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# A Study on Role of FII & FDI in Indian Economic Growth

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**Abstract—***New industrial policy 1991, has brought new dimensions to the Indian economy through Globalization. The basic motto like self-sustainability, domestic savings and infrastructure development were replaced by robust economic growth since a decade. Global trade vanished the cross borders and paved the way for international business. Being most populous country, India is facing many challenges that hampering the growth of economy like societal and financial factors. Deficit in trade, interest rates, inflation are a part of them. Indian economy was influencing by western countries through their investments in to the financial system. Thus, the sources of foreign capital like FDI, FII were become dominant players in capital formation as well as risky too. These investments were welcomed through direct participation in production areas or investing in stock exchanges. Recently, it is evident from the RBI statistics that majority of the capital sources are from foreign countries. This would definitely effect the financial system and economy as a whole. Current research paper focusing on the effect of these factors on Indian economy. For this purpose, researcher had taken GDP as growth indicator and the factors like FDI and FII were chosen as independent variables.*

**Keywords***: FDI, FII, Economic growth and GDP*

## Introduction:

The recent history of Indian financial system shown the stubborn growth in terms of its horizontal and vertical integrating activities. This was happened only because of the introduction of foreign capital in to Indian financial system. India being one of the great developing countries, marked its own way in developing and structuring a transparent, stable and innovative financial system across the globe. These caused to raise the economic growth resulting a double digit growth rate since a decade. These foreign investments are helpful not only for the developing countries, developed countries too. Various economists proved that FDI and FII were attracted by India due to the reasons like availability of raw materials, man power and infrastructure facilities at low cost. These investments are allowed to invest in India through direct investment/participation in the company activities or through stock exchanges. FDI can invest directly in to the company and can have control and influence the activities of the business. Whereas, FII investments are tuned only to the stock exchanges. FDI not only encourages gathering of capital to the country, it also encourages skills, bringing technology to the host country and also creates sources of employment. These benefits caused FDI to focus more than FII in the capital formation.

## Foreign Direct Investment:

Foreign Direct Investment may be of any of the form like long-term, short-term capital and equity. It does not include the purchase of shares. FDI enhance employment opportunities and skills, innovations, technology support to the company with their expertise. India become the favor most destination due to the following reasons:

- Availability of abundant raw materials
- High interest rates for investments
- Tax regimes
- Ease of transactions

The FDI may also affect due to the government trade barriers and policies for the foreign investments and leads to less or more effective towards contribution in economy as well as GDP of the economy (MahantaDevajit, 2012).

Even though some of the developed and developing countries offering very high interest rates than India, Foreign investors are not willing to invest in risky avenues. FII and FDI are very essential for the Indian economic growth. FDI encourages economic development through direct involvement whereas FII provide liquidity for those stock issued by the company. These acts as catalyst in the race of global economies. Unlike FII, FDI is said to be stable capital. Most of the critics faced by FII are being sensitive and creates volatility in the secondary market. But due to the expertise knowledge and means of trading, analytical technology, they are making profits out of the stock exchanges. These on the other hand enhances the value of the firm by fixing the price for the shares thus caused to raise the liquidity and demand for the stock as a result net worth will groom. The sectoral limit for FDI can be understand from the following table.

**Table 1 Sector wise cap limit for FDI**

| Sector | Cap limit |
|---|---|
| Agriculture & Animal Husbandry | 100% |
| Plantation Sector | 100% |
| Mining | 100% |
| Petroleum and natural gas<br>PSU | 100%<br>49% |
| Manufacturing | 100% |
| Defense | 100% |
| Broadcasting carriage services<br>Content services | 100%<br>49% |
| Print media | 26% |
| Publishing & printing | 100% |
| Civil aviation | 100% |
| Construction developments | 100% |
| Industrial parks | 100% |
| Satellites establishment and operations | 100% |
| Private security agencies | 74% |
| Telecom services | 100% |
| Trading | 100% |
| e-commerce | 100% |
| Single brand retail trading<br>Multi brand | 100%<br>51% |
| Railways infrastructure | 100% |
| Banking private sector | 74% |
| Insurance | 49% |
| Pension sector | 49% |
| Power exchanges | 49% |
| White label ATM operations | 100% |
| Financial services | 100% |
| Pharmaceuticals | 100% |

*Source: DIPP, consolidated FDI policy, August 28, 2017.*

**Table 2 Top 10 Sources of FDI flow to India during 2000-2017**

| Rank | Name of the country | FDI(in Rs.Crores) | % of inflow |
|---|---|---|---|
| 1 | Mauritius | 659,539.33 | 34.45 |
| 2 | Singapore | 349,147.08 | 16.76 |
| 3 | Japan | 148,377.72 | 7.45 |
| 4 | United Kingdom | 129,692.24 | 6.97 |
| 5 | Netherlands | 127,464.64 | 6.33 |
| 6 | U.S.A | 119,075.08 | 6.06 |
| 7 | Germany | 58,064.81 | 2.98 |
| 8 | Cyprus | 48,159.87 | 2.62 |
| 9 | France | 32,599.08 | 1.69 |
| 10 | U.A.E | 27,767.83 | 1.39 |

*Source: DIPP official website, FDI statistics.*

### Foreign institutional Investors:

FII is an institutional body situated in a foreign country and invest in domestic country through stock markets. FDI and FII activities are go hand by hand. FII provide liquidity and value based trading, price fixing of the shares that are issued by the company. FII plays a vital role in stock markets and causes market volatility. This embosses a larger effect on domestic financial markets like stock market, money markets and foreign exchange markets.

### Review of literature:

For the purpose of this research paper, researcher consider the following literature:

- **R.Anitha (2012)** Government should revise the sectoral cap and bring more sectors under the automatic route. Further, India should sign the agreement of Double Taxation treaties with other countries in order to increase bilateral trade. Therefore, there is an urgent need to adopt innovative policies and good corporate governance practices on par with international standards, by the Government of India.
- Dr. JasbirSingh,Ms. Sumita Chadha, Dr. Anupama Sharma (2012) Foreign investments must met the financial requirement for building up the basic and essential infrastructure industries of priority sector. The inflow of foreign investment should be welcome in such way that it should be convenient and favorable for Indian economy and enable it to achieve our cherished goal like rapid economic development, removal of poverty, internal personal disparity in the development and making our Balance of Payment favorable.
- Bhavya Malhotra (2014),India must also focus on areas of poverty reduction, trade liberalization, and banking and insurance liberalization. Challenges facing larger FDI are not just restricted to the ones mentioned above, because trade relations with foreign investors will always bring in new challenges in investments.

### Objectives:

- To study the FDI and FII investment flows into the Indian economy during the sample period.
- To study the relation between GDP, FDI and FII.
- To study the impact of FDI and FII on Indian economic growth through GDP.

### Research methodology:

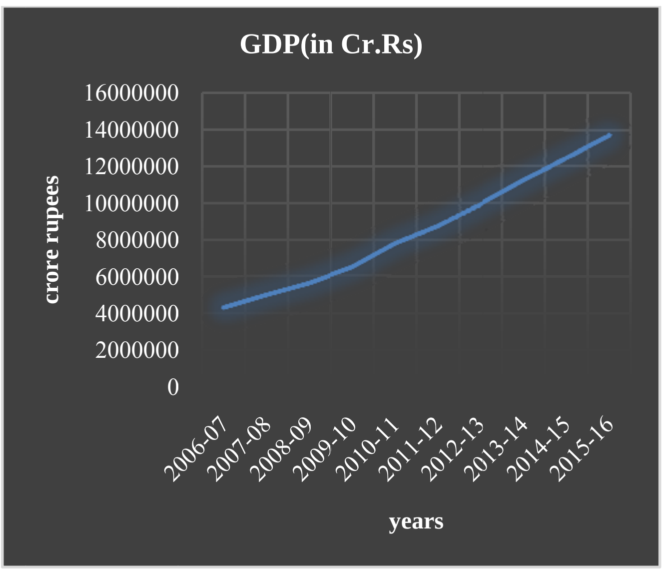
The present study based on the secondary data. For the sake of researcher convenience, the period of study was considered between the financial years 2006-2016. The required FDI & FII data was collected from annual reports of RBI. Real GDP was taken as economic growth indicator and was collected from IMF annual reports from the official websites. Statistical tools like correlation and regression analysis is used. Correlation coefficient ranges from -1 to +1 which can give the strength of the relation between the variables under the study. Regression analysis can interpret the effect of one independent variable on the dependent variable.

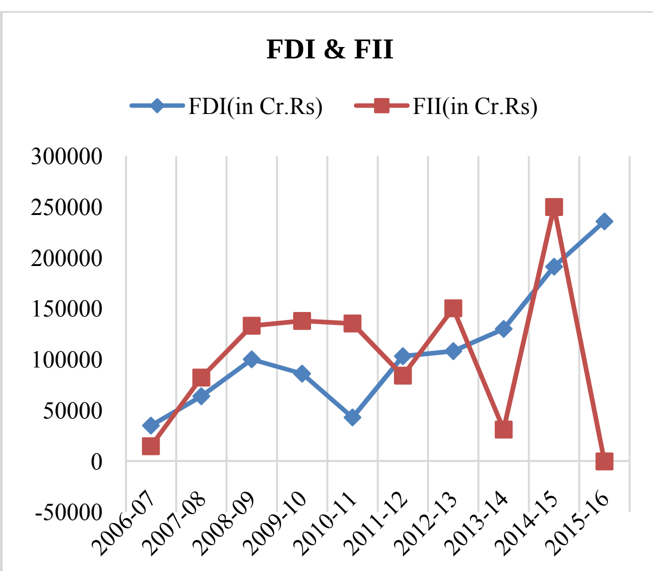
Here, the present research paper considered FDI & FII as independent variables and GDP as a dependent variable.

**Data analysis, Interpretation & Discussion:**

| Year | GDP(in Cr.Rs) | FDI(in Cr.Rs) | FII(in Cr.Rs) |
|---|---|---|---|
| 2006-07 | 4294759 | 34910 | 14660 |
| 2007-08 | 49,87090 | 63800 | 82200 |
| 2008-09 | 5630060 | 100100 | 133100 |
| 2009-10 | 6477830 | 86000 | 137900 |
| 2010-11 | 7784120 | 42900 | 135300 |
| 2011-12 | 8736330 | 103167 | 83986 |
| 2012-13 | 9944010 | 108186 | 150228 |
| 2013-14 | 11233520 | 129969 | 30991 |
| 2014-15 | 12445130 | 191219 | 249853 |
| 2015-16 | 13682040 | 235782 | -262.07 |

*Source:RBI ANNUAL REPORTS*




**Graphical interpretation**

From the above graphs, it is clear that GDP of India is continuously increasing during the entire period of study. FDI also increasing with exceptions during 2009-2011. But FII is not following any particular trend. FII were continuously investing till 2010. Up and downs were seemed to be more dominant in FII investments.

**Correlation between FDI, FII and GDP**

| Correlation matrix (Pearson): | | | |
|---|---|---|---|
| **Variables** | **GDP(in Cr.Rs)** | **FDI(in Cr.Rs)** | **FII(in Cr.Rs)** |
| GDP(in Cr.Rs) | 1 | 0.882 | 0.018 |
| FDI(in Cr.Rs) | 0.882 | 1 | -0.032 |
| FII(in Cr.Rs) | 0.018 | -0.032 | 1 |

*Values in bold are different from 0 with a significance level alpha=0.05*

Significance of Correlation coefficient:

Coefficient of correlation (r), ranges from -1 to +1. Positive values exceeding 0.5 denotes the strong relation between the variables, whereas the values for 'r' less than 0.5represents a weak relation among the variables. The sign indicates the direction of relation. If it is positive indicates the increase in the value of one variable cause an increase in the other variable vice versa. The negative sign indicates the increase in the value of one variable causes decrease in the value of other variable. Present value for 'r' between FDI and GDP is 0.882 which resembles the strong relation. Whereas, the correlation coefficient 'r' between FII and GDP is 0.018 which is very week. Un intentionally, here the 'r' value between FDI & FII is inversely related. But the strength of the relation is very weak. Sometimes, 'r' values will be fake, that depends upon the selectivity and association of variables choose to test.

| p-values (Pearson): | | | |
|---|---|---|---|
| **Variables** | **GDP(in Cr.Rs)** | **FDI(in Cr.Rs)** | **FII(in Cr.Rs)** |
| GDP(in Cr.Rs) | 0 | 0.001 | 0.961 |
| FDI(in Cr.Rs) | 0.001 | 0 | 0.930 |
| FII(in Cr.Rs) | 0.961 | 0.930 | 0 |

Significance of p-values:

Here the p-value between GDP and FDI is 0.001<α. So, there is a significant relation between FDI and GDP. It is also very clear that there is no significant relation between GDP and FII.

| Coefficients of determination (Pearson): | | | |
|---|---|---|---|
| Variables | GDP(in Cr.Rs) | FDI(in Cr.Rs) | FII(in Cr.Rs) |
| GDP(in Cr.Rs) | 1 | 0.778 | 0.000 |
| FDI(in Cr.Rs) | 0.778 | 1 | 0.001 |

| | | | |
|---|---|---|---|
| FII(in Cr.Rs) | 0.000 | 0.001 | 1 |

Coefficient of determination:

Pearson's Coefficient of determination explains how much percentage of dependent variable can be explained by the independent variable. From the above result, it is clear that 77% of GDP can be explained by FDI.

**Summary & Conclusion:**

Indian economy is one of the emerging economy with robust growth in terms of welcoming foreign investments not only to overcome current account deficit, these helping India to develop infrastructure, technology, innovations, employment and ripple the economic growth. Since two decades, the trend of indices like HDI, IIP showing how India is moving as the best among the emerging economies. The policy makers focused and implemented the policies that are evitable to the sources of foreign investments and also for the sake of the country. But there are some areas left unfocussed/ to be implemented in case of FII investments. Because FII were the profit makers in stock market and active role players. Still they were not significantly caused to raise the economy as FDI do. The capital they were bringing to India is not stable. In this way, they were just causing stock exchanges to breeze and break. So, along with the tax relaxations and exceptions, there must be strict locking period for long term investments.

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