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Foreign Direct Investment – A Pillar of a Nation's Economy

Dr. krishnanand Tripathi
Professor
Commerce Department Seth P.C. Bagla (P.G.) College Hathras U.P.

Abstract
Foreign Direct Investment (FDI) serves as a critical method through which developing countries like India establish their non-debt financial resources required for economic growth. The economic impact of FDI extends its benefits to both developed countries and developing countries. The developing countries have developed their policies to attract foreign direct investments through the combination of fiscal stability and structural development and international relationship building and external economic strength. The attraction of foreign direct investments requires positive and attractive conditions which include the ease of doing business index and the global competitiveness index and the logistics performance index and the global innovative index. India attracted its total foreign direct investment (FDI) of US$81.72 billion through its FDI inflow of US$6.24 billion which occurred during April 2021. The total foreign direct investment (FDI) that India received reached its highest point in history. The total FDI inflows for the current period exceed the previous year by 38 percent when you compare them to the FDI inflows from April 2020. According to the Department for Promotion of Industry and Internal Trade (DPIIT), top investor countries are Singapore (29%) with $17.41 billion, US (23%) with $12.1 billion, Mauritius (9%) $5.64 followed by UAE ($4.2 billion), Cayman Island ($2.79 billion), Netherlands ($2.78 billion), UK ($2.04 billion), Japan ($1.95 billion), Germany ($667 million), and Cyprus ($386 million). The automotive industry receives 27 percent of total foreign direct investment (FDI) while computer hardware and software sector receives 17 percent and service sector receives 11 percent.

Keywords: *FDI(Foreign Direct Investment), FEMA (Foreign Exchange Management Act), Economy, FDI Route.*

I. Introduction

Foreign direct investment (FDI) refers to investments which individuals and businesses from one nation make into another nation's economy. Investors can use their funds to establish brand new enterprises or to support preexisting businesses which belong to foreign entities. A company establishes foreign direct investment when it spends money to obtain majority control of a foreign business. FDI enables companies to manage their international operations through direct participation in foreign business activities. The foreign direct investment (FDI) process brings international funding into the nation while establishing a platform that enables knowledge and expertise together with technological resources to be shared between countries.

Foreign direct investment (FDI) serves as a crucial financial resource that enables economic growth in all nations and especially helps developing nations such as India. The economic liberalization that followed the 1991 crisis brought about an uninterrupted growth in foreign direct investment (FDI) to India. India currently occupies the 100th position on the Ease of Doing Business (EoDB) list and holds the top position in the world for Greenfield foreign direct investment (FDI) operations.

Businesses can obtain foreign funding through two methods which are known as organic and inorganic funding. Foreign investors make organic investments by bringing capital which they use to grow their existing business operations. Inorganic investment happens when an investing entity purchases a business unit in another country. FDIs occur in open economies that have a highly proficient workforce and prospective growth. Foreign direct investment arises when an investor set up a foreign business operation or purchase foreign assets including initiating ownership or controlling interest in a foreign company.

Benefits of FDI

Economic advancement

A foreign investment enters a country through two methods which include organic and inorganic investment. A country requires Foreign Direct Investment (FDI) because it provides essential support for its long-term growth unlike Foreign Portfolio Investments (FPI). Foreign Direct Investment (FDI) serves as the main conduit through which foreign funds enter India because it constitutes the primary method for foreign financing in developing nations. The program generates new jobs through its various initiatives which include transferring technology and enhancing workforce abilities and creating additional employment opportunities that lead to increased earnings and points of purchase (PoP).

Easy international trade

Countries that establish strong regulations for foreign direct investment and domestic business growth will see their foreign investment rates increase. The two main factors that attract more foreign direct investment to a country include its capacity to create favorable conditions for incoming foreign direct investment and its ability to develop infrastructure and technology and human resources. The elements that affect foreign direct investment (FDI) include transparent policy frameworks together with the enforcement of intellectual property rights and the existing levels of corruption and the current tax structure. For attracting foreign direct investment (FDI), companies need to assess three key factors which include their cost efficiency and their ability to provide skilled employees and their overall operational environment.

Employment and economic boost

The economic growth objectives of developing nations require them to depend on foreign nations for investment and technological expertise and job creation. The primary driver of economic growth in developing countries exists through their process of creating new employment opportunities. In India, FDI brings multiple economic benefits but the country continues to face significant challenges in creating new employment opportunities.

Tax Benefit

The Indian government has established multiple incentive programs and built Special Economic Zones (SEZs) to boost foreign direct investment. The SEZ unit of a company can receive multiple advantages which include import duty exemption and income tax exemptions and value-added tax (VAT) export rebates. Foreign investment income in India falls under the country's tax regulations. Non-residents receive tax exemptions on foreign investment income that they do not physically receive in India. The tax rate for short-term capital gains stands at 30% while long-term capital gains attract a 20% tax rate.

The government intends to raise the foreign direct investment limit for insurance companies to 74% while permitting international entities to possess complete operational authority. The government has received more than 120 foreign direct investment proposals from Chinese investors which amount to Rs. 12,000 crores since April 2020. India has established Double Tax Avoidance Agreements (DTAAs) with 80 nations to prevent double taxation. Between April 2000 and September 2020, China invested US$ 2.43 billion in foreign direct investment to India..

Development and transfer of resources

The Indian government estimates that Foreign Direct Investment (FDI) for the financial year 2020-21 reached its highest point ever at US$81.72 billion which marks a record achievement for the country. Foreign direct investment which includes equity and capital and reinvested earnings increased by 10 percent when compared to the previous fiscal year's foreign direct investment which reached US$74.39 billion. The UN Conference on Trade and Development (UNCTAD) reported that India experienced a 27 percent rise in foreign direct investment (FDI) in 2020 compared to 2019 which made India the fifth-largest FDI receiver in the world. The computer software and hardware sectors attracted 44 percent of FDI equity investments which made these sectors the most important industries in FY21.

The epidemic challenges became manageable through two components which included the quick advancement of digital technology and the growing adoption of artificial intelligence (AI) technology. The government has freshly developed the production-linked incentive plan to enhance export-oriented investment. The government programs succeeded in helping certain sectors which included rubber goods and retail commerce and medicines and automobiles and electrical equipment to achieve almost complete equity growth during the fiscal year.

FDI policy Reforms

The government has established several rules and exemptions to govern foreign direct investment across various sectors which include defense and public sector enterprises that operate oil refineries and telecommunications and power exchanges and insurance and stock exchanges. The government enacted major changes through its introduction of the Goods and Services Tax (GST) in 2017 which created a single market system and the Insolvency and Bankruptcy Code of 2016 and the unification of labor regulations into four main codes to protect foreign direct investment (FDI) activities. The government's PLI Schemes which it operates across 13 major industries have improved global manufacturing strength and export capabilities. The government provides incentives for businesses to increase their product sales because this strategy helps attract foreign investors who bring capital to the country. More than 20 international companies which include Samsung and Pegatron and Visicon and AT&S and Siemens and Wipro GE have received PLI Schemes production authorization.

Productivity Gains

Joint ventures between foreign companies and domestic organizations will lead to technology transmission and management knowledge sharing which will benefit the host nation. The system enables work force mobility between different countries which results in better skills development for employees. The program enables skilled workers to move to international companies which offer better pay and working conditions. Foreign Direct Investment creates strong labor market competition through its provision of capital which leads to new job creation and improved risk management.

Regulatory approvals

The investments made by non-residents in India are regularized through two routes namely automatic route and government route. The automatic route has fewer restriction and more liberalized regulations. Under this route, the investment by a non-resident or the Indian company does not require any approval from the Government of India or Reserve bank for the investment. Automatic approval is provided by RBI within a period of two weeks. Under the government route or approval route, the foreign investor or the Indian company should possess prior approval from the Government of India or reserve bank for investments in India.

Every non-resident individual or business can invest in India either through an automatic route or government route other than the prohibited sectors. However, the individual or business units of Bangladesh and Pakistan can invest in India only through the government route.

There are some sectors where foreign investment is strictly prohibited through both routes by the government in order to protect the economy of the country. The prohibited sectors include atomic energy, cigar and tobacco products, lottery, gambling, betting, Nidhi company, chit funds, real estate, etc

Sectors that come under the ' 100% Automatic Route' category:

Agriculture & Animal Husbandry	Auto-components
Air-Transport Services (non-scheduled and other services under civil aviation sector)	Coal & Lignite
Airports (Greenfield + Brownfield)	Capital Goods
Asset Reconstruction Companies	Chemicals
Automobiles, Biotechnology (Greenfield),	Pharmaceuticals
Broadcast Content Services (Up-linking & down-linking of TV channels, Broadcasting Carriage Services	Duty-Free Shops
Credit Information Companies	E-commerce Activities
Cash & Carry Wholesale Trading (including sourcing from MSEs)	Thermal Power
Mining & Exploration of metals & non-metal ores	Other Financial Services
Construction of Hospitals	Textiles & Garments
Construction Development	Roads & Highways
Services under Civil Aviation Services such as Maintenance & Repair Organizations	Railway Infrastructure
Tourism & Hospitality and White Label ATM Operations	Renewable Energy
Single Brand Retail Trading	Plantation sector
Petroleum & Natural gas	Ports & Shipping

Sectors that come under up to 100% Automatic Route' category are:

- Infrastructure Company in the Securities Market: 49%
- Insurance: up to 49%
- Medical Devices: up to 100%
- Pension: 49%
- Petroleum Refining (By PSUs): 49%
- Power Exchanges: 49%

The category includes Foreign Direct Investment which applies to all sectors that do not have automatic route designation. The Foreign Investment Promotion Board together with different sector regulators which include Telecom Regulatory Authority of India (TRAI) for telecommunications and Insurance Regulatory and Development Authority (IRDA) for insurance applications conducts the approval process. The approval process typically requires four to six weeks.

Sectors that come under the 'up to 100% Government Route' category are

- Banking & Public Sector: 20%
- Broadcasting Content Services: 49%
- Core Investment Company: 100%
- Food Products Retail Trading: 100%
- Mining & Mineral operations will achieve complete success in separating titanium-bearing minerals and ores: 100%
- Multi-Brand Retail Trading: 51%
- Print Media (publications/ printing of scientific and technical magazines/ specialty journals/ periodicals and facsimile edition of foreign newspapers): 100%
- Print Media (publishing of newspaper, periodicals and Indian editions of foreign magazines dealing with news & current affairs): 26%
- Satellite (Establishment and operations): 100%

FDI prohibition

A few sectors are there where FDI is strictly prohibited under any route. These industries are

- Public agencies that handle atomic energy generation activities of their programs.
- All business operations which involve either gambling activities or betting activities.
- All types of lotteries which include online lotteries and private lotteries and government lotteries.
- Individuals who want to invest in Chit Funds.
- Nidhi Companies function as a specific type of financial institution.
- People can work in agricultural activities but there exist multiple exceptions which include horticulture and fisheries and tea plantations and pisciculture and animal husbandry.
- Real estate development and housing construction activities cannot operate for anything other than township projects and commercial building developments.
- People who engage in TDR trading activities.
- All products that belong to the tobacco industry including cigars and cigarettes and all tobacco-related products.

FDI comes under the capital account transaction and hence any FDI is a capital account transaction and any infringements of its regulations attract severe penal provisions under FEMA. In case of violation, RBI administers FEMA and Directorate of Enforcement, Government of India has the right to investigate it.

Types of FDI

The foreign direct investments are categorized as horizontal, vertical, conglomerate and, platform FDI

- **Horizontal FDI:** Companies use horizontal investment when they try to grow their operations into international markets beyond their home country. A business makes this type of investment when it spends capital to acquire ownership stakes in a foreign enterprise that manufactures products identical to its own. For Example, Zara Barcelona-based company will make an investment into Fab India which operates in India and produces goods that replicate Zara's product line. The investment made by Zara into Fab India is categorized as horizontal FDI because both companies operate within the same merchandise and apparel industry sector.
- **Vertical FDI:** Vertical FDI describes foreign investment which exists in supply chains of different industries. The definition of foreign investment refers to a business which invests in a foreign company that operates at different supply chain levels. The case of Apple Inc. demonstrates vertical foreign direct investment through its backward integration business strategy which enables the company to produce its own chipsets. This process enabled the company to control both the quality and the cost of the chipsets used in its devices. Apple Inc. has succeeded in creating high-quality products which it sells to customers at affordable prices. McDonald’s represents a prominent example of vertical FDI. The American corporation McDonald’s operates in more than 100 countries while it owns a large-scale Canadian farm which it uses to raise beef for its restaurants to maintain product quality across its international locations.
- **Conglomerate FDI:** Conglomerate FDI refers to the investment of a company in a foreign enterprise that operates in a sector distinct from the investing company's primary activity. The US retailer Walmart may invest in TATA Motors the Indian automotive producer.

- **Platform FDI:** A business unit that invests in a foreign firm and exports the output from the foreign business to a third country is called platform FDI. Chanel established its manufacturing facility in the United States to produce goods which it sells throughout the Americas and Asia and various European countries.

Types of Investments of FDI

- **Greenfield Investments:**
  The term Greenfield investment describes a company's decision to establish a subsidiary in a different country through its financial backing. They start their work by obtaining land and building the necessary systems before they start their business activities. The company will achieve complete investment control through this mechanism. The foreign company faces extreme danger because of its decision to stop all operations within its foreign market. In 2007, Mercedes Benz established a manufacturing facility in Pune, India as part of their development strategy.

- **Brownfield Investments:**
  A brownfield investment occurs when a company merges and acquires (M&A) or leases an existing facility. The company chooses to invest in the existing facility because it needs to establish its business operations in the foreign market whilekeeping its initial expenses low. A business needs to make certain compromises during this type of investment because its current facility needs major updates to meet present-day production requirements. The companies will experience financial and time savings from this method because they can begin their business activities without delays. Vodafone company headquartered in London acquired the major stake of Mumbai-based Hutchison Essar.

Approval Process for FDI

The DIPP established a standard operating procedure which governs the processing of FDI proposals. The approval process is as follows:

1. The proposal should be submitted and relevant documents should be uploaded on Foreign Investment Facilitation Portal.
2. The Department of Industrial Policy and Promotion (DIPP) needs to receive the proposal within 2 days after its submission.
    a. The concerned department does not require physical copies of digitally signed documents.
    b. Applicants who do not use digital signatures must submit one signed physical copy of their proposal to the Competent Authority within 5 days after they receive online communication about their application status.
3. The Reserve Bank receives the proposal to evaluate FEMA within 2 days after its online distribution. The Ministry of External Affairs (MEA) and the Department of Revenue (DoR) receive all proposals for record purposes. The departments provide their advice/comments which help determine the decision on the proposal.
4. Proposals undergo scrutiny during the first week after which the review team requests additional information if needed.
5. The competent authority needs to reach a decision within two weeks after obtaining all required documentation. The applicant receives approval or rejection letters through online communication. The competent authority needs to obtain committee approval on economic affairs when foreign inflows exceed Rs 5000 crores according to established time limits..

List of documents to be submitted for the approval process:

1. From both Investee & Investor entities:
    a. Certificate of Incorporation
    b. Memorandum of Association (MOA)
    c. Board Resolution
    d. Last financial year audited financial statement.
    e. Article of Association
2. Names addresses and identification proof of all foreign collaborators of the investor company.
3. Investee company's pre-and post-investment shareholding pattern
4. An Affidavit for the correctness of information provided in hard copy and online.
5. In the case of existing ventures, copy of joint venture agreement/shareholders' agreement/ technology transfer/trademark/brand assignment agreement (whichever applicable).
6. Downstream intimation copy.
7. Relevant past FIPB/SIA/RBI approvals copies, connected with the current proposal.

8. Relevant remittance certificates for foreign inward should be submitted in case investment has already flowed in.
9. In case of a scheme of arrangement, a high Court order should be submitted.
10. Valuation certificate approved by a certified Chartered Accountant.

This list is not exhaustive and based on specific cases, other documents may be required.

Important FEMA guidelines for foreign direct investment

The Foreign Exchange Management Act (FEMA) serves as the primary law that controls foreign exchange transactions throughout India. The Indian economy needed economic liberalization through deregulatory measures which FEMA establishes as its main purpose. All foreign exchange violations according to FEMA rules are defined as civil offenses. FERA treats these violations as criminal offenses. Companies must follow particular rules which govern their foreign investment activities. The requirements which they need to follow appear in the subsequent list:

- FEMA does not apply to Indian citizens who reside outside the country. The Indian citizen requirement gets assessed through the total days a person spent in India during the previous financial year. A person needs to stay in India for 182 days or more to establish residency. A branch office or agency can function as a person who needs to be evaluated for residency requirements.
- The central government gives FEMA authority to create restrictions which it uses to control all international payments that go to recipients outside India and to manage all international payment receipts.
- The Reserve Bank of India (RBI) or the Government needs to give approval for all areas which require Forex acquisition or holding according to FEMA regulations.
- FEMA divides foreign exchange transactions into two categories which are capital account and current account. A capital account transaction includes any exchange that affects an Indian resident's overseas financial assets and obligations together with their opposite effects. The current account includes all transactions that are not capital account transactions.

Significant FDI announcements made in FY 2021

- Copenhagen Infrastructure Partners CIP which operates from Denmark unveiled its plan to fund a US$ 100 million investment into Canada-based Amp Energy India Pvt. Ltd. for their joint equity investment to develop renewable energy capabilities throughout India.
- FedEx which operates from the United States as a logistics and supply chain management company announced its US$ 100 million investment in Delhivery which represents the largest integrated logistics start-up in India during July 2021.
- Ascendas India Trust which operates from Singapore as an IT and logistics park developer announced its first data center project in India through a Rs. 1,200 crore (US$ 162.78 million) investment which will provide funding for initial project development.
- Swiggy obtained US$ 1.25 billion in funding from Soft Bank's Vision Fund 2 and Prosus which operates as a Dutch multinational conglomerate during July 2021.
- Urban Company which operates as a home services marketplace raised Rs. 1,857 crore (US$ 255 million) from Wellington Management and Prosus Ventures and Dragoneer during June 2021.
- Amazon India introduced the US$ 250 million 'Amazon Smbhav Venture Fund' which will support Indian start-ups and entrepreneurs to develop digitalization and agricultural and healthcare technologies through this funding initiative..

II. Conclusion

The host nation will experience the arrival of fresh business operations because of Foreign Direct Investment. The host country receives extra funding through Foreign Direct Investment which also provides access to cutting-edge research facilities and industrial expertise and business management solutions. Foreign Direct Investment creates more market competition which forces domestic businesses to adjust their operations according to new market conditions. Foreign investments lead to decreased production expenses which result in increased customer interest that drives higher earnings for the company. Customers can now access better and cheaper products and services because of foreign direct investment (FDI). The development of a transparent comprehensive and efficient policy framework will enable countries to create an investment climate that attracts foreign direct investment (FDI).

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