional Investors play an important role in the economic development of the country. There is significant relationship between Foreign Direct Investment and investment by Foreign Institutional Investors. The forms of foreign investment both Foreign Direct Investment and Investment by Foreign Institutional Investors are also different from one another and both impact the Indian economy. But Foreign Direct Investment is considered better than Investment by Foreign Institutional Investors. Investment by Foreign Institutional Investors also plays a very crucial role in any country's economy. Market trend moves upward when any foreign company invests or buys securities, and similarly, it goes down if it withdraws the investment made by it.

Recommendations

- 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.
- It recommends that government must also control over inefficient bureaucracy, red-tapes, and the corruption, so that investor's confidence can be maintained for attracting more FDI inflows to India.

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