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FDI and FII role in the Economic Growth of the country – Analytical Study

Prof. K.V. Satya Prakash[1] and J. Sowmya[2]

1HOD- MBA, Avanthi Institute of Engineering and Technology, Tagarapuvalasa. He can be reached or contacted on Mobile- 9492103369 and/ or e- mail ID- spkv12@rediffmail.com

2Faculty- MBA, Avanthi Institute of Engineering and Technology, Tagarapuvalasa

Abstract
India got vast potentiality in respect of absorption of large investments as there is huge scope for growth with a large market and ever expanding economy. Indian Government categorized capital inflows into the country from outside as Foreign Direct Investment (FDI), Foreign Institutional Investment (FII), Non- Resident Indian (NRI), and Person of Indian Origin (PIO) Investment. Inflows of investment from other countries are encouraged since it complements domestic capital in finance resource- scarce economies of developing nations. India opened up to investments from abroad gradually over the past two decades, especially since the landmark economic liberalization of 1991. Apart from helping creating additional economic activities and generating increasing employment opportunities, cross- borders money infusions facilitates flows of technology inside and helps Industry to be competitive. FDI and FII are equally connected to investments in foreign countries. FDI is an investment that a parent company builds in a foreign nation and on the contrary FII is an investment prepared by an investor in the markets of a foreign country. It is with this aim an attempt is made in this paper based on secondary sources to analyze and relate it to economic growth.

Introduction

Indian economic landscape underwent a paradigm shift when the economy was liberalized in 1991. It also laid the foundation for a strong regulatory network and Indian economy has been one of the star performers globally in the recent years having grown at around 8% consistently. India started initiating the second generation reforms intended for a faster integration of the Indian Economy with World Economy. In the present decade India has witnessed unprecedented levels of economic expansion and also seen healthy growth of trade. GDP reflects the potential market size of Indian economy and India recorded stellar economic performances through the periods, which was manifested in higher growth rates.

Nation's progress and prosperity is reflected by the pace of its sustained economic growth and development. Investment provides the base and pre- requisite for economic growth as well as development. Apart from a Nation's Foreign Exchange reserves, exports, Government revenue, financial position, available supply of domestic savings, magnitude and quality of foreign investment is necessary for the well being of a country. United Nations Conference on Trade and Development Report on World Investment prospects ranked India in the third place in global foreign direct investments to remain among top five attractive destinations for international investors. In recent times, FIIs have started selling their investments from the stock market and the impact can be clearly seen in the market instability that is taking place.

Foreign Direct Investment (FDI)

It refers to investments made from an investor from a country of origin into a different nation, a distinct/ other host country. Economic growth has a profound effect on the domestic market as countries with expanding domestic markets should attract higher levels of the FDI inflows.

Foreign Institutional Investment (FII)

FII is defined by SEBI as Institution established or incorporated outside India which propose to make investment in India in securities provided that domestic asset Management Company or domestic portfolio manager who mainly manages funds raised or collected or brought from outside India for investment in India on behalf of a sub- account, shall be deemed to be a FII.

Difference between FDI and FII

FDI and FII are equally connected to investment in a foreign country. While FDI is an investment that a parent company builds in a foreign nation, FII is an investment prepared by an investor in the markets of a foreign country. In FII, the companies just require to get registered in the stock exchange to make investments, whereas in FDI it is somewhat different as it involves investment in a foreign country. FII is famously called as Hot Money as investors have the liberty to sell it and take it back. In FDI, it is not as simple or possible.

FDI is considered to be steadier than FII as it not just brings in capital but also assists in high- quality governance, good practices and improves management skills and enables technology transfer. While FII assists in promoting high- quality governance and improving accounting, it does not provide other benefits like in FDI. While FIIs are short- term, FDIs are long- term.

Effects of FII on Indian Economy

Positive Impact

It has been emphasized upon the fact that the stock market reforms like improved market transparency, automation, dematerialization and regulations on reporting and disclosure standards were initiated because of the presence of the FIIs. But FII flows can be considered both as cause and effect of the stock market reforms. The market reforms were initiated because of the presence of them and this in turn has led to increased inflows inside country.

In view of the above, the benefits of FII can be mentioned in the following points

1. Enhanced Flows of Equity Capital
2. Managing Uncertainty and Controlling risks
3. Improving Capital Markets
4. Improved Corporate Governance

Negative Impact

The market trends of past few years indicate that the Indian Equity Markets have become slaves of FIIs inflow and are dancing to their tunes. This dependence has caused lot of trouble for the Indian Economy and these are summarized in some of the following stated points:

1. Potential Capital Outflows
2. Inflation
3. Problem to Small Investors
4. Adverse Impact on Exports

Effect of FDI on Indian Economy

Effect for the Host Country

1. a) Improve Balance of Payments position by crediting inflow of investment to capital account. b) Current account improves as FDI aids import substitution and export promotion. c) Exports gets boost by foreign investor expertise in export market intelligence and mechanism. d) Updates Technology by producing global standard goods at available low cost. e) Provides easy Exports Credit from the cheapest source in the international market
2. a) Foreign firms foster forward and backward economic linkages. b) Demand for various inputs gives rise to the development of the supplying industries which through employment of labour force raise their income and increase the demand for domestic industrial production. c) The standard of living of domestic consumers improves as quality products at competitive prices are available. d) Pool of trained personnel would be created for use at any point of time
3. a) Foreign investor by investing in economic/ social infrastructure, financial market and marketing system helps the host country to develop a support base essential for quick industrialization. b) The presence of foreign investors creates a multiplier effect leading to the emergence of a sound support system that would be very much useful to company/ economy
4. a) Foreign investors are a boon to Governments for generation of revenue and income tax. b) They pay tariff on imports. c) Government expenditure requirements are greatly reduced by supplementing Government investment activities in big way, lessening burden on budget
5. a) FDI aids to maintain a proper balance amongst the factors of production by the supply of scarce resources thereby accelerating economic growth. b) Capital brought in by the FDI supplements domestic capital as the savings rate at home is very low to augment investment. c) Through the inflow of scarce foreign exchange, domestic savings get a boost to support the investment process. d) Foreign investors are bold enough to take risks not prevalent among local investors resulting in investment projects being implemented in a large way. e) FDIs bring in skilled labour force to perform jobs which the local workers are unable to carry out. f) There is a fear of imposition of alien culture being imposed on the local labour force. g) Foreign investors make available key raw materials along with updated technology to the host country. h) It helps the Host Country to update R & D work of the investing company

Effect for the Home Country

a) Home Country gets the benefit of the supply of raw materials as FDI helps/ aids in its exploitation. b) Balance of Payments improves due to parent company getting dividend, royalty, technical service fees, and also from its increased export to the subsidiary. c) There is employment generation and the parent company enters into newer financial markets by its investment outside. d) The Government of the home country increases its revenue income of the parent organization, imposition of tariff on import of the parent company from its foreign subsidiary. e) FDI helps to develop political relationship between home and host countries

Impact on Indian Economy

1. Creates employment opportunity for domestic country
2. Good relation between two countries
3. Brings in modern technology
4. Provides inflows of foreign funds in Indian Economy
5. Promotes Competition among the domestic company and MNC- In this domestic company can increase their efficiency
6. Chance for Indian Companies to work more professionally
7. Opportunity for the Indian Company to work with world market leader company

8. Development of Backward Areas
9. Improving good capital market in India
10. Helps earn for the Government additional license/ registration fees, taxes, etc.

FDI is considered to be the life blood and an important vehicle for economic development as far as the developing nations are concerned. The important effect of FDI is its contribution to the growth of the economy. FDI has an important impact on country trade balance, increasing labour standards and skills, transfer of technology and innovative ideas, skills and the general business climate. FDI also provides opportunity for technological transfer and up gradation, access to global managerial skills and practices, optimal utilization of human capabilities and natural resources, making industry internationally competitive, opening up export markets, access to international quality goods and services and augmenting employment opportunities.

FIIs have been investing on financial instruments in India and providing incentives for financial innovations in the country. Recently, they have become the movers and shakers of the market. Given this growing importance of FIIs for the Indian Economy, it is essential that the dynamics of such cross- border portfolio investment in the context of economic growth.

Conclusion

On the basis of above analysis, it is clear that the FII and FDI are influencing the economic development to a greater extent. FDI is preferred over FII since it is considered to be the most beneficial form of foreign investment for the economy as a whole. Direct investment targets a specific enterprise, with the aim of increasing its capacity, productivity or changing its management control. Direct investment to create or augment capacity ensures that inflows into secondary market, the effect is to increase capital availability in general, rather than availability of capital to a particular enterprise. Translating an FII inflow into additional production depends on production decisions by someone other than the foreign investor- some local investor has to draw upon the additional capital made available via FII inflows to augment production. In the case of FDI that flows for the purpose of acquiring an existing asset, no addition to production capacity takes place as a direct result of FDI inflow. Just like in the case of FII inflows, in the case of FDI too addition to production capacity does not result from the action of the foreign investor- the domestic seller has to invest the proceeds of the sale in a manner that augments capacity or productivity for the foreign capital inflow to boost domestic production. There is a widespread notion that FII inflows are hot money- that it comes and goes, creating volatility in the stock market and exchange rates. This might be true of individual funds, cumulatively; FII inflows have only provided net inflows of capital.

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