MODULE 2

FDI

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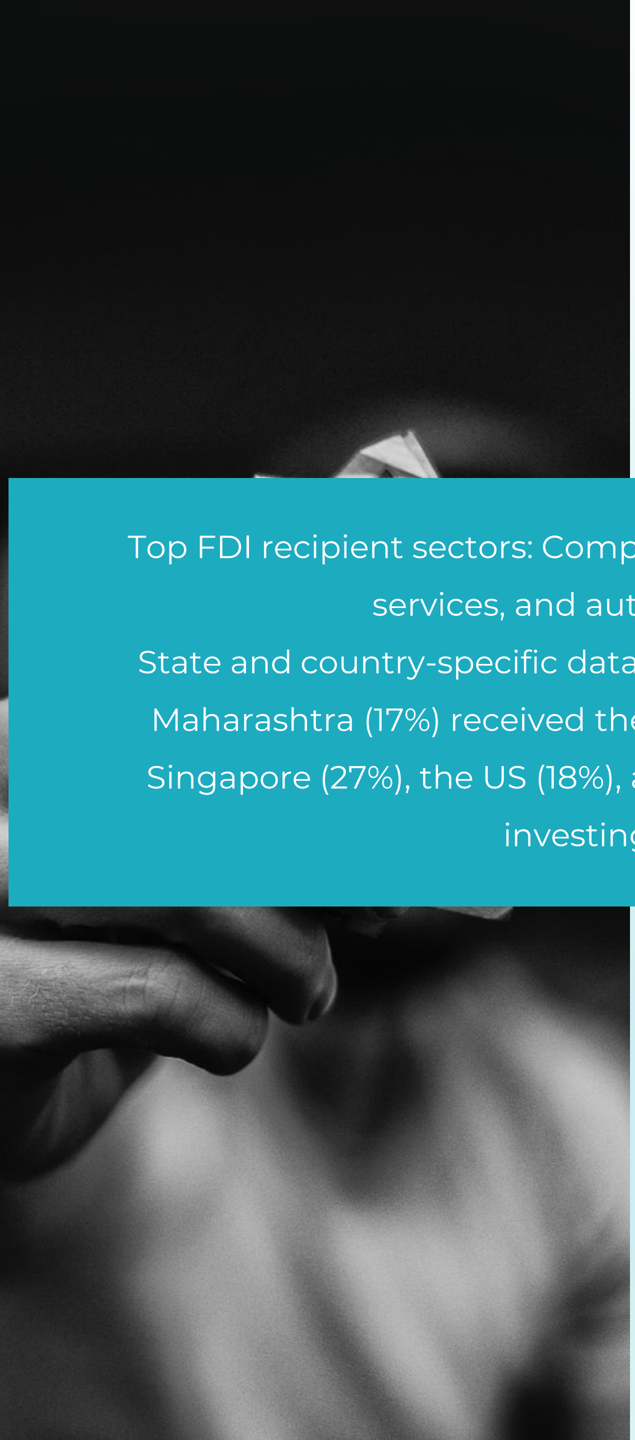


Top FDI recipient sectors: Computer software and hardware (25%), services, and automobile (both 12%)

State and country-specific data: Karnataka (53%), Delhi (17%), and Maharashtra (17%) received the highest FDI equity inflows, with Singapore (27%), the US (18%), and Mauritius (16%) being the top investing countries

INDIA'S RAPIDLY GROWING FDI INFLOWS

India is emerging as a preferred destination for foreign investments, particularly in the manufacturing sector, with a significant increase in foreign investment inflows over the years.

FY 2021-22: Highest-ever FDI figure reached at $83.57 billion

Manufacturing sector growth: FDI equity inflows in manufacturing increased by 76% in FY22

Post-Covid increase: FDI rose by around 22% from 2020-2022 ($171.84 billion) compared to pre-Covid inflows of $141.10 billion from 2018-2020

FOREIGN DIRECT INVESTMENT (FDI) IN INDIA

FDI plays a crucial role in India's economic development, attracting foreign companies that actively participate in the country's business operations, bringing not only financial resources but also expertise and technology.

DEFINITION

FDI refers to the ownership and control of business operations by foreign companies or investors in another country, bringing not just money but also knowledge, skills, and technology.

IMPORTANCE

FDI is a significant non-debt source of monetary inflow for India's economic development.

GROWTH

Since the economic liberalization in 1991, FDI in India has steadily increased, contributing to the country's economic progress.

ROUTES

Government Route: For sectors requiring prior approval from the Foreign Investment Promotion Board (FIPB).

Automatic Route: For sectors that do not require prior government approval.

CATEGORIES OF FOREIGN DIRECT INVESTMENT (FDI)

FDI can be categorized into horizontal, vertical, and conglomerate types. Horizontal FDI involves expanding the same business, vertical FDI involves acquiring related businesses, and conglomerate FDI involves investing in unrelated businesses in foreign countries.

Vertical FDI

Definition: Investor engages in different but related business activities in a foreign country, complementing its main business.
Example: A car manufacturer acquiring a foreign company that supplies components or raw materials for its production.

Horizontal FDI

76%

Definition: Investor establishes the same type of business operation in a foreign country as it operates in its home country.
Example: A retail chain expanding its stores in another country with a similar business model.

Conglomerate FDI

84%

Definition: Investor makes foreign investment in a business unrelated to its existing business in the home country.
Example: A technology company investing in a hospitality business in a foreign country.

FOREIGN PORTFOLIO INVESTMENT (FPI)

FPI involves adding foreign assets to an investment portfolio

FPI allows diversification of investment portfolios by including international assets, reducing risk.

FPI provides access to global opportunities, enabling investors to benefit from the growth and performance of different economies and industries.

01 **Definition**

Addition of international assets to the portfolio of a company, institutional investor, or individual investor.

02 **Purpose**

Portfolio diversification by purchasing stocks or bonds of foreign companies.

03 **Size of Investment**

Smaller investment amounts compared to FDI.

04 **Responsibility**

Fewer regulatory obligations in the host country compared to FDI.

FOREIGN DIRECT INVESTMENT (FDI)

Responsibility: Compliance with host country regulations.

Definition

Substantial investment in or acquisition of a foreign company.

Purpose

Enhancing growth and gaining control over operations.

Size of Investment

Generally larger commitment compared to FPI.

BENEFITS OF FOREIGN DIRECT INVESTMENT (FDI)

FDI plays a crucial role in promoting economic growth and development in host countries. It stimulates job creation, enhances productivity, and brings in advanced technology and operational practices. FDI also boosts exports, stabilizes exchange rates, fosters competition, and can contribute to addressing climate change challenges. Overall, FDI is instrumental in improving the economic performance and competitiveness of host countries.

01

Economic Growth

FDI promotes economic growth and development by creating jobs and improving the functioning of the economy.

02

Human Capital

FDI contributes to the development of human capital through investment in education and skills training.

03

Transfer of technology

FDI brings in advanced technology and operational practices, enhancing productivity and efficiency.

04

Exports

FDI boosts exports by producing goods that are targeted for global markets

05

Exchange rates

FDI stabilizes exchange rates by providing a steady flow of foreign capital and building foreign exchange reserves.

LIMITATIONS OF FDI

Limitations on strategic industries, lack of moral attachment, unethical market access, hindrance to domestic investment, political risks, and poor working conditions in foreign factories are potential drawbacks associated with foreign direct investment (FDI).

- Limitations on strategically important industries
- Lack of moral attachment and potential value-stripping by foreign investors
- Unethical access to local markets
- Hindrance of domestic investment
- Risk from political changes

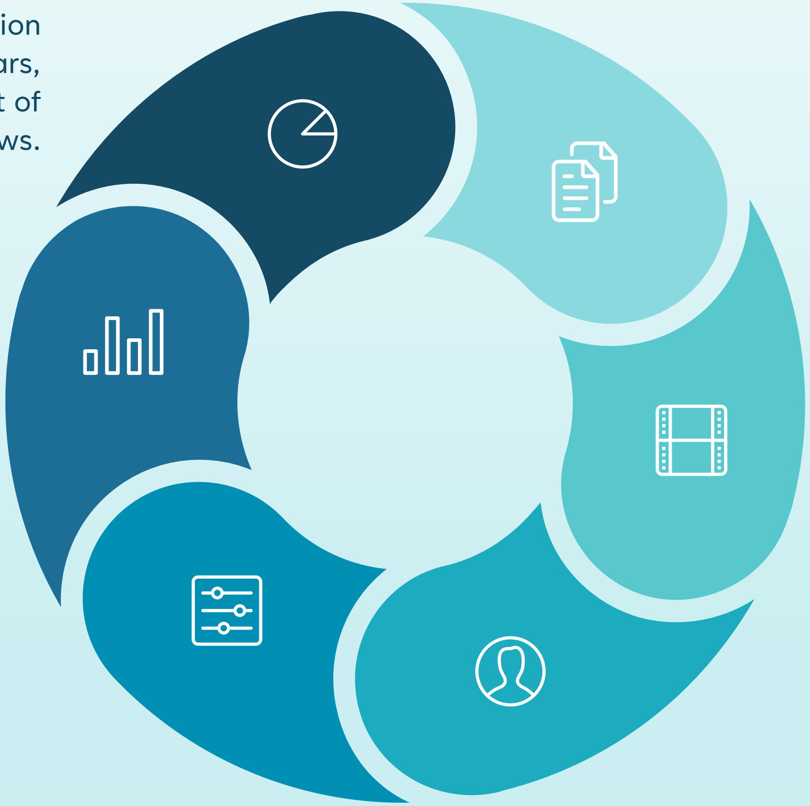
GOVERNMENT INITIATIVES TO BOOST FDI

Department of Revenue approval removed, mandating clearance of all proposals within 10 weeks.
Introduction of Production Linked Incentive (PLI) scheme to boost FDI inflow in various sectors.

Government aims for USD 100 billion FDI inflows in the next two years, positioning India as the top recipient of Greenfield FDI Inflows.

National E-Commerce Policy draft encourages FDI in e-commerce marketplace model for fair competition.

Revised FDI rules allow 100% FDI in the marketplace-based model of e-commerce.



National Digital Communications Policy targets USD 100 billion FDI inflows in the telecommunications sector by 2022.

Government removes the need for approval for 100% FDI in Real Estate Broking Services.

Single-window clearance system strengthened for faster approval processes for Japanese investors.

INCREASING FDI INFLOW IN MANUFACTURING SECTORS

India's manufacturing sectors saw a substantial 76% increase in FDI inflow, reaching USD 21.34 billion in FY 2021-22. This propelled India to the 7th position among the top 20 host economies for FDI inflows in 2021. FDI routes in India include the Automatic Route for non-critical sectors and the Government Route for sensitive sectors and specific countries.

- 04 — FDI in India's manufacturing sectors increased by 76% in FY 2021-22 to USD 21.34 billion.
- 03 — India improved one position to rank 7th among the top 20 host economies for FDI inflows in 2021, according to the UNCTAD World Investment Report 2022.
- 02 — Automatic Route: Allows FDI up to 100% in non-critical sectors without security clearance from the Ministry of Home Affairs.
- 01 — Government Route: Requires government approval or security clearance for investments in sensitive sectors and investments from Pakistan and Bangladesh.

KEY FACTORS INFLUENCING FOREIGN DIRECT INVESTMENT DECISIONS

Pro-active Measures to Promote Investment in Infrastructure

Expansion of ports, captive power, development of highways, atomic power, etc. to attract more foreign direct investment.

Tar Policies and Concessions

Adopting uniform tax policies aligned with international norms to encourage foreign direct investment, avoiding heavy excise duty or sales tax that could deter investors.

Exchange Rate Stability

Maintaining stable exchange rates to ensure the commercial viability of FDI and prevent foreign investors from incurring heavy losses during fund repatriation.

Scope of the Market

Exploiting domestic and foreign markets to reduce production costs and provide opportunities for diversification, making the market attractive for FDIs.

OTHER INFLUENCES

These factors collectively influence foreign direct investment decisions, with governments and businesses striving to create an environment that maximizes these advantages.

Favourable Location Factors

Availability of high-productivity labor, skilled workforce, and efficient transportation facilities (land, rail, air) to support the operations and logistics of foreign investors.

Return on Investment

Attracting FDIs by offering higher returns compared to other countries, ensuring consistent and increasing profits, and providing a safe investment environment.

UNDERSTANDING FOREIGN PORTFOLIO INVESTMENT (FPI)

FPI represents foreign investment in securities and financial assets, offering investors the opportunity to participate in overseas economies

Definition and Nature of FPI

- FPI consists of securities and financial assets held by investors in another country.
- It includes stocks, ADRs, GDRs, bonds, mutual funds, and exchange-traded funds.
- Unlike FDI, FPI does not provide direct ownership or control over a company's assets.

Role of FPI in International Investment

- FPI, along with FDI, is an important source of funding for economies.
- It allows investors, including retail investors, to participate in overseas markets and economies.

Characteristics of FPI

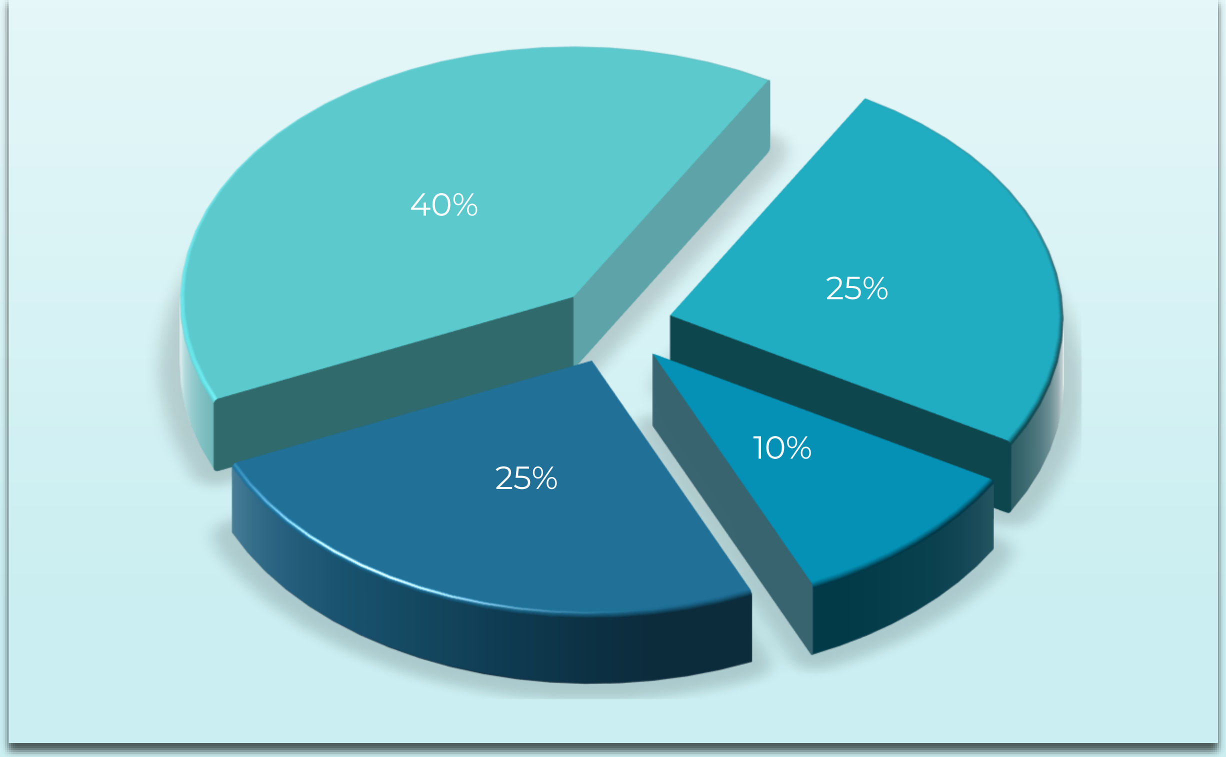
- FPI holdings are relatively liquid, depending on market volatility.
- It is part of a country's capital account and is reflected in the Balance of Payments (BOP).
- FPI is considered more liquid, volatile, and riskier compared to FDI.

Distinction from FDI

- FPI involves passive ownership, with no control or direct ownership of ventures or company assets.
- In contrast, FDI entails a substantial investment in or acquisition of a company in another country.

FOREIGN PORTFOLIO INVESTMENT (FPI): EXPLORING GLOBAL OPPORTUNITIES

FPI involves passive investment in foreign securities for earning returns. It provides individuals with opportunities outside their own country, contributes to a country's capital account, and influences global capital flows and financial markets.



Definition of Foreign Portfolio Investment (FPI)

- FPI involves passive investment in securities for earning returns.
- It includes stocks, ADRs, GDRs, bonds, mutual funds, and ETFs.
- These investments can be in companies or governments outside the investor's country.

Nature of FPI

- FPI is a hands-off or passive investment approach.
- Investors expect returns from the securities they hold.
- It can be in the form of stocks, bonds, mutual funds, or ETFs.

Role of FPI

- FPI allows individuals to invest in opportunities beyond their own country.
- It contributes to a country's capital account and is reported in the balance of payments (BOP).
- The BOP tracks money flows between countries over a monetary year.

Significance of FPI

- FPI provides diversification by accessing securities in foreign markets.
- It enables investors to participate in global economic growth.
- FPI impacts capital flows, financial markets, and exchange rates.

FPI V/S FDI

General overview

Aspect	Foreign Portfolio Investment (FPI)	Foreign Direct Investment (FDI)
Control	No direct control over assets or businesses	Direct control and active management of investments and businesses
Investment Type	Financial assets such as stocks, bonds, mutual funds, and ETFs	Purchase of direct business interests in a foreign country
Liquidity	Relatively more liquid and marketable	Less liquid and harder to sell due to direct ownership
Return on Investment	Offers quicker returns and exit options	Long-term income generation and ROI
Risk	Less exposure to political and currency risks	Higher exposure to political, currency, and economic risks
Investor Profile	Suited for retail investors and institutions	Attractive to institutional investors and high-net-worth individuals
Market Impact	More susceptible to market volatility and capital outflows	Can have a significant impact on local economies and job creation
Examples	Stock investments, bond holdings, mutual funds	Acquiring real estate, establishing manufacturing plants

FPI V/S FDI

FPI is more suitable for retail investors and institutions, while FDI is commonly pursued by institutional investors, high-net-worth individuals, and companies

FPI

Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI) are two distinct forms of investment with different characteristics and objectives. FPI involves passive investment in financial assets such as stocks, bonds, and mutual funds in a foreign country. Investors do not have direct control over the assets or businesses they invest in. FPI offers liquidity and the potential for quicker returns, as financial assets can be easily bought or sold. However, FPI is also more susceptible to market volatility and capital outflows, as investors may quickly withdraw their investments in response to uncertain or negative market conditions.

THE CHOICE

The choice between FPI and FDI depends on investors' goals, risk tolerance, and desired level of control over their investments. FPI is more suited for retail investors and institutions seeking diversification and liquidity in their portfolios. It provides an opportunity for a quicker exit and flexibility in adjusting investment positions. On the other hand, FDI is commonly pursued by institutional investors, high-net-worth individuals, and companies looking to establish a significant presence in foreign markets and actively participate in the management and growth of their investments. FDI offers the potential for long-term returns and the ability to shape the strategic direction of the invested businesses.

FDI

FDI refers to the purchase of direct business interests in a foreign country. It allows investors to actively manage and control their investments and businesses. FDI is typically pursued with the aim of long-term income generation and can have a significant impact on local economies, including job creation and technology transfer. However, FDI carries higher risks related to political factors, currency fluctuations, and the overall economic stability of the host country. Unlike FPI, FDI involves a more substantial commitment and is often associated with strategic objectives, such as market expansion or accessing new resources.

OFFICIAL DEVELOPMENT ASSISTANCE

India and Japan signed an agreement for a loan of up to 50 billion yen (approximately Rs. 3,550 crore) to support India's economic support programs for those affected by the Covid-19 crisis.

The loan is a part of Japan's Official Development Assistance (ODA) loan, which aims to promote the economic development and welfare of developing countries. It carries an interest rate of 0.65% per annum and a repayment period of 15 years, including a five-year grace period.

The financial support aims to back the Indian government's programs such as Pradhan Mantri Garib Kalyan Yojana (PMGKY), which includes schemes for distributing food grains to the poor and vulnerable, providing assistance to construction workers, and offering special insurance for health workers fighting Covid-19.

The loan will contribute to the implementation of health and medical policies by the Indian government, leading to the development of hospitals equipped with ICUs and infection prevention facilities. Additionally, it will enhance telemedicine services using digital technology in various villages across India.

PREVIOUS SUPPORT

Japan had previously provided budget support of 50 billion yen and grant assistance worth one billion yen to aid India's efforts in combating the Covid-19 crisis.

The total Japanese assistance to India for Covid-19 relief now amounts to approximately Rs. 5,800 crores.

THE HISTORY

India and Japan have a longstanding history of bilateral development cooperation since 1958, and their economic relations have evolved into a strategic partnership.

Japan is the fourth-largest investor in India and has been the largest provider of ODA loans to India for several decades. The partnership extends to supporting strategic connectivity between South Asia and Southeast Asia through initiatives like the Act East policy and Partnership for Quality Infrastructure. Notable examples of Japanese cooperation include the successful collaboration on the Delhi Metro project.

THANK YOU

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