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Changing Pattern of Foreign Direct Investment in India during Post Reform Period

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Abstract:
This paper delves into the evolving landscape of Foreign Direct Investment (FDI) in India's retail sector during the post-reform period, spanning from the early 1990s to the present day. Through an extensive review of literature and empirical analysis, it sheds light on the intricate interplay between policy reforms, market dynamics, and economic growth in shaping FDI patterns. It underscores the significance of FDI in bridging the gap between domestic savings and investment, thereby fueling overall capital formation.

Through empirical data analysis, the paper provides insights into the changing patterns of FDI inflows, sector-wise distribution, and geographical preferences of investors. Furthermore, the paper delves into the challenges and opportunities associated with FDI in India's retail sector. It highlights regulatory hurdles, such as local sourcing requirements and complex tax structures, as significant impediments to foreign investors. In conclusion, the paper underscores the pivotal role of FDI in driving economic growth and sectoral development in India. It advocates for continued policy reforms and initiatives to attract foreign investment while addressing regulatory bottlenecks. By providing valuable insights and recommendations, the paper aims to inform policymakers, investors, and stakeholders about the evolving landscape of FDI in India's retail sector.
***Key Words: -** FDI, Retail Sector, investment, economic growth.*

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Introduction

Foreign Direct Investment or FDI are the capital inflows from outside that are invested in or used to increase the production capacity of the producing units. It is the most effective way to spread business expertise from the world's industrialized economies. FDI inflows stimulate the economy by making domestic investments and raising the host nation's human capital formation, which has a major and favourable effect on the economic development of a nation. It provides a bilateral gain situation to the host and the home countries. The simplest explanation of FDI would be a direct investment by a corporation in a commercial venture in another country. In recent years, however, companies have been able to make a foreign direct investment that is long-term management control as opposed to direct investment in buildings and equipment. Foreign Direct Investment is the investment made in production or business by the country in another country by either means of buying a company or expanding its business in the foreign country. FDI also facilitates international trade and transfer of knowledge, skills, and technology[1]. Thus, FDI is defined as the net inflows of investment to acquire a lasting management, joint venture, transfer of technology and expertise. It is important to note that the developing countries had significantly eased restrictions on FDI inflows and operations of MNEs in the early 1980s. This trend became even more widespread during the 1990s, which brought a significant FDI inflow into the developing countries. Developing countries received nearly 44 per cent global FDI inflows in 2011 compared to 16 per cent in 1990 (UNCTAD handbook of statistics 2012). China has been the largest developing country recipient of FDI projects and India has been placed in the 4th Position in 2012 (FDI Intelligence)[2]. In fact, as part of the reform process at the start of the 1990s, India opened up its economy and permitted MNEs in the core sectors; in this sense, India opened FDI in the retail sector. Since then, it has drawn a sizable portion of foreign direct investment (FDI) inflows among developing nations and has emerged as one of the most lucrative places for international investors to make investments. In recent years, foreign investors have begun to make investments in India's retail sector[3].

Foreign Direct Investments

FDI has a multifaceted impact on the host nation's overall development. It is seen to be a significant driver of economic expansion in developing nations. Because of its capacity to address two primary challenges—a lack of capital and a lack of necessary technology and skills—it has drawn the attention of policymakers in low-income nations. It can have a number of effects on the host economy. Foreign direct investment operations also facilitate the transfer of technology, skills, innovative ability, and organizational and managerial practices between nations.

In fact, inflows of foreign direct investment continue to be a crucial indicator for directing the course and orientation of the formulation and execution of economic policies and goals by the governments of these regions. It is also well known that influxes of foreign direct investment bring much-needed cash to support domestic endeavors and establish a foundation for the transfer of technology and technical know-how to the receiving nation. Without a doubt, these elements are necessary preconditions that, when combined with other efforts to promote economic development, can create the groundwork for developing economies to be integrated into the global economy[4]. It may generate benefits through bringing non-debt creating foreign capital resources, technology upgradation, skill enhancement, new employment, spill over and allocative efficiency effects. FDI plays a complementary role in overall capital formation and filling the gap between domestic saving and investment. The objective of this paper is to examine the significance and assess the various aspects pertaining to performance of the FDI in India viz-a-viz sector-wise, country-wise, state-wise and year-wise during pre and post reform period[5].

Types of FDI

These are the following types of FDI:

Horizontal FDI- It arises when a firm duplicates its home country-based activities at the same value chain stage in a host country through FDI.

Platform FDI- Foreign direct investment from a source country into a destination country for the purpose of exporting to a third country.

Vertical FDI- takes place when a firm through FDI moves upstream or downstream in different value chains i.e., when firms perform value-adding activities stage by stage in a vertical fashion in a host country.

Importance of FDI in Economic Development

The whole structure of the Indian economy has altered since 1991 as a result of the country's economic policy reforms, which were implemented in the wake of the historic economic crises of 1990–1991 and a few significant shifts in the global economic system. The reforms have included, among other things, opening up the economy, increasing its level of competition, releasing the government from its onerous regulatory framework, giving the states more authority to manage their economies, and fostering a rivalry among them for foreign investment. The Indian economy had experienced major policy changes in the early 1990s. The policy of Liberalization, Privatization and Globalization (LPG) aimed at making the Indian economy a fast growing and globally competitive economy. The series of reforms undertaken with respect to the industrial sector, trade as well as the financial sector have made the economy more efficient[6].

FDI has the potential to impact economic development by boosting the availability of capital and other production factors. However, FDI is not limited to capital. Perhaps even more significant is the potential for foreign-owned businesses to benefit both the local economy and the productivity levels of domestic businesses. There could be multiple ways that the presence of foreign enterprises boosts local productivity.

FDI has increased in India since the reforms. In addition, India's structure and character have changed significantly since it began to expand into international markets, which has raised expectations that foreign direct investment (FDI) will serve as a conduit for faster economic growth. India, like most industrializing countries, followed a sensible strategy of limiting foreign investment up until 1991, when it became largely dependent on long-term bilateral and multilateral loans. FDI was important being the channel to obtain industrial tech which was absent with the help of licensing contracts and capital goods import[7].

Post-Liberalization Era

When India adopted financial liberalization and a reorganization plan in 1991, it marked a significant step toward improving its economic prospects and joining the global economy. While changes in business strategy eliminated venture schemes and commercial development constraints gradually but unquestionably, they also made it possible for broader access to foreign equipment and support. A sequence of actions which were focused in the direction of liberalization of overseas venture comprised:

1) Initiation of double course of sanction of FDI–RBI’s spontaneous course and Government’s sanction (SIA/FIPB) course.
2) Spontaneous authorization for contracts of technology in businesses of high-priority in addition to elimination of constraint of Foreign Direct Investment in low-technology zones along with technological liberalization imports.
3) Authorization to NRIs (Non-resident Indians) and OCBs (Overseas Corporate Bodies) to capitalize till 100% in segments of high priority.
4) Increase in the overseas fairness contribution limited 51% for prevailing corporations and liberalization of the overseas-brands tag usage.
5) Employing the MIGA Agreement (Multilateral Investment Guarantee Agency) for security of overseas Reserves.

Table 1 FDI Inflows in Indian economy (from 2001-2022-23) in Amount in USD Million

Financial Year (April-March)	FIPB Route/ RBI's Automatic Route/Acquisition Route	Equity capital of unincorporated bodies	Re-invested Earnings	Other Capital	Investment by FII's Foreign Institutional Investors Fund (net)	Total FDI Inflows	%age growth over previous year
2001-02	3904	191	1645	390	1505	7635	(+) 52%
2002-03	2574	190	1833	438	377	5412	(-) 18%
2003-04	2197	32	1460	633	10918	15240	(-) 14%
2004-05	3250	528	1904	369	8686	14737	(+) 40%
2005-06	5540	435	2760	226	9926	18887	(+) 48%
2006-07	15585	896	5828	517	3225	26051	(+) 155%
2007-08	24573	2291	7679	300	20328	55171	(+) 53%
2008-09	31364	702	9030	777	(-)15017	26856	(+) 20%
2009-10	25606	1540	8668	1931	29048	66793	(-) 10%
2010-11	21376	874	11939	658	29422	64269	(-) 8%
2011-12	34833	1022	8206	2495	16812	63368	(+) 34%
2012-13	21825	1059	9880	1534	27582	61880	(-) 26%
2013-14	24299	975	8978	1794	5009	41055	(+) 5%
2014-15	30933	978	9988	3249	40923	86071	(+) 25%
2015-16	40001	1111	10413	4034	(-)4016	51543	(+) 23%
2016-17	43478	1223	12343	3176	7735	67955	(+) 8%
2017-18	44857	664	12542	2911	22165	83139	(+) 1%
2018-19	44366	689	13672	3274	(-) 2225	58776	(+) 2%
2019-20	49977	1757	14175	8482	552	74943	(+) 20%
2020-21	59,636	1,452	16,935	3,950	38,725	81,973	(+) 10%
2021-22 (P)	58,773	910	19,347	5,805	84,835	-14,071	(+) 3%
2022-23 (P)	46,034	1,390	19,354	4,192	70,970	-5,407	(-) 16%

Source: https://dpiit.gov.in/sites/default/files/FDI_Factsheet_March_23.pdf

The above table is exhibiting the constantly changing pattern of FDI through different routes from 2000 to 2022. From the above table it can be easily identified that, India attained enough FDI through various modes: FIPB Approval, RBI, FII, RBI's NRI Schemes and External borrowings. In 2000-01 the FDI in retail was yet to start as it was almost close to zero, however, it slowly started gaining momentum in 2004 through equity capital and FIPB approvals. In 2008-09 in spite of huge financial recession all over the world, India was still managed to attain FDI through FIPB approvals, FIIs, and re-invested earnings via Indian nationals. Slowly gaining momentum, in 2014-15 India maintain the highest record of FDI investment through FIPB approvals, FIIs, re-invested capital and other capital inflows which accelerated the total FDI inflows in Indian economy. FDI has not only strengthened Indian economy but also opened inflows to various sectors of economy including education, textile, retail, fertilizers, agriculture, railways, and many more. The table 2 is exhibiting the economic sectors attaining highest FDI in 2023-24.

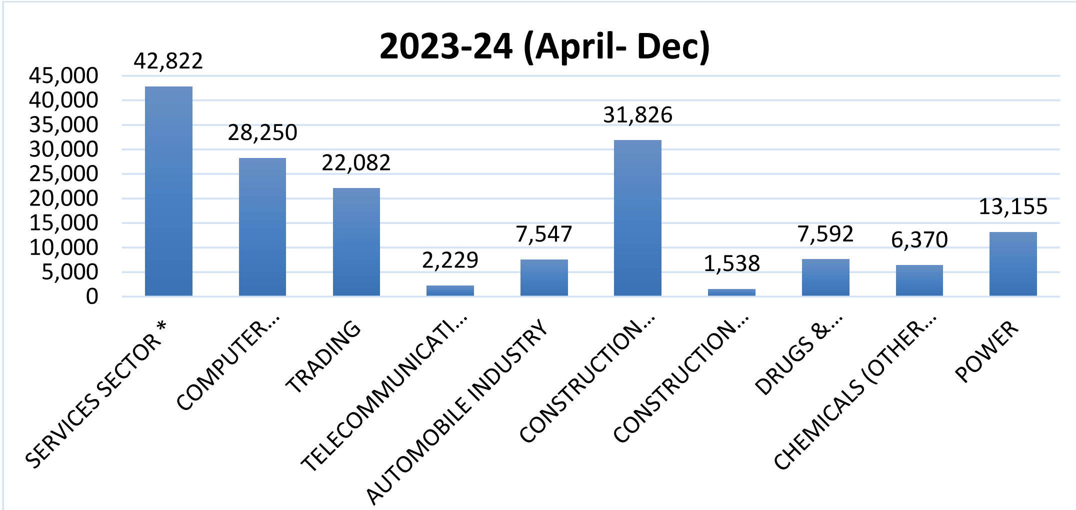
Table 2 Sectors Attracting Highest FDI Equity Inflow (in Rupees crores)

Rank	***Sector***	***2023-24 (April-Dec)***	***Cumulative EquityInflow *(April,2000-Dec,2023)***	***%age outof total FDIEquityinflow***
1	SERVICESSECTOR	42,822	6,74,807	16%
2	COMPUTERSOFTWARE &HARDWARE	28,250	6,81,029	15%
3	TRADING	22,082	2,89,261	6%
4	TELECOMMUNICATIONS	2,229	2,34,752	6%
5	AUTOMOBILEINDUSTRY	7,547	2,30,212	5%
6	CONSTRUCTION(INFRASTRUCTURE) ACTIVITIES	31,826	2,36,304	5%
7	CONSTRUCTIONDEVELOPMENT	1,538	1,30,747	4%
8	DRUGS &PHARMACEUTICALS	7,592	1,33,628	3%
9	CHEMICALS (OTHERTHANFERTILIZEINR)	6,370	1,33,089	3%
10	POWER	13,155	1,08,010	3%

Source: www.dpiit.gov.in

Based on table 2 the following chart has been prepared:

Figure:1 Sector wise FDI Inflows



Source: www.dpiit.gov.in

India's economic success is best demonstrated by the services sector, which represents the country's shift from primarily an agrarian to a service-driven superpower. Historically, India's economy was centred on agriculture. But as liberalization and globalization advanced, the services sector took off, completely changing the course of the country's economy.

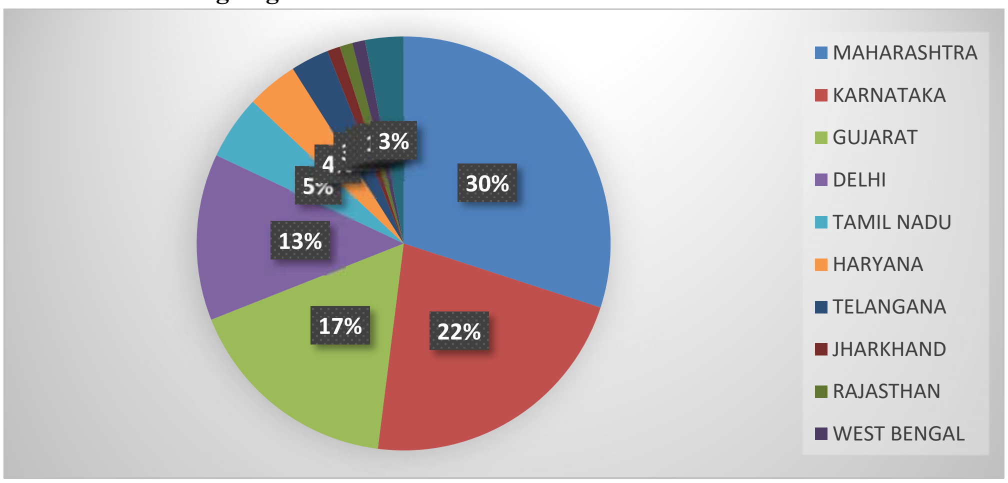
This industry group includes a wide range of sectors, including banking, healthcare, hotels, and information technology and telecommunications. Its rapid expansion has increased India's GDP and established the nation as a centre for innovation, technological improvement, and first-rate customer service. Following are the sectors of computer software and hardware, trading, telecommunication etc. The table 3 below will exhibit the top ten states in India which are considered as the most attractive FDI destination according to the data gathered in recent financial year 2023-24.

Table 3 Top 10 States attracting Highest FDI Inflows
(Amount in Rupees Crores)

Rank	*Sector*	***2023-24 (April-Dec)***	***CumulativeEquity Inflow *(October,2019-Dec.2023)***	***%age outof total FDIEquityinflow***
1	MAHARASHTRA	1,00,112	5,07,440	30%
2	KARNATAKA	30,219	3,65,276	22%
3	GUJARAT	48,410	2,87,435	17%
4	DELHI	31,361	2,21,455	13%
5	TAMILNADU	14,547	78,634	5%
6	HARYANA	10,773	70,246	4%
7	TELANGANA	19,906	55,672	3%
8	JHARKHAND	90	19,382	1%
9	RAJASTHAN	1,867	17,725	1%
10	WESTBENGAL	949	11,846	1%

The data in the table 3 shows that, among the other states, Maharashtra has been considered as the most preferable destination by FDI investors. The main reason behind this is that Maharashtra allows easy setup of manufacturing, R&D, and service industries (including IT, Biotechnology, Pharmaceuticals, and Telecom). However, Gujarat becomes the largest manufacturer of frozen potato including FDI which also made its stake in Retail sector. Based on the data following pattern has been drawn in figure.

Figure: 2
Top 10 States attracting Highest FDI Inflows



Source:www.dpiit.gov.in

Challenges of Foreign Direct Investment

The Indian economy is one of the expanding worldwide retail markets. The number of middle-class customers in the Indian economy has grown significantly since the nation underwent liberalization 20 years ago in 1991. The primary causes of the unexpected rise and expansion of the Indian retail sector are dual career couples, rising purchasing power, internet access, e-commerce, smart phone users, and the country's fast urbanization[8].

While neighboring economies such as China, Indonesia, Pakistan, Bangladesh, and others have rapidly opened their borders to foreign direct investment (FDI) in order to spur growth, the Indian government has been relatively sluggish to grant FDI into its retail sector. In accordance with guidelines issued by the Reserve Bank of India (RBI), Foreign Direct Investment (FDI) is defined as the establishment of a business subsidiary or other unit in India by a foreign organization. This can include the establishment of a company under the Companies Act, 1956 (a joint venture or wholly owned subsidiary) or the establishment of a liaison office, project office, or branch office of the foreign company that is authorized to carry out activities under the Foreign Exchange Management Regulation, 2000[9].

The rise of the Indian economy after liberalization was mostly fueled by FDI, which increased the country's GDP (gross domestic product). First wary of foreign direct investment (FDI) in the retail sector, the country eventually approved it—but only as joint ventures or with local backing required—because of worries about economic and political instability. The goal of this strategy was to protect small and medium-sized businesses in the area. As a result, an important shift occurred in the Indian retail scene, moving from an unorganized to an organized industry and greatly boosting the country's economy. A number of benefits were made possible by this paradigm shift, including increased consumer spending power, infrastructure development, technical breakthroughs, and the support of small and medium-sized businesses through joint ventures and foreign direct investment.

FDI pattern has changed from cash and carry whole trade route to automatic trade route and expanded from 51% to 100% in both single and multi-brand retail trade. With the emergence of digital technology and increasing number of smart phone users, e-commerce also flourished which attracted more FDI in Indian retail business. However, foreign investors also find investing in Indian economy a risky venture because of various factors like political instability, lack of basic infrastructure, largely expanded untapped rural markets, Indian bureaucracy, lack of talent and market instability. Other problems of Indian retail industry identified while conducting this study are discussed in next section followed by limitations of the study and future research scope.

Major Findings

The retail sector in India has witnessed significant changes in terms of foreign direct investment (FDI) during the post-reform period. Here are some major findings on the changing pattern of FDI in the retail sector in India:

- Policy Reforms: India opened its economy to outside investment and liberalized its economy in 1991. But the Indian government didn't approve FDI (foreign direct investment) in the retail industry until 2006. FDI was initially limited to single-brand retail. Later, in 2012, it was broadened to include multi-brand retail, but only under certain restrictions.
- Gradual Market Penetration: Due to legislative restrictions, complex tax structures, and the difficulties involved in acquiring land, international retailers entered the Indian market gradually at first. Many international retail companies were cautious and chose to negotiate the market environment by forming strategic alliances with local businesses.
- Emergence of E-Commerce: Foreign Direct Investment (FDI) in India's retail industry has been shaped in large part by the growth of e-commerce. Online retail platforms have experienced rapid expansion and have drawn significant investments from foreign corporations. Notably, the retail sector in India has been significantly impacted by the purchases of Flipkart by corporations such as Amazon and Walmart.
- Focus on Single-Brand Retail: Foreign retailers have demonstrated a strong preference for single-brand retail projects in India, even after multi-brand retail was opened to FDI. This preference is mostly due to the complex regulatory environment that oversees multi-brand retail, which includes requirements for local sourcing that are mandated and limitations on the locations of stores.
- A surge in Foreign Direct Investment (FDI) Inflows: The retail industry in India has seen a steady increase in FDI inflows over the years. This tendency is ascribed to the loosening of rules governing foreign direct investment as well as the growing middle class and consumer market. The trust of international investors has been reinforced by the aggressive initiatives taken by the Indian government to alleviate investor concerns and streamline regulatory frameworks.
- Impact on Conventional merchants: Foreign merchants entering India, especially under the cover of sizable, well-organized chains, have resulted in a variety of negative effects for traditional retailers there. Some have struggled to compete with organized retail's convenient locations and low prices, but others have successfully shifted their focus to niche markets and provided individualized customer experiences.
- Creation of Employment and Enhancement of the Supply Chain: The entry of international retailers into India's retail market has promoted the creation of jobs directly and indirectly. It has also encouraged the creation of improved cold storage facilities, efficient supply chains, and infrastructure improvements, all of which have improved the country's retail environment as a whole.

- Persistent Regulatory Hurdles: Despite the advancements, India's retail industry still faces regulatory barriers. For international merchants, requirements pertaining to local sourcing, limitations on shop locations, and complex tax arrangements continue to be major challenges. These obstacles could deter certain foreign companies from entering or growing their presence in the Indian market.

Conclusion

Henceforth, FDI plays a very important role in promoting economic growth. Foreign direct investment has a major impact on sector growth, development, and employment. FDI inflows into the retail sector have increased significantly after post reform period. There is huge potential in retail sector which should be backed by implementing government policies.

On the other hand, it is also important to note that the retail sector in India is dynamic, and the pattern of FDI may continue to evolve with changing economic and policy dynamics. The findings mentioned above provide insights into the major trends and challenges observed during the post-reform period, but the actual scenario may vary over time.

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