

**FOREIGN DIRECT INVESTMENT IN INDIA: TRENDS,
IMPACT, DETERMINANTS AND INVESTORS' EXPERIENCES**

by:

MANPREET KAUR
Department of Management Studies

Submitted

in fulfillment of the requirements of the degree of Doctor of Philosophy

to the



INDIAN INSTITUTE OF TECHNOLOGY DELHI

MAY 2013

CERTIFICATE

The thesis titled, “Foreign Direct Investment in India: Trends, Impact, Determinants and Investors’ Experiences”, being submitted by Ms Manpreet Kaur to the Indian Institute of Technology, Delhi, for the award of the degree of Doctor of Philosophy (Ph.D.) is a record of bonafide research work carried out by her. She has worked under our guidance and supervision, and has fulfilled all the requirements for the submission of this thesis, which has attained the standard required for a Ph.D. degree of this Institute. The results presented in this thesis have not been submitted elsewhere for the award of any degree or diploma.

(Surendra S. Yadav)

Professor
Department of Management Studies
Indian Institute of Technology
New Delhi

(Vinayshil Gautam)

Professor
Department of Management Studies
Indian Institute of Technology
New Delhi

ACKNOWLEDGEMENTS

“Gratitude is the attitude that takes you to your altitude.”

This study has been accomplished with the help, encouragement, cooperation and guidance of many people and I convey my heartfelt thanks to all of them. At the outset, I would like to thank The Almighty for His blessings which helped me to achieve this academic endeavor.

I would like to express my deepest gratitude to respected guides, Prof. Surendra S. Yadav and Prof Vinayshil Gautam, for their invaluable guidance, inspiration, motivation, encouragement and support to develop an independent researcher out of me. Further, I would like to thank them again from the core of my heart for having offered me unique opportunity to teach at the IIT, involving in different academic activities and their untiring fatherly support which helped me to grow both as an academician and as an individual.

A special gratitude goes to my father, Mr Mohan Singh Panesar, whose stimulating suggestions and encouragement helped me in accomplishing this research work. I take this opportunity to thank my mother, husband, father-in-law, brother and bhabhi for their motivation and encouragement. My sincere indebtedness also goes to Prof. P.K Jain, Prof. S.K. Jain, Prof. V. Upadhyaya (Department of Humanities) and all other faculty members of DMS who spared their valuable time for providing useful insights in this research effort. I am grateful to Prof. Kanika T. Bhal, Head, DMS, for providing all the support needed for this research.

My sincere gratitude is also due to Mr. D.S Tarzan who has always rendered a helping hand to me during the course of my research. I am indebted to my fellow researchers, especially Ms. Ishita G. Tripathy, at IIT-D for their valuable discussions, help and support.

I am also obliged to all the respondents of the survey, who took out time from their busy schedules to provide useful data for this research.

A special thanks to my little angel, Gurbani Kaur, who helped me in her own ways to achieve this uphill task.

Last but not the least, I would like to thank Prof. Barjesh Kochar (GNIM) for his unending support and guidance in the accomplishment of this research work.

Date: May 27, 2013

(Manpreet Kaur)

ABSTRACT

The process of Globalization has made world a single global village. Foreign Direct Investment is one of the important outcomes of globalization. FDI is increasingly considered as an important source of economic growth and development for emerging economies. The role of FDI in reinforcing domestic growth in many countries has given way to a greater openness to FDI in order to support investment and productivity of the host countries. In the present era of Liberalization, Privatization and Globalization (LPG), there is a tremendous scope for increase in the trade and investment across countries all over the world. This trend is more pervasive in developing countries like India with huge domestic market and abundant labor force, making it a preferred foreign investment destination. FDI is increasingly described as source of economic growth and development that triggers technology and knowledge spillovers, contributing to international trade & commerce by enhancing exports, in particular, and improves the productive efficiency of the host country. FDI and trade provide stimulus to economic growth and development of the recipient country. It is, therefore, pertinent to investigate the relationship between these two variables. India is the largest democracy and fourth largest economy in terms of GDP (based on Purchasing Power Parity) in the world. With its consistent growth performance and highly skilled manpower, India provides enormous opportunities for foreign investments. As a result, the focus of the study is India, one of the attractive destinations for FDI, all over the world.

Foreign direct investment (FDI) is a category of international investment in which a resident entity in one economy (the direct or foreign investor) acquires a lasting interest in an enterprise resident in another economy (the direct investment enterprise). Before 2000-2001, while

reporting FDI, only the equity capital component was considered. However, after 2000, India began to report FDI as per the reporting practices of OECD to make the FDI data comparable with other countries of the world.

This study aims at examining the relationship between FDI and select economic variables. A comprehensive study including three set of variables categorized into economic and policy variables, infrastructure variables and financial sector development variables is undertaken to identify and analyze the determinants of FDI in the pre-liberalization and post-liberalization phase. Moreover, a survey has been administered amongst the FDI firms to gauge their experiences on investment in India and corroborate the findings from the secondary data.

The major finding of the study, based on the analysis, is that there are various factors which affect the inflow of FDI to India. Apart from the policy issues, the factors like extent of human resource development, availability of infrastructure facilities and efficiency of banking sector as well as capital market affect FDI inflows. Another notable finding of the study reveals that FDI has a strong relationship with economic growth of India. On the other hand, FDI is contributing to current account deficit due to increased imports of goods and technology.

Given the legitimate political climate, FDI undoubtedly emerges as a dominant source of economic development. Although FDI is certainly having overwhelming preponderance on investors' confidence, its role in recipient countries is untenable. Planners need to take cognizance of extent of foreign investment required to bolster economic development.

Table of Contents

	Page No.
Acknowledgements	i
Abstract	iii
List of Figures	xii
List of Tables	xiv
List of Appendices	xix
Glossary	xx
Abbreviations	xxii
Chapter-1	
Introduction to the Study	
1.1 Introduction	1
1.2 Evolution of FDI in India	3
1.2.1 Stylized facts about FDI in India	7
1.2.2 A paradigm shift from foreign loans to equity/portfolio investment	11
1.3 Global trends of FDI	13
1.4 Description of the problem	16
1.5 Significance of the study	18
1.6 Scope of the study	19
1.7 Methodology of the study	19
1.8 Organization of the thesis	20
1.9 Concluding observations	21
Chapter-2	
Review of Literature	

2.1 Introduction	22
2.1 Definition of FDI	23
2.2 Impact of FDI on growth of host country	25
2.3 Balance of payments and FDI	29
2.4 Determinants of FDI	33
2.5 Concluding observations	39
Chapter-3	
Research Methodology	
3.1 Introduction	41
3.2 Gaps from the literature, research objectives and hypotheses	42
3.2.1 Identified gaps in the literature	42
3.2.2 Research objectives	42
3.2.3 Research hypothesis	43
3.3 The data	44
3.3.1 Secondary data	44
3.3.2 Primary data	44
3.3.2.1 Expert opinion	44
3.3.2.2 Firm level data	45
3.4 Research methodology and scope	45
3.4.1 Causal relationship between FDI with economic growth and current account	45
3.4.1.1 Testing the stationary properties	46
3.4.1.2 Testing the cointegration properties	46

3.4.1.3 Granger causality test	47
3.4.2 Identification and analysis of determinants of FDI	47
3.4.2.1 Identification of determinants of FDI	47
3.4.2.2 Analysis of determinants of FDI	49
3.4.3 Analysis of primary data	52
3.4.3.1 Stratified sampling	52
3.4.3.2 Ordered logistic regression	52
3.4.4 Case study	53
3.5 Scope of research	56
3.6 Use of statistical software	56
3.7 Concluding observations	57
Chapter-4	
Trends and performance of FDI	
4.1 Introduction	58
4.2 Trends in FDI	59
4.2.1 Country based analysis	64
4.2.2 Sector based analysis	65
4.2.3 Regional distribution of FDI	67
4.3 Concluding observations	69
Chapter-5	
Causal relation between FDI and select economic variables	
5.1 Introduction	71
5.2 FDI and balance of payments	72

5.2.1 Trends of balance of payments and FDI	73
5.2.2 Testing the stationary properties and order of integration	78
5.2.3 Testing the cointegration properties	79
5.2.4 Granger causality test	80
5.2.5 Empirical results	81
5.2.6 Impulse response function	86
5.3 FDI and economic growth	89
5.3.1 Testing the stationary properties and granger causality	89
5.3.2 Empirical results	90
5.4 Concluding observations	93
5.4.1 FDI and current account	93
5.4.2 FDI and economic growth	94
Chapter-6	
Determinants of FDI	
6.1 Introduction	97
6.2 Economic and policy variables	98
6.2.1 Variables from the literature	99
6.2.2 Expert opinion on economic and policy variables	102
6.2.3 Variables identified for analysis	105
6.2.4 Analysis of economic and policy variables	107
6.3 Infrastructure variables	115
6.3.1 Variables from the literature	115
6.3.2 Analysis of expert opinion on infrastructure variables	118

6.3.3 Infrastructure variables identified for analysis	121
6.3.4 Analysis of infrastructure variables	122
6.4 Financial sector development variables	130
6.4.1 Financial sector development variables used in literature	132
6.4.2 Analysis of expert opinion on financial sector development variables	135
6.4.3 Financial sector development variables identified for analysis	137
6.4.4 Analysis of financial sector development variables	138
6.5 Concluding observations	147
Chapter-7	
Survey analysis and findings	
7.1 Introduction	151
7.2 Survey methodology	152
7.2.1 Questionnaire development, scales used and identification of target population	152
7.2.2 Pre-testing of questionnaire (reliability and validity)	153
7.2.3 Sample selection/sample technique used	154
7.2.4 Questionnaire administration and data collection	154
7.3 Profile of the respondents	155
7.3.1 Regional distribution of the respondents	155
7.3.2 Distribution of respondent firms by home country of investment	157
7.4 Analysis and empirical results	159
7.4.1 Initial route of investment of FDI respondent firms	160
7.4.2 Distribution of respondent firms by percentage of foreign investment	161

7.4.3 Nature of industry of respondent firms	163
7.4.4 Distribution by years of investment in India	164
7.4.5 Reasons for investment in India	165
7.4.6 Factors affecting choice of particular region	169
7.4.7 Factors affecting choice of particular sector	173
7.4.8 Preference for manufacturing over licensing	178
7.4.9 Problems faced by foreign investors in India	180
7.4.10 Perceived risks associated with FDI	183
7.4.11 Important sources for information for assistance	185
7.4.12 Expansion plans – reasons and mode of expansion	187
7.5 Concluding observations	190

Chapter- 8

Financial sector development and FDI –a case of BRIC countries

8.1 Introduction	194
8.2 Financial sector development in BRIC-A synopsis	196
8.2.1 Brazil	196
8.2.2 Russia	196
8.2.3 India	197
8.2.4 China	198
8.2 Data and methodology	198
8.3 Research framework	200
8.4 Empirical results	201
8.5 Concluding remarks	207

Chapter-9

Summary and conclusions

9.1 Introduction	209
9.2 Major findings from the research	211
9.2.1 Findings related to trends and performance of FDI in India	211
9.2.2 Findings related to causal relationship between FDI and select economic variables	213
9.2.3 Findings of the analysis of determinants of FDI in India	215
9.2.4 Findings from the survey	217
9.3 Recommendations from the study	220
9.4 Contribution of the study	224
9.5 Limitations of the study	224
9.6 Scope for future research	225
9.7 Concluding observations	225

References

Appendices

Curriculum Vitae