**Role, factor affecting and Operation of FDI in India**

As the name suggests, it is an investment by foreign individual(s) or company(ies) into business, capital markets or production in the host country. Foreign direct investment policy in India is regulated under the Foreign Exchange Management Act (FEMA) 2000 administered by the Reserve Bank of India (RBI).

FDI plays an important role in the economic development of a country. The capital inflow of foreign investors allows strengthening infrastructure, increasing productivity and creating employment opportunities in India. Additionally, FDI acts as a medium to acquire advanced technology and mobilize foreign exchange resources. Availability of foreign exchange reserves in the country allows RBI (the central banking institution of India) to intervene in the foreign exchange market and control any adverse movement in order to stabilize the foreign exchange rates. As a result, it provides a more favourable economic environment for the development of Indian economy.

**Role of FDI**

**1) Helps in Balancing International Payments:**

FDI is the major source of foreign exchange inflow in the country. It offers a supreme benefit to country’s external borrowings as the government needs to repay the international debt with the interest over a particular period of time. The inflow of foreign currency in the economy allows the government to generate adequate resources which help to stabilize the BOP (Balance of Payment).

**2) FDI boosts development in various fields:**

For the development of an economy, it is important to have new technology, proper management and new skills. FDI allows bridging of the technology gap between foreign and domestic firms to boost the scale of production which is beneficial for the betterment of Indian economy. Thus, FDI is also considered an asset to the economy.

**3) FDI & Employment:**

FDI allows foreign enterprises to establish their business in India. The establishment of these enterprises in the country generates employment opportunities for the people of India. Thus, the government facilitates foreign companies to set up their business entities in the country to empower Indian youth with new and improved skills.

**4) FDI encourages export from host country:**

Foreign companies carry a broad international marketing network and marketing information which helps in promoting domestic products across the globe. Hence, FDI promotes the export-oriented activities that improve export performance of the country. Apart from these advantages, FDI helps in creating a competitive environment in the country which leads to higher efficiency and superior products and services.

**Factors that affect foreign direct investment (FDI)**

In summary, the main factors that affect foreign direct investment are

* Infrastructure and access to raw materials
* Communication and transport links.
* Skills and wage costs of labour

**Factors affecting foreign direct investment**



**1. Wage rates**

A major incentive for a multinational to invest abroad is to outsource labour-intensive production to countries with lower wages. If average wages in the US are $15 an hour, but $1 an hour in the Indian sub-continent, costs can be reduced by outsourcing production. This is why many Western firms have invested in clothing factories in the Indian sub-continent.

* However, wage rates alone do not determine FDI, countries with high wage rates can still attract higher tech investment. A firm may be reluctant to invest in Sub-Saharan Africa because low wages are outweighed by other drawbacks, such as lack of infrastructure and transport links.

**2. Labour skills**

Some industries require higher skilled labour, for example pharmaceuticals and electronics. Therefore, multinationals will invest in those countries with a combination of low wages, but high labour productivity and skills. For example, India has attracted significant investment in call centres, because a high percentage of the population speak English, but wages are low. This makes it an attractive place for outsourcing and therefore attracts investment.

**3. Tax rates**

Large multinationals, such as Apple, Google and Microsoft have sought to invest in countries with lower corporation tax rates. For example, Ireland has been successful in attracting investment from Google and Microsoft. In fact, it has been controversial because Google has tried to funnel all profits through Ireland, despite having operations in all European countries.

**4. Transport and infrastructure**

A key factor in the desirability of investment are the transport costs and levels of infrastructure. A country may have low labour costs, but if there is then high transport costs to get the goods onto the world market, this is a drawback. Countries with access to the sea are at an advantage to landlocked countries, who will have higher costs to ship goods.

**5. Size of economy / potential for growth**

Foreign direct investment is often targeted to selling goods directly to the country involved in attracting the investment. Therefore, the size of the population and scope for economic growth will be important for attracting investment. For example, Eastern European countries, with a large population, e.g. Poland offers scope for new markets. This may attract foreign car firms, e.g. Volkswagen, Fiat to invest and build factories in Poland to sell to the growing consumer class. Small countries may be at a disadvantage because it is not worth investing for a small population. China will be a target for foreign investment as the newly emerging Chinese middle class could have a very strong demand for the goods and services of multinationals.

**6. Political stability / property rights**

Foreign direct investment has an element of risk. Countries with an uncertain political situation, will be a major disincentive. Also, economic crisis can discourage investment. For example, the recent Russian economic crisis, combined with economic sanctions, will be a major factor to discourage foreign investment. This is one reason why former Communist countries in the East are keen to join the European Union. The EU is seen as a signal of political and economic stability, which encourages foreign investment.

Related to political stability is the level of corruption and trust in institutions, especially judiciary and the extent of law and order.

**7. Commodities**

One reason for foreign investment is the existence of commodities. This has been a major reason for the growth in FDI within Africa – often by Chinese firms looking for a secure supply of commodities.

**8. Exchange rate**

A weak exchange rate in the host country can attract more FDI because it will be cheaper for the multinational to purchase assets. However, exchange rate volatility could discourage investment.

**9. Clustering effects**

Foreign firms often are attracted to invest in similar areas to existing FDI. The reason is that they can benefit from [external economies of scale](https://www.economicshelp.org/blog/glossary/external-economies-of-scale/) – growth of service industries and transport links. Also, there will be greater confidence to invest in areas with a good track record. Therefore, some countries can create a virtuous cycle of attracting investment and then these initial investments attracting more. It is also sometimes known as an [agglomeration effect](https://www.economicshelp.org/blog/glossary/agglomeration-economies/).

**10. Access to free trade areas.**

A significant factor for firms investing in Europe is access to EU Single Market, which is a free trade area but also has very low non-tariff barriers because of harmonisation of rules, regulations and free movement of people. For example, UK post-Brexit is likely to be less attractive to FDI, if it is outside the Single Market.

**UK – Post Brexit**

If the UK leaves the Single Market, there will be two factors which make the UK less attractive as a place for FDI

1. Outside Single Market – the possibility of tariffs or greater barriers to trade with rest of Europe. Even if tariffs to EU are low (World trade rules) there is a considerable significance of being outside Single Market which may put off firms, who prefer the security of being in a country committed to Single Market
2. Access to labour. The UK economy has benefited from migrant labour, e.g. construction sector has a high percentage of Eastern European workers. Without free movement of labour, there may be a greater unwillingness to invest in UK.

**FDI operation in India**

Many changes have been made to the [Foreign Direct Investment (FDI) policy](http://pib.nic.in/newsite/PrintRelease.aspx?relid=158262) in the last few years.  Further, FDI is also allowed through two different routes namely, Automatic and the Government route. The erstwhile Foreign Investment Promotion Board (FIPB) has been [phased out](http://pib.nic.in/newsite/PrintRelease.aspx?relid=162097) recently. In the automatic route, foreign entities do not need the prior approval of the government to invest. However, they have to inform the RBI about the amount of investment within a stipulated time period. In the government route, any investment can be made only after the prior approval of the government. Various other conditions as defined in the [consolidated FDI policy](http://dipp.nic.in/sites/default/files/CFPC_2017_FINAL_RELEASED_28.8.17.pdf) are applicable to various sectors. In specific sectors, the FDI is prohibited.

**Sector wise**[**FDI Limits**](http://dipp.nic.in/sites/default/files/CFPC_2017_FINAL_RELEASED_28.8.17.pdf)

| **Sector** | **FDI Limit** | **Entry Route & Remarks** |
| --- | --- | --- |
| **Agriculture & Animal Husbandry**• Floriculture, Horticulture, Apiculture and Cultivation of Vegetables &      Mushrooms under controlled conditions• Development and Production of seeds and planting material• Animal Husbandry(including breeding of dogs), Pisciculture, Aquaculture• Services related to agro and allied sectors | **100%** | **Automatic** |
| **Plantation Sector**• Tea sector including tea plantations• Coffee plantations• Rubber plantations• Cardamom plantations• Palm oil tree plantations• Olive oil tree plantations | **100%** | **Automatic** |
| **Mining**Mining and Exploration of metal and non-metal ores including diamond, gold, silver and precious ores but excluding titanium bearing minerals and its ores | **100%** | **Automatic** |
| **Mining (Coal & Lignite)** | **100%** | **Automatic** |
| **Mining**Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities | **100%** | **Government** |
| **Petroleum & Natural Gas**Exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas, marketing of natural gas and petroleum products etc | **100%** | **Automatic** |
| **Petroleum & Natural Gas**Petroleum refining by the Public Sector Undertakings (PSU), without any disinvestment or dilution of domestic equity in the existing PSUs. | **49%** | **Automatic** |
| **Defence Manufacturing** | **100%** | **Automatic up to 49%****Above 49% under Government route** in cases resulting in access to modern technology in the country |
| **Broadcasting**• Teleports(setting up of up-linking HUBs/Teleports)• Direct to Home (DTH)• Cable Networks (Multi System operators (MSOs) operating at National or State or District level and undertaking upgradation of networks towards digitalization and addressability• Mobile TV• Head end-in-the Sky Broadcasting Service(HITS) | **100%** | **Automatic** |
| **Broadcasting**Cable Networks (Other MSOs not undertaking up gradation of networks towards digitalization and addressability and Local Cable Operators (LCOs)) | **100%** | **Automatic** |
| **Broadcasting Content Services**• Terrestrial Broadcasting FM(FM Radio)• Up-linking of ‘News & Current Affairs’ TV Channels | **49%** | **Government** |
| **Up-linking of Non-‘News & Current Affairs’ TV Channels/ Down-linking of TV Channels** | **100%** | **Automatic** |
| **Print Media**• Publishing of newspaper and periodicals dealing with news and current affairs• Publication of Indian editions of foreign magazines dealing with news and current affairs | **26%** | **Government** |
| Publishing/printing of scientific and technical magazines/specialty journals/ periodicals, subject to compliance with the legal framework as applicable and guidelines issued in this regard from time to time by Ministry of Information and Broadcasting. | **100%** | **Government** |
| Publication of facsimile edition of foreign newspapers | **100%** | **Government** |
| **Civil Aviation – Airports**Green Field Projects & Existing Projects | **100%** | **Automatic** |
| **Civil Aviation – Air Transport Services**• Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline• Regional Air Transport Service(Foreign Airlines are barred from Investing in Air India) | **100%** | **Automatic up to 49%****Above 49% under Government route****100% Automatic for NRIs** |
| **Civil Aviation**• Non-Scheduled Air Transport Service• Helicopter services/seaplane services requiring DGCA approval• Ground Handling Services subject to sectoral regulations and security clearance• Maintenance and Repair organizations; flying training institutes; and technical training institutions | **100%** | **Automatic** |
| **Construction Development: Townships, Housing, Built-up Infrastructure** | **100%** | **Automatic** |
| **Industrial Parks (new & existing)** | **100%** | **Automatic** |
| **Satellites- establishment and operation, subject to the sectoral guidelines of Department of Space/ISRO** | **100%** | **Government** |
| **Private Security Agencies** | **74%** | **Automatic up to 49%****Above 49% & up to 74% under Government route** |
| **Telecom Services** | **100%** | **Automatic up to 49%****Above 49% under Government route** |
| **Cash & Carry Wholesale Trading** | **100%** | **Automatic** |
| **E-commerce activities** (e-commerce entities would engage only in Business to Business (B2B) e-commerce and not in Business to Consumer (B2C) e-commerce.) | **100%** | **Automatic** |
| **Single Brand retail trading**Local sourcing norms will be relaxed up to three years and a relaxed sourcing regime for another five years for entities undertaking Single Brand Retail Trading of products having ‘state-of-art’ and ‘cutting edge’ technology. | **100%** | **Automatic up to 49%****Above 49% under Government route** |
| **Multi Brand Retail Trading** | **51%** | **Government** |
| **Duty Free Shops** | **100%** | **Automatic** |
| **Railway Infrastructure**Construction, operation and maintenance of the following• Suburban corridor projects through PPP• High speed train projects• Dedicated freight lines• Rolling stock including train sets, and locomotives/coaches manufacturing and maintenance facilities• Railway Electrification• Signaling systems• Freight terminals• Passenger terminals• Infrastructure in industrial park pertaining to railway line/sidings including electrified railway lines and connectivities to main railway line• Mass Rapid Transport Systems. | **100%** | **Automatic** |
| **Asset Reconstruction Companies** | **100%** | **Automatic** |
| **Banking- Private Sector** | **74%** | **Automatic up to 49%****Above 49% & up to 74% under Government route** |
| **Banking- Public Sector** | **20%** | **Government** |
| **Credit Information Companies (CIC)** | **100%** | **Automatic** |
| **Infrastructure Company in the Securities Market** | **49%** | **Automatic** |
| **Insurance**• Insurance Company• Insurance Brokers• Third Party Administrators• Surveyors and Loss Assessors• Other Insurance Intermediaries | **49%** | **Automatic** |
| **Pension Sector** | **49%** | **Automatic** |
| **Power Exchanges** | **49%** | **Automatic** |
| **White Label ATM Operations** | **100%** | **Automatic** |
| **Financial services activities regulated by RBI, SEBI, IRDA or any other regulator** | **100%** | **Automatic** |
| **Pharmaceuticals(Green Field)** | **100%** | **Automatic** |
| **Pharmaceuticals(Brown Field)** | **100%** | **Automatic up to 74%****Above 74% under****Government route** |
| **Food products manufactured or produced in India**Trading, including through e-commerce, in respect of food products manufactured or produced in India. | **100%** | **Government** |

**Prohibited Sectors**

FDI is prohibited in the following sectors

* Lottery Business including Government/private lottery, online lotteries, etc.
* Gambling and Betting including casinos etc.
* Chit funds
* Nidhi company
* Trading in Transferable Development Rights (TDRs)
* Real Estate Business or Construction of Farm Houses (Real estate business does not include development of townships, construction of residential /commercial premises, roads or bridges )
* Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes
* Activities/sectors not open to private sector investment e.g. Atomic Energy and Railway operations (other than permitted activities)

**Government Initiates to Promote FDI**

The Indian government has initiated steps to promote FDI as they set an investor-friendly policy where most of the sectors are open for FDI under the automatic route (meaning no need to take prior approval for investment by the Government or the Reserve Bank of India). The FDI policy is reviewed on a continuous basis with the purpose that India remains an investor-friendly and attractive FDI destination.

FDI covers various sectors such as Defence, Pharmaceuticals, Asset Reconstruction Companies, Broadcasting, Trading, Civil Aviation, Construction and Retail, etc.

In the Union Budget 2019, the cabinet approved 100% FDI under the automatic route for single-brand retail trading. Under this change, the non-resident entity is permitted to commence retail trading of ‘single brand’ product in India for a particular brand. Additionally, the Indian government has also permitted 100% FDI for construction sector under the automatic route. Foreign airlines are permitted to invest up to 49% under the approval route in Air India.

The main purpose of these relaxations in foreign investment by the government is to bring international best practices and employee the latest technologies which propel manufacturing sector and employment generation in India. To boost manufacturing sector with a focus on ‘Make in India’ initiative, the government has allowed manufacturers to sell their products through the medium of wholesale and retail, including e-commerce under the automatic route.