AN INTER-COMPARATIVE STUDY OF FDI COMPONENT OF JAPANESE FDI INFLOWS TO INDIA SINCE LIBERALIZATION

ABSTRACT

THESIS

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By

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ABSTRACT

The annals on evolution history of human civilisation show that the first significant shift was seen with the introduction of activities as performed by the humans. Within the realm of economic activities, the transformation predominantly constituted emergence of trade between humans, via Barter system. As the developments in the world took place, there roused political frontiers among the nations as seen in the present scenario, and the feeling of getting excellence over other counterparts divided the whole world into “developed” and “developing” countries. Within the realm of economic activities another set of major reforms in the form of liberalisation of exchange controls emerged and resulted in well-knitted framework of financial markets which got acceleration due to increasing completion among market participants, leading to introduction of new financial instruments with broad market access and lower transaction costs, thereby attracting investors of many nationalities and countries (economies). Thus, another set of transition which took place within the economic activities expanded its scope from orthodox trade and included emergence of investment relations between the countries to mitigate the need of finance of developing countries by their developed counterparts. Investment relations between the countries got warm welcome all around the globe sooner or later, as it become source of huge funds to satiate the requisites of developing countries of attaining dual objectives of sustained and high growth rate by bridging the huge gap between the savings and investment as prevalent in most of the developing countries. These financial assistances were provided through external sources and extended its scope through time to include different forms of financing. Presently, these sources of finance include Foreign Institutional Investment (FII) or Foreign Portfolio Investment (FPI), Foreign Direct Investment (FDI), Commercial Loans, Foreign Aid, etc. Among all these available sources the most prominent had been FDI and FPI.

FDI, which according to OECD’s Benchmark Definition of FDI, Fourth Edition, refers to as “a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor”, provided bundle of physical benefits to both the parties, viz., the home country (investing country) and the host country. This excelled
popularity and acceptability of FDI over FPI. Since, FDI got applause from all-around the world; it captured the centre-stage in the economic activities of the countries and became one of the prominent sources for countries seeking finance for its distinct development programmes. FDI led various countries to get into more close and comprehensive relations.

Considering the growing proximity of various countries of the world with one another, in terms of FDI, the study attempts to build understanding of the term Foreign Direct Investment (FDI) and its different facets, alongwith, bringing out a detailed scenario of FDI relations shared by India and Japan (with special reference to Japanese FDI inflows to India). For the purpose, the study has been divided into six chapters. The first chapter brings out conceptual framework of the entire study by bringing out the relevance of FDI for India. In order to signify its importance, the study undertakes all the possible dimensions of Japanese Foreign Direct Investment (JFDI) in India since it adopted liberalization regimes in 1991. The study attempts to throw ample light over the old and new aspects of JFDI in India by looking at the relations that both India and Japan share with each other because of some of the commonalities on certain grounds and the relation they both have been sharing with each other since decades. The study also helps in ascertaining whether policy formulation and implementation efforts made from time-to-time by the Indian government officials for alluring higher and higher amount of JFDI, and thus, ensuring growth and development of the country, to certain extent, has played its role comprehensively or not. Furthermore, the study will undertake the exploration of various problems faced by the Japanese investors at different phases of their investment process, along with, prospects available in various sectors in India, as also, various suggestions regarding policy provisions and other matters that can be undertaken to ensure higher FDI inflows from Japan to India.

Since, the study is based upon FDI scenario in India, in general, and Japanese FDI inflows to India, in particular; in order to fulfil relevance of the study, the objectives of the study are framed accordingly. The objectives of the present study, henceforth, constitute general objectives and specific objectives.
**General Objectives:**

Since, the study, in general, is based upon FDI scenario in India, therefore, the general objectives attempts to:

i) Put forth relevance of FDI for India;

ii) Highlights distinct facets of FDI, like its concept, components and types; theories associated to FDI and various costs and benefits of FDI associated to host and home countries; and

iii) Highlight FDI in India and various policy measures adopted by the country from time to time to encourage FDI inflows into the country.

**Specific Objectives:**

Since the study, specifically, focuses upon Japanese FDI inflows to India; following are the specific objectives, set forth for the study:

i) To bring out, in detail, Japanese FDI scenario in India;

ii) To test whether Japanese FDI inflows to India (JFDI) and India’s total exports (TEXP) are co-integrated or not;

iii) To test whether Japanese FDI inflows to India (JFDI) and India’s total imports (TIMP) are co-integrated or not;

iv) To test whether Japanese FDI inflows to India (JFDI) and India’s total exports (TEXP) granger-cause each other or not;

v) To test whether Japanese FDI inflows to India (JFDI) and India’s total imports (TIMP) granger-cause each other or not;

vi) To examine various problems and prospects associated to Japanese FDI in India; and

vii) To provide suggestive measures to ensure higher Japanese FDI inflows to India.
In order to fulfil the above-mentioned objectives, the study extends its scope by:

1. Finding reasons that enhanced the relevance of FDI for India.

2. Focusing upon distinct theories associated to FDI which emerged at different phases of time.

3. Highlighting distinct factors that determine the flow of FDI in a country; and various costs and benefits faced by the two countries involved in the process, viz., the host country and the home country.

4. Focusing upon distinct phases of India’s economic liberalization and the reaction registered from different countries around the globe in terms of quantum of FDI inflows.

5. In particular, highlighting emergence of Japan as a major global investor and its reaction towards India’s initiatives to entice higher quantum of FDI.


7. Ascertain reason(s) for roller-coaster ride in the quantum of JFDI inflows in India.

8. Exploring the sectors/industries where lies the prospects for Japanese investors.

9. Making suggestions that would be of much help in increasing the flow and volume of JFDI inflows to India.

The second chapter is an attempt to carve-out a detailed study of FDI for better understanding of the term and its distinct facets. As such, it includes aspects like concept and definition of FDI as provided by international organisations and other sources; components that comprise FDI; different types of FDI; distinct theories associated to FDI; factors determining flow of FDI; and its various costs and benefits to the home and host country, which helped in exploring that FDI is an important source for home country for registering its presence in the host country. It provides numerous benefits, as also costs, to both the home and the host country and is affected
by various factors. FDI, as such, can take many forms and can be directed through various routes. It consists of three broad components as determined by discrete international organizations. Theories associated to FDI tries to provide answers to the questions, like why FDI occurs, when it occurs, where it occurs and who makes such an investment, thereby, making attempt to explain emergence and flow of FDI.

**Chapter three** of the study puts focus upon economic liberalisation in India and resultant trends in the inflows of FDI in India. In particular, the chapter the chapter brings out a synoptic view of emergence of Japan as one of the major foreign direct investor on the global panorama; establishment of its economic relations with India and reasons for the same. The chapter further entails trends in Japanese FDI outflows in case of India by covering various facets associated to it. The chapter helped in exploring that the process of transformations had not just been the highlighting feature for global milieu, but for the situation of various countries as well. India had been among those rare countries which, even after having strong financial standing on the world panorama, had gone through a drastic transition from financially strong economy to financially starving economy with deep-rooted imprints of its brutal exploitation during the British rule. British rule distorted the economic condition of this “full of potentials” country so much that by the time it decided to give India status of an independent country, India was empty-handed. Moreover, it became paralysed of number of problems hindering economic scenario of the country, as well as, become prone to number of other disastrous problems. To overcome these challenges India intensely required certain measures that would make deep impact on the economic condition of the country by overhauling the lunatic scenario prevailing on the economic front of the country. Thus, with the attainment of independence it was clear that India would be in need of some very heroic efforts in order to let India out of the dismay of havoc economic scenario of the country at the earliest. From herein, with an urge to be in line with the “Big-Wig” countries of the world, India initiated upon restless efforts by adopting the path of planned economic growth. The move focussed upon fulfilling certain objectives as was found necessary to build a strong economy, along with, providing ample scope for assistance through foreign financial assistance allowed remained limited to Overseas Development Assistances (ODAs) for many decades. This was because of the deep-rooted fear in the minds of Indian citizens, be it the officials or the general public, as created by the brutal regime of the
British. Henceforth, albeit India adopted to open its economy for foreign players in a phased manner, the role of external finance and foreign players was limited to a great extent. However, growth and development scenario enjoyed by economies similar to India during the decades of 1960s and 1980s, alongwith, India's zest to showcase itself on the global panorama as a leading economy, spurred it to take some stringent action, blithe with the long hold policies of Nehru's and Gandhi's. The liberalisation of the Indian economy, to tune itself with the changing economic milieu of the world, finally came up after almost 45 years of its independence on July 22, 1991. The enactment of the 1991 liberalisation reforms was not an easy task as it encountered number of agitations from employees of Public Sector Units (PSUs) and other problems like, decay in number of PSUs, poor management of PSUs, etc. Moreover, illusion about the probable role of FDI in the minds of the government officials and public; and its respective impact also created dilemma, as till that time FDI was considered as a mechanism for developing and mechanising the economy. In contrast to the various bottlenecks, liberalisation came up with series of reforms through time which helped not just in building, but also, in increasing the confidence of foreign players in India as investment destination. Some of the remarkable features included amendment in Foreign Exchange Regulation Act (FERA) with Foreign Exchange Management Act (FEMA); increasing importance of FDI over External Commercial Borrowings (ECBs); integration with world market; etc. With the enactment of relaxation regimes, the country registered spurt in the flow of FDI in the country. As such, FDI inflows into the country was registered at US$ 165 million (Rs. 4081 million) in 1991-92 (August-March) which reached the level of US$ 2,223 million (Rs. 94,040 million) by 1999-2000, even when the country faced criticism and sanctions from most countries of the world on attempting nuclear tests. For this, number of reasons was held responsible ranging from bureaucratic lethargy to policy paralysis. However, the prominent reason had been the existence of contradiction with regard to coverage of FDI statistics, as till 1999, India had been considering only the equity capital while reporting for FDI inflows in India in contrast to the items as defined in Balance of Payments (BoPs) Manual 5 of the International Monetary Fund (IMF), wherein, the components of FDI includes equity capital, reinvested capital and other capitals. With an attempt to bring uniformity in country's FDI statistics with those of the international standards, India appointed a committee who, in 2002, recommended inclusion of fourteen items under three broad heads in
country's FDI statistics to comply with the international standards. Since then, India had been publishing its FDI statistics under three broad heads, alongwith, the revised data for 2000-01 and 2001-02. During the same time, India launched second generation reforms with intent to upgrade the country with new know-how and to register India's presence on the global platform in a stronger way. The initiatives resulted in dramatic turnaround in FDI inflows compared to the previous decade. Accordingly, FDI inflows which were registered at US$ 4029 million in 2000-01 roused to US$ 36,396 million for the year 2013-14, though, during the decade downfall was also recorded in FDI inflows as an impression of global financial turmoil.

Out of the total FDI inflows of the country since 1991, Mauritius had been successful in clinching the top spot, since long back, on the list of major investors making investment in India, via. FDI. Even in case of cumulative FDI inflows (from August 1991 to January 2014), it had been ranked as number one. On the list, though, Singapore, Cyprus and UAE had been late entrants, but were successful in placing themselves among the top ten investing nations for the last five years or so. Else than this, other countries on the list, viz., U.S.A., U.K., Netherlands, Japan, Germany and France had retained their presence on the list of top ten, since liberalisation, though at different positions at different phases of time.

While looking at the direction of FDI inflows (Sectoral FDI) of India, it had been observed that sectoral FDI inflows face tremendous turnarounds. An analysis of the top ten sectors shows that electrical equipments, though, ruled the list from 2003-04 to 2005-06, had not been able to attract ample FDI in the later years, and thus, dropped out not just from the top spot, but also from the list of top ten. Similar is the case with other industries which includes transportation industry, food processing industries, drugs and pharmaceuticals, etc. Since 2006-07, the list of the top ten FDI attracting sectors had been out-rightly reigned by service sector with frequent reshuffles in case of other sectors leading to entry and exit of various sectors and rise and fall, in position, of distinct sectors on the list of top ten.

On the other hand, while making analysis of the region-wise FDI inflows to India from April 2000 to March 2014, it had been observed that Mumbai region had been
leading the list since 2008-09 followed by New Delhi region, Chennai, Bangalore and Ahmadabad respectively.

While India became the front runner in major economic transformations among the developing countries, the front runner in case of developed counterparts predominantly constitutes Japan. Japan encountered a brutal destruction of its country, both socially and economically, by the nuclear attacks. However, after this incidence of 'mass-massacre', Japanese government started attempts to overhaul its economy by amending its Foreign Exchange Law. Resultantly, by 1951, Japanese companies were allowed to make direct investment in the overseas market. Still, Japanese FDI was not able to ensure any significant presence on global platform, at least till 1960s, due to imposition of severe restrictions by the Japanese government as a result of Balance of Payments (BoPs) deficits. The radical shift in the prevailing scenario emerged in the late 1960s and early 1970s. During this time, on the one hand, the world faced the shocks of oil crisis, and on the other, the neighbouring countries of Japan faced reduction in manufacturing costs, thereby, becoming palpable choice for Japanese investors by encouraging investment from Japanese companies. In particular, the oil crisis during 1970s contributed in the emergence of manufacturing sector as one of the most alluring sector that helped in boosting Japanese FDI during that phase. Among various Japanese companies, companies associated to chemical industry and the iron and steel industry were the early birds that stepped up with efforts to establish their bases in other countries, even if, there were restrictions of obtaining official approval, which had been subject to certain conditionalities, by the investors.

With the introduction of Plaza Accord in 1985, a further turnaround in FDI outflows of Japan was registered. All these initiatives collectively let Japan to emerge on global platform as one of the largest sources of FDI. Number of other factors also provided a helping hand in this regard. Some of these include country's surged current account surpluses, yen appreciation, higher labour costs in domestic markets, etc. Moreover, Japanese FDI not just registered a frequent and massive surge in its quantum, but also, turnaround in its direction as, by 1980, about half of the FDI from Japan was directed towards developing countries. Since then, though Japanese FDI outflows had seen downfall, it still able to comprehensively manage its position among the top-notch investors of the world. Though, Japan emerged as a world's major economy and a dominant trade force in the entire world, and particularly, in the Asian region; and
though India and Japan holds a long history of indirect cultural and economic exchange, it didn’t helped India much in giving boost to this bilateral economic relations, at least, upto early 1990s as India seems to be entertained by sizeable quantum of Japanese FDI only since 1997.

Earlier to this, ODAs from Japan was the only representation of Indo-Japanese economic ties and low investment attractiveness of India for Japanese firms was the cumulative effect of “Cold War” and the economic planning in India. With the enactment of 1991 reforms and “Look-East Policy” in 1992, India adopted to develop strong economic ties with the member countries of the Association of South-East Asian Nations (ASEAN) and other “Big-Wig” countries. Resultantly, in a decade or so, India registered good economic bonding with some of the major countries of East Asia. However, India doesn’t found itself successful in framing policies which could entice Japanese FDI both in pre-and post- liberalisation period, considerably hindering the FDI flows from the country. India caught eyes of Japanese investors in the later half of the decade 1990. Since then, Japan had been a key source of FDI for India, even if, the economic relations had dwindled due to incidences taking place in and outside the country.

The growing preference of India as an investment destination for Japanese investors had been designated as an aftermath of shared past. However, there had been number of reasons which included special position held by India in the region because of historical, ethnic and emotional relations with the neighbouring countries; India’s robust economic growth; India’s efforts for creating a better and peaceful world; Japan’s “China plus one” policy; etc. With the growing engagement of relations between India and Japan increase in FDI inflows from Japan also started to surge. Today, Japan holds its position among the top ten investment countries with cumulative investment of US$ 13,578 million (Rs. 66,185 Crores) for the period ranging August 1991 to March, out of which US$ 11,867 million (Rs. 59,115 Crores) had flows into the country since April, 2003. The sectoral analysis revealed that for the decade 1990 the concentration of the Japanese FDI was mainly in the transportation sector which was taken over by drugs and pharmaceuticals industry for the period ranging January, 2000 to December, 2012. The analysis of region-wise Japanese FDI inflows reveals that it is prominently concentrated in the southern region of the country due to infrastructural set up and state government policies
towards FDI. Later followers on the list include Delhi/NCR region, Western region, region around Bangalore and the Eastern region respectively. Within the southern region Tamil Nadu had been the favoured state followed by Delhi/Haryana of the NCR/Northern India region and Maharashtra of the Western India region respectively.

Chapter four, by considering the growing engagement between India and Japan, with specific reference to FDI, attempts to carry out the empirical part of the study. As such, the study attempts to analyse whether Japanese FDI inflows to India holds long-run association with India’s total exports and imports; and whether there exist some causality between Japanese FDI inflows to India and India’s total exports and Japanese FDI inflows to India and India’s total imports, on the basis of quarterly data for the period ranging January-March 2006 to January-March 2014. For the purpose, following hypothesis had been framed:

The first two hypotheses, in this regard, attempts to explore whether variables TEXP and TIMP are co-integrated to JFDI or not. For this purpose, hypothesis as stated below has been framed and worked upon:

Hypothesis No. 1:

Null Hypothesis (H₀): Co-integration (or long-run association) between Japanese Foreign Direct Investment (JFDI) and Total Exports from India (TEXP) does not exist.

Hypothesis No. 2:

Null Hypothesis (H₀): Co-integration (or long-run association) between Japanese Foreign Direct Investment (JFDI) and Total Imports to India (TIMP) does not exist.

For the purpose of testing existence of causality between TEXP and JFDI; and TIMP and JFDI; and in case of existence of causality between the variables, the direction for the same, following sets of hypothesis has been framed and worked upon:
Hypothesis No. 3:

3.1 **Null Hypothesis (H₀):** Japanese Foreign Direct investment (JFDI) does not granger-cause Total Exports from India (TEXP).

3.2 **Null Hypothesis (H₀):** Total Exports from India (TEXP) does not granger-cause Japanese Foreign Direct investment (JFDI).

Hypothesis No. 4:

4.1 **Null Hypothesis (H₀):** Japanese Foreign Direct investment (JFDI) does not granger-cause Total Imports to India (TIMP).

4.2 **Null Hypothesis (H₀):** Total Imports to India (TIMP) does not granger-cause Japanese Foreign Direct investment (JFDI).

In case of hypothesis 1 and 2, wherein, attempt is to test for existence or non-existence of co-integration or long-run associationship, the results revealed that the p-value was found to be 0.304 OR 30.4 percent and 0.639 or 63.9 percent respectively. Since the p-value in both the cases are more than the criteria of 5 percent or 0.05, therefore, null hypothesis stands accepted, which states that there is non-existence of co-integration or long-run associationship between the variables Japanese FDI (JFDI) and India’s total exports (TEXP); and Japanese FDI (JFDI) and India’s total imports (TIMP). On the other hand, in case of hypothesis 3, wherein the attempt is to test for the existence of causality, the p-values were found to be 0.941 or 94.1 percent and 0.011 or 1.1 percent respectively, in case of Japanese FDI (JFDI) granger-cause India’s total exports (TEXP) and India’s total exports (TEXP) granger-cause Japanese FDI (JFDI). Moreover, the F-statistic revealed values of 0.006 and 7.37 respectively against the critical value of 2.114. Thus, in this case there is existence of unidirectional causality, wherein, TEXP granger-cause JFDI.

Contrary to this, in case of hypothesis 4, wherein, the attempt is to test for the causality the p-values were found to be 0.029 or 2.9 percent and 0.026 or 2.6 percent respectively, in case of Japanese FDI (JFDI) granger-cause India’s total exports (TIMP) and India’s total exports (TIMP) granger-cause Japanese FDI (JFDI). In adjuncts, the F-statistic, in this case, revealed values of 5.27 and 5.54 respectively.
against the critical value of 2.114. Thus, there is existence of bidirectional causality, wherein, JFDI granger-cause TIMP; and TIMP granger-cause JFDI.

Compendiously, the results revealed that between the variables in both the cases, co-integration does not exist; causality is unidirectional, in case of causality between JFDI and TEXP, wherein, total exports from India granger-cause Japanese FDI in India; and causality is bidirectional, in case of causality between JFDI and TIMP, wherein, Japanese FDI in India and total imports to India granger-cause each other.

From the emerging trends in Japanese FDI inflows to India and its associationship with India’s total exports and total imports, alongwith, its causality with India’s total exports and total imports, it was required to inquire about the reasons for low quantum of FDI inflows from Japan, even when the two countries share a strong economic bonding with each other. Chapter five, henceforth, attempts to inquire about the various problems that have hampered the flow of JFDI in India, even if the country holds enormous prospects for Japan, as also, when it shares the centre stage with China as most favoured investment destination for Japan. Further, the chapter also focuses upon prospects available for Japanese FDI in different sectors of the country where they Japanese companies can ensure their presence and contribute by making investment – financial and technical. The examination of these aspects helped in exploring that Japanese investors face various problems even after sharing a rich past in terms of political, cultural and economic relations. These gamut of problems range from physical facilities to policy paralysis and bureaucratic bottlenecks that had acted as an impediment to the Japanese investment in India – directly or indirectly. However, it was revealed that the problems are in existence on both fronts, India holds much more problems as far as JFDI inflows are concerned. These problems are considered as fierce issue in low level of FDI relations and demands for immediate efforts to resolve these issues. Moreover, albeit number of problems exists with making investment in India, the prospects are also quite alluring. There are number of sectors/industries wherein the Japanese investors can look for their presence. Presence of flourishing prospects in various sectors/industries of the country had made Japanese investors to maintain their zeal for investment in India even after facing number of problems, and even if, present Japanese business establishments in India and prospective Japanese investment are feeling the heat of it. Some of these sectors/industries include Information Technology/ Information Technology Enabled
Services (IT/ITES), infrastructure, steel, drugs and Pharmaceuticals, food-processing, etc.

In order to reap benefits by increased Japanese FDI inflows in the prospective sectors/industries, as well as other sectors/industries, of the country there are number of suggestive measures implementation of which may found to be worthy enough. Therefore, *Chapter six*, within its ambit, embrace the conclusions of the study and, on the basis of the problems faced by the Japanese investors, made various suggestive measures that may be adopted by India to overcome these problems and subsequently help in increasing the quantum of FDI from Japan. Moreover, some other suggestions that may help in increasing the quantity and flow of Japanese FDI towards India had also been made. Some of the suggestive measures include building efficient infrastructure, use of high-end IT/ITES, mitigating policy, regulatory and bureaucratic bottlenecks, etc. In addition to this, number of general problems that need to be rectified at the earliest and in the best possible manner constitutes achieving and sustaining high economic growth rate, analyzing and acting in accordance to the changing trends in the nature of Japanese investment; achieving and sustaining high economic growth rate; address issue of “round-tripping” and “Double Tax Avoidance Agreements” (DTAA); encourage consistent bilateral exchange of views between the two countries on matters of investment or on matters that may encourage flow of investment from Japan to India; analysing the “best practices” adopted by each state, etc.

Contrary to the fact that India is paralysed of number of problems hindering inflows of FDI in India from various countries, in general, and from Japan, in particular, and need serious attention from the Indian government; it solely cannot be held responsible for lower volume of FDI from Japan in India as number of loopholes exist on the part of Japan as well and need vigilant concern from Japan in order to ensure strong and perpetual economic ties with India which will not only lead to increase in FDI from Japan to India, but also, its trade with India. In this regard, *firstly*, Japanese investors need to study India’s dynamic business milieu and consumer behaviour in a more comprehensive manner and accordingly adapt to it. *Secondly*, Japanese companies need to respond quickly to move away from traditional approach of controlling the management of their establishments in India and look towards the option of delegating complete autonomy to Indian managers for managing their
Indian establishments. Thirdly, Japan should also look forward to convert its ODA into FDI to the maximum possible extent.

The study, since, attempt to ordeal the point that if Japan and India holds one of the oldest and strongest bilateral relations, so much that they are regarded as the ‘natural ally’; the same had been reflected in their economic ties as well or not, by laying objectives of the study, specifically, attempted to bring out an inter-comparative study of Japanese FDI inflows to India with India’s total exports and imports. Henceforth, there remains number of spheres uncovered which can be extended by making an inter-comparison of Japanese FDI (inflows to India) with spheres like, India’s economic growth, trade balance, foreign exchange, Japanese ODA, India’s total FDI inflows, etc.
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2014
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I, Bhawana Rawat, Department of Commerce, certify that the work embodied in this Ph.D. thesis is my own bona fide work carried out by me under the supervision of Prof. Badar Alam Iqbal at Aligarh Muslim University, Aligarh. The matter embodied in this Ph.D thesis has not been submitted for the award of any other degree.

I declare that I have faithfully acknowledged, given credit to and referred to the research workers wherever their works have been cited in the text and the body of the thesis. I further certify that I have not willfully lifted up some other's work, para, text, data, result, etc., reported in the journals, books, magazines, reports, dissertations, thesis, etc., or available at web-sites and included them in this Ph.D. thesis and cited as my own work.

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CERTIFICATE FROM THE SUPERVISOR

This is to certify that the above statement made by the candidate is correct to the best of my knowledge.

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[Signature of the Chairman of the Department with seal]
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This is to certify that Ms. Bhawana Rawat, Research Scholar, Department of Commerce has satisfactorily completed the course work/comprehensive examination and pre-submission requirement which is part of her Ph.D. programme.

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*Feeling gratitude and not expressing it is like wrapping a present and not giving it.*

– William Arthur Ward

*I would maintain that thanks are the highest form of thought; and that gratitude is happiness doubled by wonder.*

– G.K. Chesterton

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(Bhawana Rawat)
Preface

In the economic sphere of the present world order foreign Direct Investment (FDI) has shown unprecedented growth. FDI, which came into existence as a result of efforts of developed countries to liberalise its economy with intent to embrace FDI within its economic system, in order to complement their international trade activities, seems to out-pace it by frequently becoming one of the prominent activities within the economic sphere of the global business milieu. Seeing the benefits enjoyed by the developed countries, though later, developing countries also joined the league.

The result of making global economic milieu more liberalised came in the form of integration of countries leading to comprehensive bilateral relations, however, other reasons also contributed in giving boost to these close economic ties. One example of such a comprehensive bilateral ties is of India and Japan. The bilateral relation of the two countries had been designated to have emerged due to shared common past and shared history of their upsurge in their own respective ways. Today, the bilateral relations between the two countries are so well-knitted that they are often designated as “Natural Ally” of each other, wherein, both the countries seek for, and thereby, offer unconditional helping hand to fulfil other’s economic and strategic aspirations. Within, the realm of economic sphere, particularly FDI, Japan had emerged as one of the major investor fulfilling the financial requirements of India to a considerable extent in the crucial sectors/industries of the country.

Considering the growing economic scenario between India and Japan, in terms of FDI, the study makes an endeavour to: develop understanding of the term FDI by highlighting distinct facets of FDI, like its concept, components and types; theories associated to FDI and various costs and benefits of FDI associated to host and home countries by putting forth the growing relevance of FDI for India; deeply examine the distinct facets associated to JFDI in India since liberalization by highlighting emergence of Japan as major global investor; various policy measures adopted by India from time to time to encourage FDI inflows into the country; resultant scenario of Japanese FDI inflows to India; and bring out an inter-comparative study of Japanese FDI with India’s total exports and India’s total imports on the basis of quarterly data for the period ranging January-March 2006 to January-March 2014.
The study also puts focus upon distinct problems faced by Japanese investors in India and the availability of distinct prospects that had encouraged Japanese investors to stick to their plans of investment in India. The study, moreover, attempts to enlist suggestive measures that would be of much assistance to India in ensuring that higher quantum of FDI outflows from Japan gets directed towards India.
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1.1 INTRODUCTION

Trade has been an indispensible concept since the inception of the human civilization. The nature of trade activities was unique in its own sense, as also, its extent was limited. As the developments in the world took place, there roused political frontiers leading to creation of different nations. At the same time, there took place technological advancements which took the human civilization into the new world, providing ample scope for trading activities. With this, trade activities extended its arms of operations and were started taking place between countries which registered an extraordinary paced growth after World War II; credit of which could be easily attributed to the world wide increase in demand and rapid developments in infrastructure and technology. Emergence of political frontiers reaped the feeling of getting excellence over other countries of the world which encouraged the countries to get them engaged in activities which were far more novel and progressive than others. This feeling led to the emergence of another major global scenario in the form of division of the entire world into “developed” and “developing” countries. Developed and developing countries were the representatives of two extremely different worlds in one single world due to the qualities possessed by the two ends. As such, since developed world was successful in reaping benefits from the changes taking place around the globe, they were able to equip themselves with the high-end facilities, in addition to sufficient financial resources. On the other hand, developing world remained almost empty-handed as they were not able to reap benefits from the same, and had to stare towards their developed counterparts to mitigate their insatiate desires.

The world saw another major reform in the form of liberalization of exchange controls and market access which paved the way for emergence of well-knitted global framework of financial markets, acceleration to which was provided by increasing competition amongst market participants, leading to introduction of new financial instruments with broad market access and lower transaction costs, thereby, attracting investors of many nationalities and countries (economies) (OECD, 2008). As a result, the global milieu saw extension in its activities in different spheres, in addition to trade and investment.
Among all sorts of assistance prospects available, investment is not just the vital, but also, the first and the foremost requirement for every country peeping-around for long term growth, varying over the life of an economy – from growing stage to maturity and to decay. At the nascent stages of development process economies requires relatively large quantum of investment for ensuring attainment of dual objective of sustained and high growth rate. In case of developing economies, since the domestic savings to investment ratio is considerably low, the money so generated does not prove to be ample to carry-out the developmental programmes. This requires assistance from external sources which could be arranged through various means like, Foreign Institutional Investments (FII), Commercial Loans, Foreign Aid, etc. Henceforth, the transition of global economic milieu and the after-effect transmission of efforts by the entire world set the stage for foreign investment which had been an eye-catching issue since a long period of time.

Investment in a country from other countries represents an important aspect of international finance, as it is seen as a means to supplement domestic investment for achieving a higher level of economic development. Foreign investment is quite often favoured and encouraged because of the benefits availed by domestic industry, as well as, by the consumers through availability of opportunities for technological upgradation, access to global managerial skills and practices, optimal utilization of human and natural resources, developing international competitiveness, providing backward and forward linkages, access to international quality goods and services, etc. (Saleem, 2007)

In the present scenario, albeit, distinct sources of external finance are available to facilitate finance-seeking countries, the flow of international finance in any country prominently take the form of portfolio investment or direct investment. The difference between the two arises as a result of bundle of physical benefits provided by the former compared to the latter. In this regard, Foreign Direct Investment (FDI) is outsider’s cash, invested directly into another country to enhance production or purchase of company (fully or partially). Thus, FDI is also termed as brick and mortar investment which focuses profit at its core. Contrary to this, Foreign Portfolio Investment (FPI) is investment into financial instruments such as stocks and bonds. The objective, herein, is not to have direct involvement in business but to generate dividend income, interest income, and capital gains (Jonnard, 1998). Thus, among the
various modes of foreign investments, direct form had gained substantial preference over others because of the bundle of benefits provided by it to the home and the host country.

The transition of India from financially strong economy to financially starving country had imprints of its exploitation during the British rule which distorted the economic condition of this ‘full of potentials’ country. With the attainment of independence, India had been looking forward to be on par with other countries of the world. In this effort it had been supported by some of the countries through Overseas Development Assisances (ODAs). Even India doesn’t look, for decades, towards other sources of finance to mitigate its financial requirements for its growth and development. However, with the passage of time, India realized that, for sustained growth and development of the country, the need of the hour is to untap its resources for foreign players. This made the country’s think-tank to look over the possibilities for intrusion of foreign investment by way of direct investment, i.e., Foreign Direct Investment (FDI) and portfolio investment, i.e., Foreign Portfolio Investment (FPI), and probable benefits from it. Resultantly, came the ‘Red-letter Day’ for India, in 1991, with the adoption of the Liberalization, Privatization, and Globalization regimes, which opened the flood gates for huge foreign inflows in various sectors of the country.

FDI in this regard, had indeed played an appreciable role as compared to its counterparts around the globe. India seeking possibility of reaping numerous benefits from it and the possibility of overcoming from the burden of heavy balance of payments (BoPs) debts liberalized its policy regimes in 1991. However, the step did not come instantly and was the result of number of phases. Resultantly, India registered a phenomenal growth in FDI inflows in the country. India’s growth made it accentuated by the world as it was slowly, but steadily, kept on crawling above the preference list of present and prospective investors because of number of benefits it possessed for the investors, and the number of benefits it offered to the investors by bringing reforms from time-to-time. Changing scenario in the global arena, for India, led to the entry of almost all the major economies throughout the world, thus, making it an obvious selection of their “Destination FDI”. Since then, FDI in India is venturing into new dimensions with every new dawn, providing assistance in
fulfilling India’s aim of being recognized as a “Super Power”, having potential to move the world around.

Japan, the “land of opportunities and rising sun”, whose majestic efforts towards its growth and development, after getting rebirth from its ashes, had outshined many countries to become one of the prominent investors for developing nations. It had, since centuries back, been sharing some of its major characteristics with India and had been the biggest ODAs provider to India for decades. Seeing the growth trajectory of India on global stage it also brought a sea-change in its perception, and started its zest towards looking around the prospects of putting India under the purview of its investment radar.

The initiative to have better investment relations was not a unidirectional effort, emerging from Japan’s way. India was equally inquisitive in the initiative because of the numerous benefits that could not be offered to it by other investing countries. For the purpose, both the countries focused upon formulations of new policies and transformations in the existing ones as and when became necessary. These initiatives helped both the countries to become a home and host country for each other in case of investment, even if, they have faced some leaps and bounds in their relations. An extensive exploration for searching-out the possible reasons, that created “magnet-effect” and brought India and Japan close to each other as FDI host and home country respectively, put forth bundle of reasons. Some of these reasons include:

- two of the oldest civilizations with shared past (Rajamohan, Rahut, and Jacob, 2008);

- Robust economic growth of India in the recent past which have dramatically changed India’s image on global panorama, and especially in Japan, had also helped the country in clinching some of the major joint ventures (JVs) with Japan. Delhi-Mumbai Industrial Corridor (DMIC); Delhi Metro Project; Daiichi-Ranbaxy; Tata-Doconmo; are few on the list to describe the growing economic bond between the two countries (RIETI, 2006) (para 3);

- Japanese companies strategy of “China plus One”, in order to disperse risk which mainly aroused as the aftermath of the anti-Japanese demonstrations in
China in 2005. India seems to be strongly fulfilling the requirements of this
"plus one" for Japan (RIETI, 2006) (para 1); and

- Large domestic market share; rich spectrum of human capital; complementary role of India in certain sectors; abundance of raw materials and minerals in India had also gave acceleration to the pace of Indo-Japanese economic relations. (www.ibef.org, 2010) (p-6)

In addition to these specific reasons, some general reasons for "Destination India", as implemented by Japan, includes efficiency of majority of Indian population over English language; largest and strongest democracy; enactment of open-door policy for investors by the Indian government; and India’s constant support in restructuring of better and peaceful world (i.e., free from war and disharmony); etc. (nrifinanceguide.com, 2009)

1.2 FDI: RELEVENCE TO INDIA

An extract from the study conducted by OECD (2002) (p-5) emphatically enlists various benefits of FDI for developing countries. Accordingly,

"The overall benefits of FDI for developing countries/economies are well documented. Given the appropriate host-country policies and a basic level of development, a preponderance of studies shows that FDI triggers technology spillovers, assists human capital formation, contributes to international trade integration, helps create a more competitive business environment and enhances enterprise development. All of these contribute to higher economic growth, which is the most potent tool for alleviating poverty in developing countries. Moreover, beyond the strictly economic benefits, FDI may help improve environmental and social conditions in the host country by, for example, transferring "cleaner" technologies and leading to more socially responsible corporate policies."
India, being part of the developing world, had been suffering from the chronic problem of scarcity of financial resources, and thus, always been in dire need of foreign capital which had encouraged it to indulge in the efforts that can entice huge amount of FDI in the country in order to reap various benefits through it. Among the various sources of external finance, since FDI provides number of visible and invisible benefits, henceforth, it had become an palpable choice for making financial arrangements for India, like most of its counterparts, and most of India’s efforts had been directed towards enticing higher and higher quantum of FDI in the country. These benefits can be enlisted as under:-

1.2.1 Capital Inflows

Since FDI is the investment of capital, therefore, at its most basic level, direct investment by multinationals leads to capital inflows into the economy. These capital inflows are directed towards increasing the productive capacity of the host country or increasing its foreign exchange earnings through export expansion. (Paul, 2008)

1.2.2 Fill the Savings Gap

One of the fiercest problems for any developing country is the presence of huge gap between domestic savings and investment required for undertaking its growth activities. To this, FDI, with the help of huge capital inflows, acts as a supplement in filling the huge gulf between and domestic savings and funds required for growth. (Arango, n.d.)

1.2.3 Increased Productivity in Domestic Firms

Since FDI facilitates intrusion of foreign competitors in the country, domestic firms are bound to become more productive in order to face competition posed by the foreign firms. The increased productivity holds importance as it makes a crucial contribution to country’s economic growth. (Chatterjee, 2003)

1.2.4 Employment Generation

The upgradation of the production capacity by the domestic companies as a result of entry of foreign companies leads to generation of employment opportunities within the country, thereby, making a crucial contribution to country’s growth both directly as well as indirectly. (Paul, 2008)
1.2.5 Technology and Know-how

Among the various benefits of FDI includes the transfer of technology from home to the host country, particularly in the form of new varieties of capital inputs that cannot be achieved by means of financial investments or trade in goods and services (Loungani & Razin, 2001). Transfer of technology and know-how via FDI is of extreme importance and is highly prized in developing countries like India, as it results in enhanced productivity, thereby, making commendable contribution in the growth of India. Contribution to the technological base of the host economy by the foreign firms can be made directly as well as through technological spillovers to other firms in the industry. (Paul, 2008)

1.2.6 Transfer of Risk

Various studies on FDI also provides ample evidences to support the view that FDI helps in shifting the burden of risk of making investment in large quantity from domestic investors to the foreign investors (Cherunitam, 2009). This is because of the reason that in case of FDI, investment in a country for the enactment of its growth and developmental programs flows from outside the country, which performs the responsibility of taking every risk arising in the meantime, the burden of which would otherwise fall over the country.

1.2.7 Development of Basic Infrastructure

It has been quite often observed that because of the inadequacy of the domestic capital in case of developing countries like India, the responsibility of undertaking development programs to edifice its economic objectives cannot be fulfilled on its own. Henceforth, in order to undertake this task, capital deficit countries had to stare for the opportunities for getting assistance of capital from foreign firms, especially in the form of FDI. (Jain & Singh, 2007)

1.2.8 Strengthening of Government Budget

FDI also helps in easing the burden on national budget. This is because of the reason that foreign firms are a source of income-tax for the government, as also, the source of tariff on their import, and a supplement for government’s investment activities. (Sharan, 2008)
1.2.9 Integration with World Economies

FDI, as it comes from foreign countries, acts as a bonding device to integrate Indian economy with different investing countries. In addition, through its varied forms, FDI ensures entry of new goods and services, produced anywhere in the world, in its domestic market. (Arango, n.d.)

1.3 SIGNIFICANCE AND UTILITY OF THE STUDY

In order to make the study more meaningful and purposeful, an attempt has been made to undertake all the possible dimensions of Japanese Foreign Direct Investment (JFDI) in India since it adopted liberalization regimes, i.e., since 1991. The study attempts to throw ample light over the old and new aspects of JFDI in India. The worth of the study can be outlined with ease by looking at the relations that both India and Japan share with each other because of some of the commonalities on certain grounds and the relation they both have been sharing with each other since decades. The results, so derived, will help in ascertaining whether policy formulation and implementation efforts made from time-to-time by the Indian government officials for alluring higher and higher amount of JFDI, and thus, ensuring growth and development of the country, to certain extent, has played its role comprehensively or not. In addition, Japanese response with respect to JFDI inflows in India will help in enlisting distinct sectors where JFDI plays a prominent role, and thus, comprehensively contribute to the fulfillment of Indian aspirations, i.e., its economic development. Furthermore, the study will undertake the exploration of various problems faced by the Japanese investors at different phases of their investment process, along with, prospects available in various sectors in India, wherein Japan can ensure its presence as a major player and can extract bunch of benefits. The study also undertakes various suggestions regarding policy provisions and other matters to ensure higher FDI inflows from Japan to India, which had already been moving smoothly over the path of grabbing considerable chunk out of the global FDI flows throughout the world.
1.4 REVIEW OF LITERATURE

In order to ascertain the feasible research gap, the review of literature is a pre-requisite. Hence, in the following pages effort to review various studies having relevance for conducting this research has been carried out. As such, review of various literatures has been done from three distinct perspectives which include:

1.4.1 Review from Indian Perspective;
1.4.2 Review from Japanese Perspective; and
1.4.3 Review from Indo-Japan Perspective.

1.4.1 Review from Indian Perspective

Hameedu, M. S. (2014), through his paper entitled, 'Foreign Direct Investment: The Indian Scenario', carves out the scenario, role and scope of Foreign Direct Investment in India by analyzing its trend in India to reveal that through creation of jobs in India, from April 2000 to March 2013, inflow of FDI in service sector and construction and development sector has attained substantial sustained economic growth and development. While Computer Software & Hardware and Drugs & Pharmaceuticals sectors received due importance by FDI, performance of other sectors had been quite poor. The paper also brings out some recommendations to improve the position of FDI in India.

Aggarwal, S.; Singla, A. and Aggarwal, R. (2012), through their paper entitled, ‘Foreign Direct Investment in India’, tries to find out the role of FDI in India and found it as an important stimulus for India’s economic growth. Analysis of sector-wise & year-wise analysis of FDI inflows to India reveals that Mauritius had invested highly in India followed by Singapore, Japan, and USA etc.; and during the year 2000 to 2011, FDI inflow in India had increased tremendously in Service sector and Banking and insurance sector. The findings also revealed that FDI had created high perks jobs for skilled employee in Indian service sector and had also played important role in development of country’s infrastructure; and albeit India had restricted FDI in certain sectors, yet, FDI can have good future growth in Retailing and Real estate sector in India.
Devajit, M. (2012), in his paper, entitled, ‘Impact of Foreign Direct Investment on Indian economy’, tries to find out the implications which have affected the economic scenario in India by investigating the impact of FDI on India’s economic growth. The paper also attempts to measure the level of predominance of various factors through which FDI can play a role of catalyst for India’s economic growth to reveal that the country need to redesign its FDI policy focusing upon opening up of the export oriented sectors and much freedom to states.

Goel, S.; Kumar, K. P. and Rao, K. S. (2012), in their paper entitled, ‘Trends and Patterns of FDI in India and its Economic Growth’, tries to identify importance of distinct variables (at the macro-level) in attracting FDI inflows to the country and assess their impact on India’s FDI inflows and revealed that while Trade GDP (Total Trade as percentage of GDP), Reserves GDP (Foreign Exchange Reserves as percentage of GDP), and FIN. Position (Financial Position) variables are the pull factors, exhibiting a positive relationship, for FDI inflows to the country; R&DDGDP (R&D as percentage of GDP) and Exchange rate are the deterrent forces, exhibiting a negative relationship, for FDI inflows into the country. The paper also revealed that failure to raise R&D and stabilizing exchange rates of the economy, depicts appreciation of Indian Rupee in the international market providing opportunity to the policy makers to attract FDI inflows in Greenfield projects rather than attracting FDI inflows in Brownfield projects, as also, that FDI has been a significant factor that had influenced the level of economic growth in India, as also, helped in increasing the trade in the international market.

Ray, S. (2012), in her paper entitled, ‘Impact of Foreign Direct Investment on Economic Growth in India: A Co integration Analysis’, provides a rich insight of the relationship shared between FDI and Growth by using co-integration approach for the period 1990-91 to 2010-11, results of which revealed existence of positive relationship between FDI and GDP and vice versa; as unit root test and Johansen co-integration test revealed existence of co-integration, Granger causality confirmed presence of unidirectional causality running from economic growth to FDI. On the front of suggestive measures, to ensure that FDI play a prominent role in economic growth in India, the paper stressed the need to improve upon number of aspects like, infrastructure, human resources, developing local entrepreneurship, etc.
Bhanagade, D.B. and Shah, P.A. (2011), through their article, ‘Study Of Impact Of FDI On Indian Economy’, makes an endeavour to put-forth distinct benefits of FDI, by analyzing study made by Bosworth and Collins (1999) in Indian scenario. By exhibiting trends in FDI inflows in developing countries and perception of foreign companies regarding India’s business environment, the article carves-out the success factors for India, as revealed by studies of Mark and Moira and FICCI 2002, and FDI climate in Indian states by considering FDI in India’s service sector from 2000 to 2008.

Chaturvedi, I. (2011), in her paper entitled, ‘Role of FDI in Economic Development of India: Sectoral Analysis’, makes an endeavour to highlight the role of foreign direct investment in India’s economic development through analytical study of secondary data. The paper identifies country-wise approval of FDI inflows to India; its sectoral distribution; sectors enticing highest FDI; and correlation between FDI and economic development, and concludes that FDI is one of the utmost requirements of developing economies for its economic development. Further, policy recommendations have also been put forward.

Kumar, G. and Dingra, N. (2011), in their paper, ‘Impact of Liberalisation on FDI Structure in India’, makes an attempt to examine the growth of FDI inflows to India in pre and post liberalization period; structure of FDI in India; and changes in the sectoral composition of FDI under the policy of liberalization. The paper by considering growth of FDI inflows during 1981 to 1990 and 1991 to 2010 by calculating CAGRs concludes that FDI inflows have shown significant growth in the post liberalization period. Moreover, there has been a shift in FDI inflows towards service sector on the cost of manufacturing sector FDI.

Mahalakshmi S., Thiagajaran S. and Naresh G. (2011), through their paper entitled, ‘Influence of Macro-Economic Indicators on Foreign Direct Investments in India’, evaluates the impact of some specific macro-economic determinants of FDI inflows, as outlined by analysis of empirical studies, to India for a period ranging from 1991-92 to 2009-10. The results, by applying Least Square technique and after writing-off certain discrepancies, inferred that all the growth factors has an equal influence on FDI inflows to India. Lastly, suggestive measures were put-forth that efforts are required to boost-in the growth factors for enticing foreign investment,
especially Greenfield investments and increment in its bargaining power among other
developing nations.

Ansari, Md. S. and Ranga, M. (2010), through their paper, ‘India’s Foreign Direct
Investment: Current Status, Issues and Policy Recommendations’, tries to study
the current status of FDI in India. The findings on the basis of analysis of data from
1991-2000 and various other aspects, viz., factors affecting FDI flows in India;
reasons for regional imbalances; review of FDI policy; and issues and concerns
associated to FDI, shows that India’s economic policy acted as a constraint for FDI
inflows in the country as compared to Newly Industrialized Asian Countries (NIAEs).
Lastly, policy recommendations were put forth.

Choorikkadan, V. (2010), through his article, ‘Can India Become a
Manufacturing Power House Too?’ highlights determinants that has driven Indian
growth over the past two decades. It also includes comparison of India’s and China’s
manufacturing contribution to merchandise exports and GDP growth, and reveals that
lack of unskilled labour-intensive manufacturing units are hampering growth in the
Indian economy. Even India’s import-substitution regime has favoured capital and
skill-intensive manufacturing, and the reforms so made have not been fruitful.
Comparison of FDI inflows reveals lack of openness to FDI as a constraint in India’s
growth, India attracting horizontal FDI more because of higher tariff rates and trade
costs, and suggests creation of congenial environment to become self-sufficient and a
manufacturing powerhouse.

Demibas, D.; Patnalk, I. and Shah, A. (2010), through their paper, ‘Graduating to
Globalization: A Study of Southern Multinationals’, studies relationship between
firm’s productivity and different modes of globalization activities emerging in
developing countries as an aftermath of FDI, by using firm-level panel data from
India. The conclusions, with the help of ordered-probit model, predictions of the
literature on firm’s exports versus FDI decisions (as shown in HMY, 2004 and Head
and Reis, 2003), exhibits clear demarcation between domestic firms, exporting firms,
and firms that invests abroad (especially in knowledge investment); existence of
ladder of quality in the evolution of a firm while graduating to globalization, and
ordered-probit model were found to be in accordance with HMY model.
Ganpathi, R.; Sivamani, M. and Malar, S. A. (2010), in their paper, ‘Foreign Direct Investment: Post-reform Era’, depicts the importance of FDI in India, especially after post-reform period, by undertaking study from 1991 to 2007, covering issues like, dispersion of global FDI among the developed and developing nations, and the reasons for developed countries attracting major chunk of FDI. An exploration of reasons for investment in India by major countries; sectors alluring highest Japanese FDI; initiatives taken by Indian government to put-on seal on huge amount of FDI inflows in the sector, had also been made.

Jha, S. N. (2010), in his paper, ‘FDI in Retail Sector: An Analysis for Probable Outcomes’, attempts to examine the organized retail sector in global arena and changes taken place so far, for describing opportunities that organized retail have for Indian consumers, and how FDI can bring changes with the current set up. The paper further covers study of various facets related to FDI in India’s retail sector to conclude that various initiatives are required on the part of India for enhancing the scope of liberalization and growth, along with, the major hurdles faced and the role of FDI inflows in overcoming these hurdles.

Prasanna, N. (2010), in his paper, ‘Impact of Foreign Direct Investment on Export Performance in India’, tries to focus upon studying the role of FDI in manufacturing-oriented exports. The paper attempts to study the two facets, viz., the impact of inward FDI on the total manufactured exports of India; and the impact of inward FDI on the high technology manufactured exports of India from 1991-92 to 2006-07. The inferences drawn depicts that FDI has improved India’s export performance. The paper also puts forth the need of initiative for intelligent blending of India’s FDI policies and domestic policies, in order to achieve a complementary effect on each other.

Ranganath, N. Santosh (2010), in the paper entitling, ‘FDI and India’s Economic Growth: The New Paradigm’, examines various facets associated to FDI in India and its impact on India’s growth. With the help of Granger causality test with a panel co-integration framework, the paper concludes that the impact of FDI on growth vary widely across sectors, especially for FDI stocks and output in manufacturing sector; absence of casual relationship in primary sector; appearance of transitory effects of
FDI on output in the service sector resulting in growth in manufacturing sector through cross-sector spillovers.

Satapathy, U. B. and Sahoo, S. K. (2010), in their treatise entitled, ‘FDI Fuelling India’s Growth: How Long Will it Last?’ make use of regression analysis to examine the relationship between FDI, GDP and exports, for ascertaining role of FDI in India’s growth. The analysis reveals a strong bonding between FDI and exports, FDI contributing to export growth first, and then, indirectly to GDP of India; insignificant effect of FDI on domestic investment, with no predominant pattern emerging in case of India. Study of future focal areas for FDI recommends diversion of FDI towards developing indigenous R&D; focus on quality FDI; attraction towards technology-intensive sectors and localization of production.

Bera, S. and Gupta, S. (2009), in their paper, ‘South-South FDI vs North-South FDI: A Comparative Analysis in the Context of India’, highlights the growing importance of South-South FDI in Indian context, and compares its distinct features with North-South FDI, considering distinct aspects; consistency of India’s FDI activities with Dunning’s Investment Development Path (IDP); impact on sectoral profile of a country even in case of drastic changes in country’s profile. Econometric analysis at the sectoral industry level observed that sectors with local import intensity and larger sectors attract greater FDI from both the North and the South, albeit, FDI from South seems to flow into more dynamic/growing sectors than North. Lastly, firm-level analysis, on the basis of detailed survey, finds that factors like excessive government bureaucracy, corruption and competition policy have hindered inward FDI.

Mitra, S. (2009), through the article, ‘FDI in Media’, brings out the story of emergence of media in India and the intrusion of FDI in this area, by studying the efforts made by the media sector for allowing FDI for meeting-out its distinct needs; perception of government and various committees over opening-up of the sector for FDI; relaxation in rules for FDI by India, and thereafter, framing of new norms for FDI in the sector.

Sankar, S. and Lai, Yu-Cheng (2009), through their paper, ‘Foreign Direct Investment, Spillovers and Output dispersion- The Case of India’, analyses the relationship between FDI in an industry and output of domestic firms in the same sector, by using published firm-level panel data in India from Capitaline (2005) and
by assuming that domestic firms doesn’t equally reap benefits from the presence of foreign firms. On the basis of various statistical tools, the paper concludes that there is positive and significant affect of FDI on firm’s output, and domestic firms in sectors with greater foreign presence are less productive as compared to the firms in sectors with relatively small foreign capital, as increase in competition results in losses in their output.

Sharma, P.; Kumar, M. and Sengupta, R. (2009), through their paper, 'Implication of Economic Slowdown on FDI Inflows to Indian Economy', traces out the affect of slowdown in specific sector for annual data (1991 to 2009) by applying correlation to industry and sector-wise FDI growth and correlation and lagged regression on quarterly data (2005 to 2009). The results showed positive correlation between GDP and FDI inflows. Sector-wise correlation analysis showed presence of strong correlation between the two in case of service, automobiles and construction sector. Lastly, the paper analysis emerging policy environment for attracting enhanced FDI inflows, and outlines various limitations associated with the study.

Vembu, T.S. and Satish, J. (2009), through their article entitled, 'Foreign Direct Investment in Real Estate during Economic Downturn', explores the importance of FDI in real estate sector of India. It further highlights the present scenario of FDI policy in different sectors of India; impact of global downturn on Indian economy; foreign players in India’s real estate sector and proposals of DIPP for enticing higher FDI inflows in the sector. Lastly, it includes the findings of the survey, relating to FDI in real estate, conducted by FICCI.

Alse, J. A. and Srinivasan, A. K. (2008), through their paper, 'An Analysis of Perception of Foreign Direct Investment in India', assesses perception of Indian citizens on liberalization, FDI and its impact on them as well as the economy, on the basis of survey conducted during 2003 and 2004 and by using paired t-test. The results obtained shows that there is no significant difference in the perception that “the liberalization policies have been beneficial to the country” across all age groups, i.e., results elicited are consistent with that of investor’s perception and will found to be beneficial for government’s future initiatives for attracting enhanced FDI flows.

Baek, J. and Koo, Won W. (2008), through their paper entitled, 'A Dynamic Approach to the FDI Environment Nexus: The Case of China and India', traces
out the relationship between FDI inflows and environment nexus in a dynamic framework of multivariate time-series. Assessment of short-and long-run relationship among FDI, Sulphur-di-Oxide (SO₂) emission and GDP in the two countries, through Johansen co-integration analysis and vector-error correction (VEC) model, exhibits that FDI acts as a crucial determinants in economic growth (on the basis of capital accumulation and technical-spillovers), and environmental quality; and there is unidirectional causality from FDI inflows to economic growth and the environment.

Banerjee, A. (2008), through the article, ‘Liberalization and FDI in India’, tries to study the impact of FDI in external sector on the economy of India, its future prospects, and an analogy of FDI among India, China and some other selective Asian countries to derive conclusions regarding India’s position as an investment destination and initiatives required to ensure higher FDI inflows in the country. The article also puts impetus upon equitable distribution of FDI in different regions and states and on India’s “Look-East Policy.”

Gupta, J. (2008), in her paper, ‘Globalization and Indian Economy: Sector-wise Analysis of FDI Inflows in India’, tries to review the changing sectoral pattern of FDI inflows in India since 1991, and its likely impact on the Indian economy. The paper also studies FDI policy in India and its changing nature during different phases of liberalization; sectors alluring major chunk of FDI inflows between August 1991-September 2006; comparative decadal analysis of industry-wise FDI inflows during 1980-97; impact of policy reforms on sectoral composition of FDI inflows; initiatives required to ensure qualitative and quantitative FDI inflows in different sectors of economy; and points of criticism for FDI.

Iqbal, B. A. (2008), in his article, ‘FDI inflows to India- Trends and Issues’, attempts to study the emerging trends in FDI inflows to India, by considering major investing countries; sectors attracting higher FDI inflows; comparative study of China’s and India’s FDI inflows; and reasons for China’s dominance in attracting FDI. The article further covers reforms needed at national and state level to enhance India’s competitiveness in attracting FDI inflows; major components of FDI during 2002-05 and some other critical observations; and five-point strategy proposed by World Bank, so as to consolidate India’s position as preferred destination for global FDI inflows.
Kumar, D. (2008), in his article, ‘FDI in Indian Infrastructure Sector’, investigates the reasons for higher FDI inflows in China, and the need of higher FDI inflows by India in infrastructure sector. The article studies sector-wise break-up of FDI inflows from August 1991 to March 2004, for exploring the reasons for uneven FDI composition and investors’ preference to India as FDI destination. In addition, review of the policies framed and implemented so far to promote FDI in infrastructure sector and the future initiatives required to allure higher amount of FDI inflows for better perspectives in future has also been included.

Kumar, P. (2008), in his article, ‘FDI: A Comparative Study between India and China’, compares FDI inflows in India and China for briefing-out the reasons for differences on performance index of various international organizations. The article further investigates regarding the gulf between India’s and China’s FDI inflows; study of various initiatives taken by both for enticing higher FDI inflows and various strategic advantages possessed by India over China. The article concludes with various measures taken or likely to be undertaken by India for making sure higher FDI inflows.

Mathiyazhagam, M. K. and Sahoo, D. (2008), through their paper, ‘Do Foreign Direct Investment Inflows Benefit the Major Sectors in India’, attempts to examine the benefits of FDI inflows for destination sectors of the country. ‘Panel co-integration test’ has been used to assess the long-run relationship of FDI with gross output, export and labour productivity in nine (9) major sectors, and concludes with the imprints of existence of significant co-integrating relationship among these variables, with exception to few. The paper further covers reasons for the same and suggestions to resolve the problem.

Mishra, V. K. (2008) in his article, ‘FDI in Indian Telecom Sector: A Bonanza for Growth’, briefly studies the origin and transformation story of telecom sector in India (from public to private ownership), and its growth by covering distinct aspects, like, India’s FDI policy for telecom sector; its impact; comparative study with China; and future outlook. The article concludes with the success story of Indian telecom sector; importance and impact of policy reforms; and future requirements for overall benefit of the country.
Samanta, A. and Singh, K. K. (2008), in their article entitled, 'Foreign Direct Investment- An Assessment Through Tax Treaties', makes an attempt to put forth the various components of Foreign Direct Investment (FDI) as provided by International Monetary Fund (IMF), along with various tangible and intangible benefits of FDI as considered by India and China, leading to huge gulf between FDI inflows of the two. The article further enlists the top contributors of foreign investment in India; reasons for supremacy of Mauritius in this regard; and concludes with emphasis on framing of intelligent tax treaties with other countries to promote non-harmful tax competition.

Singh, P. (2008), in his paper entitled, 'Foreign Direct Investment, Spillovers, Linkages and Economic Development', tries to bring out a comparative study of growth of India and China by covering number of facets, like, relevance of promoting FDI on economic grounds; factors determining location for MNEs, importance of growth of IT sector in the economic development; etc., and concludes that comparison between the two is not judicious as they both are complementary to each other and had their strong presence in different zones.

Singh, S. (2008), through her article, 'FDI in India: An FDI Hotspot in the Developing World', explores various reasons contributing to FDI inflows and efforts made by Indian government to draw foreign investment. After considering FDI data from 1990-2006; its respective sectoral breakdown; and major source countries for the same, conclusion includes comparison of India's performance with China and developed countries to ascertain reasons that have hampered FDI inflows in India. It further includes initiatives required in this direction.

Subramaniam, R. (2008), in the article entitled, 'FDI in Software: Which in the Favourite Destination- India or China?' brings out a comparative analysis between India’s and China’s performance in Software industry in the global arena and the reasons which may promote FDI inflows in China. The article also studies trend of software exports from India and China explaining reasons for India’s accelerated performance in the global industry circuit. At last, six-dimensional analysis of Indian and Chinese internet and major drawbacks in Indian and Chinese software industry has been included to provide various measures that may help in overcoming the problem.
Suresh, K. (2008), in his paper entitling, ‘Indian Retail: The FDI Dilemma’, comprehensively highlights the dilemma of whether allowing FDI in Retail sector business or not. The paper presents the brief scenario of retail business in India and the impact of FDI over issues, like, retail practices; small traders, shoppers, etc.; and economy, by studying the presence of foreign retailers in India. The pendulum of conclusion swings around the efforts made by ‘corporate biggies’ to ensure opening up of retail sector for FDI, and efforts taken by unorganized retail sector to go against this wave.

Sury, N. (2008), in her paper, ‘Determinants of Foreign Direct Investment in India’, tries to investigate about the various determinants of FDI inflows to India on the basis of number of surveys, case studies and econometric studies. The paper makes an analysis of quarterly data from 1991 to 2003, which revealed that FDI inflows in India are determined by factors like expected national income, tax-rate, trade openness and labour cost, consideration of which may extend help to the policymakers in framing such policies which ensures higher FDI inflows in the country.

Iqbal, B. A. (2000), in his book, ‘Global FDI flows to China and India (A Case of German FDI)’, attempts to address some vital issues relating to German FDI flows to Asian biggies by covering aspects like overview of German economy; trends and patterns of its FDI in Asia during 1980s; comparative study of Japanese and German FDI; trends and pattern in German FDI flows to China during 1990-95; India’s efforts for economic liberalization and its impact there-off. The book further brings out the comparative study between India and China covering distinct dimensions associated to FDI inflows, for providing reasons for huge gulf between the two countries, and focus over India’s future strategy to ensure higher FDI inflows; present and future risks affecting or may affect FDI in India; and different guidelines need to be considered for increasing FDI inflows in the country.

Iqbal, B. A. (1998), through his book, ‘Foreign Direct Investment Inflows in India’, tries to develop theoretical base for understanding the different vital facets associated with FDI, and highlight the importance of FDI as a means for economic transformation. It also includes trends in US FDI covering various dimensions, and with special respect to South Asia and India. The book further highlights future prospects for US FDI in India, by examining US FDI; factors hampering it; present
and future strategies and the role of government for enticing higher amount of FDI inflows from US.

Iqbal, Badar A. (1994), through his book, ‘German Foreign Direct Investment in India- Performance and Prospects’, makes an attempt to bring out the growing importance of German FDI in Indian context during the decade of 1980s, covering a range of aspects from conceptual issues, importance of FDI, etc. to multi-dimensional analysis of trends in German FDI in South Asia, and India in particular. The book also makes attempt to bring out the probable reasons for rise of Germany as one of the leading economies, along with, a detailed description of India’s efforts for adopting liberalization, features of New Industrial Policy (NIP), and initiatives required to attract more FDI inflows, particularly from Germany.

1.4.2 Review from Japanese Perspective

Hamanaka, S. (2011), in his paper, ‘Examination of the Singapore Shift in Japan’s Foreign Direct Investment in Services in ASEAN’, makes an endeavour to examine the impact of regional agreements, covering services and investments, on the geographical distribution of services FDI by considering the dramatic structural changes in Japan’s services FDI among ASEAN region. The paper by focusing on analysis of Singapore-shift among Japanese companies, through regression analysis based on incomplete data set and by employing eclectic methods, finds the presence of considerable shift in Japanese FDI in case of transport sector and not in case of financial sector.

Katayama, S.; Lahiri, S. and Tomiura, E. (2011), in their paper, ‘Cost heterogeneity and the Destination of Japanese Foreign Direct Investment: A Theoretical and Empirical Analysis’, develops a Cournot oligopolistic model with the heterogeneous firms to examine each firm’s choice between export-oriented foreign direct investment (FDI) and FDI to serve the host-country market, by using firm-level data on 118,300 Japanese firms covering the entire manufacturing sector for the year 1998. The testing of theoretical prediction, using multi-nominal logit analysis, shows equilibrium in allocation of firms between the two host countries such that firms at the lower end of the efficiency distribution makes export-oriented FDI, and the firm at higher end invest to serve the host country market.
Lee, C.G. (2010); in his paper, ‘Outward Foreign Direct Investment and Economic Growth: Evidence from Japan’, employed bivariate and multivariate Granger Causality framework with the Japanese FDI from 1977-2006 to assess the impact of short-run and the long-run outward FDI on the economic growth of a home country and to investigate the causal relationship between outward FDI and income and revealed that Japanese GDP per capita has short-run effects on outward FDI. Results obtained by using bounds testing approach to co-integration in a multivariate framework indicates that outward FDI has positive effects on GDP per capita in the long-run only, and thus, suggests that increased outward FDI is only a cause of increased income.

Blaise, S. (2009); in his paper, ‘Japanese aid as a prerequisite for FDI: the case of Southeast Asian countries’, considered the link between Japanese ODA and FDI in China, to verify presence of same logic and spill-over effect in case of four South-east Asian countries (ASEAN-4), viz., Indonesia, Malaysia, the Philippines and Thailand. By using conditional logit model, the paper confirms the presence of spill-over effect of Japanese ODA on FDI, i.e., effective cooperation between public and private sectors in Japanese assistance programs, both in manufacturing and non-manufacturing sectors. In case of loan component of ODA, possibility of future private investment and technology transfers results in higher rate of loan reimbursement indicating solvability perception by private investors, which require further investigation.

Deliosa A., Beamishb, P.W. and Zhao X. (2009), through their paper entitled, ‘The evolution of Japanese investment in China: from toys to textiles to business process outsourcing’ examines three aspects, viz., subsidiary development and multinational firm strategy; institutions and international business; and off-shoring, outsourcing and international business theory, by reviewing changes in Japanese investment in China in three distinct phases. The analysis shows deep-rooted and dynamic nature of Japanese FDI in East, mid-South and North China. Even, beneficial facilities had made Japanese MNEs to emphasize upon high-value activities, including off-shoring and outsourcing in these regions, thus, showing a shift in low value-added, high labour component activities towards interior of China or other regions of Asia.
Greaney, T. M. and Li, Y. (2009), in their paper, ‘Assessing FDI relations between Japan, the People’s Republic of China, and the United States’, makes a detailed examination of FDI inflows and its relative importance in the three countries. Conclusions drawn on the basis of the sectoral concentration of FDI and comparison of employment patterns and sales destinations of Japan and the U.S. in China, shows that Japan and U.S. share stronger bilateral relations than with China. Industry-level analysis exhibits concentration of Japanese FDI in manufacturing sector; American had been more successful in making export-oriented investment in China with exception to manufacturing sector; movement of U.S. affiliates towards export sales, and Japan’s vice-versa. The paper concludes with various reasons that may promote the two countries to invest in China.

Dolansky, E. and Alon, I. (2008), in their article, ‘Religious freedom, religious diversity, and Japanese foreign direct investment’, examines the impact of two religious variables, freedom and diversity, on foreign direct investment of Japanese companies by considering three hypothesis on the basis of data from 1986-2001 over number of investments in 59 countries. The article employed techniques like, MANCOVA, regression, etc. and demonstrates a clear correlation between religious diversity and FDI. This novel finding is indicative of importance of foreign investment decisions over economic factors; social indicators as a tool for attraction towards a company or host nation and government’s way of addressing about its diversity of religion and tolerance.

Hugh, E. (2007), through his article, ‘Japanese foreign direct investment in other countries’, gives an account of surge in Japanese investment outflows since early 1980s and scenario thereafter. By including dispersion of Japan’s investment in the world and its ripple-effect, the article tries to exhibit diversifying nature of Japanese investment and efforts required to overcome the problem of loosening comparative advantage.

1.4.3 Review from Indo-Japan Perspective

Hudson, P. J. (2013), in his article, entitled, “Rising and Shining: The Coming Bloom in Indo-Japanese Economic Relations”, make analysis of the changing scenario of Indo-Japanese economic relations and the immense opportunities available for Japan in India. The article also enlists the needs of those Japanese
businesses that are willing to invest in India, even if, Japan is having considerable presence in India’s developmental programmes.

Joshi, S. (2013), in her paper entitled, “The Geopolitical Context of Changing Japan-India Relations”, focused upon the geopolitical context in which Japan-India relations are evolving to explore whether rise of China and Indo-US engagement insisted Japan to raise its bilateral relations with India to a higher level with stronger economic and politico-strategic dimensions. The results of the study revealed that Japan is no more complacent about rise of China; Japan had started viewing economic relations with India as an insurance policy, as well as a critical component of its economic diversification strategy, to reduce dependence on the Chinese market; Japan continues to be firmly committed to the alliance with the United States to advance its national security; and strategic partnership with India is the vision emanating from Washington linking India, Japan and the United States in the realm of Asian security and had stimulated Japan’s politico-strategic initiatives involving India.

Masanori, K. (2012), through his research paper, entitled, “Japan-India Economic Relationship: Trends and prospects”, tracks Japan-India trade and investment relations by analyzing significance of the Comprehensive Economic Partnership Agreement (CEPA), in addition to present-day characteristics of Japanese investment in India and their interest in industries like IT, finance and retail to reveal India’s emergence as most favoured investment destination for Japanese small- and medium-sized enterprises (SMEs). The paper also highlights strategy of diversification adopted by Japanese businesses towards southern cities such as Chennai, alongwith, the problems faced by Japanese investors in India.

Masanori, K. (2012), in his paper entitled, “Strategies for Japanese Companies in India”, addresses possible reasons for Japanese reticence towards India, in addition to the strategies that Japanese companies have adopted and would likely to continue in future. The paper also compared tactics adopted by Japanese and Korean companies in India for facilitating suitable comparisons between the two and to find highlighting features of Korean companies through which it dinged Japanese presence in India.

Joshi, S. (2011), in her article, ‘India-Japan Relations: It’s Economics All the Way’, traces out the role of economics in driving the Indo-Japan relations, by highlighting the scope of Indo-Japan engagement, which stands on five pillars;
significant progress in bilateral relations in recent years; trends in merchandise trade; Japanese FDI and ODA loans to India and number of Japanese companies operating in India. The article further deals with various factors that changed Japanese perception towards India, and encouraged efforts to boost relations with India.

Ahmed, F. (2010), through his article entitled, ‘FDI: Rediscovery of India’, tries to put-forth an account of India’s emergence on Japanese investment trajectory as an aftermath of China’s agitation against Japanese companies and the transformation in Japan’s perception towards India – from aid-oriented to trade and investment-oriented – by highlighting the leaps and bounds in relations of the two nations. Lastly, it provides a brief account of stagnation in Japanese investment in India, ODA investment, and measures to carve-out maximum benefits from this relationship.

Mancheri, N. (2010), in his article, ‘India’s Deepening Relations with Japan’, gives a brief account of Annual Bilateral Summit between Japan and India in 2009, consisting of discussions on bilateral, regional and global issues for ensuring peace and prosperity throughout the region and the world. The article, further, compendiously includes changing scenario of Indo-Japan relations; importance of Annual Summit and Annual Defense Meeting; bilateral trade; Japanese FII, FDI and ODA in India; future plans of Japanese companies with respect to investment in India, along with, number of one’s companies operating in other’s country; need for continuous dialogue for stronger bilateral relations and decision over CEPA/EPA.

Mathur, A. (2010), in her policy-brief, ‘Japanese Foreign Direct Investment in India: A Weak Link in Ties’, explores probable reasons for weak India-Japan links, even after Japan’s phenomenal performance in respect to some other developed country’s FDI, by considering overview of Japanese FDI in India, putting due impetus on the major industry attracting JFDI, and uprising of South Korean counterparts in India more efficiently and effectively than Japanese ones. In addition, various reasons leading to reluctance on the part of Japanese investors while making investment decisions in favour of India, changing perception and future prospects for JFDI in India, and various recommendations required to be considered to put India on par with China for attracting enhanced JFDI, has also been included in the study.

Nataraj, G. (2010), in her paper, ‘India-Japan Investment Relations: Trends and Prospects’, attempts to study the system of FDI inflows in order to present an
overview of macro-economic indicators of India and Japan which affects FDI, providing due emphasis on external sector. The paper further takes into account the analysis of various barriers affecting FDI flows in each other’s country, in addition to ODAs from Japan to India; Foreign Technology Transfers; and Policy suggestions for improving investment relations.

Choudhary, S. R. (2009), through the paper, 'Japan’s Foreign Direct Investment Experiences in India: Lessons Learnt from Firm Level Surveys', tries to explore the reasons for the reluctance by Japanese investors while making investment decision in favour of India, by studying the experiences of eight firms which are either subsidiaries or Joint Ventures of Japanese companies, and finds existence of number of reasons which, at times, acts as a hurdle while deciding for partnership. Skill-gap at lower level is of great concern than labour unions, and need to be corrected by ensuring skill enhancement. Availability of cheap, knowledgeable and capable talent pool has made India a potential hub for R&D activity. Even, investor-friendly policies of Indian government have also been able to ensure higher FDI inflows.

Dukkipat, U. (2009), through article, 'India-Japan Relations: A Partnership for Peace and Prosperity', highlights the importance of Indo-Japan relations for peace and prosperity of the individual countries as also of the region by covering study of changing economic cooperation on the basis of aspects like infrastructure and industry; private sector ventures; obstacles to economic ties; collaborations on energy issues like nuclear cooperation; initiation of security relationships. The article further takes into account the snapshot view of shift in Indo-Japan relations, as also, the future of such relations.

Nataraj, G. (2009), in her article entitled, 'India-Japan: Increasing Interest, Declining Inflows', traces-out a brief scenario of Indo-Japan ties by considering distinct initiatives and programmes undertaken by the two nations for ensuring stronger ties. By considering Japan’s trade with India and China; and some other important aspects, the article brings-out reasons for detioriation in Japan’s position as an investor, as also, provide reasons for Japan’s fascination for India and efforts required for enhanced bilateral relations to mitigate the emerging challenge due to growing supremacy of China in the region.
De, P. (2008), through his article entitled, 'India, Japan Bhai, Bhai', makes an endeavour to explore various characteristics of India and Japan that acted as a force to bond them into strong relationship. The article also highlights distinct pacts signed between the two from time to time; trade and investment relations shared by them and its future prospects; and takes a further stride to include initiatives taken and likely to be taken to bring about a more strong bonding between the two, and resultantly, a successful Pan-Asian economic community.

Kollamparambil, U. (2008), in the paper, 'Transfer of Soft Technology via FDI: Case Studies of US and Japanese Firms in India', examines the transfer of soft technologies through FDI mode to host developing countries by comparing US and Japanese firms in India. Analysis of behaviour of US and Japanese FDI in Indian context, on the basis of country-wise and industry-wise FDI flows during 1990s, reveals that Japanese FDI is highly concentrated as compared to US. The study in respect to FDI in auto ancillaries sector by exploiting various qualitative and quantitative aspects, in order to compare transfer of production organization and HR related technology to FDI firms, finds no major difference between the firms of two countries and the success of Japanese management style has lured US to mingle the same with their own policies.

Rajamohan, P.G.; Rahut, D.B. and Jacob, J.T. (2008), through their paper, 'Changing Paradigm of Indo-Japan Relations: Opportunities and Challenges', analyses various opportunities and challenges in bringing cooperation between India and Japan by considering changing Indo-Japan relations from Pre-World War II to liberalization in India, Japanese ODAAs to India; FDI and trade relations since 1991 and its focus and makes policy recommendations. The paper explores existence of improving relations between the two because of Post-Cold War circumstances, especially, rise of China; and current and future economic and population dynamics as the reasons for building strong ties between India and Japan.

Singh, A. (2008), through his article, 'India-Japan Ties', explores the changing perception of Japan for India by covering analysis of initiatives and programmes associated to economic and cultural linkages, alongwith, defense and security aspects for strengthening bilateral ties between India and Japan. After comparing Japan’s ties with India and China, the article put-forth recommendations of JSG (Joint Study
Group) and highlighting features there-off and efforts required to conclude CEPA for stronger bilateral ties and maintaining and developing international trade system.

Abe, S. (2007), through his paper, ‘Can Japan Dance with India?’ sheds light on the various dimensions to exhibit whether Japan can find itself compatible with Indian requirements or not. For the purpose, issues like emergence of China and India on world’s economic platform; future prospects and strategic importance of the two Asian Giants, in particular India, and reasons for the same; suggestions for Japan to ensure better prospects with the two; Japan’s trade relations with BRIC countries; its FDI in India and China; and IT Development, have been included. The conclusions, so derived, emphasize upon expansion of economic bonds between Japan and India; replacement of vertical investment with massive one’s, especially in IT; opening-up of doors for Indian students by bringing ease to them, and enhancing region-wise networking involving Singapore and Thailand.

Ghosh, I. (2007), in his paper, ‘Responding to Globalization: Japanese Investments in India’, exhibits Japan’s benefit from emergence of India in the global economy, by way of FDI. Initiating with various aspects of FDI, the main focus of the paper has been to draw a broad overview of Japanese investment in India by studying investment trends, especially in West Bengal, of some large-scale projects; developmental role of FDI; Japanese FDI in India (sector-wise and region-wise) and around the globe. Conclusions show the sea-change in the presence of opportunities for Japanese firms to invest in India.

IBEF (2007), in its report, ‘A Little of Japan in India’, makes a prediction of existence of little Japan in India in years to come, by highlighting presence of Japanese products and services in Indian lives. By giving a brief scenario of Japanese investment in India since 1991 and future expectations, the report enlists importance of India as a host country for Japanese and global investment. It further includes performance of various Japanese companies in India and includes brief summary of survey reports of various agencies, like, JETRO and JBIC; and efforts made by Japan to strengthen Indo-Japan relations.

Nataraj, G. (2007), in her article, ‘Strengthen India-Japan Ties’, traces out various initiatives taken by the two countries to enhance their friendly cooperation relations, by covering present scenario of bilateral economic relations; trade and investment
(FDI) scenario between the two; recent developments in Indo-Japan engagement; and spheres for Indo-Japan cooperation. It further includes India’s zest towards having deeper partnership with US, Japan, India and Australia; importance of India-Japan-China economic ties in changing environment; need of comprehensive cooperation relations in sectors besides trade and investment; and stronger Indo-Japan ties to counter balance China’s growing power in the region.

Iqbal, B. A. (1997), through his book entitled, ‘Japanese Foreign Direct Investment in South Asia- A Case of India’, makes an exclusive effort to bring out the relevance of Japanese FDI (JFDI) for Asia, particularly India during 1980s, by covering distinct issues relating to FDI. The book undertakes emergence of Japan in the FDI arena during 80s and the trends in FDI flows during early 90s; comprehensive study of Japanese and U.S. model of FDI; initiatives required by South-Asia to ensure higher JFDI; comparison of JFDI in India with other major investing countries; and major financial collaborations during 80s for exploring reasons for adverse impact on JFDI in India. Further, critical review of India’s FDI policy and comparison of India’s FDI scenario with some selected East and South-east Asian economies; reasons for need of FDI by India; and the implications, performance and prospects of JFDI flows to India during 90s because of 1991 reforms have also been compiled-in.

1.5 RESEARCH GAP

Indo-Japan economic relations are not new to the present world. Considering the bonding that the two countries possess, there had been number of studies associated primarily to the two nations. These studies try to highlight relationship, especially economic, between these two countries from distinct aspects.

From the examination of various empirical works (papers, books, articles, treatise, reports, etc.) included for the purpose of conducting this research work, it had been observed that there exists plethora of literature on FDI in India, covering distinct facets and dimensions. Even, work had also been conducted with reference to Japanese Foreign Direct Investment (JFDI) and Japanese FDI in India, albeit, it had been sector specific, industry specific or company specific. Even if it had been an overall study, it had been limited in its scope. In addition to this, these studies had not concentrated on inter-comparative study of JFDI and its distinct components in
Indian economy. Thus, it can be easily derived that there exists a dearth in this respect. Henceforth, an endeavour has been made to deeply examine the distinct facets associated to JFDI in India since liberalization, as also, bring out an inter-comparative study.

1.6 OBJECTIVES OF THE STUDY

Since, the study is based upon FDI scenario in India, in general, and Japanese FDI inflows to India, in particular; the objectives of the study has been framed accordingly. The objectives of the present study, henceforth, constitute general objectives and specific objectives.

1.6.1 General Objectives

The study, in general, attempts to:

i) Put forth relevance of FDI for India;

ii) Highlight distinct facets of FDI, like its concept, components and types; theories associated to FDI and various costs and benefits of FDI associated to host and home countries; and

iii) Highlight FDI in India and various policy measures adopted by the country from time to time to encourage FDI inflows into the country.

1.6.2 Specific Objectives

Since the study, specifically, focuses upon Japanese FDI inflows to India; following are the specific objectives, set forth for the study:

i) To bring out, in detail, Japanese FDI scenario in India;

ii) To test whether Japanese FDI inflows to India (JFDI) and India’s total exports (TEXP) are co-integrated or not;

iii) To test whether Japanese FDI inflows to India (JFDI) and India’s total imports (TIMP) are co-integrated or not;

iv) To test whether Japanese FDI inflows to India (JFDI) and India’s total exports (TEXP) granger-cause each other or not;
v) To test whether Japanese FDI inflows to India (JFDI) and India’s total imports (TIMP) granger-cause each other or not;

vi) To examine various problems and prospects associated to Japanese FDI in India; and

vii) To provide suggestive measures to ensure higher Japanese FDI inflows to India.

1.7 SCOPE OF THE STUDY

Giving due impetus to the above-mentioned objectives, the study tries to highlight the under-mentioned aspects:

1. Reasons that enhanced the relevance of FDI for India.

2. Distinct theories associated to FDI which emerged at different phases of time.

3. Distinct factors that determine the flow of FDI in a country; and various costs and benefits faced by the two countries involved in the process, viz., the host country and the home country.

4. Distinct phases of India’s economic liberalization and the reaction registered from different countries around the globe in terms of quantum of FDI inflows.

5. In particular, highlighting emergence of Japan as a major global investor and its reaction towards India’s initiatives to entice higher quantum of FDI.

6. To brings out comparative study between Japanese FDI and India’s total exports and imports on quarterly data for the period ranging March, 2006 to March, 2014.

7. It will also try to ascertain the reason(s) for roller-coaster ride in the quantum of JFDI inflows in India.

8. Explore the sectors/industries where lies the prospects for Japanese investors.

9. Suggestions that would be of much help in increasing the flow and volume of JFDI inflows to India.
1.8 HYPOTHESIS OF THE STUDY

In an attempt to support the significance of the study distinct hypotheses will be examined and analyzed. These hypotheses have been framed as under:

Hypothesis No. 1: -

Null Hypothesis ($H_0$): Co-integration (or long-run association) between Japanese Foreign Direct Investment (JFDI) and Total Exports from India (TEXP) does not exist.

Alternate Hypothesis ($H_a$): Co-integration (or long-run association) between Japanese Foreign Direct investment (JFDI) and Total Exports from India (TEXP) do exist.

Hypothesis No. 2: -

Null Hypothesis ($H_0$): Co-integration (or long-run association) between Japanese Foreign Direct Investment (JFDI) and Total Imports to India (TIMP) does not exist.

Alternate Hypothesis ($H_a$): Co-integration (or long-run association) between Japanese Foreign Direct investment (JFDI) and Total Imports to India (TIMP) do exist.

Hypothesis No. 3:

3.1 Null Hypothesis ($H_0$): Japanese Foreign Direct investment (JFDI) does not granger-cause Total Exports from India (TEXP).

Alternate Hypothesis ($H_a$): Japanese Foreign Direct investment (JFDI) does cause Total Exports from India (TEXP).

3.2 Null Hypothesis ($H_0$): Total Exports from India (TEXP) does not granger-cause Japanese Foreign Direct investment (JFDI).

Alternate Hypothesis ($H_a$): Total Exports from India (TEXP) does cause Japanese Foreign Direct investment (JFDI).
Hypothesis No. 4:

4.1 **Null Hypothesis** ($H_0$): Japanese Foreign Direct investment (JFDI) does not granger-cause Total Imports to India (TIMP).

**Alternate Hypothesis** ($H_a$): Japanese Foreign Direct investment (JFDI) does cause Total Imports to India (TIMP).

4.2 **Null Hypothesis** ($H_0$): Total Imports to India (TIMP) does not granger-cause Japanese Foreign Direct investment (JFDI).

**Alternate Hypothesis** ($H_a$): Total Imports to India (TIMP) does cause Japanese Foreign Direct investment (JFDI).

1.9 **LIMITATIONS OF THE STUDY**

While looking for the prospects for undertaking inter-comparative study to serve the purpose of the study, some aspects had been compromised; and these forms part of the limitations of the study. In this regard, since the country-specific data on various components of FDI is not maintained by the appropriate authorities of India, with exception to equity-component, henceforth, the same has been undertaken for bringing inter-comparative study. In adjuncts, quarterly data of the variables has been used in order to fulfill the criteria of number of observations for hypothesis testing. Moreover, attempt was to be made to bring inter-comparative study between Japanese FDI inflows to India and Japanese exports to India and Japanese imports from India. However, due to non-availability of the required data with respect to imports and exports, total exports and imports of India has been considered.

1.10 **RESEARCH DESIGN**

For the purpose of conducting the present study, **non-sampling method** (preferably purposive sampling) has been preferred for the purpose of data collection.

The study has been carried out by explicitly exploiting the secondary data sources. To serve the purpose of the study, the secondary data has been collected from the following sources:

- Journals, Periodicals and Magazines.
- Reports by the ministries of countries concerned.
• Reports and publications of national and international institutions.
• Business and Financial dailies.
• Text Books and Reference Books related to the subject.
• Internet.
• Others.

These sources of data collection have been preferred as these are easily available, and much more than that, reliable.

To serve the empirical part of the study, various statistical/econometrics tools have been used. For the purpose of hypothesis testing, Johansen co-integration has been used to test presence/absence of long-run association between the variables considered for the study; Dickey-Fuller Test – to test for the stationarity of data of the different variables; and Granger-causality to test for the presence/absence of causality, and in case of its presence, the direction of causality. In adjuncts, t-test and F-test have been used to support the results of stationarity and granger-causality respectively.

1.11 SCHEME OF CHAPTERIZATION

With an attempt to bring a clear understanding of various aspects associated to Foreign Direct Investment and to bring-out an inter-comparative study of Japanese FDI inflows to India since liberalization, the following scheme of chapterization has been proposed:

Chapter One comes up as an introduction to the study. As such, it constitutes aspects like, relevance of FDI to India, literature review, research gap, scope of the study, objectives of the study, hypotheses to be tested, research methodology adopted, limitations of the study, and its significance and utility.

Chapter Two dwells upon the conceptual framework of FDI taking within its realm aspects like meaning of FDI; components and types of FDI; determinants of FDI; various theories associated to FDI and costs and benefits of FDI.

Chapter Three compiles examination of process of economic liberalization in India and amendments in policies and procedures for ensuring hurdle-free entry of FDI in
the country; Japanese FDI scenario; Japanese response towards India’s economic reforms; trends in Japanese FDI inflows to India; relevance of Japanese FDI for Indian economy;

*Chapter Four* is associated to empirical part of the study, wherein, hypothesis testing and its analysis and interpretation has been made.

*Chapter Five* draws its focus upon various problems associated to Japanese FDI (JFDI) inflows in India. In addition, the chapter also constitutes distinct prospects available for Japanese investors in India.

Lastly, *Chapter Six* comes forth with various conclusions drawn from the study, and various suggestions or recommendations that may be of grave assistance in increasing the quantum and flow of Japanese FDI towards India. It further compiles direction for future researcher which would be of help in extending the scope of the present study.

### 1.12 CONCLUSION

From the forgoing discussion we can compendiously frame-out that as conceptual framework, the present chapter deals with the snapshot view of distinct aspects to be dealt at distinct phases of the study. Initiating with a brief introduction on emergence of foreign investment, especially foreign direct investment, the chapter brings-out the reasons which had helped in enhancing the relevance of FDI in specific context of India. The chapter further entails the significance and utility of the present study. In adjuncts, the chapter includes review of empirical literature available, from distinct perspectives, for highlighting the research gap and setting forth the direction of the study. Moreover, it includes distinct objectives that the study proposes to achieve. These objectives complement the scope of the study and determination of the hypothesis to be examined. All these efforts helped in finalizing the research design for the purpose of data collection. Lastly, scheme of chapterization has been compiled-in to show the maneuver of the proceedings of the whole study.
CHAPTER TWO

CONCEPTUAL FRAMEWORK OF FOREIGN DIRECT INVESTMENT (FDI)
## Index

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2.1 INTRODUCTION

With the rapid pace being witnessed in evolution of international economic integration, also referred to as globalization, FDI has emerged as a key element providing bunch of benefits to the home and host countries leading to creation of direct, stable and long-lasting links between economies. It has been quite evident that with the edifice of right policy environment, FDI can play a vital role not just in the development of local enterprises, but also in improving the global competitiveness of both the host and the home economy by providing benefits of inflow of huge amount of capital, transfer of technology and know-how, opportunity for the host economy to promote its products around the globe in a more comprehensive manner, significant and favourable effect on the development of international trade, etc.

Considering the growing impetus of FDI on the world panorama, the present chapter is an attempt to carve-out a detailed study of FDI for better understanding of the term and its distinct facets. As such, it includes aspects like concept and definition of FDI as provided by international organizations and other sources; components that comprise FDI; different types of FDI; distinct theories associated to FDI; factors determining flow of FDI; and its various costs and benefits to the home and host country.

2.2 DEFINITIONS OF FDI

The word FDI has gone through number of transformations, since its inception, for making it more accurate, conceptually, in accordance with the changing milieu. Foreign direct investment, in its classic definition, is defined as ‘a company from one country making a physical investment into building a factory in another country’. However, considering the rapidly changing global economic order and the investment pattern thereof, the scope of the term FDI had been broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investing firm’s home country. Broadening of the scope had opened options for FDI to ensure its presence in the markets in distinct ways. As such, FDI may enter the country in distinct forms, which constitutes direct acquisition of a foreign firm, construction of a facility, or investment in a joint venture or strategic alliance with a local firm. (www.goingglobal.com, n.d.)
Organization for Economic Co-operation and Development (OECD), through its Benchmark Definition of Foreign Direct Investment, third edition, defined foreign direct investment as:

"Foreign direct investment reflects the objective of obtaining a lasting interest by a resident entity in one economy ("direct investor") in an entity resident in an economy other than that of the investor ("direct investment enterprise")." (OECD, 1999) (p-7)

The definition reveals that FDI is the investment which is made by an individual or entity of one country in entity of other country. Such an investment is made with an objective of acquiring lasting interest (Note 1) which gives investor an effective voice in the management of the entity.

While ascertaining the above, it should be taken care of that the capital transactions which do not give rise to any settlement, e.g. an interchange of shares among affiliated companies, should form part of Balance of Payments (BoPs) and must be recorded appropriately in the International Investment Position (IIP). (OECD, 1999)

FDI and FPI constitute the two, quite popular, modes of making investment in enterprise of other country. Since FDI holds an important distinguishing feature of exercising effective control in the management of an enterprise, among the two, it is the preferred mode for investing in overseas markets.

The striking aspect that emerges is that OECD does not recommend the guideline of 10 percent cut-off as a fast rule, as it acknowledges that smaller percentage may entail a controlling interest in the company (and, conversely, that a share of more than 10% may not signify control) (Duce, 2003), henceforth, some countries considers provision of 10 percent cut-off in a flexible manner, in order to fit the circumstances. Consequently, provision has been framed for the countries that choose not to follow the 10 per cent rule in all cases that they should identify, where possible, the aggregate value of transactions not falling under the 10 per cent cut-off rule, so as to facilitate international comparability. (OECD, 1999)

Still, International Monetary Fund (IMF) recommends using the percentage of 10 percent as the basic dividing line to demarcate between direct investment and
portfolio investment in the form of shareholdings. Thus, when a non-resident, who previously had no equity in a resident enterprise, purchases 10% or more of the shares of that enterprise from a resident; the price of equity holdings acquired should be recorded as direct investment. From this moment, any further capital transactions between these two companies should be recorded as a direct investment. When a non-resident holds less than 10% of the shares of an enterprise as portfolio investment, and subsequently acquires additional shares resulting in a direct investment (10% or more), only the purchase of additional shares is recorded as direct investment in the Balance of Payments. The holdings that were acquired previously should not be reclassified from portfolio to direct investment in the Balance of Payments but the total holdings should be reclassified in the IIP. (Duce, 2003)

The ambiguities in the third edition of OECD’s Benchmark Definition of FDI, was rectified by the OECD in its Benchmark Definition of Foreign Direct Investment, Fourth Edition, 2008. The fourth edition defined FDI in a revised manner after some rectifications, for making the term more comprehensive – conceptually. Accordingly, “direct investment is a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor”.

The definition reflects that the motivating force that drives the flow of direct investment is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise. The “lasting interest” is evidenced when the direct investor owns at least 10% of the voting power of the direct investment enterprise. Another motivating factor for direct investment is to gain access to the economy of the direct investment enterprise which it might otherwise be unable to do. (OECD, 2008)

Thus, direct investment comprises of initial equity transaction that meets the 10% threshold and all subsequent financial transactions and positions between the direct investor and the direct investment enterprise, as well as qualifying FDI transactions and positions between incorporated and unincorporated fellow enterprises included under the Framework for Direct Investment Relationships (FDIR) (OECD, 2008),
reinvestment of earnings and the provision of long-term and short-term intra-company loans (between parent and affiliate enterprises). (Duce, 2003)

The main features of the Benchmark Definition, 4th edition can be summarized as follows:

(i) Full consistency with the Balance of Payments Manual (BPM) concepts and definitions relating to cross-border investment positions and corresponding international financial and income flows;

(ii) Consistency with the broad definitions and accounting framework of the System of National Accounts, 2008 (SNA, 2008);

(iii) Clarification of certain recommendations of the Benchmark Definition 3rd edition with a view to eliminate possible misinterpretations by national compilers which may lead to deviations from the standards;

(iv) Preserving a reasonable degree of continuity in national statistical systems by making relatively few changes to the fundamental recommendations of the Benchmark Definition, 3rd edition;

(v) Introduction of new concepts and breakdowns in response to user requirements to analyze direct investment in the context of globalization;

(vi) Providing new chapters devoted to uses of FDI statistics and to FDI globalization indicators;

(vii) Introduction of an FDI glossary; and

(viii) Transparent revision process and close cooperation with national and international experts, including the establishment of a future research agenda for developmental work to advance methodological issues which remain unresolved at the time of publication. (OECD, 2008)

The Benchmark Definition, fourth edition, was introduced to serve several objectives which include:

(i) a single point of reference for compilers and users of FDI statistics;

(ii) clear guidance for individual countries compiling direct investment statistics as they develop or change their statistical systems;
(iii) international standards for FDI, taking into account the effects of globalization;

(iv) an international standard that provides the basis for economic analysis, especially for international comparisons and for identifying national deviations from the standard that impact on the comparison;

(v) practical guidance to users of direct investment statistics including the relationship of FDI to other measures of globalization; and

(vi) an objective basis for measuring methodological differences that may exist between national statistics that need to be taken into account both for cross-country and industry analysis of FDI. (OECD, 2008)

According to The World Bank Group, FDI has been defined in following words:

"Foreign Direct Investment is the foreign investment that establishes a lasting interest in or effective management control over an enterprise. Foreign direct investment can include buying shares of an enterprise in another country, reinvesting earnings of a foreign-owned enterprise in the country where it is located, and parent firms extending loans to their foreign affiliates". (www.worldbank.org, n.d.).

Eurostat, for the purpose of collecting FDI data, considers FDI as that category of international investment in which an enterprise resident in one country (the direct investor) acquires an interest of at least 10% in an enterprise resident in another country (the direct investment enterprise). Subsequent transactions between affiliated enterprises are also direct investment transactions as it gives the investor an effective voice in the management of the enterprise and a substantial interest in its business, FDI implies a long-term relationship between the direct investor and the direct investment enterprise and may take place through the establishment of an entirely new firm, so-called ‘Greenfield’ investment, or through the complete or partial purchase of an existing firm via a merger or an acquisition. (Eurostat, 2007)

On the imprints of the international organizations, definitions of FDI have seen proliferation from various other sources as well with the aim of bringing more clarity to its concept. As such, various definitions of FDI from various sources are as under:
Direct investments in productive assets by a company incorporated in a foreign country, as opposed to investments in shares of local companies by foreign entities, is termed as foreign direct investment (FDI). (www.investorwords.com, n.d.)

FDI stands for Foreign Direct Investment, a component of a country's national financial accounts. Foreign direct investment is investment of foreign assets into domestic structures, equipment, and organizations. It does not include foreign investment into the stock markets. (economics.about.com, n.d.)

FDI refers to investment made in a company outside the country of the investor, who sets up subsidiaries or acquires usually about 10% of the stock with voting rights, thus gaining influence in the foreign company's management. (www.qfinance.com, n.d.)

Foreign Direct Investment (abbreviated as FDI) is the acquisition of controlling interest in foreign firms and businesses from one country in another country. FDI can also take the form of constructing factories, structures and equipment (or any form of physical capital) in foreign soil. FDI does not include foreign investment into the stock markets (portfolio investment). (glossary.econguru.com, n.d.)

Foreign direct investment (FDI) is the movement of capital across national frontiers in a manner that grants the investor control over the acquired asset. Thus, it is distinct from portfolio investment which may cross borders, but does not offer such control. Firms which source FDI are known as multinational enterprises’ (MNEs). In this case control is defined as owning 10% or greater of the ordinary shares of an incorporated firm, having 10% or more of the voting power for an unincorporated firm or development of a Greenfield branch/plant that is a permanent establishment of the originating firm. (www.wordiq.com, n.d.)

Foreign Direct Investments are investments into other countries with the objective of owing partially or entirely an economic enterprise for the purpose of establishing market share and generating revenue and profits that can ultimately be transformed into stockholders' dividends. (Jonnard, 1998)

From the literature over the definitions and concept of FDI, it can be derived that FDI emerges as a result of mutual interest of multinational firms and host countries. Due to various direct and indirect benefits provided by FDI, it has become more enticing source of foreign investment for developing economies which due to resource
limitations require huge funds from the external sources in order to bridge demand and supply gap relating to investment finance (Paul, 2008). Moreover, from the analysis of the definitions mentioned above, we can easily derive that though every definition had attempted to define FDI in its own sense, they all share certain commonalities between them. From this analysis we can easily derive at two broad features as tinted by FDI. The first one, as a convention, includes acquisition of a 10 percent threshold ownership. The other one being inclusion of direct investment transactions and subsequent transactions between affiliated enterprises for the purpose of calculating FDI.

2.3 COMPONENTS OF FDI

From the analysis of distinct definitions, as forwarded by different organizations and other sources, we may come at a point that the main financial components that form part of components of FDI includes:

2.3.1 Equity Capital;
2.3.2 Reinvested Earnings
2.3.3 Other Capital

2.3.1 Equity Capital

Equity capital is the money invested by the investor for acquiring common stock (ordinary/equity shares) of a company. Investment in equity capital is of permanent nature and the amount invested is not repaid to the investors in the normal course of business. Due to its permanent nature, equity capital represents the risk capital.

The value of equity capital is ascertained by estimating the current market value of everything owned by the company (known as assets) from which the total of all outsiders' claims (known as liabilities) is subtracted. On the balance sheet of the company, equity capital is listed as stockholders' equity or owners' equity, also called equity financing or share capital. (businessdictionary.com, n.d.)

Equity capital comprises: (i) equity in branches; (ii) all shares in subsidiaries and associates (except non-participating preferred shares that are treated as debt securities and included under direct investment, other capital); and (iii) other capital contributions. (OECD, 2001)
2.3.2 Reinvested Earnings

It refers to the earnings of investors which have been retained by the business for mitigating the purpose of its future financial requirements for growth and expansion. Reinvested earnings in case of FDI can be classified under two broad categories. These include:

i) **Reinvested Earnings on Direct Investment**: - Reinvested earnings are not actually distributed to the direct investor but rather increase the direct investor’s investment in its affiliate. Thus, it is calculated by subtracting distributed earnings from the earnings on equity capital accruing to direct investors. Reinvested earnings form part of the investment income as the earnings of the direct investment enterprise are deemed to be the income of the direct investor (proportionate to the direct investor’s holding of equity in the direct investment enterprise), whether they are reinvested in the enterprise or remitted to the direct investor. Reinvested earnings is shown by an entry that is equal to that made in the direct investment income account with an entry of opposite sign in the direct investment transactions account. In the direct investment income account, this transaction is referred to as “reinvested earnings”, while in the direct investment transactions account, this transaction is referred to as “reinvestment of earnings”. (OECD, 2008)

ii) **Reinvested Earnings and Undistributed Branch Profits**: - Reinvested earnings and undistributed branch profits comprise earnings, in proportion to equity shares held by direct investors, which foreign subsidiaries and associated enterprises do not distribute as dividends, and earnings that branches and other unincorporated enterprises do not remit to direct investors. (OECD, 2001)

2.3.3 Other Capital

The term other capital covers the borrowing or lending of funds between direct investors and subsidiaries, branches, and associates. Thus, other capital comprise of number of items which includes debt securities, suppliers’ credit, and non-participating, preferred shares (which are treated as debt securities). (OECD, 2001)
2.4 TYPES OF FDI

Annals of FDI activities show that FDI had been playing major role in the internationalization of business. Reacting to distinct changes taking place in the global business milieu pertaining to technology, growing liberalization of the national regulatory framework governing investment in enterprise, and capital markets, remarkable changes have occurred in the size, scope and the methods to keep itself in conformity with these changes. New information technology systems have brought decline in global communication costs, thereby, making management of foreign investments far easier than in the past. In such a context, foreign direct investment can take many forms, depending on the type of investors, the investor's investment objective and the degree of risk the investor is willing to assume (Uddin, 2011). FDI, thus, can be broadly categorized by its direction, target, and motive (Box 2.1). These three broad classifications of FDI had been explained as below:

2.4.1 By Direction

While classifying FDI on the basis of its direction, it may consist of the following types:

i) **Inward FDI**: - When foreign capital is invested in local resources, it is known as inward foreign direct investment. This type of investment is encouraged by the policies and provisions framed by the domestic government pertaining to aspects like, tax breaks, subsidies, low interest loans, grants, lifting of certain restrictions, etc.; and the underlying thought is that 'the long term gain is worth short term loss of income'. Contrary to this inward FDI of any country is discouraged by various types of restrictions and other hurdles imposed by the host country pertaining to aspects like, ownership restraints or limits, differential performance requirements, etc.

ii) **Outward FDI**: - Outward foreign direct investment, sometimes also termed as "direct investment abroad", is when local capital is invested in foreign resources. Outward FDI is quite often found to be encouraged by the initiatives of the home government, prominent being government-backed insurance to cover risk. On the other hand, host of reasons are found to be responsible for hindering the outward flow of FDI. These reasons includes
issues like, tax incentives or disincentives on firms that invest outside of the home country or on repatriated profits; subsidies for local businesses; and leftist government policies that support the nationalization of industries (or at least a mediocum of government control) Self-interested lobby groups and societal sectors who are supported by inward FDI or state investment, for example labour markets and agriculture. Security industries are often kept safe from outwards FDI to ensure the localized state control of the military industrial complex (services.indiabizclub.com,n.d.).

**Box 2.1: Types of FDI**

2.4.2 **By Target**

On the basis of target to be achieved by it, FDI may consist of the following types:

i) **Greenfield Investments:** Greenfield Investments means the expansion of existing facilities or a direct investment in new facilities (in an area where no previous facilities exist). The name comes from the idea of building a facility verbatim on a "green" field, such as farmland or a forest. Over time the term has become more metaphoric.

Due to the presence of distinct benefits it provides to the host nation, Greenfield investments not just forms the core of a host nation's promotional efforts, but also, is warmly welcomed (www.Investments&Income.com, n.d.). The Organization for International Investment cites the benefits of
Greenfield investment (or in-sourcing) for regional and national economies to include increased employment (often at higher wages than domestic firms); investments in research and development; and additional capital investments (services.indiabizclub.com, n.d.). However, allegations have been put that Greenfield investment often does this by crowding out local industry as multinationals are able to produce goods more cheaply (because of advanced technology and efficient processes) and used up resources (intermediate commodities, labour, etc). Another downside of Greenfield investment is that profits from production do not feed back into the local economy, but instead to the multinational's home economy. This is in contrast to local industries whose profits flow back into the domestic economy to promote growth. Greenfield Investing is offered as an alternative to other types of investment, for example as mergers and acquisitions, joint ventures, or licensing agreements. (www.Investments&Income.com, n.d.)

ii) Brownfield Investments: - A related term to "Greenfield Investment" which is becoming popular is Brownfield Investment (www.Investments &Income.com, n.d.). Sometimes, the term ‘Brownfield investment’ is used to describe a situation where investments that are formally an acquisition resemble Greenfield investment. This happens when the foreign investor acquires a firm but replaces almost completely the plant and equipment, labour and the product line. This concept has been used most to describe acquisitions in transition economies. (Moosa, 2002)

The term "Brownfield" came into use in the year 1992, at a U.S. congressional field hearing hosted by the Northeast Midwest Congressional Coalition. (www.Investments&Income.com, n.d.)

iii) Mergers and Acquisitions: - Mergers and Acquisitions is the primary kind of foreign direct investments and refer to transfer of existing assets from local firms to foreign firms.

Foreign (or cross-border) mergers occur when the assets and operation of firms from different countries are integrated to establish a new legal entity. Mergers are the most common way for multinationals to do Foreign Direct Investment. On the other hand, foreign acquisitions occur when the control of
assets and operations is transferred from a local to a foreign company, with
the local company becoming an affiliate of the foreign company. Unlike
Greenfield investment, acquisitions provide no long term benefits to the local
economy – even in most deals the owners of the local firm are paid in stock
from the acquiring firm, meaning that the money from the sale could never
reach the local economy. Nevertheless, mergers and acquisitions are a
significant form of Foreign Direct Investment (www.Investments
&Income.com, n.d.). Mergers are the most common way for multinationals
to undertake FDI activity. (services.indiabizclub.com, n.d.)

iv) *Horizontal FDI:* - The most common type of FDI that world’s business
milieu sees today is the Horizontal FDI which involves the act of investment
in the same industry abroad as a firm operates in at home
(services.indiabizclub.com; n.d.). Thus, a company under horizontal FDI
‘duplicates’ its production chain in order to place its production closer to
foreign markets. The investment decision may result from a trade-off between
fixed costs (the new plant) and variable costs (high tariffs and transport costs
associated with exporting to that country) (Eurostat, 2007). In short,
Horizontal multinational companies produce the same product in
multinational plants, and service local markets through affiliate production
rather than through exports from the home country of the MNE.

Horizontal FDI gives investors strategic market access and reduces delivery
time (Eurostat, 2007); hence, sometimes being referred to as “market-
seeking” FDI. The advantage of being close to the customers may be due to
factors such as reduced transportation costs, smaller cultural barriers or
avoidance of tariffs. (Bjorvatn, Kind & Nordas, 2001)

v) *Vertical FDI:* - Vertical FDI involves a geographical decentralization of the
firm’s production chain, where foreign affiliates in the poorer countries
typically produce labour-intensive intermediates that are shipped back to
high-wage countries, often to the parent country itself. Thus, in this case, a
company ‘slices’ its production chain by allocating different parts to those
countries in which production costs are lower (Eurostat, 2007). Since the
main motive for the investment is to improve the cost effectiveness of the
firm's production, it is sometimes referred to as “efficiency-seeking” FDI (Bjorvatn, Kind & Nordas, 2001). Vertical FDI can be classified into:

**Backward Vertical FDI:** Backward Vertical FDI is where an industry abroad provides inputs for a firm's domestic production process. (services.indiabizclub.com, n.d.)

**Forward Vertical FDI:** Forward Vertical FDI is where an industry abroad sells the outputs of a firm's domestic production. (services.indiabizclub.com, n.d.)

2.4.3 By Motive

FDI can also be categorized based on the motive behind the investment from the perspective of the investing firm. In this respect, FDI may consist of the following types:

i) **Resource-Seeking:** - This type of investment is driven by the local availability of natural resources and low-cost labour (WIR, 2010). Thus, these are the investments which seek to acquire factors of production that is more efficient than those obtainable in the home economy of the firm. In some cases, these resources may not be available in the home economy at all (e.g. natural resources, an over words - naturally occurring materials such as coal, fertile land, etc., that can be used by man, and cheap labour). This characterizes Foreign Direct Investment into developing countries, for example seeking cheap labour in Eastern Europe and Southeast Asia, or natural resources in the Middle East and Africa (www.Investments&Income.com, n.d.)

ii) **Market-Seeking:** - Market-seeking FDI is attracted by the size and growth prospects of the host country markets, advantages linked to a direct presence in consumers' vicinity, avoidance of import barriers, discriminatory government procurement policies and high transport costs in supplying markets through exports (Saeed, 2001). In short, investments which aim at either penetrating new markets or maintaining existing ones are termed as market-seeking FDI. FDI of this kind may also be employed as defensive
strategy; it is argued that businesses are more likely to be pushed towards this type of investment out of fear of losing a market rather than discovering a new one (services.indiabizclub.com, n.d.). Market-seeking FDI can also be a result of oligopolistic competition, as transnational corporations (TNCs) try to get a foothold in each other’s markets (Saeed, 2001). This type of FDI can be characterized by the foreign Mergers and Acquisitions in the 1980’s by Accounting, Advertising and Law firms (services.indiabizclub.com, n.d.).

The main reason for market-oriented FDI is transaction costs including transport costs, tariffs, barriers to trade and uncertainty about exchange rates, etc. It is conducted to secure or increase market shares by “tariff jumping”. The main motive referred to by firms for market-oriented FDI, is to overcome trade protection in order to supply goods and services to the local market. (Gari & Jasefsson, 2004)

iii) Efficiency-Seeking: - This type of investment requires host countries to offer advantages such as low cost production or specialized expertise, as well as low-cost trade (WIR, 2010). In other words, efficiency-seeking investments are the investments which firms hope will increase their efficiency by exploiting the benefits of economies of scale and scope, and also those of common ownership (services.indiabizclub.com, n.d.). Efficiency-seeking FDI is attracted generally by lower costs of labour or environmental resources in host country than in home countries (Saeed, 2001). It is suggested that this type of FDI comes after either resource or market seeking investments have been realized, with the expectation that it further increases the profitability of the firm. Typically, this type of FDI is mostly widely practiced between developed economies; especially those within closely integrated markets (e.g. the EU). (services.indiabizclub.com, n.d.)

iv) Strategic-Asset Seeking: - Strategic-Asset Seeking FDI usually takes place at an advanced stage of globalization of a firm’s activities (Saeed, 2001). This type of FDI is driven by access to create assets such as special skill and technology (WIR, 2010). Hence, strategic-asset seeking FDI is a tactical investment to prevent the loss of resource to a competitor (services.indiabizclub.com, n.d.). Here, assets of foreign firms are secured by new plants and acquisitions or joint ventures, to create synergies with the
existing pool of assets through common ownership (Rugman & Verbeke, n.d.). Such kind of investment can be easily compared to that of the oil producers, whom may not need the oil at present, but look to prevent their competitors from having it. (services.indiabizclub.com, n.d.)

2.5 THEORIES OF FOREIGN DIRECT INVESTMENT

Intrusion of business enterprises in foreign boundaries paved the way for emergence of theories, finding reasons for this phenomenon. The theories in the very beginning, focused only on the trade aspect. But due to emergence of other modes of inter-nation transactions, contrary to traditional import and export, international trade theories has proved to be too limited in their scope. Henceforth, theories focusing particularly on FDI emerged to complete the ambit of international business. Also, the growing interest in the causes and consequences of FDI (Moosa, 2002), after the World War II, gave a boost to this phenomenon. Before this time, all sorts of international investments were thought to be synonymous to each other and the rationale behind it was assumed to be profit-motive. However, with the change in the global milieu, conceptual differences between different types of investment and its reasons emerged, leading to the emergence of various theories over occurrence of FDI, thus, contributing to plethora of explanations, present today, borrowing from the economic and behavioural fields (Boddewyn, 1985). These theories provide explanations to questions pertaining to aspects like ‘why FDI occurs?’ and ‘when it takes place?’ and ‘where it locates?’

2.5.1 MacDougall-Kemp Hypothesis (1958; 1964)

One of the earliest theories – regarding FDI was developed by GDA MacDougall (1958), subsequently elaborated by Murray C. Kemp (1964) (Sharan, 2009). The theory revolves around standard neo-classical theory of capital movements to study the nature of marginal productivity by assuming a two-country model – one being the investing country and the other the host country – and the price of capital being equal to its marginal productivity, to propound that movement of capital takes place from the areas of low rates of return to higher rates of return (Jones & Wren, 2006); bringing efficiency in the use of resources which lead to increase in welfare. However, it doesn’t seem to be true, as on the one hand it leads to decrease in the
output in the investing country, on the other, national income does not fall because the investing country receives returns on the capital invested abroad which is equivalent to marginal productivity of capital times the amount of foreign investment. (Sharan, 2009)

2.5.2 Hymer's Contribution (Monopolistic Advantage Theory, 1960)

Hymer (1960), by analyzing the flaws of the standard neo-classical theory, tried to demarcate between the direct investment and portfolio investment on the basis of level of control it provides to the investing firm.

Theory propounded by Bain’s (1956), “barriers to entry model of industrial economics” (Jones & Wren, 2006), formed the basis for Hymer’s theory which tried to answer the question – ‘Why a firm engage itself in FDI’ even when it faces a number of entry barriers, by providing three reasons:-

- participation in more than one market in order to eliminate competition between the two markets;
- exploitation of strategic advantage by participating in foreign operations; and
- to provide diversification (though it does not provide control).

(www.lotsofessays.com, n.d.)

However, these reasons didn’t turn good because of presence of other modes of entry in foreign markets to fully appropriate profits. Moreover, the firm may risk of losing the secret of its special advantage over its competitors, making it less likely that profit can be fully appropriated, and more likely for the firm to undertake direct investment. (Jones & Wren, 2006)

2.5.3 Raymond Vernon (Product Life-cycle Theory, 1966)

Hymer’s contribution to the theory of FDI led to an upsurge in research on international investment by firms. Hymer, while defining theory of FDI, considered the “Why” aspect of FDI and didn’t look into consideration “When” and “Where” aspects. It was Raymond Vernon (1966) who added these aspects on the basis of data obtained from US corporate activities. His theory was titled as the ‘Product Life-cycle Theory’. This theory concerns the stages of production of a product with new
“know-how”. The theory tries to explain why a product that begins as a nation’s export ends up becoming an import, i.e., why a product is first produced by the parent firm, then by its foreign subsidiaries, and finally anywhere in the world where costs are the lowest.

Vernon felt that most of the products follow a life-cycle that is divided into three stages (Jones & Wren, 2006). These stages which are important and have implications for the international location of a product are as follows:-

**Stage One (Product Development Process or Innovation Stage):** - Under this stage, in order to compete with the other firms and to have a lead in the market, innovation of a product takes place through R&D. The product is manufactured in the home country primarily to meet the domestic demand, but a portion of the output is also exported to other developed countries. The quality of the product, and not the price, forms the basis of demand because the demand is price-inelastic at this stage (Sharan, 2009). In other words, a product is standardized by proper communication between the producers, the suppliers and the customers, which is of utmost importance in this stage. These lead to a location decision that results in the product being situated near to its markets. (Jones & Wren, 2006)

**Stage Two (Maturing Product Stage):** - As years go by, the product enters the mature phase of its cycle, and an increasing percentage of sales are achieved through exporting (Ashwathappa, 2003). Simultaneously rival firms in the host country itself begin to appear at this stage to supply similar products at a lower price owing to lower distribution cost, whereas the product of the innovator involves the transportation cost and tariff which are imposed by the incorporating government. Thus, in order to compete with the rival firms, the innovator decides to set up a production unit in the host country itself that would eliminate the transportation cost and tariff. This leads to internationalization of production. (Sharan, 2009)

**Stage Three (Standardized Product):** - This is an extension to the maturing product stage, where the standardization of the product has reached its ‘zenith’, and a final framework of the product has been found (Jones & Wren, 2006). At this stage, the technology becomes widely diffused and available; the product is standardized and the production techniques are no longer the exclusive possession of the innovating firm. Rival firms from the home country itself or from some other developed country
present stiff competition. The innovator shifts the production to a low-cost location, preferably a developing country where labour is cheap. The product manufactured in a low-cost location is exported back to the home country or to other developed country (Sharan, 2009). The firm will also try to differentiate the product and to prevent the emergence of price competition, where price is the sole determinant of demand.

The literature on the subject finds one more stage in the product’s lifecycle. It is known as “dematuring” stage when development in technology or in consumers’ preference breaks down product standardization. Sophisticated models of the product are manufactured again in the technology-advanced, high-income countries so that the firm could have a close linkage with consumers’ taste and with the basic infrastructure required for production. Cheap labour does not matter much at this stage as sophisticated models involve a capital-intensive mode of production. (Sharan, 2009)

FDI, therefore, occurs when, as the product matures and competition becomes fierce, the innovator decides to shift production in developing countries because lower factor costs make this advantageous (Vita & Lawler, n.d.). Life cycle of a product, as depicted by Paul, J. (2007), consists of six cycles, and thus, these different cycles of product Life-cycle theory has been demonstrated by him in a manner as shown in Box 2.2.

![Box 2.2: Stages of Product Life Cycle](image)


2.5.4 Aliber (1970)

The very first attempt to predict the timing of switching over from exporting to foreign-based production came from Aliber (1970), who in his theory, advances
macro-economic factor currency variability to suggest that the relative strength of the investor's home country currency accounts for its position vis-a-vis FDI flows (Dreyhaupt & Winkel, 2005). For the purpose, he assumes that the source-country firm has a monopolistic advantage or 'patent' which it can choose to employ either in the host or source country, and either internally or externally, the latter by sale of a license to a host country producer. In a world of unified currency areas but separate customs areas, Aliber argues that, FDI decision is merely one of the economies of location, although tariffs should be included as a type of transport cost. Initially, when location costs indicate foreign-based production, licensing would be the preferred alternative, for although, Aliber includes 'cost of doing business abroad' as an extra cost for a foreign investor, he assumes that the licensor would be able to extract the full rent from the license. However, at a larger market size 'cost of doing business abroad' decline and FDI is preferred, because at a 'certain point' in the growth of the host country market, the host country firm is no longer willing to pay the capitalized value of the patent demanded by the source-country firm.

On the other hand, in case of multiple currency worlds, Aliber suggests that interest rates on similar assets dominated in different currencies may differ, because of the premium demanded by currency holders for bearing the uncertainty that exchange rates may be changed. Financial markets therefore apply a different capitalization rate to the same income stream according to its currency of denomination (Buckley & Casson, 1981). Accordingly, countries with relatively strong currencies become FDI home countries, and those with relatively weak currencies become FDI host countries (Dreyhaupt & Winkel, 2005). A source country firm applies a higher capitalization rate to the same income stream than a host country firm. Consequently, FDI becomes the preferred form of market-serving at a lower market size than in a unified currency area. The choice between licensing and FDI is determined by the balance of the 'cost of doing business abroad' (which favour licensing) and national differences in capitalization rates.

Hence, in Aliber's scheme, the market servicing decision is dependent on:

1) The relative costs of production in source and host-countries,
2) Transportation costs and tariffs,
3) The 'cost of doing business abroad'- an extra cost which is relevant only to the FDI mode of marketing servicing.

4) Different rates of capitalization of income streams, depending on the currency of denomination, and

5) Market size and market growth in the host country which provides the main dynamic element in the theory. (Buckley & Casson, 1981)

However, the theory is limited in scope, since it cannot account for either FDI flows between hard currency countries or industry clustering of FDI projects (Dreyhaupt & Winkel, 2005).

2.5.5 Caves Theory (Product and Factor Market Imperfections, 1971)

Caves (1971) hypothesized that firm’s excellence over product-differentiation – particularly in case of high-income consumer goods and services – may be a key ownership advantage of firms leading to foreign production. Caves was of the view that the firm specific advantages are transmitted more effectively if the firm participates effectively in the production of the host country, then through other ways such as export or licensing agreements (Sharan, 2009). Thus, the importance of Caves work is that he linked Hymer’s theory to then current theories of industrial organization on horizontal and vertical integration. Caves distinguished between firms that engage in horizontal FDI and those that undertake vertical FDI. (Jones & Wren, 2006)

**Horizontal FDI:** Horizontal FDI takes place when a firm enters into its own product market within a foreign country. According to Caves, a firm will undertake horizontal FDI if it either possesses a unique asset which others do not have or because of the adverse effect of tariffs on its exports. Both reasons are likely to result in FDI occurring in market structures characterized by oligopoly and product differentiation, so that the firm can move into these markets at little cost. Overall, horizontal FDI can occur if the tariffs imposed by the host country are too high, as this will make the good costly to export. However, market structure again plays an important role. Conversely, entry is possible if barriers to entry exist, so that long run profit can be made, and the market structure associated with this is oligopoly. Overall, it leads to the conclusion that the market structure where horizontal FDI occurs will be differentiated oligopoly.
**Vertical FDI:** Vertical FDI occurs when a firm enters into the product market at a different stage of production. Caves also look at FDI occurring at the different stages of production but within the same industry, i.e., vertical foreign investment. Caves argues that vertical FDI is more likely when there is a high-seller concentration, the size of the firm is large enough to cope with the size of the investment made and the competitors are small in number. (Jones & Wren, 2006)

2.5.6 Buckley and Casson (Internalization Theory, 1970s)

In the 1970s a further strand to the FDI literature began to emerge, known as the Internalization Theory of FDI. Based on Coase’s theory of the firm (1937) (Jones & Wren, 2006), internalization theory hypothesized that FDI arises from efforts by firms to replace market transactions with internal transactions.

One of the leading proponents of this theory was Buckley and Casson (1976), who, by assuming market imperfection, note that the operations of firms, specially large firms are associated with number of activities which are interdependent and are connected by ‘Intermediate products’ taking the form of either material products or knowledge and expertise. In such a case an initiative arises for the firm to internalize these, provided the benefits exceed the costs, and occurrence of it across national boundaries results in emergence of MNE, and hence, FDI. (Jones & Wren, 2006)

The theory, henceforth, concentrates on the notion that firms aspire to develop their own internal markets whenever transactions can be made at lower cost within the firm. Thus, internalization involves a form of vertical integration bringing new operations and activities, formerly carried out by intermediate markets, under the ownership and governance of the firm. (www.Lotsofessays.com, n.d.)

2.5.7 Knicker Bocker (Oligopolistic Reaction and Multinational Enterprises, 1973)

While most of the earlier studies, that look at FDI, showed that firms based in oligopolistic industries tended to imitate each other’s FDI, F.T. Knicker Bocker came up with a research that explains the rational of FDI based on the idea that FDI flows are a reflection of strategic rivalry between firms in the global market place (Hill, 2005). F.T. Knicker Bocker, on the basis of data on the manufacturing FDI of 187 US MNCs, found that the oligopolistic firms try to counter any advantage that the firm may obtain from its FDI by following it with their own FDI in order to maintain a
competitive equilibrium. As such, oligopolistic reaction increases with the level of concentration, and decreases with the diversity of the product (Moosa, 2002). In other words Knicker Bocker’s theory is that when one member of an oligopoly undertakes FDI, the other feels constrained to imitate that initiative. (Hill, 2005)

The theory argued that, as risk minimizers, oligopolist, wishing to avoid destructive competition, would normally follow each other into (example foreign) markets, to safeguard their own commercial interest (Barnat, n.d.). In other words, in an oligopolistic environment, FDI by one firm triggers a similar action by other leading firms in the industry in an attempt to maintain their market share (Moosa, 2002). Thus, Knicker Bocker’s “follow the leader” hypothesis, which exerts that companies follow each other into foreign markets in order to negate strategic and other advantages gained by the first mover. These gains are obtained through the quasi-monopolistic position in the host-market, and the reaction of the followers is simply a move to restore the oligopolistic equilibrium (Dreyhaupt & Winkel, 2005). From this, he concluded that increased industrial concentration causes increased oligopolistic reaction in the field of FDI, except at very high levels. He also found that profitability of FDI is correlated negatively with product diversity. (Moosa, 2002)

This theory is considered defensive because competitors are investing to avoid the loss of the markets served by exports when their initial investor begins local production. They may also fear that the initiator will achieve some advantage of risk-diversification that they will have unless they also enter the market (Barnat, n.d.). Also, while this mode is useful to explain “bunching” in certain sectors (e.g. automotive industry) it does not explain why the follower does not choose a different mode of market entry instead of FDI. Moreover, it gives no motive for the first move, i.e., the initial investment by the leader (Dreyhaupt & Winkel, 2005).

2.5.8 Kojima (Macro-economic/Factor endowment Approach) (1973, 1975, 1985)

Kojima (1973, 1975, 1985), in his study, viewed direct investment as a means that helps host country in equipping it with capital, technology and managerial skills from the source country making it a ‘macro-economic approach’ or ‘factor endowment approach’ rather than typical ‘international business approach’ to FDI. Kojima, through his study, classified FDI into two kinds, viz. Trade oriented and anti-trade oriented. The first type, being trade oriented, generates an excess demand for imports and an excess supply of
exports at the original terms of trade which leads to welfare improvement in both countries. On the other hand, the second type of FDI, i.e., anti-trade oriented has exactly opposite effects to those of the first kind as it has an adverse effect on trade, and it also promotes unfavourable restructuring in both countries. (Moosa, 2002)

2.5.9 Dixit-Stiglitz Model (1977)

The Dixit-Stiglitz (DS) model (1977) considered an economy in which pure consumers prefer diverse consumption, while there are global economies of scale for pure producers (firms) in the production of each good, and formulated a general equilibrium model that endogenizes the number of consumption goods by formulating the trade-off between economies of scale and consumption variety.

The DS model predicts three types of scale effect. Type I of scale effect is a monotone positive correlation between population size and per capita real income; Type II of scale effect is a monotone positive correlation between average firm size and population size; and a monotone positive correlation between average firm size and per capital real income, which is Type III of the scale effect. With the CES utility function, they found that each good individually is not a necessity, so that the number of consumption goods is endogenized in equilibrium, i.e., the trade-off between economies of scale and consumption goods. But, as the size of the population increases, the scope for trading-off economies of scale against consumption variety is enlarged, so that the number of goods and size of each firm increase concurrently, resulting in an upward co-movement of per capita real income, total factor productivity, and the average size of firm (Yang & Zhang, 2001)

2.5.10 The Eclectic Paradigm (1977, 79, 81, 88a, 88b, and 1998)

Dissatisfied with the fragmentation of previous explanations of FDI, as provided in Hymer’s contribution, Caves theory, and Buckley and Casson theory, Dunning’s search (1977, 79, 81, 88a, 88b, and 1998) for a generalized framework capable of integrating the existing hypothesis resulted in the eclectic theory, later renamed ‘paradigm’, of international production. (Vita & Lawler, n.d.)

Dunning’s “Eclectic Paradigm”, as it is popularly known, thus, is a combination of the major imperfect market-based theories of FDI, viz., industrial organization theory, internalization theory and location-specific theory, to postulate that at any given time,
the stock of foreign assets owned by multinational firm is determined by three factors which includes combination of firm-specificity or ownership advantage (O), the extent of location-bound endowments (L), and the extent to which these advantages are marketed within the various units of the firm (I). Although in many ways the core of the paradigm shares similarities with the previous research, Dunning does manage to introduce some new considerations. These considerations comprised the impact that different country and industry characteristics have on each of the ownership, location and internalization advantages of FDI and that FDI will be more where the configuration of these advantages is more pronounced. (Jones & Wren, 2006)

![Diagram showing the relationship between structural, market imperfection, and transactional factors, with barriers of entry, government intervention, spatial, common governance, scale, and cognitive factors.]  


Box 2.3: OLI Paradigm of International Production

He also introduced a “Dynamic Add-on” variable, strategic change, to his theory, which may be either autonomous or strategy-induced. Considering this variable, Dunning assumed that international production during a particular period would be
the sum of the strategic responses of the firm to the past configuration of O-L-I and the changes in such configuration as a sequel to exogenous and endogenous changes in environment (Sharan, 2009). Thus, the Eclectic Paradigm, also came to be known as the OLI paradigm, and proposed that the undertaking of FDI is determined by the realization of three groups of advantages which are necessary rather than sufficient conditions. These include:

**Ownership advantages** - Ownership advantages are company-specific advantages and are related to the accumulation of intangible assets, technological capacities or product innovations (Jones & Wren, 2006), which gives it an advantage over other competing firms.

**Internalization advantages** - Internalization advantages stem from the capacity of the firm to manage and co-ordinate activities internally in the value-added chain. Thus, these advantages are related to the integration of transactions into multinational hierarchies through FDI.

**Locational advantages** - Locational advantages refer to the institutional and productive factors which are present in a particular geographic area. They arise when it is better to combine products manufactured in the home country with irremovable factors and intermediate products of another location. (Galan & Benito, 2001)

2.5.11 Hood & Young (Location-specific Theory, 1979)

Hood & Young (1979) stressed upon the location specific theory and suggested that location specific advantages act as a driving force for foreign investment. According to them, there are four factors which are pertinent to the location specific theory. They are:-

- Labor costs;
- Marketing factors (like market size, market growth, stages of development and local competition);
- Trade barriers; and
- Government Policy (Cherunilam, 2009)

Hood & Young argued that since real wage varies among countries, firms with low-cost technology move to low-wage countries. Moreover, in countries where trade
barriers are created to restrict import, MNCs make investment to start manufacturing there and so evade the trade barriers. Sometimes the availability of cheap and abundant raw material encourages the MNCs to invest in a particular country. (Sharan, 2009)

However, the theory was criticized on the grounds that there are also other factors which influence foreign investment. Further, it is the total cost, and not labour cost alone, that is important. (Cherunilam, 2009)

2.5.12 Helpman (1984)

Helpman (1984) developed a general equilibrium theory of international trade in which multinational corporations play an essential role, on the assumption that firm-specific assets associated with marketing, management, and product-specific R&D can be used to service production plants in countries other than the country in which these inputs are employed (Helpman, 1984). The theory, thus, identified and analyzed the implications of circumstances in which corporations are well-defined economic entities, they possess firm-specific assets, they engage in monopolistic competition, and they play an active role in foreign trade; as also, explained the simultaneous existence of intersectional trade, intra-industry trade, and intra-firm trade as a result of impediments to trade (such as transport costs and tariffs) (Helpman, 1984).

The theory, thus, concluded that FDI can be motivated by the desire of MNEs to take advantage of lower-cost factor off-shore through vertical investments in labour-intensive assembly stages. (Maskus & An, 2009).

2.5.13 Markusen (1984)

Markusen, taking references from the theories developed by Helpman, and more particularly by Dunning's original insight and the related industrial organization literature, developed a model to analyze implications of the presence of intangibles, building on the concept of multi-plant economies of scale, i.e., advantages possessed by a single owner of two or more production facilities over independent owner of the same production facilities. Management or R&D — the same services invoked by Helpman's model — work here as a joint input (a non-rival input) giving a single two-plant firm a cost-efficiency over two single-plant firm. (Soci, n.d.)
Through his model, Markusen concluded that FDI can be motivated by the desire of MNEs to capture local markets abroad through horizontal investments in similar products (Maskus & An, 2009).

2.5.14 Caves (1989)

Caves (1989) examined inward investment flows into the US from over a dozen different countries, and found that the strength of a country's currency relative to the US dollar was an important explanatory variable for that country's direct investment in the USA (Vita & Lawler, n.d.). In addition to this, in one of his later writing Caves expanded the scope of his study by mentioning couple of channels through which exchange rate influences FDI. First, changes in exchange rate influence the cost and revenue stream of a firm. According to this view, depreciation in the domestic currency, leads to expansion of import bill and diminishing, in turn, the net income. But if exports expand in the wake of currency depreciation, income will rise. Second, exchange rate changes influences FDI through giving rise to capital gains. Accordingly, depreciation in the value of currency, that is expected to be reversed in the near future, will lead to capital gains following appreciation and in lure of capital gains, foreign capital will flow in. Thus, the theory by empirical evidence found a negative correlation between the level of exchange rate and the level of FDI in the USA. (Sharan, 2009)

2.5.15 Froot and Stein (1991)

Froot and Stein (1991), considered the situation of informational imperfections in the globally integrated markets and presented an unambiguous connection between exchange rates and FDI (Vita & Lawler, n.d.), by taking example of US firms, i.e., analyzed effect of imperfect capital markets with asymmetric information scenario. Under such assumption, internal funds, which are less dominated in the currency of the home country, are less costly than external funds because depreciation of the US Dollar increases the wealth of foreign firms compared to US firms, enabling them to bid more aggressively for US assets, thus increasing FDI into the US. Froot and Stein's relative wealth hypothesis dovetails with the stylized facts of US dollar movements and FDI inflows in the 1980s and early 1990s. However, contradictions to the theory arise after 1991, when Japanese FDI into the US fell sharply despite the depreciation of the US dollar. (Alba, Park & Wang, 2010)
2.5.16 Helpman, Melitz and Yeaple (HMY) Model (2003)

Helpman, Melitz and Yeaple (HMY) (2003) introduced intra-industry firm heterogeneity into the proximity-concentration trade-off of literature, by making analysis of data of US affiliate sales and US export in 38 different countries and 52 sectors and built a multi-country and multi-sector general equilibrium model that explains the firm’s choice between “exports” and “horizontal FDI”. (Helpman, Melitz & Yeaple, 2003)

The analysis predicted that if greater relevance is granted to planned-economies and transport (export) cost is lower, then foreign markets are served more by exports then by FDI. Productivity difference is an important factor which divides the firms into those that engage in exports and those that engage in FDI (Soci, n.d.). The theory concluded that, at equilibrium, only the more productive firms choose to serve the foreign markets and the most productive among this group will further choose to serve the overseas market via FDI. This exhibits that firm level heterogeneity is an important determinant of relative export and FDI flows, and plays an important role in explaining the structure of international commerce. (Helpman, Melitz & Yeaple, 2003)

2.5.17 Yeaple and Nocke (2004)

Yeaple (2004), considered cross-border acquisitions to analyze interaction between trade costs and the source of firm heterogeneity (mobile versus non-mobile capabilities), and developed an assignment theory of foreign direct investment in which firms conduct FDI either by engaging in Greenfield investment or in Cross-border acquisitions. However, at equilibrium point, Greenfield FDI and Cross-border acquisitions co-exist, but the composition of FDI between these two modes varies with the characteristics possessed by them. Accordingly, firms engaging in Greenfield investment are systematically more efficient than those engaging in Cross-border acquisitions. Furthermore, if difference in the factor price between the countries is small, majority of the FDI flow into the country in the form of Cross-border acquisitions, while Greenfield investment plays a more important role for FDI from high-wage into low-wage countries. (Nocke & Yeaple, 2004)
2.5.18 Neary (2005)

Neary (2005), in an attempt to explain the nature, causes and consequences of FDI, focussed his study on single-industry (so that general equilibrium repercussions are ignored), and on the location decisions of a single potential multinational firm. The theory suggests that if FDI is driven primarily by the proximity-concentration trade-off, then falls in trade cost (tariffs and transportation) should discourage it, as the benefits of concentrated production increasingly outweigh the gains from improved market access. In addition to this, by considering different routes of FDI, viz. horizontal FDI, vertical FDI, export-platform FDI and cross-border mergers and acquisitions, concluded that higher fixed cost favours exporting over FDI, whereas higher trade cost favours FDI over exporting. Furthermore, a single firm can never engage in both FDI and trade. By facilitating comparisons across sectors it implied that lower trade costs should be associated with more exports relative to FDI and vice-versa. And for comparisons across space it implies that closure market should be served by exports and further ones by FDI. (Neary, 2002)

2.5.19 The theory of FDI: Five “W’s” and an “H”

The theory attempted to bring forth the answers to certain questions that are crucial for the flow of FDI. These questions constitute:

1. **Who-** Who is the investor?

   (A new firm or an established MNE? An insider or an outsider?)

2. **What-** What kind of investment?

   (Greenfield v/s Brownfield? Mergers and Acquisitions? First time investment or Sequential investment?)

3. **Why-** Why go abroad?

   (Firm X wants to earn more profit either by raising its revenue or reducing its cost.)

4. **Where-** Where is the investment made?
(Choice of host country location-affect by economic, social/cultural and political factors.)

5. **When**- When is the investment made?

(Timing of entry decision-affect by age of product, multinationality of firm. Product life cycle theory offers an explanation for the timing of FDI.)

6. **How**- How does the firm go abroad? What mode of entry?

(Choice includes exports, licensing, franchising, FDI.)

The OLI paradigm provides a theoretical base for answering at least some of these questions. (kyon88.wordpress.com, n.d.)

### 2.5.20 The Politics Of FDI

Governments of both the host country and the home country hold variety of interests in FDI. These interests can be consolidated to form three approaches to FDI. They are:

i) **The Radical or Marxist View**;

ii) **The Free Market View**; and

iii) **The Pragmatic Nationalism View**. (www.slidefinder.net, n.d.)

i) **The Radical View**:

The most prevalent view in the economic sphere pertaining to investment by the end of 1980s was the radical view. Marxist political and economic theory forms the base for this view. Thinkers supporting the radical view argued that the multinational enterprise is an instrument of imperialist’s domination (www.blurtit.com, n.d.). The assumption which led to the emergence of radical view included:

- Repatriation of profits takes place in favour of the home country and host country remains empty-handed in exchange;
- Strict control over technology by MNE and expertise is denied by the host country.
- Senior posts in the company are held by expatriates.
• All the above mentioned points acts as a means to keep less-developed countries (LDCs) relatively backward and dependent on developed (capitalist) countries for investment, jobs and technology. (www.marcbowles.com, n.d.)

Thus, according to extreme version of this view, foreign corporations should not be allowed to undertake foreign direct investment activities by any country since they are instruments of economic domination and does not make contribution in economic development of the host country. The view also suggested that if multinational companies exist in a country they should be immediately nationalized. (www.blurtit.com, n.d.)

ii) The Free Market View: - The free market view is deemed to have been originated from the works of Adam Smith (Absolute advantage theory) and David Ricardo (Comparative advantage theory) (www.marcbowles.com, n.d.). The free market view holds that international production should be distributed among countries (Hill, 2009) because impediments to trade, such as tariffs and quotas, invariably rebound to the detriment of consumers in the country they are supposed to protect. (www.marcbowles.com, n.d.).

iii) The Pragmatic Nationalism: - The radical view and the free market view exhibited two extremely opposite spectrums and nations rather than wholly adopting to one or the other view prefers to stand in between the two extremely opposite views. Considering the political stance of the governments, a novel view came into existence to bring compromise between the radical view and the free market view. This came to be known as pragmatic nationalism and it acted as a mid-line between the two views. However, with the decline of communism across the world, the world has seen a shift towards the free market-end of the spectrum (www.marcbowles.com, n.d.). In other words, pragmatic nationalism suggests that FDI has both benefits, such as inflow of capital, technology, skills and jobs and costs, such as, repatriation of profits to the home country and negative balance of payment effect. (www.quizlet.com, n.d.)
2.6 DETERMINANTS OF FDI

The rapid growth of FDI, particularly since 1990s, when there were steep rise in the cross-border financial and trade flows around the whole world, had garnered greater interest in international economic research, and the quest to identify the motivations that drive FDI is experiencing a revival (Kim & Oh, 2007). Various comparisons facilitating concentration of FDI among the developing countries, had found that in spite of large increase in FDI going to developing economies, the concentration remains in only a meager number of these developing nations. Thus, for developing countries whose future growth highly relies upon its successful participation in the world economy, it is of utmost importance that they understand the selection criteria that multinational corporations (MNCs) apply when investing abroad (Kahai, 2004). In this regard, there is plethora of studies which attempts to identify the determinants of FDI; however, there is lack of consensus among experts regarding widely accepted set of explanatory variables that can be regarded as the “true” determinants of FDI. Moreover, the results produced by these studies are typically sensitive, indicating a lack of robustness. For example, factors such as labour costs, trade barriers, trade balance, exchange rate, R&D and tax have been found to have both negative and positive effects on FDI (Kok & Ersoy, 2009). Nevertheless, on the basis of analysis of various studies associated to FDI determinants, we may underline following as the factors which determine quantity of FDI inflows in any country:

2.6.1 Infrastructure

Infrastructure has a wide coverage covering in its ambit many dimensions, ranging from physical assets such as roads, sea ports, railways, and telecommunications, to institutional development, such as accounting and legal services (Kahai, 2004). Possession of well established and quality infrastructure is a crucial determinant of FDI flows for any country. Since, a country which has opportunity to attract FDI flows will stimulate itself to equip with good infrastructure facilities; therefore, we find existence of a significantly positive relationship between FDI and infrastructure (Vijayakumar, Sridharan & Rao, 2010). It is, hereby, interesting to note that infrastructure not only acts as a determinant of FDI but also a host sector for attracting FDI. As such, while on the one hand, poor infrastructure could be deterrent to investments in a country; on the other hand, it offers an opportunity to foreign
investors of vast investments from foreign investors (Paul, 2008). Hence, infrastructure is a very important determinant for defining presence of or for enticing FDI in a country, and it is important for the country to have sufficiently developed infrastructure to support various activities to be carried out by the company.

2.6.2 Exchange Rate

While making explanation of a country’s business climate, one has to make inclusion of aspects like, tax policies, a sound economic and financial environment, and favorable exchange rates (Kahai, 2004). The local currency must retain its value or exchange rate because if a currency depreciates, the purchasing power of the investors in foreign currency terms is enhanced, showing existence of a positive and significant relationship between the currency value and FDI inflows (Vijayakumar, Sridharan & Rao, 2010). Thus, rapid and considerable fluctuations in exchange rate of a country’s currency influences all types of investment including FDI, as fluctuation in exchange rate affects the prices of host country assets, the value of repatriated profits, and the competitiveness of exports. (Kahai, 2004)

2.6.3 Labour Cost

Because of the existence of significantly negative relationship between labour costs and FDI (Kahai, 2004), labour cost has always been argued to be one of the major component of total production cost and of the productivity of firms (Sawkut, Boopen, Taruna & Vinesh, 2009). This means that higher labour cost is most likely to result in higher cost of production and limited FDI inflows (Vijayakumar, Sridharan & Rao, 2010). Wage variables have thus quite often gets its place in the empirical literature, particularly in the cases where labour-intensive production activities are employed, as in this case wages are higher which would be deterrent for FDI inflows of a country. However, contradiction lies that higher wages in a country is not because of nature of production activities, as at times, higher FDI flows also acts as a supplement for increase in wages or labour costs. (Sawkut, Boopen, Taruna & Vinesh, 2009)

2.6.4 Market size

The market size of the host country, which also represents the host country’s economic and the potential demand of the host country’s production, is an important
element that is rewarded due consideration while making FDI decisions (Sawkut, Boopen, Taruna & Vinesh, 2009). Market size is generally measured by Gross Domestic Product (GDP), GDP per capita income and size of the middle class population (Vijayakumar, Sridharan & Rao, 2010). Since, large developing countries provide substantial markets which exhibit demand-supply disequilibrium, i.e., consumers’ demand for certain goods far exceeds the available supplies (Bhasin, 2008). This demand potential acts as a big draw for many foreign-owned enterprises (Saleem, 2007); henceforth, countries with large (Bhasin, 2008) market size generally becomes host to larger amount of FDI inflows than that of smaller countries having small market size. It is expected to be a positive and significant determinant of FDI flows (Vijayakumar, Sridharan & Rao, 2010), as companies generally resist to invest in a market where there is little potential to make profit.

2.6.5 Economic Freedom

The degree of competitiveness of a country and government (home and host) interference while entering a country’s market, are important factors (Cherunilam, 2009) that are considered while taking FDI decisions. Economic freedom facilitates in the evaluation of the effects of the economic environment on the level of FDI inflows, as economic freedom signifies absence of government controls on production, distribution, or consumption of goods and services by its citizens (Kahai, 2004). Thus, there is also a positive and significant relation between economic freedom and FDI inflows and it can be said that the freer the market, the more alluring it becomes for foreign investors to undertake investment activities. (Cherunilam, 2009)

2.6.6 Level of Corruption

A number of studies have argued that the level of corruption in a country has an effect on domestic and foreign investment in a country. This variable has found to have an expected negative impact on the level of FDI. The presence of corruption makes dealing with government officials (for example, to obtain local licenses and permits, etc.) opaque and more costly, particularly to foreign investors. In support of this, Wei through his study concluded that a rise in the corruption level in a country reduces inward FDI (Kahai, 2004). Thus, it is of utmost importance that the host country should ensure a corruption free milieu so that an investor can easily and undoubtedly rely upon its integrity and its ability to maintain law and order. (Cherunilam, 2009)
2.6.7 Human Capital

Foreign direct investors are found to be equally concerned for the quality of the labour force. In fact, the cost advantages accrued by lower wages in developing nations can well be mitigated if workers with low skilled levels are employed. In this regard, a more educated labour force will be extremely important as they can learn and adopt new technology faster, and thus, are generally more productive. Higher level of human capital is a good indicator of the availability of skilled workers, which can significantly boost the locational advantage of a country. Thus, we can found that the level of human capital is a significant determinant of the locational advantage of a host country and has a key role to play in attracting FDI. (Sawkut, Boopen, Taruna & Vinesh, 2009)

2.6.8 Growth Rate

In today's world, the future potential of any country's market is worked out on the basis of the annual real GDP growth rate of that country (Kahai, 2004). From the evidences prevailing around the globe, it can be easily stated that a country that represents a stable macroeconomic condition with high and sustained growth rates enjoys higher FDI inflows compared to those countries which has more volatile economy (Vijayakumar, Sridharan & Rao, 2010). Thus, there exists a positive relationship between GDP growth and FDI. Moreover, evidences are found that foreign investors, while making investment decisions, take consideration of the future growth potential of the market rather than the current potential of the market. (Kahai, 2004)

2.6.9 Political Instability

Political instability is another major determinant that affects the flow of FDI. Evidences are found that countries which are politically unstable, in other words, they face frequent changes in governments and their policies and decisions, face reluctance from investors (Saleem, 2007); as frequent occurrences of disorder leads to unfriendly business milieu for risk-averse foreign investors, thereby, seriously eroding its confidence. This causes reluctance on the part of foreign investors towards the prospective host country's investment climate, leading to withdrawal of FDI projects (Sawkut, Boopen, Taruna & Vinesh, 2009). However, even if, the argument, that
unstable economy may deter flow of inward investment, do not require any explanations, the empirical significance of this scenario and its relative importance is vague and require more clarifications. (Vita & Lawler, 2004)

2.6.10 Legal and Regulatory Framework

The transition of a country into an exclusive market economy entails the combination of establishment of a legal and regulatory framework which will be compatible with the needs of the private sector activities and the operation of foreign-owned companies (Bhasin, 2008). Since, these rules and regulations pertains to a wide sphere which includes protection of property rights, ability to repatriate profits, and free market for currency exchange, henceforth, rules, regulations and administrative procedures framed by the host country regarding foreign investment must be transparent (Saleem, 2007) and easily comprehensible; simultaneously, meeting the demands of the foreign investors to the maximum possible extent.

2.6.11 Trade Openness

Openness to trade is considered as another factor that typically forms part of the function that determines the flow of FDI. There is acceptance to the widespread perception that MNEs are found to be enticed by those countries, which exhibit features of trade openness, as ‘open’ economies are able to instill confidence in foreign investors to a greater extent by virtue of their better performance record and generally more stable economic climate. (Vita & Lawler, 2004)

Consequently, openness to trade, like others, has also received considerable support in the empirical literature as it is expected to have a positive and significant impact on FDI inflows for any country. (Vijayakumar, Sridharan & Rao, 2010)

2.6.12 Research and Development

Another determinant that had caught considerable attention is the Research and Development (R&D). It is typically portrayed that the MNEs possess more advanced knowledge and are capable of introducing new and standardized capital goods at a lower cost. However, it is argued that the application of more advanced technology requires the presence of a skilled human capital in the host country. If a country is not able to satiate this requirement, then the flow of FDI into the host country would be
significantly hampered (Moosa, 2002). Thus, ability to acquaint and adapt according to MNEs, R&D is an important aspect considered while making foreign direct investment decisions.

The above mentioned are the most likely determinants that affects the flow of FDI in any country, or that directs the flow of FDI in any country. A study, attempted to analyze the effects of distinct determinants of FDI, had been conducted by Kok & Ersoy (2009), the brief outcome of the study has been revealed in Table 2.1.

2.7 COSTS AND BENEFITS OF FDI

Since, in the present world order, FDI has become a crucial part of almost every economy, therefore, it has a crucial role to play in the economic development of the country. Adoption of economic reforms and the far-reaching political changes had contributed in gradual and substantial changes in the international capital flows (Cherunilam, 2009). The flow of direct investment from one country to another creates benefits both for the home country (source of investment) and the host country (recipient or the destination country). Thus, when decision regarding FDI is taken by a firm, then the prospective benefits, that will entertain not only the home country, but also, the host country are taken into account. The perspective of the host government is equally significant to that of the investor as the underlying benefits for host country ensures their full cooperation (Sharan, 2009). In addition, to the bunch of benefits, FDI gives rise to certain costs pertaining to both the home and the host country. This section, thus, focuses upon making analysis of various costs and benefits from the host and home country’s perspectives; and henceforth, is divided into two parts stated as below:

2.7.1 Costs and Benefits to the Host Country.

2.7.2 Costs and Benefits to the Home Country.

2.7.1 Cost and Benefits to the Host Country

i) Costs to the Host Country

➢ Strained Balance of Payments following Reverse Flows: - Thinkers, who stand against FDI, claims that intrusion of FDI may create balance of payments problems in the host country, making it prone to exploitation by
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MNEs in distinct ways. As such, presence of strong MNEs into the country, at times, makes the host country helpless in managing its own economy. Moreover, they can even exploit the markets if there lies some interest for it like, high profits, high entry barriers, etc. (www.essaycoursework.com)

- **Dependence on the Import of Technology:** It has always been argued that exploration and exploitation of raw materials, in case of FDI, are made keeping in consideration the perspective of the home country that may found to be detrimental to the host country. It is also argued that parent company, though supplies technology to its subsidiary, does not disseminate it to the host market, keeping them to peep towards them for the same.

- **Employment of Expatriates:** Multinational Corporations (MNCs) are generally found to show indifference towards training of local people. Lack of skills, so generated, keeps them deprived of employment. Also, since the technology brought-in is usually capital-intensive, it ceases the probability of large-scale employment.

- **Inappropriate Technology:** Critics are also of the view that the home country if provides technology to the host country, is either obsolete or does not match the requirements of the host country. This, in turn, brings substantial losses to the host country. Even, arguments have been put-forth that, at times, the manufacturing process adopted by the foreign investors in the host country does not stand for the pollution norms with respect to optimum use of the available natural resources, or the locational norms.

- **Unhealthy Competition:** Foreign investors being more powerful, in general, outshine the local firms. This provides foreign companies the oligopolistic advantage, resultantly leading to charging-up of higher prices for their products.

- **Cultural and Political Interference:** Intrusion of foreign companies in the host country's industrial set-up infuses home country's culture in it and also into the society. At times, the companies are so influential that it can even sabotage the host country's government.
ii) **Benefits to the Host Country**

- **Availability of Scarce Factors of Production:** FDI, by ensuring free-flow of scarce factors of production in the host country, helps in maintaining equilibrium among different factors of production, thereby, fostering pace of economic growth of the host nation. Investment by multinationals in the host country acts as a supplement to the domestic capital, most importantly, in countries where there exists a huge gulf between country's savings and its investment requirements. Intrusion of foreign exchange helps in circulating the domestic savings of the host country, which would otherwise have not been invested. Foreign investors, via FDI, also attempts to share the risk, likely to arise while implementing any investment project in the host nation.

More importantly, intrusion of FDI ensures technology transfer and creation of employment in the least developed countries (LDCs). Technology transfer benefits the host country as it includes scientific processes, and organizational, managerial and marketing skills. The benefits not only affect the affiliate of the MNE, but also, the country as a whole as they are able to use their resources more efficiently by employing new technology in production processes ([www.essaycoursework.com](http://www.essaycoursework.com), n.d.). Thus, FDI can serve as a powerful force for increasing the skills of the domestic labour pool.

- **Improvement in the Balance of Payments:** Ample evidences can be found regarding the changes brought in the balance of payments (BoPs) and foreign exchange reserves position of several host countries due to the changes in the composition of the capital flows and the substantial increase in the magnitude of some of the flows, like FDI ([Cherunilam, 2009](http://cherunilam.com)). These changes are preferably done either by import substitution or export promotion. Advent of FDI generates caliber in the host country to produce those items that were being imported earlier. Foreign investors, being equipped with distinct wherewithal, like, knowledge of exporting mechanics and of foreign markets; improved technology for producing standardized goods at lower cost; world-reputed brand name; etc. also help in augmenting exports.
- **Building of Economic and Social Infrastructure:** Investment by foreign affiliates in sectors like economic and social infrastructure, financial markets and the marketing system, assist the host country in developing a support system for its rapid industrialization. Even, if it is not so, mere presence of foreign investors in the host country creates a multiplier-effect, which inevitably develops the support system of the country.

Mr. Gordan Wu, at the seminar organized by Confederation of Indian Industry (CII) and Asian Society, in New Delhi on March 9, 1997 on *'moving to the market: sustaining reforms in India and Asia'*, addressed that foreign investment brings four 'Es'- efficiency, equity, experience and expertise. In return, there is a fifth 'E'- expatriation of profits. *(Cherunilam, 2009)*

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<td>- Strained balance of payments following reverse flow.</td>
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<th>Benefits to the Host Country:</th>
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<tr>
<td>- Availability of scarce factors of production.</td>
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<td>- Improvement in the balance of payments.</td>
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<td>- Building of economic and social infrastructure.</td>
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<tr>
<td>- Fostering of economic linkages.</td>
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<tr>
<td>- Strengthening of the government budget.</td>
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**Source:** Sharan, V. (2009); International Financial Management; 5th Edition; PHI Learning Private Limited; P-223.

**Box 2.4: Costs and Benefits to the Host Country**
➤ **Fostering of Economic Linkages:** - The demand for various inputs by the foreign firms because of the existence of forward and backward linkages helps in developing the input-supplying industries. This phenomenon is known as crowding-in effect. The effect so generated helps in creating employment for the host country’s labour force, which leads to upsurge in their income resulting in increased demand, and hence, industrial production in the country. In adjunct, availability of quality goods of large varieties at competitive price helps in improving the living standards of the consumers. Foreign firms also train the labour force that creates a pool of trained personnel in the country (Sharan, 2009). Thus, FDI brings the potential for linkages to the domestic economy and increased domestic economic activity through purchase of local inputs and the production of inputs for use by local producers. (Paul, 2008)

➤ **Strengthening of Government Budget:** - Foreign firms, making investment in host nation, are a good source for revenue generation by way of tax, tariff on imports, etc. Along with, foreign investment act as a supplement to host government’s investment activities, thereby, reducing the burden over government expenditure requirements leading to eased burden on the national budget of the host country.

### 2.7.2 Costs and Benefits to the Home Country

#### i) Costs to the Home Country

➤ **Undesired outflow of Factors of Production:** - Even though the cost accruing to the home country is only few, the impact seems to be so large that it hampers the home country’s interest. Critics of the policy of FDI, claim that it can lead to possible negative effects on the “home country”, such as, FDI sends the job to other countries and puts a downward pressure on wages. Critics also argue that the home nation suffers as a result of this and loses out on exports, which in turn, affects the country’s employment and balance of payments.

➤ **Possibility of Conflict with the Host-Country Government:** - Foreign companies operate in distinct parts of the globe with a zest to ensure larger
profits. In this effort, the companies adopt and implement various techniques that may be deteriorating for the host country. This creates a tussle between the home and host governments leading to deleterious effect on bilateral relations between the two.

ii) Benefits To the Home Country

➢ **Availability of Raw Material**: Involvement of foreign investor's money in exploration of a particular raw material ensures the home country with regular supply of necessary raw material(s).

➢ **Improvement in Balance of Payments**: Investment through FDI ensures regular incomes by distinct means. These include dividends, royalty, technical service fees and other payments. FDI also results in rising exports of the parent company to its subsidiary. This results in improved balance of payments of the parent company.

### Costs to the Home Country

- Undesired outflow of factors of production
- Possibility of conflict with the host-country government

### Benefits to the Home Country

- Availability of Raw Material
- Improvement in Balance of payments
- Employment generation
- Revenue to the government
- Improved political relations


**Box 2.5: Costs and Benefits to the Home Country**
- Employment Generation: - Employment of FDI in the vertical set-up by the investing country results in enhanced exports between the home and host nation. If such an investment is accompanied by the personnel, the result is greater employment of the nationals.

- Revenue to the Government: - As discussed earlier that, intrusion of FDI ensures parent company with regular supply of incomes by way of dividends, royalty, other incomes, etc. These incomes attract tax liability, resulting in revenue to the government of the home country. In adjuncts, revenue is also generated by imposing tariff on the import made by the parent company from its subsidiary abroad.

- Improved Political Relations: - By playing the complimentary role of providing financial aid, FDI helps in building closer and better political relations between the home and the host country resulting in simultaneous benefits to both.

2.8 CONCLUSION

The present chapter deals with distinct facets of FDI to bring about a clear view regarding conceptual knowledge of FDI. From the analysis of these aspects, we can compendiously derive that FDI is an important source for home country for registering its presence in the host country. It provides numerous benefits, as also costs, to both the home and the host country and is affected by various factors. The chapter further brings out various components of FDI as ascertained by definitions provided by discrete international organizations and modes that can be adopted for the purpose of making investment in any destination country. Further, theories of FDI try to provide answers to the questions, like why FDI occurs, when it occurs, where it occurs and who makes such an investment. Thus, the theories attempts to explain emergence and flow of FDI.
2.9 NOTES

1. Lasting interest, according to the Benchmark Definition implies the existence of a long-term relationship between the direct investor (foreign) and the enterprise and a significant degree of influence on the management of the enterprise (OECD, 1996). Foreign direct investor, within this realm, is an individual, an incorporated or unincorporated public or private enterprise, a government, a group of related individuals, or a group of related incorporated and/or unincorporated enterprises which has a direct investment enterprise — that is, a subsidiary, associate or branch — operating in a country other than the country or countries of residence of the foreign direct investor or investors (OECD, 1996); and a direct investment enterprise as an incorporated or unincorporated enterprise in which a single foreign investor either owns 10 per cent or more of the ordinary shares or voting power of an enterprise (unless it can be proven that the 10 per cent ownership does not allow the investor an effective voice in the management) or owns less than 10 per cent of the ordinary shares or voting power of an enterprise, yet still maintains an effective voice in management". An effective voice in management only implies that direct investors are able to influence the management of an enterprise and does not imply that they have absolute control (UNCTAD, n.d.). These enterprises may be subsidiary (incorporated enterprise in which the foreign investor controls directly or indirectly more than 50% of the shareholders' voting power associates or branches); associate (an enterprise where the direct investor and its subsidiaries control between 10% and 50% of the voting shares); or branch (wholly or jointly owned unincorporated enterprise. (Duce, 2003)
CHAPTER- THREE

ECONOMIC LIBERALISATION IN INDIA
AND FOREIGN DIRECT INVESTMENT INFLOWS
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3.1 INTRODUCTION

We have so far observed the concept of FDI and the various benefits provided by it. These benefits are provided to the home country and, to a considerable extent, to the host country. Such benefits had enticed various countries, belonging to any of the three worlds - "The First (Developed) World", "The Second (Developing) World" or "The Third (Under-developed) World" - to liberalize its economy for enjoying the benefits of FDI. Since, India had also been among one of those countries who adapted itself with this flow, therefore, the present chapter aims at highlighting distinct phases of economic liberalization in India and reasons for the same. The chapter also analyses impact of economic liberalization on FDI inflows into the country, covering distinct aspects associated to it. In particular, the chapter brings out a synoptic view of emergence of Japan as one of the major foreign direct investor on the global panorama; establishment of its economic relations with India and reasons for the same. The chapter further entails trends in Japanese FDI outflows, in case of India, by covering various facets associated to it. Lastly, conclusions to the chapter are drawn.

3.2 INDIA'S ZEST TOWARDS FDI INFLOWS

The annals regarding economic liberalization in India exhibits, that the journey for ensuring higher FDI inflows towards the country had never been an easy drive. India had been resistant, since independence, towards liberalizing its policies for foreign trade and investment, and believed mostly on Official Development Assistances (ODAs) in form of loans. Even if, some of the initiatives had been taken to deviate from the long-walked path, it evinces the imprints of agony given by the British rule. India, since then, has been involved in making the best out of a "Bad Bargain". However, growth and development of the similar economies during the decades of 1960s to 1980s, and India's zest to showcase itself on the global panorama, spurred it to take some stringent actions, blithe with long-hold policies of Nehru's and Gandhi's. The liberalization process of India's foreign trade and investment regimes was a series of various initiatives made at different phases of time. These phases can be broadly classified into three distinct phases, viz.

3.2.1 Pre-Independence (Pre-1947) Phase;
3.2.2 Pre-1991 Phase (Pre-1947 to 1991); and
3.2.3 Post 1991 Phase.

3.2.1 Pre-Independence (1947) Phase

Foreign Direct Investment holds a long history of its existence in India since the colonial phase. Britishers, who earlier depend upon trade for exploiting India's resources, were the first who encouraged investment in India. However, such an investment was supposed to accomplish three purposes, viz., effective control and administration; effective exploitation of India's natural resources; and to promote foreign trade (Note 1). Thus, the Foreign Direct Investment (FDI) during that phase was directed towards: economic overheads and infrastructure (railways, ports, shipping, generation of electric energy, water works, roads and communications); promoting mining of coal, gold and petroleum and metallurgical industries; promoting commercial agriculture, investment in tea, coffee and rubber plantations; to undertake investments in consumer goods industries like cotton and jute textiles, matches, woolen textiles, paper, tobacco, sugar, etc.; investments in banking, insurance, trade, machine building, engineering, industries and chemicals. (Dutt & Sundaram, 2009)

These investments flown into the country by multinationals, predominantly with British origin, operated in India through its subsidiaries. The investments made by the British multinationals were primarily made in two forms which constituted direct private foreign investment in areas like coal, mining companies, in jute mills, tea, coffee, rubber plantation and in sugar; and Sterling loans given to the British Government in India and public and semi-public organizations to undertake investments in railways, ports, electricity undertakings and other public utilities. These loans represented sterling debt. (Dutt & Sundaram, 2009)

3.2.2 Pre 1991 Phase (Pre-1947 to 1991)

Soon after the attainment of independence in 1947, India found itself in the web of series of serious challenges (Kesavan, 2003), which extended to economic and political spheres. During this phase, India was paralyzed with problems of economic backwardness, low industrialization and low agricultural productivity, deep-rooted prevalence of landlordism and tenancy. Moreover, India was also prone to problems like poverty and low level of savings and investment (The Policy of Economic
Liberalisation in India, n.d.). On the political front, due to the partition of the country, confusion and uncertainty was at its pinnacle. (Kesavan, 2003)

Since, India was desperate to get rid-off of the problems which hindered the path of its development; dire need was felt for measures that would ensure country’s economic growth, thereby, benefitting vast majority of the country’s population (The Policy of Economic Liberalisation in India, n.d.). This demanded for comprehensive measures so that internal disorders existent in the Indian society, could be rectified. Albeit, British invested heavily in the pre-independent India in areas like extraction, plantation, shipping, etc., the same was meant to satiate colonial interests and had not been able to do wonders for India as it failed to promote development of India. This created indifference in the Indian Government towards foreign capital even if there was exigency of huge funds for developmental activities, which could only be made available by foreign investment. An incidence in this regard had been put-forth by Balasubramanyam & Mahambre (2003) (p-2) in their paper as mentioned under:

"When A GROUP of businessmen in New York asked Prime Minister Nehru about the Indian Government's policy towards foreign investment, he was reported to have looked out of the window and commented on the weather."

Although, science and technology was at the core of Nehru’s development strategy, the publicly exhibited apathy towards FDI was with the intention of protecting the economy from the vicious circle of foreign dominance in the country (Balasubramanyam & Mahambre, 2003). Henceforth, in order to escape from undue dependency on other country, India adopted the principle of planned economy and import substitution, even if, India was feeling the heat of pressures from Power Blocs. This principle promoted development of India as a self-sustained economy, wherein, there was ample scope for receiving necessary assistance from other countries, whenever need arise. The states of the country also had pivotal role in the development of the country’s economy. This strategy seem to be inevitable for the country, since the private sector in India at that time was in its nascent stage.
Within this realm, the government adopted Industrial Policy Resolution in 1948, to lay emphasis upon acquiring and securing continuous increase in production, alongwith, its equitable distribution (Note 2). After the adoption of the Constitution and socio-economic goals, the Industrial Policy was revised and adopted in 1956. To meet the challenges arising from time to time, the policy had been subject to changes, and henceforth, modified through statements in the years 1973, 1977 and 1980. (Note 3) (Ghosh, 2001)

India’s dwindled mind-set whether to allow foreign investors to operate on Indian soil or not, can be easily carved-out from the different plan documents released during different phases of India’s Five Year Plan. These plan documents are meant for planned economic development in India and highlighted the need and importance of foreign capital for the country. In this regard, Plan Document of the First Five Year Plan (1951-52 to 1955-56) on Foreign Capital questioned upon the dubious role played by foreign capital in India’s growth. As such, use of foreign capital was put under continuous and stringent scanner, making India rely more on its own resources by taking lessons from countries like Japan, Soviet Union, etc. Foreign capital was only appreciated, in case, if it was available from international institutions. Furthermore, the plan document clearly laid guidelines regarding treatment given to foreign capital.

The Plan Document of Fourth Five Year Plan (1969-70 to 1973-74) on Foreign Capital laid down the basic policy with regard to foreign collaborations and foreign investment, which seem to be on the imprints of the old provisions, being not guided by any comprehensive modifications. However, if foreign collaborations are likely to be considered, it should be resorted with an intention to mitigate discrepancies, as well as, maximum utilization of local resources (know-how and services). For the purpose, the plan document proposed the establishment of Foreign Investment Board and the guidelines for accepting foreign collaboration proposals. However, in the meantime, global economy was encountered with series of serious challenges leading to breakdown of the Bretton Woods system of stable exchange rates leading to emergence of the floating regimes. The problem became more precarious with the emergence of oil shock of 1973-74. The twin global economic disasters laid the foundation stone for the balance of payments crises in most of the developing countries with India being not an exception.
Considering the twin problems and the recommendations made by Public Accounts Committee (PAC) regarding malpractices of invoice manipulation for foreign exchange leakages (June 1971) and the Law Commission Report on 'Trials and Punishment of Social and Economic Offences' (April 1972), the Indian government reviewed Foreign Exchange Regulation Act (FERA), 1947 with an intention to *conserve foreign exchange, contrary to regulate the entry of foreign capital*. The objective of introducing such changes as may be felt necessary for effective implementation of the Government policy and by-passing the hurdles which had been confronted in the working of the previous enactment became the basis for drafting the FERA in 1973 (Bhasin, 2008). The FERA, 1973 came out as "Bad Omen" for the foreign companies as it contained numerous, that too, very stringent provisions which categorized any offence under the FERA as a criminal offence, foreign exchange law violators as criminals, and the party to it was liable for imprisonment.

The Sixth Five Year Plan (1980-81 to 1984-85) Document on Foreign Technology/Capital emphasized upon judicious blend of contemporary technology and development of indigenous know-how through domestic research and development, for industrial progress of the country, through re-orientation and review of existing procedures and parameters for technology transfer. Furthermore, the document emphasized upon development of suitable perspective and strategies for attaining appropriate and advanced technologies as per country's demand, and for strengthening appropriate institutional arrangements. (Bhasin, 2008)

Thus, the decade 1970, was the period of extreme bedeviled, wherein the policies were so framed that it fell in line with the expectations of the general public at large. Result of such an effort by the government came forth in the form of either closer of business of major multinational players in India or transferring of major equity stake of the foreign companies established in India in favour of Indian nationals.

Economic policy, so framed, though contributed to India's industrialization to some degree, it also led to emergence of many problems. For example, conversion of large scale state-sponsored enterprises into inefficient and non-competitive enterprises; piling-up of budgetary deficits due to increased government spending. Further, incidents like, natural disasters, regional conflicts and political instability, all added more to the troubles and made the economic situation of the country so precarious.
that, at the beginning of the 1980s, the government had to look for the option of taking loan from International Monetary Fund (IMF) on the conditions as imposed by it in lieu of loan granted (Kesavan, 2003). Thus, India had to initiate upon several measures to deregulate the policy adopted by it.

The Seventh Five Year Plan (1985-86 to 1989-90) Document on Foreign Capital attempted to purpose an increased participation of foreign technology in the country by underlying the importance of international economic and technological environment, alongwith, domestic resource endowment and industrial policies, as determinants of country's industrial growth.

The mid 1980s, hence, was a period which witnessed some considerable, though not a radical, relaxation in regime pertaining to spheres like trade and investment. The relaxation in regimes provided foreign enterprises with relatively benign attitude of the Indian government towards their participation in business activities taking place in the country. Moreover, then Prime Minister Rajiv Gandhi’s penchant for science and technology, similar to his grandfather Nehru, helped him in portraying himself more sanguine, than his predecessor, about participation of foreign enterprises in the economy (Balasubramanyam & Mahambare, 2002). Still, the economic policies were framed on the lines of the socialist philosophy that, in the past, had governed country’s economic policy. (Kesavan, 2003)

Compendiously, after achieving independence in 1947, India pursued a three-tier policy which concentrated upon restricting imports, promoting exports and adopting import substitution, alongwith, pegged exchange rate regime. Foreign investment was discouraged by (a) imposing severe limits on equity holdings by foreigners; and (b) restricting it to the production of only a few reserved items. In short, India’s policy regarding foreign investment during the period ranging from 1947 to 1991 can be broadly classified into three distinct phases. Phase I ranged from 1948 to mid/late 1960s where there was cautious non-discrimination in control. Phase II ranged from mid/late 1960s to 1970s and was a period of selective restrictions and control because of the promulgation of the Foreign Exchange Regulation Act (FERA), 1973 and the Industrial Licensing Policy, 1973, as the main instruments of control. Phase III constituted the phase of 1980s wherein there was provision of gradual and partial
liberalization with special incentives for investment in export-oriented units. (Bhasin, 2009)

Thus, in contrast to most of its counterparts, India opted to follow the path of fairly restrictive foreign private investment policy till 1991; and in order to fulfill its financial needs it depended upon bilateral and multilateral loans with long repayment periods (Choudhury, 2009). Moreover, during this phase importance was granted to technology imports rather than technological and financial collaborations. However, whilst the regulations implemented during this phase helped in limiting the volume of foreign capital in India, at least, in absolute terms; foreign control over Indian industry was still prevalent to a considerable extent. Specially, in case of number of consumer goods and technologically intensive industries, the foreign control was found to be of highly significant nature. The pre-1991 phase, henceforth, was an exclusive period where the outcome of carving out of cumbersome and complex regulatory framework by the then Indian governments came out in the form of highly stringent regulations over trade and investments. The Industrial Policy Resolution of 1948 promulgated the concept of mixed economy in the country, reserving the spheres of activities to be performed by the Private and the Public sectors. In addition to this, the policy introduced in 1960, though framed with the aim of ensuring growth and development of India, the underlying intentions of the government was to limit the extent of foreign control over the economy. Nevertheless, efforts were also directed to extract advantages of FDIs and foreign exchange earnings potential, whenever necessary and possible. (Balasubramanyam & Mahambre, 2003)

3.2.3 Post 1991 Phase

Although, the country took some tentative steps in 1985 in order to liberalize and unshackle the economy from dirigiste regimes by delicensing of few industries, the same had not found to be suitable for the economy for fighting severe and unsustainable macro-economic imbalances in the Indian economy, particularly with regard to escalating fiscal deficits. During a short period of three years, from 1989 to 1991, India witnessed frequent and severe shocks on the domestic front. On the one hand, India saw three changes of government (Rajan & Sen, 2002) and unprecedented socio-political upheaval; on the other hand, there were macro-economic imbalances, resulting in balance of payment crisis in 1990-91 (Nytko,
2009). In addition to this, there were incidences in the outside world as well like, collapse of cold war (Kesavan, 2003); the break-up of the Soviet Union and the unification of Germany (Nytko, 2009), that contributed in making India’s position more worse by depriving India of the many advantages it had enjoyed earlier. Resultantly, India lost its trade surplus position that it enjoyed with Soviet Union (Kesavan, 2003). Moreover, incident of Iraq’s invasion of Kuwait led to Gulf War in August 1990 paving the way for another oil shock (Nytko, 2009), resulting in mounting of oil prices, thereby, hindering India’s currency position. As a result of these circumstances, the Indian government was forced to approach to International Monetary Fund (IMF) to raise loan by mortgaging its gold reserves. (Kesavan, 2003)

A strong helping hand to India’s dwindled economic position during the decade of 1980s seems to come from the outward oriented industrialized policy by the country through the support of the country’s then Prime Minister Rajiv Gandhi. Among the various reforms introduced in the economic policy of 1991, the most prominent was the relaxation of controls over FDI (gibsdiscussions.blogspot.in, 2007). Further, considering the significant changes taken place in the world industrial economy in the form of industrial and economic cooperation marked by mobility of capital, the Government of India (GoI) stressed upon making relationship between domestic and foreign industry even more dynamic, in terms of both technology and investment, assuming that foreign investment would benefit the country in number of ways like advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for export promotion. (business.webindia.com, n.d.)

Thus, the initial policy stimulus to foreign direct investment in India came in July 1991 when the new industrial policy came into existence. The Industrial Policy (1991) was framed with an intension to cajole foreign capital to India. Broadly speaking, there were three main elements of the reform which included: (i) abolition of the licensing requirements governing domestic investment; (ii) reduction in tariffs on imports; and (iii) relaxation of controls over FDI. The principal changes in the foreign investment regime included: (i) automatic approval of FDI upto 51 percent of equity ownership by foreign firms in a group of 34 technology intensive industries; (ii) a case by case consideration of application for foreign equity ownership upto 75 percent in nine sectors, mostly relating to infrastructure; and (iii) the streamlining of
procedures relating to approval of investment applications in general. (Balasubramanyam & Mahambare, 2003)

The enactment of the new regulations in regular functioning was not an easy task. The reforms so framed and applied resulted in a number of agitations and problems, like, revolt from workers of public sector units (PSUs), decay in number of PSUs due to over-protection of such units from competition, over-manning, poor-management, obsolete technology, etc. Even the then government seems to be in illusion about the probable role FDI was likely to play and impact of FDI on the economy. FDI was not clearly defined, and was only considered as a mechanism for developing and stabilizing the economy.

In relation to foreign investment, the industrial policy statement, 1991 and The Plan Document of Eighth Five year Plan (1992-93 to 1996-97) ensured some of the major reformations regarding liberalized trade policy. Other reformations included comprehensive liberalization of the India economy; amendment in FERA – placing FERA companies equivalent to Indian companies for all operational purposes; and giving preference to FDI over External Commercial Borrowings (ECBs).

Concisely, there had been initiation of various incentives at distinct phases of time, for encouraging FDI inflows into the country, and ensuring presence of more and more FDI inflows into the country as soon as possible. The box provided below (Box 3.1), enlists number of such incentive schemes, as proposed by the steering committee to invite FDI inflows to India.

The Ninth Plan (1997-98 to 2002-03) Document on Foreign Investment stated benefits of foreign investment as a support to meet out Balance of Payment (BoP) deficit without any liability creation; access to technology and know-how, and integration with world markets. It also mentioned intensions of many Indian companies to look for foreign investment in joint ventures for technological upgradation and modernization. Further, emphasis over continued cautious liberalization in financial sector, particularly on the building up of short-term debt, was also put.
- Opening up of new sectors (integrated townships, defense industry, tea plantations, etc.).
- Removal of FDI caps in most sectors, including advertising, airports, private sector oil refining, drugs and pharmaceuticals, etc.
- Greater degree of automaticity for investment.
- Liberalization of foreign exchange regulations by way of simplification of procedures for making inward and outward remittances.
- Policy to allow foreign companies to set up wholly owned subsidiaries in India enabling foreign companies to convert their joint ventures into wholly owned subsidiaries.
- Sectoral reforms, especially in sectors such as telecom, information technology and automobiles making these sectors attractive destination for FDI.
- Public sector disinvestment emerging as an important means to promote FDI.
- Liberal policy towards Foreign Venture Capital Investment (FVCI) giving an impetus to investment in technology and infrastructure projects.
- Various investment facilitation measures such as facility for electronic filing of applications, online chat facility with the applicants, online status on registration/disposal of applications, dedicated e-mail facility for investment related queries, etc., contributing substantially to improving investors' confidence.
- An inter-ministerial Committee set up by the Government in 2001 to examine the extant procedures for investment approvals and implementation of projects, and suggest measures to simplify and expedite the process for both public and private investment.
- The activation of the Foreign Investment Implementation Authority (FIIA) that is supposed to meet at regular intervals to review and resolve investment-related problems.
- Preference to FDI over FPI as it is expected to bring modern technology, managerial practices and is long term in nature investment.
- Further liberalization of FDI norms, thereby, keeping handful of sensitive sectors in the prohibited zone and allowing FDI fully or partially in the rest of the sectors.
- Defence sector opened to FDI subject to 26 per cent cap.

Notes: 1. The percentage of FDI through merger and acquisition route has increased to around 30 per cent (from around 10 per cent in 1999), which is still much lower than the global percentage of 70-80 per cent.
2. On an average, about 2,000 responses in a year are given to investors and potential investors.
3. The committee has submitted Part I of its report to the Government, which is under examination. A sub-Group of the Committee is specifically looking into simplification of procedures relating to private investment. The sub-Group will submit its report shortly.
4. A recent study conducted by FICCI, FIIA acknowledges that it has emerged as a problem-solving platform.
5. FDI in defense also requires FIPB approval and is subject to licensing under Industries (Development & Regulation) Act, 1951 and guidelines on FDI in production of arms & ammunition. Moreover, within the 26 percent cap, FII is also permissible subject to the provision that overall cap is not breached.


Box 3.1: Some Measures of Liberalization of FDI Inflows to India/
Measures for the Rise in FDI Inflows after 1991
Simultaneously, realizing that FERA, 1973 was not in tune with the economic reforms initiated since 1991, the government decided to replace corporates’ nightmare with a new legislation. Foreign Exchange Management Act (FEMA), 1999 which came into effect from June 1, 2000, replaced FERA with the objective of facilitating external trade and payments and promote the orderly development and maintenance of the foreign exchange market in India, as stated in preamble to the act. FEMA was eventually a gradual and radical shift in the approach followed by FERA, which focussed upon conservation and optimal utilization of foreign exchange resources of the country. Thus, under FEMA, the prosecution has to prove the guilt of the accused person; only monetary penalty is provided for contraventions; and contravention of FEMA provisions are dealt with under civil procedures, for which separate administrative mechanisms in the form of Compounding Rules, Adjudicating Authority, Special Director (Appeals), and Appellate Tribunal have been established and for each process of law a time frame has been provided in the Act. (Bhasin, 2008)

With the enactment of relaxation regimes, the country registered spurt in the flow of FDI in the country. However, the quantum of such an investment was not as per the expectations. For such a scenario, though number of reasons was held responsible, the prime reason held responsible was the contradiction with regard to coverage of FDI statistics in India, as till 1999, India had been including only equity capital while reporting for FDI inflows in India (Revised Data on Foreign Direct Investment, n.d.). Contrary to this, the definition contained in Balance of payments Manual, Fifth Edition (BPM-5), as provided by International Monetary Fund (IMF), FDI constitutes three components, viz., equity capital, reinvested earnings and other direct capital (Box 3.2). There had been several countries – both from the developed and developing countries – that have been reporting FDI inflows in alignment with the IMF definition, which includes reinvested earnings and other direct capital flows, besides equity capital. Since, the Reserve Bank of India (RBI) reports FDI inflows only on the basis of investments received from non-residents on equity and preference share capital under the FDI scheme, the same do not capture reinvested earnings and other capital, thereby, not fully complying with standard international coverage and are, therefore, not comparable with FDI data released by many other countries of the world. (Report of The Committee On Compilation Of Foreign Direct Investment In India, 2002)
<table>
<thead>
<tr>
<th>IMF</th>
<th>India</th>
</tr>
</thead>
</table>
| **A. Equity capital**  
1. Equity capital in unincorporated entities;  
2. Non-cash acquisition against technology transfer, plant and machinery, goodwill, business development and similar considerations;  
3. Control premium;  
4. Non-competition fees. | Equity capital reported on the basis of issue/transfer of equity or preference shares to foreign direct investors |
| **B. Reinvested Earnings**  
5. Reinvested earnings of incorporated entities;  
6. Reinvested earnings of unincorporated entities;  
7. Reinvested earnings of indirectly held direct investment enterprises. | NA |
| **C. ‘Other capital’**  
8. Short-term and long-term inter-corporate borrowings;  
9. Trade credit;  
10. Suppliers credit;  
11. Financial leasing;  
12. Financial derivatives;  
13. Debt securities;  
14. Land and buildings. | NA |


Box 3.2: Definitional Difference of FDI of India with the IMF Format

After reviewing the international best practices as also some select country experiences, India opted to include fourteen items under three broad heads, to comply with the reporting system in line with international best practices (Revised Data on Foreign Direct Investment, n.d.). Henceforth, since 2000, India had been publishing FDI data which comply with the international standards. The data as such includes following heads while calculating FDI inflows to India:

**A. Equity Capital:** - It includes following items:

1. Equity capital of unincorporated entities;
2. Non-cash acquisition against technology transfer, plant and machinery, goodwill, business development and similar considerations;
3. Control premium;
B. **Reinvested Earnings:** - It includes following items:

5. Reinvested earnings of incorporated entities;
6. Reinvested earnings of unincorporated entities;
7. Reinvested earnings of indirectly held direct investment enterprises.

C. **Other capital:** - It includes following items:

8. Short-term and long-term inter-corporate borrowings;
9. Trade credit;
10. Suppliers credit;
11. Financial leasing;
12. Financial derivatives;
13. Debt securities; and
14. Land and buildings. *(Revised Data on Foreign Direct Investment, n.d.)*

The **Plan Document of the Tenth Five Year Plan (2002-03 to 2006-07)** on Foreign Capital considered the distinct benefits provided by FDI, and highlighted upon the continuous need for review and modification in order to make India a favoured investment destination for foreign players.

The **Plan Document of the Eleventh Five Year Plan (2007-2012)**, with respect to foreign trade and capital emphasized upon increased initiatives required to ensure higher gains from FDI, and technology transfer for improving competitiveness. For the purpose, highlighting suggestions included reduction in delay in State-level clearances and elimination of caps in key sectors. The initiatives taken by GOI in this regard includes announcement of liberal foreign technology collaboration in areas which are prohibited for foreign equity or bear equity caps, excluding the notified areas.

### 3.3 INSTITUTIONAL FRAMEWORK

There are three primary institutions in India that handle FDI-related issues: the Foreign Investment Promotion Board (FIPB), the Secretariat for Industrial Assistance (SIA), and Foreign Investment Implementation Authority (FIIA). *(NCEAR, 2009)*
3.3.1 Foreign Investment Promotion Board (FIPB)

The Foreign Investment Promotion Board (FIPB) has been constituted by the government of India under Department of Economic Affairs (DEA), Ministry of Finance. FIPB is the nodal single-window agency to address all the matters that relate to FDI or that relate to promotion of investment in the country (NCEAR, 2009). FIPB undertakes those investment proposals that do not qualify the criteria of investment under automatic route (www.fipbindia.com, n.d.). It is chaired by the Secretary, Department of Industrial Promotion and Policy, and is meant to fulfill the objective of promoting FDI in India:

i) by undertaking investment promotion activities in India and abroad;

ii) by facilitating investment in the country by international companies, non-resident Indians and other foreign investors;

iii) through purposeful negotiations/discussions with potential investors;

iv) through early clearance of proposals submitted to it; and

v) by reviewing policies and putting in place appropriate institutional arrangements, transparent rules and procedures and guidelines for investment promotion and approvals. (NCEAR, 2009)

In short, FIPB acts as a crucial channel that had an important role to play in the administration and implementation of the Government’s FDI policy introduced by the government from time to time. Possessing a strong record of being actively engaged in encouraging FDI inflows into the country through its speedy and transparent processing of applications, and providing on-line clarification, FIPB had always adopted an investor-friendly approach in case of ambiguity or conflict regarding interpretation. (www.fipbindia.com, n.d.)

3.3.2 Secretariat for Industrial Assistance (SIA)

The Secretariat for Industrial Assistance (SIA) has been set up by the Government of India in the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry to provide a single-window service for aspects like, (i) entrepreneurial assistance, (ii) investor facilitation, (iii) receiving and processing all applications which require government approval, (iv) conveying government decisions on applications filed, (v) assisting entrepreneurs and investors in setting up
projects (including liaison with other organizations and state governments); and (vi) monitoring the implementation of projects. In addition to providing single-window service, SIA undertakes the duty of notifying all government policy decisions relating to investment and technology, and collecting and publishing monthly production data for selective industry groups. (NCEAR, 2009)

3.3.3 Foreign Investment Implementation Authority (FIIA)

Another institution set up by the Government of India to deal with FDI issues is the Foreign Investment Implementation Authority (FIIA). The role of FIIA is to facilitate implementation of FDI approvals at the earliest. It is also supposed to provide a 'pro-active one-stop after-care service' to foreign investors by assisting them in obtaining necessary approvals, exploring problems that may arise while making operations in India and meet with various government agencies to seek out solutions to their problems. The Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion (DIPP) functions as the Secretariat of the FIIA. (NCEAR, 2009)

3.4 ROUTES FOR FDI IN INDIA

3.4.1 Automatic Route

Automatic route allows inflow of FDI into the country, in certain sectors/activities to the extent permitted, without prior approval either by government or by Reserve Bank of India (RBI). Under this, FDI up to 100 per cent is allowed in all activities/sectors except where the provisions of the consolidated FDI Policy, paragraph on 'Entry Routes for Investment' issued by the Government of India from time to time, are attracted. (www.rbi.org.in, n.d.)

The investors, in this case, are only required to notify the concerned regional office of the RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issue of shares to foreign investors. (NCEAR, 2009)

3.4.2 Prior Government Approval Route

Under this route, approval from the government is required by the investor, in case if investment is above the permissible limit. Thus, FDI in activities not covered under
the automatic route forms part of this route and requires prior approval of the Government which is considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance. (www.rbi.org.in, n.d.)

In the limited category of sectors requiring prior government approval, the proposals are considered in a time-bound and transparent manner by the Foreign Investment Promotion Board (FIPB) under the Department of Economic Affairs, Ministry of Finance. Approvals of composite proposals involving foreign investment/ foreign technical collaboration are also granted on the recommendations of the FIPB. (NCEAR, 2009)

**Routes for FDI in India**

**Automatic route**

Do not require any prior approval either by the government or the Reserve Bank of India (RBI).

Investors are only required to notify the concerned regional office of the RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issue of shares to foreign investors.

**Prior Government Approval route**

The proposals are considered in a time-bound and transparent manner by the Foreign Investment Promotion Board (FIPB) under the Department of Economic Affairs, Ministry of Finance.

Approvals of composite proposals involving foreign investment/ foreign technical collaboration are also granted on the recommendations of the FIPB.

*Source:* Prepared by the researcher.

**Box 3.3: Routes for FDI in India**

The Consolidated FDI Policy, as issued by Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India, from time to time, enlists the distinct provisions with respect to investment in distinct sectors of the country from foreign entities, specifically in the form of FDI. The recent FDI Policy (effective from April 17, 2014) includes following provisions with respect to investment.
3.5 PROHIBITED SECTORS

This constitutes sectors/activities where FDI is prohibited, subject to applicable laws/regulations; security and other conditionalities. FDI in India is prohibited in number of sectors/activities which includes: (a) Lottery Business including Government/private lottery, online lotteries, etc.; (b) Gambling and Betting including casinos etc.; (c) Chit funds; (d) Nidhi company; (e) Trading in Transferable Development Rights (TDRs); (f) Real Estate Business or Construction of Farm Houses; (g) Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes; (h) Activities / sectors not open to private sector investment e.g. Atomic Energy and Railway Transport (other than Mass Rapid Transport Systems). In addition to this, foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery Business and Gambling and Betting activities. (DIPP, 2014)

3.6 PERMITTED SECTORS

This constitutes the sectors/activities where FDI up to the limit indicated against each sector/activity, subject to applicable laws/ regulations; security and other conditionalities. (DIPP, 2014)

The Consolidated FDI Policy of India, which encloses various provisions framed by the government regarding FDI in different sectors/activities, is issued by Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India, in every six months. Annexure No. 1 exhibits the FDI policy of India as applicable since April 17, 2014.

The discussion made so far, exhibits that India, even after being horribly bruised by its rulers, showed immense courage in overcoming from this situation, which demanded for deviation from the long walked path of restrictions on foreign players for ensuring country’s growth and development. This asked for certain relaxations in policies and procedures for foreign players for making foreign direct investment into the country. At the same time, it was also required that the policies and procedures so framed does not hamper the domestic businesses of the country. In this regard, India had always been involved in making comprehensive and consistent, yet vigilant, efforts since attainment of its independence, to ensure enlightened future for the
country and its citizens by promoting more and more involvement of foreign
investment (especially direct) as and when felt necessary, alongwith, security to local
business houses.

3.7 FDI INFLOWS TO INDIA: AN ANALYSIS

Since 1991, India has adopted Liberalization, Privatization and Globalization (LPG)
mantra which generated ample opportunities for foreign direct investors to make
investment in distinct sectors of the Indian economy, thus, contributing to its growth
and development, alongwith fulfilling their desires by reaping required benefits by
making such investment. Indian Governments from time to time, since then, had been
taking initiatives to open new sectors to ensure enhanced opportunities not just for
foreign direct investors, but also, for the country's growth and development.

The initiatives taken by India had found to be successful enough, atleast, for the last
decade or so, as the quantum of FDI inflows registered phenomenal growth. The table
below (Table 3.1) exhibits the amount of FDI inflows to India, since it adopted the
liberalization regimes on July 22, 1991. FDI inflows to India during August, 1991 to
March, 1992 were registered at US$ 165 million (Rs. 4,081 Crores). FDI inflows
afterwards enjoyed the synergies of liberalization as it kept on surging. FDI inflows
roused a peak of US$ 3682 million (Rs. 135,482 Crores) during 1997-98, exhibiting a
growth of 33% over previous year's FDI inflows.

FDI inflows to India registered first decline during the year 1998-99 since the
adoption of New Economic Policy. India's nuclear test, which was one of the
highlighting features of the year 1998, was held responsible for the downfall in FDI
inflows. The scenario continued for two continued years, viz. 1998-99 to 1999-2000,
when FDI inflows to the country first declined to US$ 3083 million (Rs. 123,427
Crores) and then further tumbling down to US$ 2223 million (Rs. 94,040 Crores) in
the very next year. During these periods the decline was registered at 16% and 29%
respectively compared to previous year figures.

With the change in decade, in the year 2000, India implemented further liberalization
which marked the flow of FDI inflows in a growing spree for a decade ranging from
2000-01 to 2009-10, reaching a peak of US$ 25,834 million (Rs. 1,231,196 Crores)
(though in US$ terms there was a decline compared to corresponding figure of
previous year, but in rupees term there was an increase), until global economic turmoil came as a hurdle for India’s FDI inflows, being FDI inflows facing downfall of 5% during 2009-10, when total FDI inflows were registered at US$ 21,383 million (Rs. 97,320 Crores) as compared to previous year figures of US$ 25,834 million (Rs. 123,120 Crores). Total FDI inflows though had, so far, shown a growing trend for the decade 2010-20, as for the years 2010-11, 2011-12 and 2012-13, the amount of FDI inflows had been registered at US$ 21,383 million (Rs. 97,320 Crores), US$ 35,121 million (Rs. 165,146 Crores) and US$ 22,423 million (Rs. 121,907 Crores) respectively, exhibiting downfall of 17% for the year 2010-11 followed by growth of 64 %, later followed by downfall of 36 % in the respective years. For the year 2013-14, there was growth of 8% as FDI inflows was registered at US$ 24,299 million (Rs. 147,518 Crores).

Graphical representation of the trends of FDI inflows (Financial year-wise), as shown in Graph 3.1, shows that the upward trend of FDI inflows since 1991-92 came to halt in 1997-98 from where there had been declining trend till 2004-05, which in the meantime showed rise in certain years. Another downfall in the upward trend came in the year 2009-10 and continued till 2010-11. For the years 2011-12, there had been an upward trend in FDI inflows of the country followed by downfall the very next year, followed by an upward trend.

On the other hand, the calendar year-wise FDI inflows (equity component) (Table 3.2) which were recorded at US$ 144 million (Rs. 3,535 Crores) soon after liberalization for the year 1991, registered a phenomenal growth of 130% the very next year with inflows amounting to US$ 264 million (Rs. 6,912 Crores) over the previous year. The FDI inflows to the country, since then, kept on exhibiting increasing trend until year 1998 where percentage decline was recorded at 7% as FDI inflows was US$ 3,359 million compared to figures of 1997 which stood at US$ 3,621 million. Albeit there was increase in FDI inflows when compared in rupees terms, FDI inflows afterwards faced a "roller-coaster ride" scenario with leaps and bounds for the period ranging 1998 till 2003. However, since then, FDI inflows in India remained in a growing spree, until 2009, until 2009, when global turmoil started showing its imprints not just on Indian FDI inflows, but also on global FDI flows. The country showed signs of recovery quite frequently and after a gap of two years in 2011, FDI inflows came back on growth trajectory, with growth of 31% over
corresponding figures of US$ 21,007 million in previous year. The figures of FDI inflows for the year 2012 and 2013 were registered at US$ 22,789 (Rs. 121,591 Crores) and 22,035 (Rs. 129,484 Crores) with downfall of 17% and growth of 3% respectively.

Table 3.1: Financial Year-Wise FDI Equity Inflows

<table>
<thead>
<tr>
<th>Financial Year (April – March)</th>
<th>Amount of FDI Inflows</th>
<th>%age growth over the previous year (in US$ terms)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In Rupees</td>
<td>In US$</td>
</tr>
<tr>
<td>1991-92 (Aug- Mar)</td>
<td>4,081</td>
<td>165</td>
</tr>
<tr>
<td>1992-93</td>
<td>10,939</td>
<td>392</td>
</tr>
<tr>
<td>1993-94</td>
<td>20,184</td>
<td>654</td>
</tr>
<tr>
<td>1994-95</td>
<td>43,123</td>
<td>1,374</td>
</tr>
<tr>
<td>1995-96</td>
<td>69,163</td>
<td>2,140</td>
</tr>
<tr>
<td>1996-97</td>
<td>96,542</td>
<td>2,770</td>
</tr>
<tr>
<td>1997-98</td>
<td>135,482</td>
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</tr>
<tr>
<td>1998-99</td>
<td>123,427</td>
<td>3,083</td>
</tr>
<tr>
<td>1999-00</td>
<td>94,040</td>
<td>2,223</td>
</tr>
<tr>
<td>2000-01</td>
<td>10,733</td>
<td>2,463</td>
</tr>
<tr>
<td>2001-02</td>
<td>18,654</td>
<td>4,065</td>
</tr>
<tr>
<td>2002-03</td>
<td>12,871</td>
<td>2,705</td>
</tr>
<tr>
<td>2003-04</td>
<td>10,064</td>
<td>2,188</td>
</tr>
<tr>
<td>2004-05</td>
<td>14,653</td>
<td>3,219</td>
</tr>
<tr>
<td>2005-06</td>
<td>24,584</td>
<td>5,540</td>
</tr>
<tr>
<td>2006-07</td>
<td>56,390</td>
<td>12,492</td>
</tr>
<tr>
<td>2007-08</td>
<td>98,642</td>
<td>24,575</td>
</tr>
<tr>
<td>2008-09 *</td>
<td>142,829</td>
<td>31,396</td>
</tr>
<tr>
<td>2009-10 #</td>
<td>123,120</td>
<td>25,834</td>
</tr>
<tr>
<td>2010-11 #</td>
<td>97,320</td>
<td>21,383</td>
</tr>
<tr>
<td>2011-12 ^</td>
<td>165,146</td>
<td>35,121</td>
</tr>
<tr>
<td>2012-13 #</td>
<td>121,907</td>
<td>22,423</td>
</tr>
<tr>
<td>2013-14</td>
<td>147,518</td>
<td>24,299</td>
</tr>
</tbody>
</table>

**Cumulative Total (from August 1991 to March 2014)**

|                          | 1,044,431 | 217,703 | - |

**Notes:**
(i) including amount remitted through RBI's-NRI Schemes (2000-2002).
(ii) # Figures for the years 2009-10, 2010-11, 2011-12 & 2012-13 (from April, 2012 to September, 2012) are provisional subject to reconciliation with RBI.
^ Inflows for the month of March, 2012 are as reported by RBI, consequent to the adjustment made in the figures of March, 2011, August, 2011 and October, 2011.

**Source:** DIPP, various issues.
Graph 3.1: Financial Year-Wise FDI (Equity) Inflows

Research on the basis of Table 3.1.
Table 3.2: FDI Equity Inflows: Calendar Year-Wise

<table>
<thead>
<tr>
<th>Calendar Year (Jan-Dec)</th>
<th>Amount of FDI Inflows</th>
<th>% age growth over the previous year (in US$ terms)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In Rupees</td>
<td>In US$</td>
</tr>
<tr>
<td>1991 (Aug.-Dec.)</td>
<td>3,535</td>
<td>144</td>
</tr>
<tr>
<td>1992</td>
<td>6,912</td>
<td>264</td>
</tr>
<tr>
<td>1993</td>
<td>18,620</td>
<td>608</td>
</tr>
<tr>
<td>1994</td>
<td>31,122</td>
<td>992</td>
</tr>
<tr>
<td>1995</td>
<td>64,854</td>
<td>2,065</td>
</tr>
<tr>
<td>1996</td>
<td>87,522</td>
<td>2,545</td>
</tr>
<tr>
<td>1997</td>
<td>129,898</td>
<td>3,621</td>
</tr>
<tr>
<td>1998</td>
<td>132,692</td>
<td>3,359</td>
</tr>
<tr>
<td>1999 *</td>
<td>92,599</td>
<td>2,205</td>
</tr>
<tr>
<td>2000 *</td>
<td>104,411</td>
<td>2,428</td>
</tr>
<tr>
<td>2001 *</td>
<td>160,711</td>
<td>3,571</td>
</tr>
<tr>
<td>2002 *</td>
<td>162,184</td>
<td>3,379</td>
</tr>
<tr>
<td>2003 *</td>
<td>97,364</td>
<td>2,117</td>
</tr>
<tr>
<td>2004 *</td>
<td>147,814</td>
<td>3,213</td>
</tr>
<tr>
<td>2005</td>
<td>192,991</td>
<td>4,361</td>
</tr>
<tr>
<td>2006</td>
<td>503,573</td>
<td>11,119</td>
</tr>
<tr>
<td>2007</td>
<td>797,356</td>
<td>19,156</td>
</tr>
<tr>
<td>2008</td>
<td>1,397,467</td>
<td>33,035</td>
</tr>
<tr>
<td>2009</td>
<td>1,309,799</td>
<td>27,044</td>
</tr>
<tr>
<td>2010</td>
<td>960,150</td>
<td>21,007</td>
</tr>
<tr>
<td>2011</td>
<td>127,362</td>
<td>27,579</td>
</tr>
<tr>
<td>2012 #</td>
<td>121,591</td>
<td>22,789</td>
</tr>
<tr>
<td>2013 #</td>
<td>129,484</td>
<td>22,035</td>
</tr>
<tr>
<td>CUMULATIVE TOTAL (From August 1991 to December 2013)</td>
<td>6,780,011</td>
<td>215,437</td>
</tr>
</tbody>
</table>

Notes: (i) * Excludes amount of inflows received as advance pending for issue of shares.
(ii) # Figures are provisional, subject to reconciliation with RBI, Mumbai.

Source: DIPP, various issues.

The graphical representation of India's calendar year-wise FDI inflows had been depicted in Graph 3.2. As such, the trend which showed an increasing trend since 1991 came to halt in the year 1998. From here the trend has shown an up and down scenario till 2003, from where onwards there had again been an upsurge in the inflows which breakdown with consecutive downfall during the years 2012 and 2013.
Graph 3.2: FDI Equity Inflows: Calendar Year-Wise

Source: Prepared by the researcher on the basis of Table No. 3.2.
Table 3.3 comes up with the segregated data since 2000. The data is in accordance with the internationally accepted practice of publishing FDI data, which was adopted by India in 2002, on the recommendation of the Committee formed in 2002. India, therefore, has been publishing FDI data in accordance to the international best practices since 2000. As such, FDI inflows were divided into three broad categories, viz. Equity capital, re-invested earnings and other capital. The table below comes up with the data complying international standards. From the data provided, we can easily conclude that major chunk of FDI inflows to India is in the form of equity capital, which includes equity capital through FIPB Route/ RBI's Automatic Route/ Acquisition Route and Equity capital of unincorporated bodies. As also, albeit there had been considerable difference between the above-mentioned three categories, the gap has widened comprehensively since 2006-2007, and though, there had been certain ups and downs in the quantum of different components of FDI, the scenario of equity component had been comprehensively well compared to other components, viz. Reinvested earnings and other capital.

Analyzing the FDI inflows to India from the top ten investing nations (Table 3.4), it can be concluded that there doesn't seem to be much shuffles in the composition of the top ten nations making foreign direct investment in India since August 1991, albeit, there had been comprehensive shuffles in the positions among top ten investing countries in case of year on year comparisons. On the list Mauritius had been successful in proving itself as a 'top-notch', being at the top of the list in making FDI to India since long back. Albeit, for the year April, 2013 to March, 2014 Singapore had dinged Mauritius to grab the top position among the top ten investing nations, still, in case of cumulative FDI inflows (from August 1991 to March 2014), it had been ranked as number one. Singapore, Cyprus and UAE, though are late entrants on the list, but are successful in placing themselves among the top ten investing nations for the last five years or so. Else than this, other countries on the list like U.S.A., U.K., Netherlands, Japan, Germany and France had been successful in retaining their presence on the list of top ten, since liberalization, though at different positions at different phases of time.

Cumulatively, for the period ranging August 1991 to March 2014, Mauritius holds the top rank among the top ten FDI making nations, with FDI registered at US$ 82,114 million (Rs. 383,651 Crores). Singapore, even after being emerged as one of the
Table 3.3: Financial Year-Wise FDI Inflows Data: As Per International Best Practices

<table>
<thead>
<tr>
<th>S. No</th>
<th>Financial Year (April-March)</th>
<th>FOREIGN DIRECT INVESTMENT (FDI)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td><strong>Equity</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Re-invested earnings</strong> +</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Other capital</strong> +</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>FDI FLOWS INTO INDIA</strong></td>
</tr>
<tr>
<td></td>
<td><strong>FIPB Route/ RBI's Automatic Route/ Acquisition Route</strong></td>
<td><strong>Equity capital of unincorporated bodies #</strong></td>
</tr>
<tr>
<td>-------</td>
<td>----------------------------------------------------------</td>
<td>---------------------------------</td>
</tr>
<tr>
<td>FINANCIAL YEARS 2000-2012</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td>2000-01</td>
<td>2,339</td>
</tr>
<tr>
<td>2.</td>
<td>2001-02</td>
<td>3,904</td>
</tr>
<tr>
<td>3.</td>
<td>2002-03</td>
<td>2,574</td>
</tr>
<tr>
<td>4.</td>
<td>2003-04</td>
<td>2,197</td>
</tr>
<tr>
<td>5.</td>
<td>2004-05</td>
<td>3,250</td>
</tr>
<tr>
<td>6.</td>
<td>2005-06</td>
<td>5,540</td>
</tr>
<tr>
<td>7.</td>
<td>2006-07</td>
<td>15,585</td>
</tr>
<tr>
<td>8.</td>
<td>2007-08</td>
<td>24,573</td>
</tr>
<tr>
<td>9.</td>
<td>2008-09</td>
<td>31,364</td>
</tr>
<tr>
<td>10.</td>
<td>2009-10 (P) (+)</td>
<td>25,606</td>
</tr>
<tr>
<td>11.</td>
<td>2010-11 (P) (+)</td>
<td>21,376</td>
</tr>
<tr>
<td>12.</td>
<td>2011-12 (P)</td>
<td>34,833</td>
</tr>
<tr>
<td>13.</td>
<td>2012-13 (P)</td>
<td>21,825</td>
</tr>
<tr>
<td>14.</td>
<td>2013-14 (P)</td>
<td>24,299</td>
</tr>
<tr>
<td>CUMULATIVE TOTAL (from April, 2000 to March, 2014)</td>
<td>219,265</td>
<td>10,805</td>
</tr>
</tbody>
</table>

Notes: (i) "#" Figures for equity capital of unincorporated bodies for 2010-11 are estimates.
(ii) (P) All figures are provisional
(iii) "+" Data in respect of 'Re-invested earnings' & 'Other capital' for the years 2009-10, 2010-11 are estimated as average of previous two years.
(iv) RBI had included Swap of Shares of US$ 3.1 billion under equity components during December 2006.
(v) Monthly data on components of FDI as per expended coverage are not available. These data, therefore, are not comparable with FDI data for previous years.
(vi) Figures updated by RBI up to January, 2014.

Source: DIPP, Various Issues.
major investor quite lately, had been successful in clinching the second position, thus, showing its worth to India. Foreign Direct Investments to India, in this case, registered at US$ 25,788 million (Rs. 127,053 Crores). U.K., with an investment of US$ 19,020 million (Rs. 92,418 Crores), emerged at the third rank in case of cumulative investment (foreign direct) to the country. Japan on this list with cumulative FDI of US$ 13,578 million (Rs. 66,185 Crores), had been placed at number four. Later on, the list is followed by countries namely, U.S.A., Netherlands, Cyprus, Germany, France and U.A.E.

Sectoral FDI inflows face serious turnarounds with regard to foreign direct investment. Table 3.5 exhibits top ten sectors in India that took away the major chunk of the total FDI flowing into the country. An analysis of these tables shows that electrical equipments that ruled the list from 2003-04 to 2005-06, had not been able to attract ample FDI in the later years, and thus, dropped out not just from the top spot, but also from the list of top ten.

Similar is the case with industries, like, transportation industry, fuels (Power + Oil Refinery) food processing industries, drugs and pharmaceuticals and cement and Gypsum products. These industries also lost-out their positions from the list of top ten sectors attracting majority quantum of FDI flowing into the country. This had been, in some cases, due to fission of industries. Since 2006-07, the list of the sectors attracting FDI inflows had been out-rightly ruled by service sector which had been absorbing majority of the FDI flowing into the country. In case of other sectors that had been placed among the top ten, there had frequent reshuffles leading to entry and exit of various sectors and rise and fall, in position, of distinct sectors on the list of top ten.

On the other hand, while making analysis of the FDI inflows in India from April 2000 to March 2014, as recorded by the regional offices of the Reserve Bank of India (RBI), it was found that the region covered under the financial capital of India, Mumbai, covering states/union territories viz. Maharashtra, Dadra & Nagar Haveli and Daman & Diu, had been leading the list since 2008-09. Moreover, in case of cumulative FDI inflows to India, it also tops the chart with 31 percentage share among all regions. Following Mumbai is the New Delhi region covering states/union territories viz. Delhi, Part of Uttar Pradesh and Haryana with 19 percent share for the similar time frame. Later followers includes Chennai, Bangalore and Ahmadabad respectively (covering states/union territories as mentioned in Table 3.6), which holds respective shares of 6, 6 and 4 percent for the similar time period.
## Table 3.5: Sectors Attracting Highest FDI Inflows

**Amount Rupees in crore / (US$ in million)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Electrical Equipments (including computer software &amp; electronics)</td>
<td>2,449 (532)</td>
<td>3,281 (721)</td>
<td>6,499 (1,451)</td>
</tr>
<tr>
<td>2.</td>
<td>Telecommunications (radio paging, cellular mobile, basic telephone services)</td>
<td>532 (116)</td>
<td>588 (129)</td>
<td>3,023 (680)</td>
</tr>
<tr>
<td>3.</td>
<td>Transportation Industry</td>
<td>1,417 (308)</td>
<td>815 (179)</td>
<td>983 (222)</td>
</tr>
<tr>
<td>4.</td>
<td>Services Sector (financial &amp; non-financial)</td>
<td>1,255 (269)</td>
<td>2,106 (469)</td>
<td>2,565 (581)</td>
</tr>
<tr>
<td>5.</td>
<td>Fuels (Power + Oil Refinery)</td>
<td>521 (113)</td>
<td>759 (166)</td>
<td>416 (94)</td>
</tr>
<tr>
<td>6.</td>
<td>Chemicals (other than fertilizers)</td>
<td>94 (20)</td>
<td>909 (198)</td>
<td>1,979 (447)</td>
</tr>
<tr>
<td>7.</td>
<td>Food Processing Industries</td>
<td>511 (111)</td>
<td>174 (38)</td>
<td>183 (42)</td>
</tr>
<tr>
<td>8.</td>
<td>Drugs &amp; Pharmaceuticals</td>
<td>502 (109)</td>
<td>1,343 (292)</td>
<td>760 (172)</td>
</tr>
<tr>
<td>9.</td>
<td>Cement and Gypsum Products</td>
<td>44 (10)</td>
<td>1 (0)</td>
<td>1,970 (452)</td>
</tr>
<tr>
<td>10.</td>
<td>Metallurgical Industries</td>
<td>146 (22)</td>
<td>881 (192)</td>
<td>681 (153)</td>
</tr>
</tbody>
</table>

### Amount Rupees / US$ in million

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>SERVICES SECTOR (financial &amp; non-financial)</td>
<td>21,047 (4,664)</td>
<td>25,589 (6,615)</td>
<td>28,516 (6,138)</td>
<td>20,776 (4,353)</td>
<td>15,539 (3,403)</td>
</tr>
<tr>
<td>2.</td>
<td>COMPUTER SOFTWARE &amp; HARDWARE</td>
<td>11,786 (2,614)</td>
<td>5,623 (1,410)</td>
<td>7,329 (1,677)</td>
<td>4,351 (919)</td>
<td>3,571 (784)</td>
</tr>
<tr>
<td>3.</td>
<td>TELECOMMUNICATIONS (radio paging, cellular mobile, basic telephone services)</td>
<td>2,155 (478)</td>
<td>3,103 (1,261)</td>
<td>11,727 (2,558)</td>
<td>12,338 (2,854)</td>
<td>7,546 (1,665)</td>
</tr>
<tr>
<td>4.</td>
<td>HOUSING &amp; REAL ESTATE</td>
<td>2,121 (467)</td>
<td>8,749 (2,179)</td>
<td>12,621 (2,801)</td>
<td>13,586 (2,844)</td>
<td>5,149 (1,127)</td>
</tr>
<tr>
<td>5.</td>
<td>CONSTRUCTION ACTIVITIES</td>
<td>4,424 (985)</td>
<td>6,989 (1,743)</td>
<td>8,792 (2,028)</td>
<td>13,156 (2,862)</td>
<td>5,077 (1,125)</td>
</tr>
<tr>
<td>6.</td>
<td>AUTOMOBILE INDUSTRY</td>
<td>1,254 (276)</td>
<td>2,697 (675)</td>
<td>5,212 (1,152)</td>
<td>5,754 (1,208)</td>
<td>6,088 (1,331)</td>
</tr>
<tr>
<td>7.</td>
<td>POWER</td>
<td>713 (157)</td>
<td>3,875 (957)</td>
<td>4,382 (985)</td>
<td>6,908 (1,437)</td>
<td>5,709 (1,252)</td>
</tr>
<tr>
<td>8.</td>
<td>METALLURGICAL INDUSTRIES</td>
<td>7,866 (173)</td>
<td>4,686 (1,177)</td>
<td>4,157 (961)</td>
<td>1,935 (407)</td>
<td>5,055 (1,105)</td>
</tr>
<tr>
<td>9.</td>
<td>PETROLEUM &amp; NATURAL GAS</td>
<td>401 (89)</td>
<td>5,729 (1,427)</td>
<td>1,931 (412)</td>
<td>1,328 (272)</td>
<td>2,621 (574)</td>
</tr>
<tr>
<td>10.</td>
<td>CHEMICALS (other than fertilizers)</td>
<td>930 (205)</td>
<td>920 (229)</td>
<td>3,427 (749)</td>
<td>1,707 (362)</td>
<td>1,810 (398)</td>
</tr>
</tbody>
</table>

Note: *Includes inflows under NRI Schemes of RBI, stock swapped and advances pending issue of shares.

Cont.
<table>
<thead>
<tr>
<th>Ranks</th>
<th>Sector</th>
<th>2011-12 (April-March)</th>
<th>2012-13 (April-March)</th>
<th>2013-14 (April-March)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>SERVICES SECTOR **</td>
<td>24,656 (5,216)</td>
<td>26,306 (4,833)</td>
<td>13,294 (2,235)</td>
</tr>
<tr>
<td>2.</td>
<td>CONSTRUCTION DEVELOPMENT: TOWNSHIPS, HOUSING, BUILT-UP INFRASTRUCTURE</td>
<td>15,236 (3,141)</td>
<td>7,248 (1,332)</td>
<td>7,508 (1,256)</td>
</tr>
<tr>
<td>3.</td>
<td>TELECOMMUNICATIONS (radio paging, cellular mobile, basic telephone services)</td>
<td>9,012 (1,997)</td>
<td>1,654 (304)</td>
<td>7,987 (1,307)</td>
</tr>
<tr>
<td>4.</td>
<td>COMPUTER SOFTWARE &amp; HARDWARE</td>
<td>3,804 (796)</td>
<td>2,656 (486)</td>
<td>6,896 (1,126)</td>
</tr>
<tr>
<td>5.</td>
<td>DRUGS &amp; PHARMACEUTICALS</td>
<td>14,605 (3,322)</td>
<td>6,011 (1,123)</td>
<td>7,191 (1,279)</td>
</tr>
<tr>
<td>6.</td>
<td>AUTOMOBILE INDUSTRY</td>
<td>4,347 (923)</td>
<td>8,384 (1,537)</td>
<td>9,027 (1,517)</td>
</tr>
<tr>
<td>7.</td>
<td>CHEMICALS (OTHER THAN FERTILIZERS)</td>
<td>18,422 (4,041)</td>
<td>1,596 (292)</td>
<td>4,738 (878)</td>
</tr>
<tr>
<td>8.</td>
<td>POWER</td>
<td>7,678 (1,652)</td>
<td>2,923 (536)</td>
<td>6,519 (1,066)</td>
</tr>
<tr>
<td>9.</td>
<td>METALLURGICAL INDUSTRIES</td>
<td>8,348 (1,786)</td>
<td>7,878 (1,466)</td>
<td>3,436 (568)</td>
</tr>
<tr>
<td>10.</td>
<td>HOTEL &amp; TOURISM</td>
<td>4,754 (993)</td>
<td>17,777 (3,259)</td>
<td>2,949 (486)</td>
</tr>
</tbody>
</table>

Note: (i) ** Services sector includes Financial, Banking, Insurance, Non-Financial / Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis.

Source: DIPP, Various Issues.

3.8 JAPANESE FOREIGN DIRECT INVESTMENT SCENARIO

After World War II, the Japanese government overhauled the Foreign Exchange Law. Since 1951, Japanese companies have been allowed to make direct investments overseas. However, because of severe restrictions imposed by balance-of-payments deficits, FDI, in numbers and value, were negligible until the 1960s (Jin, Sader, Horaguchi & Kwak, 1993). However, the country registered a radical shift and grew rapidly in the late 1960s and early 1970s resulting in comprehensive reduction in manufacturing costs in neighbouring countries, making them the palpable choice for investment by Japanese investors.

As an outcome of the oil crisis, manufacturing sector emerged as the driving force that gave boost to the Japanese FDI during 1970s. In particular, the chemical industry and the iron and steel industry were the early birds that stepped up with efforts to establish their bases in other countries. Still there were restrictions as investors were generally required to obtain official approval, subject to certain conditionalities. The scenario prevailed in the country till 1981, when relaxation of foreign exchange
controls and financial regulations were introduced. (Jun, Sader, Horaguchi & Kwak, 1993)

The Plaza Accord introduced in 1985 also helped in bringing a turnaround in Japan’s outward FDI (Hiratsuka, 2007). These initiatives brought a considerable change in Japan’s position on the global platform as Japan has been among the largest sources of FDI in the world since 1985. A helping hand to this scenario came from Japanese investors, who responded actively over the emerging economic scenario of its country. Realizing the growing current account surpluses in the country, yen appreciation, protectionism, higher labour costs in domestic market, slower domestic growth and the need to secure natural resources and markets, made Japanese corporations to explore investment opportunities in the outside markets and attempt to exploit them at earliest. (Ghosh, 2007)

The growing involvement of Japan in the global economy is an impression of the three well-knitted broad paths which shows the emergence of Japan as a key global player in the areas of trade and investment. The first path involved the phase where focus was put on encouraging trading firms to undertake their operations outside the country. In the second path focus was directed towards labour-intensive low-tech manufacturing investment in the overseas markets. This was done in two phases. The first phase ranged from late 1950’s to 1970’s, wherein production units by the Japanese companies were set up in Southeast Asia. The second phase emerged in late 1970’s when the focus for setting manufacturing units shifted to Europe and North America. The third path of Japan’s journey, as major source FDI, featured well planned investment strategy which focussed upon building capacity in export of capital goods and turnkey projects. The three paths, though independent of each other, complemented each other in helping Japan to re-emerge from ruins to become an economic superpower. (Banik & Bhaumik, 2005)

Shift in the Japanese FDI towards developing countries was so frequent that by 1980, all the developing countries collectively were host to about half of Japan’s total FDI. The increasing trend in Japanese FDI, as a result of its emergence as an economic superpower, wasn’t able to entertain the world for too long. The first boom of Japanese outward FDI, registered during 1980s, came to halt in the early 1990s with the collapse of the Japanese 'bubble' economy. This resulted in stagnation in Japanese
investments in the primary and secondary sector; while the tertiary sector registered
downfall in Japanese investments by more than 20 percent, alone in the year 1990
(Jun, Sader, Horaguchi & Kwak, 1993). The scenario was driven by the Japanese
firm’s reduced access to credit which was the outcome of Japanese banking crisis of
the 1990s that weakened Japan’s main banks’ balance sheets and reduced the
availability of credit to their client firms, thereby, diminishing their capacity to invest.
(JETRO, 2001)

Recovering from this, Japanese outward FDI started to surge again. However, the
focus at this time was much expanded and the operations of the Japanese firms in the
overseas market were established in Asian continent, alongwith, Europe and North
America. The shift in the focus towards developing countries of the Asian continent
was so significant that the continent registered intrusion of such a considerable
amount of Japanese FDI that it became the second largest host to Japan’s outward
FDI, only next to North America, by replacing Europe. The shift was an outcome of
the presence of relatively conducive investment environment in the Asian continent,
in terms of permission over operations of foreign capitals; provision of tax incentives;
establishment of industrial estates or parks; and development of supporting industries
(to certain extent). (Hiratsuka, 2007)

The set-back to the second boom of Japan’s outward FDI came in 1997 as a result of
Asian currency crisis which had its origin in Thailand. As an aftermath, not just
Japan’s outward FDI flows started exhibiting a declining trend, there was change in
the pattern of FDI flows from the country as well (Hiratsuka, 2007). Other reasons
made responsible for the boom-down were sharp depreciation of the yen against the
dollar in early 1997 and weakening of the Japanese economy. During the same time,
India registered increase in trade and investment activities from Japan, which diverted
its attention from China, in wake of the special position enjoyed by India in the region
because of its historical, ethnic and emotional relationships. (JETRO, 2001)

Learning from the shocks of re-occurring boom-downs, Japanese companies initiated
upon extensive efforts to make their overseas network more multi-layered,
particularly in the Asian, European and North American continents; and with the
dawning of the 21st century, Japanese corporations were successful in making it a
reality. (JETRO, 2001)
Compendiously, Japanese companies have travelled a long difficult path to make their country an economic giant. Since, Japanese companies started shifting their operations in overseas markets as well; they have faced drastic changes in the domestic and overseas milieu during this process. Some of the remarkable changes during this phase included transition of General Agreement on Tariffs and Trade (GATT) into World Trade Organization (WTO); Asian currency crisis; introduction of Euro; and its own long-lasting stagnant economy. (JETRO, 2001)

3.9 ECONOMIC TIES BETWEEN INDIA AND JAPAN

The “Land of Rising Sun” by its untiring efforts has found itself successful in sharing the centre stage with other major economies (developed countries) of the world, even after facing anguish brought-in by the nuclear war. Japan, in this regard, has been performing the task of providing financial assistance to the developing countries or the least developed countries (LDCs), either by ODAs or through FDI.

India and Japan holds a long history of indirect cultural and economic exchange with Buddhism finding its way to Japan from India via China and Korea in the seventh century, and Dutch East India Company establishing trade routes between Japan and India during 1638–1858. Additionally, India had not only made significant contribution in the growth of the Japanese firms, but also, acted as a significant catalyst for Japan’s industrialization process. The annals, however, exhibits that even a close connection between Japan and India had not been successful in the proliferation of vibrant economic relations between the two countries. As such, the economic relations between the two countries remain dormant even after remarkable incidences of India’s independence in 1947, and signing of bilateral peace treaty by Japan and India in 1952. Moreover, rising of Japan as a world’s major economy and a dominant trade force in the Asian region, didn’t helped much in giving boost to this bilateral economic relations, at least, up to early 1990s. (Buckley, Cross & Horn, 2012)

However, despite the fact that India remained out of the reach of Japanese investment radars, Japan had been providing substantial aid to India since 1958, via. ODA, which had been favoured by India to fulfill its financial requirements for growth and development of its competencies in order to face global challenges and for putting itself in equity with enriched countries of the world (Patel, 2007). Thus, ODAs from
Japan was the only representation of Indo-Japanese economic ties and low investment attractiveness of India for Japanese firms was the cumulative effect of ‘Cold War’ and the economic planning in India. (Buckley, Cross & Horn, 2012)

There were some efforts to lift the economic cooperation between the two countries in 1984 with the visit of Y. Nakasone, then Prime Minister of Japan (IBEF, n.d.); but the relations still remained restricted to ODAs as Japanese firms kept on neglecting India as an investment destination until it took initiative of partially lifting of MRTP and FERA regulations. As the initiative adhered to foreign ownership rules, simplification of bureaucratic procedures, production licenses and asset size, Japanese companies reacted frequently by way of introduction of capital, technology and management know-how in India also. (Buckley, Cross & Horn, 2012)

Seeing to the changing attitude of Japanese investors towards itself, India realized about the expectations of the Japanese firms, and thus, with a clear ambition towards liberalization of its economy India undertook the long-awaited economic reforms in 1991, which popularly came to be known as ‘New Economic Policy’, leading to the relaxation of rules and regulations, governing distinct aspects, in a number of industries in order to ensure higher FDI inflows along with other benefits, for making itself equipped with number of benefits for its overall growth and development.

India, soon after the enactment of economic reforms in 1991, started registering increased quantum of FDI with an accelerated pace which was a significant turnaround in the scenario of FDI inflows that prevailed within the country in the period prior to these reforms. Following the success of 1991 reforms, the then Finance Minister of India, Dr. Manmohan Singh launched India’s “Look-East Policy” in 1992, with the objective of looking forth for opportunities to develop strong economic ties with the member countries of the Association of South East Asian Nations (ASEAN) (Desai, 2005) and other ‘Big-Wig’ countries. Resultantly, in a decade or so, India registered good economic bonding with some of the major countries of East Asia. However, India doesn’t found itself successful in framing policies which could entice Japanese FDI both in pre and post-liberalization period, considerably hindering the FDI from the country, even when other countries were finding Japanese FDI as “Aladdin’s Lamp” in their robust economic growth. On the other end, despite being suffered by serious economic recession in 1990, a quick response was registered by
Japanese companies over the changing economic scenario in the Asian continent, by way of increased investment in the region, especially to economically vibrant destinations in East and Southeast Asia (Asia Age, 1996). However, in lieu of its economic reforms, India caught eyes of Japanese investors in the latter half of the decade 1990. Since then, Japan had been a key source of FDI for India, even if, the economic relations had dwindled due to incidences taking place in and outside the country (Buckley, Cross & Horn, 2012). The growing interest of Japan in India can be depicted from the statement made by Japanese Ambassador to India Tanino Sakutaro in mid-1996, which states:

"India, with its high quality of skilled labour, rich natural resources, strategic geographical location, democratic framework and above all a well-established and reliable legal system, had become an attractive investment destination." (Asia Age; 1996)

In addition to the addresses made by Japanese dignitaries, in favour of India, the increasing interest of Japan in South Asian continent, and particularly in India, has also been reflected by the visits of several high-profile investment missions. For example, visit by the officials of the Federation of Economic Organizations (Keidanren); first ever visit by the Minister of International Trade and Industry (MITI) in 1995 (Jain, 1997); annual visits by Japanese business delegates to study India’s business milieu, etc.

Various studies made to find the reasons for growing preference of India as investment destination for some prominent countries, which included Japan too, came up with list of reasons for ever flourishing bilateral economic ties between Japan and India. Some of the most likely reasons for this bonding may be outlined as under:

3.9.1 Two of the oldest civilizations of the world with shared past

India and Japan are the countries which assume to be two of the oldest civilizations of the world. The two countries shares cultural ties since long back. As stated in various studies, the cultural ties between Japan and India go back fourteen centuries when Buddhism found its way to Japan in seventh century A.D. via China and Korea. However, the relationship shared by the two countries has primarily been indirect in
nature. Direct contact between the two countries emerged quite lately, and since then, both have enjoyed fairly close economic ties. Even if, India and Japan came in direct contact quite lately, the bonding between the two had resulted in considerable sympathy for each other's aspirations among the Indian and Japanese elites. Particularly, after World War II and India's independence in 1947, both countries opened a new chapter in their relationship as two independent nations and the largest democracies in Asia. (Rajamohan, Rahut & Jacob, 2008)

3.9.2 Robust economic growth of India

Since the adoption of the LPG regime by India, it had started registering robust economic growth. Specially, during 2000s India had been consistently successful in attaining growth of 6 percent per annum and above. The consistent and continued growth of India, along with some other factors, acted in generating a 'magnet-effect' – attracting the major players of foreign direct investment from around the globe. Such an effect led to increased FDI inflows towards India.

Seeing the robust economic growth of India and its ability to attract most of the 'Big-Wig' FDI players, Japan also got mesmerized. This impact helped Japan to initiate towards examining of the prospects for expected benefits likely to be enjoyed by making FDI in India. This helped Japan to look at India as investment destination. (RIETI, 2006)

3.9.3 India's support in restructuring of better and peaceful world

Japan had been a country which was seriously wounded by the nuclear war. Facing the drastic results of war, Japan had been actively involved in bringing peace in the world, in order to make the entire world a better place to live for each and every living being. On the other hand, India had been under horrifying rule of British for centuries. It had always been involved in fight with its rulers for the in-humanitarian practices adopted by them. During all these years it had been bruised by the Britishers. The wounds so given turned India into a country which always looked forward for peace and prosperity not just for its own country, but for the entire world, and had been involved in an untiring efforts for the same.

Similar perspectives of the two countries, albeit due to different reasons, became a strong reason for bringing two countries close to each other, which led to signing-up
of various pacts in different spheres – political, economic and security. (nrifinanceguide.com, 2009)

3.9.4 Efficiency over the English language

With the inception of globalization in the first world, and thereafter around the globe, a common medium was needed to facilitate communication among the countries. Since English was the most common language among the developed world, it got an easy acceptance from almost all the countries as a medium for communication purposes.

India, as had been ruled by British for around 300 years, had registered a considerable influence over it. One of the most noticeable influences out the many on this list is the achievement of efficiency over the English language. Such an influence led to promotion of English language even after India achieved its independence in 1947. Initiatives in this respect resulted in producing manpower with the capability of communicating in English, as and when required. Such an edge had been for the last decade or so made India one of the most attractive destinations for investment, and Japan is no exception to it. (nrifinanceguide.com, 2009)

3.9.5 Japan’s “China plus one” policy

Japanese FDI outflow pattern shows that excessive FDI production facilities were transferred to China in the last decade or so, raised the concerns of the Japanese think tank, as it could make Japan over-dependent on China. Even, the agitations by Chinese labourers against Japanese companies added to the reason for looking forward for another alternative. This insisted upon Japanese companies strategy of “China plus one” for the purpose of risk diversification. In this regard, India, whose over dependence on countries like, U.S.A., Germany, Canada and Australia acted as a catalyst and strongly hindered the strategic objective of India of gaining growth and development, emerged as strong player because of its forward-looking reform policies to attract Japan who was looking keen enough to share its affluence with others. (RIETI, 2006)

3.9.6 Democracy

India is world’s largest democracy, and henceforth, gives due respect to democratic values. Considerable respect and freedom by the government is provided not just to its
own citizens, but also to the citizens of foreign origins. This aspect had been one of
the very comprehensive attracting forces for foreign investors, resulting in permanent
presence of business establishments from foreign countries, and thus, FDI.

Since Japan shares the similar values as those of India, unlike many other countries, it
also got fascinated towards India and started making efforts to ensure its presence on
India soil. (urifinanceguide.com, 2009)

3.9.7 Open-door policy for investors

The dwindled economic condition of India due to differing reasons, led the country
towards opening-up of shackles so far put on foreign investors. The reforms made
during mid-1991 were a landmark in this direction which had, since then, been adding
new dimensions as and when required. The loosening of investment regimes by India
for foreign investors allured most of the major foreign investors around the globe
resulting in remarkable surge in FDI inflows into the country. Albeit Japan was an
exception to it, as it didn’t got much mesmerized with India’s initiatives. However,
with the passage of time, India proposed some more liberalization norms due to which
Japan started realizing India’s worth. Resultantly, the country saw a remarkable spurt
in FDI inflows from Japan also. (urifinanceguide.com, 2009)

3.9.8 Large domestic market share

Even after facing the serious economic recession in 1990s, Japanese companies had
been involved in increasing the quantum of their investment in the overseas
destinations, most of which is directed towards economically vibrant destinations in
East and Southeast Asia. The investment had also flown to South Asian countries as
well, as a result of much promoted economic reform initiative stories. (Asia Age, 1996)

India’s large domestic market has been the main factor for investments by Japanese
companies. The majority of investments are in traditional fields like automobiles and
auto parts. However, some companies have invested in businesses like
pharmaceuticals (EISAI), health drinks (Yakuruto), pulp (Nihon Koso) and rice
processing (Yanmar).

Japan and India will both benefit from greater Japanese investments into the Indian
market. For example, on the one hand, Japanese companies will get increased market
share, on the other; India will get benefitted by emergence of distinct quality products in such a diversified market. (www.ibef.org, 2010)

3.9.9 Rich spectrum of human capital

Human capital is the most important aspect for any kind of business. It is the one which can raise business to new heights or may ruin it. Effective human capital of any country is among the most important determinants that can attract foreign business houses in its country, and thus, most probably ‘The FDI’.

India, world’s second most populous country around the globe, has half of its population composition of youths ranging within the age group of 18-35 years. In addition to this, most of this huge youth population holds higher education degrees in the fields like information technology, engineering and other such skilful courses, providing a huge number of prospective employees for the business houses. This huge gamut of human capital is available at comparatively lower costs with those of some competing countries, because of existence of huge gulf between availability of job opportunities and job-seekers. This became one of the reasons for emergence of Japan as a major foreign direct investor in India unlike many other countries. (www.ibef.org, 2010)

3.9.10 Abundance of raw materials and minerals

India, being a naturally-blessed country, is known for its rich natural heritage. Here, one can easily find abundance of distinct kinds of raw materials and minerals. These raw materials and minerals are, at most of the times, found to be very essential for businesses. Abundance of raw materials and minerals provides India an edge over some of its close competitors in alluring foreign investors, especially those making foreign direct investment. Seeing the possibility of extracting huge profits by cheaply exploiting India’s natural resources, business houses from distinct countries ensured their presence on Indian soil though through different routes and in different forms. Japan, after reaping benefits from countries like U.S. etc. for decades, started looking for new destinations for fulfilling its aspirations. In this wake, it found South Asia, particularly countries like China and India. (www.ibef.org, 2010)

The re-emerging Indo-Japanese economic interdependency saw a halt due to India’s nuclear proliferation programme introduced in 1998. This resulted in the introduction
of economic sanctions over India and suspension of all ODAs by Japan (Ministry of Foreign Affairs of Japan [MOFA], 1998) accompanied by general decline in FDI flows to India (Buckley, Cross & Horn, 2012), with exception to emergency and humanitarian aid (MOFA, 1998). However, India’s nuclear proliferation programme was not the sole reason for decline in Japanese foreign investment to India, as there were host of other reasons, belonging to Japan’s internal and external environment, which hindered India’s FDI inflows trend from Japan. Thus, albeit, political tensions and instability arising in India as an aftermath of its nuclear testing were claimed to be reason for attrition in Indo-Japan economic relations, the decline in Japanese FDI inflows, in reality, was an outcome of the Asian financial crisis that took place in 1997. Still, India attempted to address its inherent deficiencies by providing numerous incentives to allure foreign investors. These incentives were provided in areas like infrastructure, tax exemptions, more relaxed and simplified labour laws. (Buckley, Cross & Horn, 2012)

Even if, Japan and India shares ties which are about half a century old, as also, they have been continuously successful in developing their friendly relations which were laid down on this age-old relation, it was at the start of the 21st century (MOFA, 2006) that the two countries started realizing each other’s worth and envisaged (www.docstoc.com, n.d.) upon “Japan-India Global Partnership” in August 2000, which paved the way for strategic plan of action with the expectation that this would further enhance and strengthen their friendly cooperative relations. To take this relation a step ahead, the two countries issued a joint statement called the “Japan-India Partnership in a “New Asian Era” in 2005. (MOFA, 2006)

The two countries seems to be deeply interested in making this bilateral economic relations more and more stronger, that they had been consistently involved in taking initiatives for the same. In this regard, a Joint Study Group was set up by the Prime Minister of the two nations in November 2004, to make recommendations for strengthening the prevailing scenario of the economic relations between the two countries. The recommendations of the group lead to the creation of Joint Task Force (JTF) in 2009 for creation and implementation of Comprehensive Economic Partnership Act (CEPA), which took material shape and came into effect in February, 2011. Moreover, looking towards the possibility of increased political, economic, and defense cooperation, India and Japan articulated a Joint Statement Towards Japan-
India Strategic and Global Partnership on the lines of joint declaration made in 2001 by then Prime Ministers Vajpayee and Mori promoting full spectrum cooperation, India and Japan also entered into Strategic Partnership Agreement in December 2006 to give further boost to their existing relations. Seeing growing engagement between them, India and Japan, in August 2007, decided to declare year 2007 as “Indo-Japan friendship Year” (Nataraj, 2007). However, even though the August 2007 summit called for increased cooperation in almost 40 areas, it failed to deliver substantial progress in fields like economic, diplomatic and military cooperation. Thus, there remains an illusion over the agreements that whether the summit was merely rhetoric or was it capable of transforming ad hoc agreements into cornerstones of an Indo-Japanese alliance (Patel, 2007). Yet, there exists high hopes that existence of robust bilateral relationship between India and Japan will pave the way for prosperous future of the Asian continent. (India Brand Equity Foundation [IBEF], n.d.)

Japanese investment relation, especially foreign direct investment, between Japan and India can be depicted by analyzing the number of Japanese business establishments operating in India. The list presented in Box 3.4 exhibits that till October 2011 there were 1422 Japanese business establishments being operated within the country (Note 4). In addition to this, data with regard to Japanese Companies registered in India, it had been found that till October, 2014 there were 1072 such companies which were operating in India. (Embassy of Japan in India, 2014)

The box below (Box 3.4) exhibits the region-wise diversification of Japanese business establishments in India for the years 2008, 2009, 2010, 2011, 2012 and 2013 (till October). According to it, southern region of India had allured most of the Japanese companies in the last few years. As such, the numbers of Japanese business establishments operating in this region were found to be 182 in 2008, 224 in 2009, 332 in 2010, 406 in 2011, 489 in 2012 and 866 in 2013. The credit for such an upsurge in number of Japanese business establishments in this region goes to infrastructural set up and state government’s policy in this regard.

National Capital Region (NCR)/Northern region of the country, which had ruled the list for the years 2008 and 2009, follows the southern region on this list. Accordingly, the region had registered presence of 305, 369, 410, 474, 613 and 710 Japanese


Eastern region of the country in this regard seems to be deprived-off of the Japanese business establishments. With presence of 39 Japanese business establishments as on October 2008, the list seems to just crawl up. As such, the number of Japanese business establishments in the following years had risen to 65 till October 2009, 93 till October 2010 and 95 till October 2011. For the years 2012 and 2013 these numbers had raised upto 109 and 144 respectively.

Thus, in short, from the region-wise location analysis of the Japanese business establishments, it can be easily derived that southern India is the most favoured region for Japanese foreign direct investors, at least for last few years. This region had registered presence of highest number of Japanese companies.

Box 3.5 provides a more specific information regarding presence of Japanese business establishments in India. Tamil Nadu tops the list with 523 Japanese business establishments till October 2014. Maharashtra holds the second spot on the list with 397 such establishments. Haryana, Karnataka and Andhra Pradesh follow the list with number of Japanese business establishments, till October 2014, being registered at 325, 299 and 229 respectively. Later followers include Delhi, Kerala, West Bengal, Gujarat and Rajasthan and Uttar Pradesh with number of Japanese business establishments being registered at 175, 105, 96, 84 and 79 and 72. Even states like Madhya Pradesh, Jharkhand, Punjab Odisha, Uttarakhand, Chandigarh, Puducherry, Bihar, Assam and Goa were successful in registering presence of Japanese business establishments, though; the numbers of such establishments are comparatively much less. As such, Japanese business establishments in these cases were found to be 25, 24, 19, 15, 14, 12, 9, 9, 7 and 7 respectively.
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<td>123</td>
<td>155</td>
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<td><strong>Sub Total</strong></td>
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<td>182</td>
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<td>1236</td>
<td>1422</td>
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<td>Number of Japanese Companies registered in India</td>
<td>550</td>
<td>627</td>
<td>725</td>
<td>812</td>
<td>926</td>
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Source: Embassy of Japan in India (2014, January); Japanese Business Establishments in India.

**Box 3.4: Location-wise count of Japanese Business Establishments**
Box 3.5: State-wise Japanese Business Establishments in India

On the list Meghalaya, Himachal, Jammu and Kashmir, Daman and Diu and Chhattisgarh are the least favoured with number of Japanese business establishment till 2014 being registered at 1, 3, 3, 5 and 5 respectively.

Analysis of the Japanese FDI inflows (financial-year wise) (Table 3.7) exhibits presence of high volatility in its flows. There has been very frequent and steep rise and fall in JFDI inflows to India for the period ranging 2000-01 to 2012-13. Accordingly, JFDI had been registered at US$ 223.66 million (Rs. 976.64 Crores) during 2000-01, which dipped down to US$ 177.68 million (Rs 808.78 Crores)
with 17.19 percent downfall. It surged abruptly, with 143.70 percent growth, to US$ 411.87 million (Rs. 1970.96 Crores), the very next year, and dipped down again by 81.71 percent to US$ 78.36 million (Rs. 360.45 Crores). Since then, JFDI kept on increasing and reached US$ 208.29 million (Rs. 925.07 Crores) during 2005-06, registering growth of 60.83 percent over previous year figures. The JFDI again dipped down by 58.66 percent as JFDI was registered at US$ 84.74 million (Rs. 382.47 Crores). Thereafter, a comprehensive surge was registered during 2007-08 - JFDI grew by 772.33 percent registering inflows of US$ 815.20 million (Rs. 3336.41 Crores), followed by downfall of 43.38 percent in 2008-09 as Japanese FDI inflows to India, akin to FDI inflows to India from other countries, also felt the heat of global economic turmoil. During the period JFDI was registered at US$ 4,469.95 (Rs. 21,692.58 Crores). However, the scenario of FDI inflows from Japan to India recovered soon, as in the immediate next year Japanese FDI inflows to India registered a comprehensive growth of 200.18 percent leading to FDI inflows amounting to US$ 1,183.40 million (Rs. 5,670.40 Crores). With a further growth of 24.56 percent and 99.48 percent respectively during the years 2010-11 and 2011-12 FDI inflows from Japan reached a peak of 2971.70 million dollars (Rs. 14089.09 Crores). However, during the year 2012-13 downfall of 13.10 percent was registered in the trend of Japanese FDI inflows to India leading to Japanese FDI inflows of US$ 2237.22 million (Rs. 12,243.42 Crores).

The graphical representation of financial year-wise Japanese FDI inflows to India (Graph 3.3) since 2000-01, exhibits that inflows of Japanese FDI towards India had been almost negligible in the early part of the decade, as also, there had been frequent ups and downs in the trends; and though, there had been steep surge in the trends in the latter half of the decade the downfall during this time had been equally considerable.

The calendar-year wise analysis of JFDI inflows to India (Table 3.8) shows that the fluctuations in JFDI inflows had not been much considerable. Herein, JFDI inflows was registered at Rs. 985.69 Crores for the year 2000 and registered respective growths of 1.10 percent and 98.73 percent for 2001 and 2002 to reach the levels of JFDI at Rs. 996.54 Crores and Rs. 1,980.46 Crores respectively. In 2003, JFDI inflows to India registered a fall of 78.07 percent bottoming down the
### Table 3.7: Financial Year Wise FDI Equity Inflows: Japan

<table>
<thead>
<tr>
<th>Year (Apr-Mar)</th>
<th>FDI (Rs Crore)</th>
<th>FDI (US$ million)</th>
<th>%age growth over previous year (in terms of Rs. Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-01</td>
<td>976.64</td>
<td>223.66</td>
<td>-</td>
</tr>
<tr>
<td>2001-02</td>
<td>808.78</td>
<td>177.68</td>
<td>-17.19</td>
</tr>
<tr>
<td>2002-03</td>
<td>1,970.96</td>
<td>411.87</td>
<td>143.70</td>
</tr>
<tr>
<td>2003-04</td>
<td>360.45</td>
<td>78.36</td>
<td>-81.71</td>
</tr>
<tr>
<td>2004-05</td>
<td>575.19</td>
<td>126.24</td>
<td>59.58</td>
</tr>
<tr>
<td>2005-06</td>
<td>925.07</td>
<td>208.29</td>
<td>60.83</td>
</tr>
<tr>
<td>2006-07</td>
<td>382.47</td>
<td>84.74</td>
<td>-58.66</td>
</tr>
<tr>
<td>2007-08</td>
<td>3,336.41</td>
<td>815.20</td>
<td>772.33</td>
</tr>
<tr>
<td>2008-09</td>
<td>21,692.58</td>
<td>4,469.95</td>
<td>-43.38</td>
</tr>
<tr>
<td>2009-10</td>
<td>5,670.40</td>
<td>1,183.40</td>
<td>200.18</td>
</tr>
<tr>
<td>2010-11</td>
<td>7,062.98</td>
<td>1,562.00</td>
<td>24.56</td>
</tr>
<tr>
<td>2011-12 ^</td>
<td>14,089.09</td>
<td>2,971.70</td>
<td>99.48</td>
</tr>
<tr>
<td>2012-13</td>
<td>12,243.42</td>
<td>2,237.22</td>
<td>-13.10</td>
</tr>
<tr>
<td>2013-14 (up to February, 2014)</td>
<td>8,722.58</td>
<td>1,418.31</td>
<td>-</td>
</tr>
<tr>
<td>Cumulative Total (Ap. 2000-Feb. 2014)</td>
<td>78,817.03</td>
<td>15,968.61</td>
<td>-</td>
</tr>
</tbody>
</table>

*Note: i) Inflows for the month of March, '12 are as reported by RBI, consequent to the adjustment made in the figures of March, '11, August, '11 and October, '11.*

*ii) Country & sector specific details on 're-invested earnings' and 'other capital' are not centrally maintained by the Reserve Bank of India.*

*Source: SIA, Newsletter, Various issues.*

The level of JFDI to Rs. 434.39 Crores. However, the scenario changed in the very next year and JFDI registered growth for two consecutive years. As such, for the year 2004 and 2005, JFDI in India for the year 2004 rose to Rs. 533.74 Crores and later next year, in 2005, rose to Rs. 744.95 Crores; growth of 22.87 percent and 39.57 percent respectively. JFDI once again faced a downfall as JFDI dipped down by 29.80 percent registering the inflows of just Rs. 522.92 Crores for the year 2006. Thereafter, for the year 2007, there was tremendous increase in quantum of JFDI inflows to India with growth of 430.70 percent, rising the level of inflows to Rs. 2,775.16 Crores, followed by an unprecedented upsurge of 674.79 - JFDI for 2008 registered at Rs. 21,501.66 Crores - followed by an unprecedented downfall.
Graph 3.3: Financial Year Wise FDI Equity Inflows: Japan

Source: Prepared by the researcher on the basis of Table No. 3.7
of 71.66 percent resulting in JFDI inflows of Rs. 6,094.32 Crores for the year 2009. However, this scenario was further followed by a marginal downfall of 3.88 percent leading to JFDI inflows of Rs. 5,857.86 Crores for the year 2010. In the year 2011, FDI inflows from Japan registered steep surge as the amount of inflows of Japanese FDI was registered at Rs. 14,348.61 Crores with growth rate of 144.95 percent over the previous year. Contrary to this, for the year 2012, Japanese FDI inflows to India registered a downfall of 27.77 as the quantum of FDI inflows was registered at Rs. 10,364.42 Crores.

Graphical representation of calendar year-wise Japanese FDI inflows to India (Graph 3.4) exhibits almost similar trends as shown in case of financial year-wise inflows trends. As such, the dwindle scenario of FDI inflows from Japan to India, though, seems to have changed significantly in the latter half of the decade, the trends still suffered from frequent dwindling.

3.10 SHARE OF TOP SECTORS ATTRACTING FDI INFLOWS FROM JAPAN

3.10.1 From 1991 to 1999

Among all the sectors that have found to entice majority of the Japanese Foreign Direct Investment (JFDI), transportation sector had acquire the top rank by registering 28% of the total FDI flows coming from Japan for the time period ranging from 1991 - 1999. Telecommunication had been successful enough in grabbing majority of the JFDI, though after transportation. With acquisition of 18% of JFDI, for the above mentioned period, the sector clinches the second rank on the list of most attractive sectors. With 14% out of the total JFDI going to fuels, the sector had been ranked as third on the list for Japanese direct investors. Chemicals with 12% and trading with 7% of the total JFDI during 1991 to 1999; holds the fourth and fifth spot respectively had emerged as the most attractive sectors for investment by Japanese investors. All other sectors collectively acquired 21% of the total JFDI during this period. (Table 3.9) (Chart 3.1)
Table 3.8: Calendar Year-Wise Inflows of Foreign Direct Investment: Japan

(Amount of FDI inflows)

<table>
<thead>
<tr>
<th>Calendar Year (Jan-Dec)</th>
<th>FDI equity inflows from Japan</th>
<th>%age growth over previous year (in terms of Rs. Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(in Rs. Crores)</td>
<td>(in US$ million)</td>
</tr>
<tr>
<td>2000</td>
<td>985.69</td>
<td>229.23</td>
</tr>
<tr>
<td>2001</td>
<td>996.54</td>
<td>221.45</td>
</tr>
<tr>
<td>2002</td>
<td>1,980.46</td>
<td>412.59</td>
</tr>
<tr>
<td>2003</td>
<td>434.39</td>
<td>94.43</td>
</tr>
<tr>
<td>2004</td>
<td>533.74</td>
<td>116.03</td>
</tr>
<tr>
<td>2005</td>
<td>744.95</td>
<td>168.18</td>
</tr>
<tr>
<td>2006</td>
<td>522.92</td>
<td>116.10</td>
</tr>
<tr>
<td>2007</td>
<td>2,775.16</td>
<td>670.46</td>
</tr>
<tr>
<td>2008</td>
<td>21,501.66</td>
<td>4,470.25</td>
</tr>
<tr>
<td>2009</td>
<td>6,094.32</td>
<td>1,257.81</td>
</tr>
<tr>
<td>2010</td>
<td>5,857.86</td>
<td>1,295.00</td>
</tr>
<tr>
<td>2011</td>
<td>14,348.61</td>
<td>3,058.32</td>
</tr>
<tr>
<td>2012</td>
<td>10364.42</td>
<td>1,909.35</td>
</tr>
</tbody>
</table>

Note: i). These amounts include the inflows received through FIPB/SIA route, acquisition of existing shares, RBI’s automatic route, stock swap, RBI’s – NRI scheme & advance pending for issue of shares.

ii). The amount of FDI equity inflows, in respect of country/sector specific data was not provided by RBI, Mumbai, prior to January 2000.

Source: SIA, Newsletter, Various issues.
Table 3.9: Share of Top Sectors Attracting FDI Inflow from Japan
(From 1991 to 1999)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Sector</th>
<th>Percentage of Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Transportation</td>
<td>28%</td>
</tr>
<tr>
<td>2.</td>
<td>Telecommunication</td>
<td>18%</td>
</tr>
<tr>
<td>3.</td>
<td>Fuel</td>
<td>14%</td>
</tr>
<tr>
<td>4.</td>
<td>Chemicals</td>
<td>12%</td>
</tr>
<tr>
<td>5.</td>
<td>Trading</td>
<td>7%</td>
</tr>
<tr>
<td>6.</td>
<td>Others</td>
<td>21%</td>
</tr>
</tbody>
</table>


Chart 3.1: Share of Top Sectors Attracting FDI Inflow from Japan
(From 1991 to 1999)

Source: Prepared by researcher on the basis of Table No.3.9.
3.10.2 From January, 2000 to December, 2012

During the decade 2000-2010, however, the investment scenario from Japan with regard to sector-wise investment seems to have gone through major shuffles. For the respective decade, Drugs and Pharmaceuticals sector had ranked at the top of the list in alluring major chunk of the JFDI replacing the transportation sector, which ruled the list during last decade. Drugs and Pharmaceuticals sector, as such, registered a massive equity investment of US$ 4,161.05 million (Rs. 20,247.58 Crore) for the period ranging January 2000 to December 2012, grabbing 29.68 % of the total Japanese FDI directed towards India. Automobile industry has emerged as the second most attractive after Drugs and Pharmaceuticals sector. With Japanese investment of US$ 2,083.68 million (Rs. 9,866.73 Crore), the sector acquired 14.86 % share out of total Japanese equity investment. Service Sector (which includes Financial, Banking, Insurance, Non-Financial / Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis) had registered Japanese investment of US$2,076.69 million (Rs. 10,381.86 Crores) during January 2000 to December 2012, and hence, the sector had been the third most attractive sector on the list grabbing 14.81 % out of the total Japanese equity investment in India. Metallurgical Industries with Japanese investment of US$ 1,325.35 million (Rs. 6,073.82 Crore) and Electrical Equipment with Japanese investment of US$ 652.33 million (Rs. 2,911.45 Crore) had been successful in acquiring 9.45 % and 4.65 % of the Japan’s total equity investment, thus, successful in placing themselves on the list of most attractive sectors at fourth and fifth spot respectively. (Table 3.10) (Graph 3.3) (Chart 3.2)

Table 3.10: Share of Top Sectors Attracting FDI Equity Inflows from Japan
(From January 2000 to December 2012)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Sector</th>
<th>Amount of FDI equity inflows</th>
<th>% age of FDI equity inflows from Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Rupees in crores</td>
<td>US$ in million</td>
</tr>
<tr>
<td>1</td>
<td>Drugs &amp; Pharmaceuticals</td>
<td>20,247.58</td>
<td>4,161.05</td>
</tr>
<tr>
<td>2</td>
<td>Automobile Industry</td>
<td>9,866.73</td>
<td>2,083.68</td>
</tr>
<tr>
<td>3</td>
<td>Services Sector*</td>
<td>10,381.86</td>
<td>2,076.69</td>
</tr>
<tr>
<td>4</td>
<td>Metallurgical Industries</td>
<td>6,073.82</td>
<td>1,325.35</td>
</tr>
<tr>
<td>5</td>
<td>Electrical Equipment</td>
<td>2,911.45</td>
<td>652.33</td>
</tr>
<tr>
<td>Total of Above</td>
<td></td>
<td>49,481.44</td>
<td>10,299.10</td>
</tr>
</tbody>
</table>


Source: SIA, Newsletter.
Graph 3.5: Share of Top Sectors Attracting FDI Equity Inflows from Japan
(From January 2000 to December 2012)

Source: Prepared by researcher on the basis of Table 3.10.

Chart 3.2: Share of Top Sectors Attracting FDI Inflow from Japan
(From January 2000 to December 2012)

Source: Prepared by researcher on the basis of Table 3.10.
3.11 ROUTE-WISE JAPANESE FDI INFLOWS TO INDIA

Annexure 3 exhibits details about routes adopted by top twenty five Japanese FDI inflows to India for the period ranging January 2000 to December 2012. The table shows that majority of the Japanese FDI to India had preferred to adopt RBI route.

For the period ranging January 2000 to December 2012, out of the top twenty five Japanese FDI inflows cases, twenty-two cases were through the RBI route. The amount of JFDI from RBI route in these twenty-two cases totalled Rs. 39,332.5 Crores (US$ 8,102.52 million). On the other hand, for the similar time frame India registered three cases of Japanese FDI inflows through FIPB route with a total amount of Rs. 2840.80 Crores (US$ 639.07 million).

3.12 CONCLUSION

From the discussion made so far, it can be concluded that FDI, by playing a pivotal role in the development, first of the developed countries, and later, of some developing countries, inspired and encouraged other countries, especially the developing ones', to open up its economies for foreign firms. In case of India, the changes in global environment alongwith some internal disorders became the reason for generating interest of the Indian government to initiate over the issue of opening up of the economy for foreign players. Resultantly, the world saw initiation of economic reforms in India in 1991, leading to higher FDI inflows in the country.

Since then, subsequent, though vigilant, reform initiatives, as implemented from time to time, had helped the country in moving up on the ladder of most preferred investment destination. Whilst, such an attempts didn't mesmerized Japan a lot, atleast, for the decade 90s. Moreover, India's position as one of the most favoured investment deteriorated in this case, unless Japan started realizing importance of India, as an investment destination, by seeing the benefits enjoyed by nations making foreign direct investment in India. In addition to this, some other factors also helped in laying the foundation stone for strong bonding between the countries. Since then, India and Japan had been trying hard to ensure ever increased bilateral relations – economic, political and security – for better and peaceful world.
The initiatives emanated from both the ends resulted in increased FDI inflows to India from Japan. Albeit, FDI inflows to India from Japan had been limited to some specific industry, it had been helping India in developing its infrastructure. Thus, we can put that FDI from Japan aimed not just to reap benefits for itself, but was made with intent to develop India, in order to ensure excretion of long-term benefits from the country for itself.
3.13 NOTES

1. In the early phase of colonialism, the chief instrument of exploitation was trade but later the British thought of encouraging investment in India. There were three principal purposes of these investments. Firstly, after the first world war of Indian independence (1857), which the British described as the Mutiny, it was realized by the government that for the effective control and administration of the country, it was essential that an efficient system of transport and communication should be developed. Secondly, in order to effectively exploit the natural resources of India, it was essential to develop public utilities like generation of electricity and water works. Thirdly, to promote foreign trade so that food and raw materials collected in various mandis are quickly transported abroad and the manufactures imported in India are quickly distributed in various markets, the British thought it necessary to link railways with major ports on the one hand and the marketing centers (mandis) on the other. (Dutt and Sundaram, 2009)

2. The Industrial Policy Resolution of April, 1948 divided the industries into broad categories -
   a) The manufacture of arms and ammunition, the production and control of atomic energy, and the ownership and management of railway transport were to be the exclusive monopoly of the Central Government.
   b) The second category covered coal, iron and steel, aircraft manufacture, ship-building, manufacture of telephone, telegraphs and wireless apparatus etc. New undertakings in these industries could henceforth be undertaken only by the State.
   c) The third category was made up of industries of such basic importance that the Central Government would feel it necessary to plan and regulate them.
   d) A forth category, comprising the ‘remainder of the industrial field, was left open to private enterprise, individual as well as co-operative.
   The main thrust of the Industrial Policy (1948) was to lay the foundation of a mixed economy in which both private and public enterprises would march hand in hand to accelerate the pace of industrial development.

3. The 1956 policy resolution had as its objective the achievement of a socialistic pattern of society. In 1956, capital was scarce and the base for entrepreneurship not strong enough. Hence, the 1956 industrial policy resolution gave primacy to the role of the state to assume a predominant and direct responsibility for industrial development.

   The industrial policy statement of 1973 identified high priority industries were investment from large industrial houses and foreign companies would be permitted. The industrial policy statement of 1977 laid emphasis on decentralization and on the role of small scale, tiny and cottage industries. The industrial policy statement of 1980 focussed attention on the need for promoting competition in the domestic market, technological upgradation and modernization. The policy laid the foundation for an increasingly competitive export base and for ensuring foreign investment in high technology areas. These policies created a climate for rapid industrial growth in the country. (Ghosh, 2001)

4. In principle, any of the following is considered as a Japanese business establishment for the purpose of this list. However, some exceptional cases may also be included depending upon circumstances.
   1. Liaison/Branch/Project Office of a Japanese company in India (as a foreign entity)
   2. Indian subsidiary (wholly owned/joint venture) of a Japanese company, in the form of:
      (a) head office,
      (b) manufacturing unit, or
      (c) branch office with Japanese national(s) staying on regular basis.
   3. Business enterprise founded in India by Japanese national(s) (Embassy of Japan in India, 2011)
CHAPTER- FOUR

DATA ANALYSIS AND

HYPOTHESIS TESTING
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4.1 INTRODUCTION

From the study concluded so far, we had been confronted with the gamut of literature exhibiting various benefits provided by the FDI. In this wake, we came to know that FDI helps in economic growth of the country. During the study it was also revealed that there had been growth in exports and imports due to the intrusion of FDI in the country. In other words, FDI came to be known as the cause for growth in economy, exports and imports, in particular, to the host country. However, the literature reviewed so far in this context, had found to exploit total FDI with respect to the country concerned. Henceforth, there had been dearth in the studies associated to analysis of country-specific FDI, and requires due consideration in this regard.

Considering this backdrop, the present chapter attempts to analyze whether the country-specific FDI inflows, herein Japanese FDI inflows to India, holds long-run association with India’s total exports and imports. In addition to this, attempts has also been made to examine whether there exist causality between Japanese FDI inflows to India and India’s total exports; and Japanese FDI inflows to India and India’s total imports; and in case of existence of causality, its direction.

4.2 CLASSIFICATION OF FDI

Since the adoption of the concept of FDI, as defined by Balance of Payments Manual 5, most of the countries around the world had been reporting their FDI data within this realm. Accordingly, the FDI consists of three main components, viz., equity investment, reinvested earnings and other incomes. The three broad categories comprise fourteen items in all.

India, since long back had been recording and reporting only the equity investment made by many countries as its total FDI inflows. However, this concept of recording the FDI inflows was not in accordance to the international standards, which hindered the country in many ways. Hence, a Steering Committee was formed to look into the issue and suggest measures accordingly. With the implementation of the suggestions of the Steering Committee in 2002, India adopted the international standards and revised data for FDI inflows into the country since 2000. Now, the country like many other countries, maintains FDI data under three broad categories. Albeit, the country-wise data for FDI inflows is also maintained by India, the information for the same is
maintained only regarding equity component; and information with regard to country-wise reinvested earnings and country-wise other investments is not maintained separately.

4.3 VARIABLES USED

The present study is allied to fetch out an inter-comparative study of Japanese FDI inflows to India since liberalization, hence an attempt has been made to draw some conclusions in this regard by considering three variables, namely, Japanese Foreign Direct Investment inflows to India (represented herein as JFDI); Total Exports from India (abbreviated as TEXP) and Total Imports to India (abbreviated as TIMP). Since, distinct components of country-specific FDI are not maintained by India, an attempt has been made to carry out this comparative study on the basis of the equity component of JFDI inflows to India. For the purpose quarterly data since January-March, 2006 has been used.

4.4 DATA COLLECTION AND RESEARCH METHODOLOGY

4.4.1 Data Collection

In order to demeanor empirical part of the study quarterly data on Foreign Direct Investment (FDI) inflows to India from Japan has been used by adding month-wise data provided in fact sheet on Foreign Direct Investment as issued every month by Department of Investment Policies and Promotion (DIPP), Government of India. In addition to this, some of the data on Japanese FDI inflows to India had been collected from Secretariat of Investment Approvals (SIA), Government of India. Similarly, data related to Exports and Imports of India have been compiled by adding up month-wise data as collected from Reserve Bank’s Handbook of Statistics published by Reserve Bank of India (RBI), India.

The sample data, for the variables likely to be considered for hypotheses-testing, ranges from quarter ending March 2006, to quarter ending March 2014, which comprise 33 observations.

4.4.2 Research Methodology

In order to test the hypotheses framed for conducting the study, various econometric tools has been explicitly applied. The details of these tools has been discussed at length in the below paragraphs.

Co-integration Test is conducted to determine the long-run economic relationship between the variables. If the two variables, say $X_t$ and $Y_t$, are non-stationary then we can represent the error as a combination of two cumulated error processes, often called stochastic trends, and we would normally expect that they would combine to produce another non-stationary process. However in the special case that $X_t$ and $Y_t$ are really related, then we would expect them to move together, so that the two stochastic trends would be very similar to each other and when we combine them together it should be possible to find a combination of them which eliminates the non-stationarity. In this special case we say that the variables are co-integrated.

In theory, this should only happen when there is really a relationship linking the two variables together and so co-integration becomes a very powerful way of detecting the presence of economic structures. (Asteriou & Hall, 2007)

There are two types of Johansen test, either with Trace-value or with Eigenvalue, and the inferences might be a little bit different. (en.wikipedia.org, n.d.)

ii) **Test for Stationarity/Unit Root:** - A test of stationarity (or non-stationarity) that has become widely popular over the past several years is the unit root test (Gujarati & Sangeetha, 2007). In statistics, a unit root test tests whether a time series variable is non-stationary or not by using an autoregressive model (en.wikipedia.org, n.d.). Dickey–Fuller test is one of the tests used to identify existence (or non-existence) of stationarity (or non-
stationarity). In other words, this test tests whether a unit root is present in an autoregressive model or not. It is named after the statisticians David Dickey and Wayne Fuller, who developed the test in 1979 (en.wikipedia.org, n.d.). Dickey and Fuller (1979, 1981) devised a procedure to formally test for non-stationarity, or as is popularly expressed as 'unit root' in econometrics. The key insight of their test is that testing for non-stationarity is equivalent to testing for the existence of a unit root. The Dickey-Fuller test for stationarity is then simply the normal ‘t’ test on the coefficient of the lagged dependent variable $Y_{t-1}$. This test does not however have a conventional ‘t’ distribution and so we must use special critical values which were originally calculated by Dickey and Fuller. Though later, Dickey and Fuller extended their test procedure suggesting an augmented version of the test (Asteriou & Hall, 2007), known as Augmented Dickey–Fuller Test (ADF).

The intuition behind the test is as follows. If the series is stationary (or trend stationary), then it has a tendency to return to a constant (or deterministically trending) mean. Therefore large values will tend to be followed by smaller values (negative changes), and small values by larger values (positive changes). Accordingly, the level of the series will be a significant predictor of next period’s change, and will have a negative coefficient. If, on the other hand, the series is integrated, then positive changes and negative changes will occur with probabilities that do not depend on the current level of the series; in a random walk, where you are now does not affect which way you will go next. (en.wikipedia.org, n.d.)

The DF-test statistic is the $t$ statistic for the lagged dependent variable. If the DF statistical value is smaller in absolute terms than the critical value, then, we reject the null hypothesis of a unit root and conclude that $Y_t$ is a stationary process. (Asteriou & Hall, 2007)

iii) Test for Causality: -Causality in econometrics refers to the ability of one variable to predict (and therefore cause) the other. Suppose two variables, say $X_t$ and $Y_t$, affect each other with distributed lags. The relationship between those variables can be captured by a vector autoregressive (VAR) model (NOTE 1). In this case it is possible to have that (a) $X_t$ and $Y_t$, (b) $Y_t$
causes $X$, (c) there is a bi-directional feedback (causality among the variables), and finally (d) the two variables are independent. This problem was sought out by an appropriate procedure, developed by Granger in 1969, that allows us to test and statistically detect the cause and effect relationship among the variables. (Asteriou & Hall, 2007)

Granger (1969) developed a relatively simple test that defined causality as follows: "a variable $Y$ is said to Granger-cause $X$, if $X$ can be predicted with greater accuracy by using past values of the $Y$ variable rather than not using such past values, all other terms remaining unchanged". (Asteriou & Hall, 2007)

4.5 HYPOTHESIS OF THE STUDY

Setting up and testing hypothesis is an essential part of statistical inference (NOTE 2). In order to formulate certain test, usually some theory has been put forward, either because it is believed to be true or because it is to be used as a basis for argument, but has not been proved (Easton & McColl, n.d.). The theory set so forth, is termed as "Hypothesis."

Hypothesis, sometimes called statistical hypothesis, can be defined as a tentative assumption made in order to draw out and test its logical or empirical consequences (www.merriam-webster.com, n.d.). It describes in concrete (rather than theoretical) terms what one expects will happen in the study undertaken (www.socialresearchmethods.net, n.d.). Thus, hypothesis can also be defined as an interpretation of a proposition of a practical situation or condition (www.merriam-webster.com, n.d.) that is consistent with known data (Weisstein, n.d.) and is taken as the ground for action (www.merriam-webster.com, n.d.), but has been neither verified nor shown to be false. To put concisely, a hypothesis refers to a statement on which hypothesis testing will be based. Statistical hypothesis consists of two statements – Null Hypothesis and Alternate Hypothesis. (Weisstein, n.d.)

4.5.1 Null Hypothesis

The term “Null hypothesis” was originally coined by English geneticist and statistician Ronald Fisher in 1935 (en.wikipedia.org, n.d.). Null hypothesis, denoted
by $H_0$, is the type of hypothesis that proposes that no significance difference or variation exists in a set of given observations, or any kind of difference or significance, if exists, in a set of data is due to chance. (www.investopedia.com, n.d.)

In a mathematical formulation of the null hypothesis there will typically be an equal sign (Taylor; n.d.) and is presumed to be true until statistical evidence nullifies it for an alternative hypothesis (www.investopedia.com, n.d.) through hypothesis testing. Thus, in short, null hypothesis can be defined as a mathematical based hypothesis that’s tested for possible rejections under an assumption that it is true (usually that observation is the result of chance). (Weisstein, n.d.)

4.5.2 Alternate Hypothesis

The alternative hypothesis, denoted by $H_1$ or $H_a$ and typically paired with Null hypothesis (en.wikipedia.org, n.d.), is a statement of what a statistical hypothesis test is set up to establish (Easton & McColl, n.d.). Jerzy Neyman and Egon Pearson formalized the notion of the alternative hypothesis. It asserts a particular relationship between the phenomena (en.wikipedia.org, n.d.) or denotes the expected change in some portion of the statistical graph when compared to a null hypothesis that represents no change (www.statisticshowto.com, n.d.). The use of alternative hypotheses was not part of Fisher’s formulation, but became standard. (en.wikipedia.org, n.d.)

Conventionally, it might look a redundant technique, but plays an important role in the development of some statistics practices as it can be either non-directional or directional (Lavrakas, 2008). In many cases, alternate hypothesis will just be the negation of the null hypothesis (www.statisticshowto.com, n.d.), and thus in the formulation of the alternative hypothesis there will typically be an inequality, or not equal to symbol (Taylor, n.d.). In short, the alternative hypothesis is the hypothesis used in hypothesis testing that is contrary to the null hypothesis (Weisstein, n.d.) and anticipates a difference (or an effect) between two or more variables; that is, the observed pattern of the data is not due to a chance occurrence. (Lavrakas, 2008)

In order to carry out the empirical part of the study, it is the foremost requirement that certain hypothesis has to be framed for testing purpose by making use of certain
statistical/econometrics tools. In order to make empirical testing for the present study, four hypotheses have been framed. The first two hypotheses, in this regard, attempts to explore whether variables TEXP and TIMP are co-integrated to JFDI or not. For this purpose, hypotheses as stated below have been framed:

**Hypothesis No. 1**

**Null Hypothesis** ($H_0$): Co-integration (or long-run association) between Japanese Foreign Direct Investment (JFDI) and Total Exports from India (TEXP) does not exist.

**Alternate Hypothesis** ($H_a$): Co-integration (or long-run association) between Japanese Foreign Direct investment (JFDI) and Total Exports from India (TEXP) do exist.

**Hypothesis No. 2**

**Null Hypothesis** ($H_0$): Co-integration (or long-run association) between Japanese Foreign Direct Investment (JFDI) and Total Imports to India (TIMP) does not exist.

**Alternate Hypothesis** ($H_a$): Co-integration (or long-run association) between Japanese Foreign Direct investment (JFDI) and Total Imports to India (TIMP) do exist.

The latter two hypothesis attempts to test whether there is existence of causality between TEXP and JFDI; and TIMP and JFDI or not; and in case of existence of causality, whether the variable JFDI granger-cause TEXP/TIMP; or the variable TEXP/TIMP granger-cause JFDI. In other words, in case of existence of causality between the variables, the same is unidirectional or bidirectional. To serve the above-mentioned purpose following sets of hypotheses have been framed:

**Hypothesis No. 3**

3.1 **Null Hypothesis** ($H_0$): Japanese Foreign Direct investment (JFDI) does not granger-cause Total Exports from India (TEXP).

**Alternate Hypothesis** ($H_a$): Japanese Foreign Direct investment (JFDI) does cause Total Exports from India (TEXP).
3.2 **Null Hypothesis** ($H_0$): Total Exports from India (TEXP) does not
granger-cause Japanese Foreign Direct investment (JFDI).

**Alternate Hypothesis** ($H_a$): Total Exports from India (TEXP) does cause
Japanese Foreign Direct investment (JFDI).

**Hypothesis No. 4**

4.1 **Null Hypothesis** ($H_0$): Japanese Foreign Direct investment (JFDI) does
not granger-cause Total Imports to India (TIMP).

**Alternate Hypothesis** ($H_a$): Japanese Foreign Direct investment (JFDI)
does cause Total Imports to India (TIMP).

4.2 **Null Hypothesis** ($H_0$): Total Imports to India (TIMP) does not granger-
cause Japanese Foreign Direct investment (JFDI).

**Alternate Hypothesis** ($H_a$): Total Imports to India (TIMP) does cause
Japanese Foreign Direct investment (JFDI).

4.6 **TESTING OF HYPOTHESIS: ANALYSIS AND INTERPRETATION**

The following section of the chapter aims at bringing out an inter-comparative study
on the basis of the results revealed by the testing of the hypotheses and the
interpretations made thereof. Since the hypotheses mentioned above, aims at making a
comparative study among the Japanese Foreign Direct Investment inflows to India
(JFDI), Total Exports from India (TEXP) and Total Imports to India (TIMP), the data
regarding the three variables had been compiled from distinct sources. For the
purpose of comprehensive results quarterly data of the three variables, viz. JFDI,
TEXP and TIMP have been maintained. *(Annexure 4)*

**Hypothesis No. 1**

**Null Hypothesis** ($H_0$): Co-integration (or long-run association) between
Japanese Foreign Direct Investment (JFDI) and Total Exports from India
(TEXP) does not exist.
Alternate Hypothesis ($H_a$): Co-integration (or long-run association) between Japanese Foreign Direct investment (JFDI) and Total Exports from India (TEXP) do exist.

The hypothesis set so forth attempts to test whether there is existence of co-integration (or long-run association) between Japanese Foreign Direct investment (referred herein as JFDI) and Total Exports from India (referred herein as TEXP) or co-integration between the two variables does not exist. For the purpose, Johansen co-integration test has been applied. The results of the Johansen co-integration test at lag length of 1 (See Annexure 5) on leveled data (or original data) of the two variables has been derived on the basis of Trace Statistic and Maximum Eigen (MaxEigen) Statistic.

The results of the Unrestricted Co-integration Rank Test (Table 4.1) on the basis of Trace statistics reveals that, while considering the case of existence of co-integration between the two variables, the probability value (p-value) has been arrived at 0.304, i.e., 30.4 percent. The guideline, with regard to the acceptance of null/alternate hypothesis, states that if the p-value is found to be more than the criteria of 0.05 or 5 percent, then, null hypothesis stands accepted. Contrary to this, if the p-value is found to be less than the criteria of 0.05 or 5 percent, then, alternate hypothesis stands accepted. Herein, since the p-value is much higher than the criteria of 5 percent, henceforth, null hypothesis stands accepted, which says that co-integration between the two variables, viz., JFDI and TEXP does not exist. Alternatively, Trance statistic in this case arrived at 1.058, while the critical value at 0.05 confidence level had arrived to be 3.841. The guideline for acceptance of null/alternate hypothesis, with regard to Trance statistics, states that if the Trance statistic is found to be less than the critical value, then, null hypothesis stands accepted. In contrast, if the Trance statistic is found to be more than the critical value, then, alternate hypothesis stands accepted. In this case, since the trance statistic is less than the critical value, therefore, null hypothesis stands accepted. In short, it can be concluded that the two variables are not co-integrated or long-run association between the two variables does not exist.

**Table 4.1: Unrestricted Co-integration Rank Test (On the basis of Trace Statistic)**

<table>
<thead>
<tr>
<th>Trace Statistic</th>
<th>Critical Value (at 0.05)</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.058</td>
<td>3.841</td>
<td>0.304</td>
</tr>
</tbody>
</table>

Source: Through Eviews.
The results in case of Unrestricted Co-integration Rank Test (Table 4.2) on the basis of MaxEigen Statistic while considering the case of existence of co-integration between the two variables, the p-value has been arrived at 0.304, i.e., 30.4 percent, which is similar to that of the Trace statistics. Herein, since the p-value is much higher than the criteria of 5 percent, henceforth, null hypothesis stands accepted. Thus, the results in this case are similar to that of the Trace statistic, which concluded that the two variables, viz., JFDI and TEXP are not co-integrated or the two variables do not possess long-run association. Alternatively, Max-Eigen statistic in this case arrived at 1.058, while the critical value at 0.05 confidence level has arrived to be 3.841, which is again similar to the values arrived in case of the hypothesis testing under Trance statistic. Considering the guideline, similar to the one as applied in case of Trance statistic, since, Max-Eigen statistic is less than the critical value, therefore, null hypothesis stands accepted. In short, it can be concluded that, similar to the results of trance statistics, the two variables are not co-integrated or they do not hold long-run association.

**Table 4.2: Unrestricted Co-integration Rank Test (On the basis of MaxEigen Statistic)**

<table>
<thead>
<tr>
<th>Eigen-value</th>
<th>Critical Value (at 0.05)</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.058</td>
<td>3.841</td>
<td>0.304</td>
</tr>
</tbody>
</table>

Source: Through Eviews.

Compendiously, from the results of the testing of this hypothesis, on the basis of Trance and MaxEigen Statistic, it can be summarized that there is non-existence of co-integration between the two variables, viz. JFDI and TEXP or long-run association between the two variables does not exist.

**Hypothesis No. 2**

**Null Hypothesis (H₀): Co-integration (or long-run association) between Japanese Foreign Direct Investment (JFDI) and Total Imports to India (TIMP) does not exist.**

**Alternate Hypothesis (H₁): Co-integration (or long-run association) between Japanese Foreign Direct investment (JFDI) and Total Imports to India (TIMP) do exist.**
The hypothesis set so forth attempts to test whether co-integration (or long-run association) between Japanese Foreign Direct investment (referred herein as JFDI) and Total Imports to India (referred herein as TIMP) exists or the co-integration between the two do not exist. The results of the Johansen test at the Lag interval of 1 (See Annexure 5) on leveled data of the two variables has been derived on the basis of Trace Statistic and Maximum Eigen (MaxEigen) Statistic.

The results of Unrestricted Co-integration Rank Test (Table 4.3) on the basis of Trace statistics revealed that while considering the case of existence of co-integration between the two variables, the p-value had arrived at 0.639, i.e., 63.9 percent. Considering the guideline (as stated in Hypothesis 1), since the p-value is much higher than the criteria of 5 percent, henceforth, null hypothesis stands accepted, which says that co-integration between the two variables, viz., JFDI and TEXP do not exist or the two variables do not possess long-run association. Alternatively, Trance statistic in this case arrived at 0.220, while the critical value at 0.05 confidence level had arrived to be 3.841. Giving due consideration to the guideline stated in hypothesis 1, since, the trance statistic is less than the critical value, therefore, null hypothesis stands accepted. Thus, it can be concluded that the two variables are not co-integrated or long-run association between the two variables do not exist.

Table 4.3: Unrestricted Cointegration Rank Test (on the basis of Trace Statistic)

<table>
<thead>
<tr>
<th>Trace Statistic</th>
<th>Critical Value (at 0.05)</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.220</td>
<td>3.841</td>
<td>0.639</td>
</tr>
</tbody>
</table>

Source: Through Eviews.

The results of the Unrestricted Co-integration Rank Test (Table 4.4) on the basis of Max-Eigen Statistic while considering the case of existence of co-integration between the two variables, the p-value has been arrived at 0.639, i.e., 63.9 percent. Herein, since the p-value is much higher than the criteria of 5 percent, henceforth, null hypothesis stands accepted. Thus, the results in this case are similar to that of the Trance statistic, which concluded that the two variables, viz., JFDI and TIMP are not co-integrated or the two variables do not possess long-run association. Alternatively, Max-Eigen statistic in this case arrives at 0.220, while the critical value at 0.05
confidence level has arrived to be 3.841, which is similar to the value as arrived in case of the hypothesis testing under Trance statistic. Herein, since the Max-Eigen statistic is less than the critical value, therefore, null hypothesis can be accepted which states non-existence of co-integration or long-run association between the variables JFDI and TIMP.

Table 4.4: Unrestricted Cointegration Rank Test (Max-Eigen value Statistic)

<table>
<thead>
<tr>
<th>Eigen-value</th>
<th>Critical Value (at 0.05)</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.220</td>
<td>3.841</td>
<td>0.639</td>
</tr>
</tbody>
</table>

Source: Through Eviews.

Compendiously, from the results derived through testing of this hypothesis, on the basis of Trance and MaxEigen Statistic, it can be summarized that there is non-existence of co-integration between the two variables, viz. JFDI and TIMP or long-run association between the two variables do not exist.

Hypothesis No. 3

3.1 **Null Hypothesis** ($H_0$): Japanese Foreign Direct investment (JFDI) does not granger-cause Total Exports from India (TEXP).

**Alternate Hypothesis** ($H_1$): Japanese Foreign Direct investment (JFDI) granger-cause Total Exports from India (TEXP).

3.2 **Null Hypothesis** ($H_0$): Total Exports from India (TEXP) does not granger-cause Japanese Foreign Direct investment (JFDI).

**Alternate Hypothesis** ($H_1$): Total Exports from India (TEXP) granger-cause Japanese Foreign Direct investment (JFDI).

The hypothesis set above attempts to examine the causality between Japanese Foreign Direct Investment (JFDI) and Total Exports from India (TEXP). For the purpose, Granger Causality test has been applied. In order to ordeal the causality between Japanese Foreign Direct Investment (JFDI) and Total Exports from India (TEXP) assumptions of unit root and co-integration need to be fulfilled. Thus, in order to proceed further, it is the foremost requirement that the variables should be tested for unit root which would help in determining the order of each variable. To serve the
purpose of testing of variables for unit root, Dickey-Fuller (DF) test has been carried out separately on the variables, viz., Japanese Foreign Direct Investment inflows to India (JFDI) and India's total exports (TEXP) at certain lag length which are derived on the basis of Schwarz Information Criteria (See Annexure 6). Following are the sub-hypothesis set to serve the purpose of testing existence of unit root. The sub-hypothesis has been stated and worked upon as under:

**Hypothesis No. 3.A**

*Null Hypothesis (H0):* Japanese Foreign Direct Investment (JFDI) is not stationary or has unit root.

*Alternate Hypothesis (H1):* Japanese Foreign Direct Investment (JFDI) is stationary or does not have unit root.

This hypothesis had been set forth to test whether Japanese Foreign Direct Investment (JFDI) has unit root or not. In other words, the hypothesis attempts to find whether the variable JFDI is stationary or not. The test statistic for Unit Root has been depicted on the basis of two distinct conditions, viz., considering existence of intercept; and considering existence of trend and intercept.

The results of the DF test statistics by assuming presence of intercept, when the test is applied on leveled data, i.e., on initial or original data, has been depicted in Table 4.5. The results at maximum lag of 0 on the basis of Schwarz information Criteria (SCI) (See Annexure 6) shows that the test statistic value has been arrived at -2.80. The critical value, on the other hand, at 5% level was found to be -1.95. The guideline in this case states that, ignoring the minus signs, if the test-statistic is more than the critical value, alternate hypothesis stands accepted and vice-versa. Herein, since the test statistic is more than the critical value at 5% level, therefore alternate hypothesis stands accepted. On the other hand, while considering presence of trend and intercept at leveled data, at maximum lag of 0, the test statistic value has found to be -4.82. The critical value at 5 percent level was found to be -3.19. Herein again, since the test statistic is more than the critical values at 5 percent level, therefore, alternate hypothesis stands accepted. Hence, similar to the conclusion drawn in case of existence of intercept, it can be said that the data related to JFDI, in case of presence of trend and intercept, is stationary or does not have unit root.
Compendiously, the results of the DF test over the variable Japanese Foreign Direct Investment inflows to India (represented as JFDI), has found to be stationary when existence of intercept and existence of trend and intercept has been considered.

**Table 4.5: Dickey-Fuller (DF) Results (At Level)**

<table>
<thead>
<tr>
<th>For JFDI</th>
<th>Test Statistics (t-Statistic)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Only Intercept</strong> (Maximum Lag: 0)</td>
<td>-2.80</td>
</tr>
<tr>
<td>Test critical values: 5% level</td>
<td>-1.95</td>
</tr>
<tr>
<td><strong>Trend and Intercept</strong> (Maximum Lag: 0)</td>
<td>-4.82</td>
</tr>
<tr>
<td>Test critical values: 5% level</td>
<td>-3.19</td>
</tr>
</tbody>
</table>

*Source: Through Eviews.*

**Hypothesis No. 3.B**

**Null Hypothesis (H₀): India’s Total Exports (TEXP) is not stationary or has unit root.**

**Alternate Hypothesis (H₁): India’s Total Exports (TEXP) is stationary or does not have unit root.**

This hypothesis attempts to test whether India’s Total Exports (TEXP) has unit root or not. In other words, this hypothesis attempts to find whether the variable TEXP is stationary or not. Unlike JFDI, the test statistic for Unit Root had also been depicted on the basis of two distinct conditions, viz., considering existence of intercept; and considering existence of trend and intercept.

The results of the DF test statistics by assuming presence of intercept, when the test is applied on leveled data, i.e., on initial or original data, has been depicted in Table 4.6. The results at maximum lag of 2 on the basis of Schwarz information Criteria (SCI) (See Annexure 6) shows that the test statistic value has been arrived at 0.65. The critical value, on the other hand, at 5% level was found to be -1.95. The guideline in this case states that, ignoring the minus signs, if the test-statistic is more than the critical value, alternate hypothesis stands accepted. Herein, since the test statistic is less than the critical value at 5% level, therefore null hypothesis stands accepted.
the other hand, while considering presence of trend and intercept at leveled data, at maximum lag of 8, the test statistic value has found to be -2.62. The critical value at 5 percent level was found to be -3.19. Herein, considering the guideline, since the test statistic is less than the critical values at 5 percent level, therefore, null hypothesis stands accepted. Hence, similar to the result as arrived in case of existence of intercept, it can be said that the data related to TEXP, in case of presence of trend and intercept, is non-stationary or have unit root.

Table 4.6: Dickey-Fuller (DF) Results (At Level)

<table>
<thead>
<tr>
<th>For TEXP</th>
<th>Test Statistics (t-Statistic)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Only Intercept (Maximum Lag: 2)</td>
<td>0.65</td>
</tr>
<tr>
<td>Test critical values: 5% level</td>
<td>-1.95</td>
</tr>
<tr>
<td>Trend and Intercept (Maximum Lag: 2)</td>
<td>-2.62</td>
</tr>
<tr>
<td>Test critical values: 5% level</td>
<td>-3.19</td>
</tr>
</tbody>
</table>

Source: Through Eviews.

Compendiously, the results of the DF test over the variable Total Exports from India (represented as TEXP), has found to be non-stationary when existence of intercept and existence of trend and intercept is considered. Henceforth, conclusions for the above-mentioned hypothesis are in support of data being non-stationary.

Since the variable TEXP has found to be non-stationary at leveled or the original data, attempt would be made to make data stationary through the process of differencing at different levels, viz. first difference, second difference, etc. until stationarity is achieved. The results of the DF test, for testing stationarity of the data for the variable TEXP, at first difference in the two cases has been depicted in Table 4.7; and have been analyzed herein considering existence of intercept; and existence of trend and intercept.

While analyzing the results of the DF test statistics at first difference, in case of existence of only intercept, at lag length of 2, the test statistic value has been worked out to be -8.12. The critical value, on the other hand, at 5% level the value has found to be -1.95. Considering the criterion, since the test statistic is more than the critical
values at 5% level, therefore, alternate hypothesis stands accepted. Hence, it can be said that the variable TEXP, in case of existence of intercept, is stationary or does not have unit root at first difference.

While considering presence of trend and intercept at lag length of 2 on data of first difference, the DF test statistic value has been worked out to be -8.58. The critical value at 5% level has found to be -3.19. Herein, after ignoring the minus sigh, since the test statistic is more than the critical values at 5% level, therefore, alternate hypothesis stands accepted. Hence, it can be concluded that the data for the variable TEXP, in case of existence of trend and intercept, is stationary or does not have unit root at first difference.

Table 4.7: Dickey-Fuller (DF) Results (At First Difference)

<table>
<thead>
<tr>
<th></th>
<th>Test Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>For TEXP</strong></td>
<td>(t-Statistic)</td>
</tr>
<tr>
<td><strong>Only Intercept</strong> (Maximum Lag: 2)</td>
<td>-8.12</td>
</tr>
<tr>
<td>Test critical values: 5% level</td>
<td>-1.95</td>
</tr>
<tr>
<td><strong>Trend and Intercept</strong> (Maximum Lag: 2)</td>
<td>-8.58</td>
</tr>
<tr>
<td>Test critical values: 5% level</td>
<td>-3.19</td>
</tr>
</tbody>
</table>

Source: Through Eviews.

Compendiously, from the results of the unit root for the two variables, at leveled data, it has been revealed that JFDI does not have unit root or it is stationary; while TEXP has found to have unit root, i.e., it is not stationary. **Considering the assumption of stationarity of the variables for the hypothesis-testing, the variables has been differentiated to order one, for TEXP – to achieve stationarity (abbreviated as TEXPD); and for JFDI – to bring similarity (in order) (abbreviated as JFDID) of the two variables. Furthermore, while testing for the co-integration between JFDI and TEXP, it has been found that the two variables were not co-integrated or the variables do not hold long-run association (as tested in Hypothesis 1).**

Once the stationarity has been achieved and co-integration between the variables has been found, Granger-Causality test has been applied to ascertain the direction of the relationship between JFDI and TEXP. The results of the causality test for the
variables JFD and TEXP on the differenced data, by considering TEXP and JFDI as dependent variable one by one, at an optimal lag of 1, selected on the basis of Schwarz information Criteria (SCI) (See Annexure 7), has been depicted in Table 4.8; and interpretations has been made hereunder. According to the results arrived, the p-value, in case of JFDID does not granger-cause TEXPD – where JFDID refers to value for first difference of JFDI and TEXPD refers to first difference of TEXPD – has found to be 0.941 or 94.1 percent. Considering the guideline, i.e. in case, p-value exceeds the criteria of 5 percent, then, null hypothesis stands accepted and vice versa, since the p-value has found to be considerably higher than the criteria of 5 percent, henceforth, null hypothesis stands accepted, which states that JFDID does not granger-cause TEXPD.

Table 4.8 also brings out the values of F-statistic and the critical values at 5 percent significance level. While making comparison between the F-statistic and the critical value it has been found that the F-statistic, in case of JFDI does not granger-cause TEXP, has been arrived at 0.006. The critical value in this case has been found to be 2.114. Since the F-statistic has been found to be much lower as compared to the critical value, henceforth, null hypothesis stands accepted; which says that JFDI does not granger-cause TEXP.

<table>
<thead>
<tr>
<th>Hypothesis (Lag: 1)</th>
<th>F-Statistic</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>JFDID does not Granger Cause TEXPD</td>
<td>0.006</td>
<td>0.941</td>
</tr>
<tr>
<td>TEXPD does not Granger Cause JFDID</td>
<td>7.37</td>
<td>0.011</td>
</tr>
</tbody>
</table>

Note: Critical value of 'F' is 2.114 (derived from F-distribution).

Source: Through Eviews.

Contrary to this, the results of the hypothesis TEXP does not granger-cause JFDID shows that the p-value in this case has been arrived at 0.011 or 1.1 percent. Herein, since the p-value has found to be lower than the criteria of 5 percent, henceforth, alternate hypothesis stands accepted, which states that TEXPD does cause or affect JFDID. On the other hand, while making comparison between the F-statistic and the critical value it has been found that the F-statistic, in case of TEXP does not granger-cause JFDI, has been arrived at 7.37. The critical value in this case has been found to be 2.114. Since the F-statistic has been found to be much higher as compared to the
critical value, henceforth, alternate hypothesis stands accepted; which says that TEXP granger-cause JFDI.

Compendiously, this hypothesis attempts to direct efforts towards finding existence of causality; and if there is existence of causality between the variables, the direction of the same. The results, in this regard, revealed existence of unidirectional causality, wherein, for the hypothesis JFDI does not granger-cause TEXP, there is non-existence of causality, while for the hypothesis, TEXP granger-cause JFDI, there is existence of causality between the two variables, viz. JFDI and TEXP and TEXP affects JFDI.

Hypothesis No. 4

4.1 Null Hypothesis ($H_0$): Japanese Foreign Direct investment (JFDI) does not granger-cause Total Imports to India (TIMP).

Alternate Hypothesis ($H_a$): Japanese Foreign Direct investment (JFDI) granger-cause Total Imports to India (TIMP).

4.2 Null Hypothesis ($H_0$): Total Imports to India (TIMP) does not granger-cause Japanese Foreign Direct investment (JFDI).

Alternate Hypothesis ($H_a$): Total Imports to India (TIMP) granger-cause Japanese Foreign Direct investment (JFDI).

The hypothesis set above attempts to examine the causality between Japanese Foreign Direct Investment (JFDI) and Total Imports to India (TIMP). For the purpose, Granger Causality test has been applied. In order to ordeal the causality between Japanese Foreign Direct Investment (JFDI) and Total Imports to India (TIMP) assumptions of unit root and co-integration need to be fulfilled as mentioned in case of hypothesis 3. Through hypothesis 3.1, it has been found that the variable JFDI is stationary. In order to serve the purpose of testing whether total imports to India (TIMP) has unit root or not following sub-hypothesis has been framed and worked upon.

Hypothesis No. 4.A

Null Hypothesis ($H_0$): India’s Total Imports (TIMP) is not stationary or has unit root.

Alternate Hypothesis ($H_a$): India’s Total Imports (TIMP) is stationary or does not have unit root.
This hypothesis attempts to test whether Total Imports to India (TIMP) has unit root or not. In other words, this hypothesis attempts to find whether the variable TIMP is stationary or not. Unlike JFDI and TEXP, the test statistic for Unit Root has also been depicted on the basis of two distinct conditions, viz., considering existence of intercept; and considering existence of trend and intercept.

The results of the DF test statistics by assuming presence of intercept, when the test is applied on leveled or on the original data, has been depicted in Table 4.9. The results at maximum lag of 1, on the basis of Schwarz information Criteria (SCI) (See Annexure 6), shows that the test statistic (t-statistic) value has worked out to be 0.03. On the other hand, the critical value in this case at 5% level was found to be -1.95.

Table 4.9: Dickey-Fuller (DF) Results (At Level)

<table>
<thead>
<tr>
<th>For TIMP</th>
<th>Test Statistics (t-Statistic)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Only Intercept (Maximum Lag: 8)</td>
<td>0.03</td>
</tr>
<tr>
<td>Test critical values: 5% level</td>
<td>-1.95</td>
</tr>
<tr>
<td>Trend and Intercept (Maximum Lag: 8)</td>
<td>-2.32</td>
</tr>
<tr>
<td>Test critical values: 5% level</td>
<td>-3.19</td>
</tr>
</tbody>
</table>

Source: Through Eviews.

Considering the guideline, since the test-statistic is less than the critical value (after ignoring the minus sign), null hypothesis stands accepted. Hence, it can be said that the data in case of TIMP is not stationary or have unit root. On the other hand, while considering presence of trend and intercept on leveled data, at maximum lag of 1, the DF test statistic value, has worked out to be -2.32. The critical value at 5% level was found to be -3.19. Herein, since the critical values at 5% level is more than the test statistic, therefore in accordance to the guideline, null hypothesis stands accepted. Hence, similar to the result that arrived in case of existence of intercept, it can be said that the data related to TIMP, in case of presence of trend and intercept, is not stationary or have unit root.

Compendiously, the results of the DF test on the variable, India’s Total Imports (represented as TIMP), has found to be non-stationary when existence of intercept;
and existence of trend and intercept has been considered. Henceforth, conclusions for the above-mentioned hypothesis are in support of data being non-stationary.

Since the variable TIMP has found to be non-stationary at leveled or the original data, attempt would be made to make data stationary through the process of differencing at different levels, viz. first difference, second difference, etc. (as has been done in case of TEXP) until stationarity is achieved. The results of the DF test for testing stationarity of the data for the variable TIMP at first difference, in the two cases has been depicted in Table 4.10 and has been analyzed herein considering existence of intercept; and existence of trend and intercept.

While analyzing the results of the DF test statistics at first difference, in case of existence of only intercept, at lag length of 1, the test statistic value has been worked out to be -5.08. The critical value, on the other hand, at 5% level the value was found to be -1.95. Considering the criterion, since the test statistic is more than the critical values at 5% level, therefore, alternate hypothesis stands accepted. Hence, it can be said that the data in case of TIMP is stationary or does not have unit root at first difference.

While considering presence of trend and intercept at lag length of 1 on data of first difference, the DF test statistic value has been worked out to be -5.06. The critical value at 5% level has found to be -3.19. Herein, after ignoring the minus sigh, since the test statistic is more than the critical values at 5% level, therefore, alternate hypothesis stands accepted. Hence, it can be said that the data in case of TIMP is stationary or does not have unit root at first difference.

**Table 4.10: Dickey-Fuller (DF) Results (At First Difference)**

<table>
<thead>
<tr>
<th>For TIMP</th>
<th>Test Statistics (t-Statistic)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Only Intercept</strong> (Maximum Lag: 8)</td>
<td>-5.08</td>
</tr>
<tr>
<td><strong>Test critical values: 5% level</strong></td>
<td>-1.95</td>
</tr>
<tr>
<td><strong>Trend and Intercept</strong> (Maximum Lag: 8)</td>
<td>-5.06</td>
</tr>
<tr>
<td><strong>Test critical values: 5% level</strong></td>
<td>-3.19</td>
</tr>
</tbody>
</table>

**Source:** Through Eviews.
Compendiously, from the results of the unit root for the two variables, at leveled data, it was revealed that JFDI does not have unit root or it is stationary; while TIMP has found to have unit root, i.e., it is not stationary. **Considering the assumption of stationarity of the variables for the hypothesis-testing, the variables has been differentiated to order one, for TIMP – to achieve stationarity (abbreviated as TIMPD); and for JFDI – to bring similarity (in order) (abbreviated as JFDID) of the two variables (in hypothesis 3.A). Furthermore, while testing for the co-integration between JFDI and TIMP, it has found that the two variables were not co-integrated or the variables do not hold long-run association (as tested in Hypothesis 2).**

Once the stationarity has been achieved and co-integration between the variables has been found, Granger-Causality test has been applied to ascertain the direction of the relationship between JFDI and TIMP. The results of the causality test for the variables JFDI and TIMP on the differenced data, by considering TIMP and JFDI as dependent variable one by one, at an optimal lag of 1, selected on the basis of Schwarz information Criteria (SCI) (See Annexure 7), has been depicted in **Table 4.11**; and interpretations has been made hereunder. According to the results arrived, the p-value, in case of JFDID does not granger-cause TIMPD – where JFDID refers to value for first difference of JFDI and TIMPD refers to first difference of TIMPD – has found to be 0.029 or 2.9 percent. Considering the guideline, since the p-value has found to be considerably lower than the criteria of 5 percent, henceforth, alternate hypothesis stands accepted, which states that JFDID granger-cause TIMPD.

**Table 4.11: Pair-wise Granger Causality Test**

<table>
<thead>
<tr>
<th>Hypothesis (Lag: 1)</th>
<th>F-Statistic</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>JFDID does not Granger Cause TIMPD</td>
<td>5.27</td>
<td>0.029</td>
</tr>
<tr>
<td>TIMPD does not Granger Cause JFDID</td>
<td>5.54</td>
<td>0.026</td>
</tr>
</tbody>
</table>

*Note: Critical value of ‘F’ is 2.114 (derived from F-distribution).*

*Source: Through Eviews.*

**Table 4.11** also brings out the values of F-statistic and the critical values at 5 percent significance level. While making comparison between the F-statistic and the critical value it has been found that the F-statistic, in case of JFDI does not granger-cause
TIMP, has been arrived at 5.27. The critical value in this case has been found to be 2.114. Since the F-statistic has been found to be much higher as compared to the critical value, henceforth, alternate hypothesis stands accepted; which says that JFDI granger-cause TIMP. On the other hand, the results of the hypothesis TIMPD does not granger-cause JFDID shows that the p-value in this case had been arrived at 0.026 or 2.6 percent. Herein, since the p-value has also found to be considerably lower than the criteria of 5 percent, henceforth, alternate hypothesis stands accepted in this case as well, which states that TIMPD granger-cause or affect JFDID.

On the other hand, the results of the hypothesis TIMPD does not granger-cause JFDID shows that the p-value in this case had been arrived at 0.026 or 2.6 percent. Herein, since the p-value has also found to be considerably lower than the criteria of 5 percent, henceforth, alternate hypothesis stands accepted in this case as well, which states that TIMPD granger-cause or affect JFDID. On the other hand, while making comparison between the F-statistic and the critical value it has been found that the F-statistic, in case of TIMP does not granger-cause JFDI, has been arrived at 5.54. The critical value in this case has been found to be 2.114. Since the F-statistic has been found to be much higher as compared to the critical value, henceforth, alternate hypothesis stands accepted; which says that TIMP granger-cause JFDI.

Compendiously, this hypothesis attempts to direct efforts towards finding existence of causality; and if there is existence of causality between the variables, the direction of the same. The results, in this regard, revealed existence of bidirectional causality, wherein, there is existence of causality in case of both the hypothesis, i.e., JFDI granger-cause TIMP; and TIMP granger-cause JFDI. In other words, through this hypothesis it has been revealed that JFDI and TIMP have been affecting each other.

4.7 SUMMARY OF RESULTS

Table 4.12 exhibits a brief summary of the results derived for the hypothesis tested above.

4.8 CONCLUSION

The present chapter attempted to find that, even if, Japan and India had been termed as "natural ally" to each other, the same had been reflected in their economic relations
or not. It has been assumed, and henceforth tested, that if the two nations has such strong bonding there is existence of co-integration or long-term association between Japanese FDI and India’s total exports; and Japanese FDI and India’s total imports or not. Assumption had also been made and tested regarding existence and direction of causality between Japanese FDI and India’s total exports; and Japanese FDI and India’s total imports.

The results revealed that JFDI does not hold long-run association with India’s total exports as well as India’s total imports. While analyzing existence of causality and its direction, it was found that there was existence of unidirectional causality in case of JFDI and TEXP, being variable JFDI affected by variables TEXP. While testing for the causality between JFDI and TIMP, bidirectional causality exists between the two, being JFDI affecting TIMP and is being affected by TIMP.

Thus, it can be concluded that even after sharing strong relations with India and finding preference over the other countries with India, Japanese investors (through FDI) has not been able to significantly affect exports of India. moreover, FDI from Japan has not been able to make significant presence in the country. Henceforth, efforts would be required to examine problems responsible for lower amount of Japanese FDI. Efforts would also be required to search out prospective areas/sectors where India can privilege Japanese investors for making investment.
4.9 NOTES

1. Vector Autoregressive Model (VAR) is one of the econometric model of simultaneous equations which is used to clearly identify variables as the endogenous or the exogenous or predetermined variables, in case of those econometric models where some variables are not only explanatory variables for a given dependent variable, but they are also explained by the variables that they are used to determine.

2. Inferential statistics are methods used to determine something about the population, based on the observation of a sample, which may be presented either as mean (μ) or as proportion (p).
in India

Japanese Foreign Direct Investment

Problems and Prospects

CHAPTER FIVE
## Index

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5.1 INTRODUCTION

So far, it had been revealed that even if India opts to go for economic liberalization with the expectation of mitigating balance of payments (BoPs) crisis, the central plank was to ensure higher FDI inflows from Japan which was fostered with the initiation of “Look-East” Policy, alongwith, the New Economic Policy in 1991.

Realizing the impetus of FDI, India had been engaged in consistent efforts to ease-out policy and procedural hassles to make the country an obvious choice for investment, via FDI. Resultantly, India started registering remarkable change with surge in its total quantum of FDI inflows. However, looking at the FDI inflows pattern from Japan, it can be easily found that the quantum of Japanese FDI (JFDI) to India had started acquiring pace only since the last decade or so, even if, Japan always claims India as a crucial strategic partner and also an important destination to satiate its economic desires.

This chapter, henceforth, attempts to inquire about the various problems that have hampered the flow of JFDI in India, even if the country holds enormous prospects for Japan, as also, when it shares the centre stage with China as most favoured investment destination for Japan. Further, the chapter also focuses upon prospects available for Japanese FDI in different sectors of the country where the Japanese companies can ensure their presence and make remarkable contribute by making investment – financial and technical.

5.2 PROBLEMS WITH JAPANESE FDI IN INDIA

In the case of Indo-Japan relations, despite the great complementarities that existed between the two countries both politically – since the end of World War II (WWII) – and economically, since even earlier, neither country figured on each other’s political or economic radars for decades (Rajamohan, Rahut & Jacob, 2008). The era of strong bilateral relationship between the countries started during the early 1990s, when India actively pursued economic reforms and adopted “Look-East” Policy which led to gradual acceleration of Indo-Japanese business relations. Since then, India has been one of the lucrative destinations for Japanese investment. Factors like, high profitability for Japanese companies, high domestic demands, availability of skilled manpower and healthy markets, collectively encouraged Japanese companies
to invest in India. In 25th Annual Survey conducted by Japan Bank for International Cooperation (JBIC) in 2013, it was established that the Japanese companies perceive India as the most attractive destination in the long run and the second most promising destination in the medium term after Indonesia. (JBIC, 2013)

As such, Japanese companies had registered their presence in almost every sector in India, with mighty presence in automobiles, electronics and telecomm sector. Japanese majors like, Sony, Nissan, Panasonic and Suzuki have already set-up their manufacturing facilities in India. Even, companies like, Isuzu, Hitachi, Daikin, Yamaha etc are also planning to invest in India to set up their manufacturing bases in the country. Major part of these investments heads towards transportation, telecommunications, fuel, chemicals and trading sector, as reported by DIPP.

An analysis of the trends of JFDI inflows to India in the recent past reveals that Japan had been adopting Mergers & Acquisitions (M&A) to invest in India. Representative examples include acquisition of 80 percent stake in Mumbai-based electrical accessories major Anchor Electricals for Rs 2,000 crores (economictimes.com, 2007) by Japanese electrical giant Matsushita Electric Works (now Panasonic) in 2007; acquisition of 63.9 percent stake of Ranbaxy Laboratories (indianexpress.com, 2008) for approximately 12740 crores (finance.paidcontent.org, 2009) by Daiichi Sankyo in 2008; acquisition of 26 percent stake in Tata Teleservices Limited (TTSL) by NTT DoCoMo for around Rs. 13,070 crores (indianexpress.com, 2008) the same year. In addition to this, there was acquisition of 14.9 percent stake in JSW Steel for Rs 4,800 crores by JFE Steel in 2010 (economictimes.com, 2013); aggregate investment of Rs. 1,450 crores by the Nippon Life Insurance Company to acquire 26 percent strategic stake (thehindu.com, 2012) in the Reliance Life Insurance Company; and acquisition of 50.74 percent stake of Camlin by Kokuyo in 2011 at Rs 365 crores. (business-standard.com, 2011)

Still, Japanese investment in India has not been able to reach heights that had been expected by the two countries because of strong bilateral ties. The events taking place in the past shows that the Japanese investors come to India to examine investment climate and go back with disappointment with the country’s poor investment climate. However, while other countries have expanded their presence in the Indian market,
Japanese investors continue to undermine India's investment climate, and for long, remained reluctant towards investing in India.

An analysis of JFDI trends in India reveals that, even though the quantum of JFDI in India have increased over the years, especially in recent past, Japanese investment in India had just been around 2% of the country's global investment (Note 1). This gives insight of existence of certain problems between the two countries, hampering JFDI inflows to India. Differing views had been forwarded by the experts in this regard. Some are of the view that the problem does not lie only with India - as conservative nature of Japan on almost every issue had also been an issue for lower Japanese FDI in India. Takashi Yamaguchi, Joint CEO, Daiwa Asset Management (India) agrees to this view saying that "Japanese companies are conservative by nature. They don't get aggressive if they're not confident about doing business in a country." Japanese lack of confidence in India, according to analysts, stemmed from two factors, slow opening of Indian economy during 1990s and exhibition of its nuclear capabilities in 1998. This portrayed India as a volatile region in the eyes of Japanese companies. (Kakkar & Subramaniam, 2012)

However, since the turnaround of the decade, these issues ceased to be of any relevance for lower JFDI in India, as not only these issues were tackled effectively; also other problems associated to requisites for smooth business operations reaped as of major concern for Japanese investors. ‘The Japan Chamber of Commerce and Industry in India (JCCII), for example, has drawn the attention of the Indian government towards 61 issues relating to infrastructure, taxation system and customs clearance that need to be addressed to step up Japanese investments in India’. (www.indiaonestop.com, 2009) (para 2)

Understated are the various problems that had been explored from the analysis of various literatures:

5.2.1 Infrastructure

Availability of adequate, efficient and affordable infrastructure facilities constitutes the core of development strategy and efforts for any country (Bhasin, 2008), as capital rich countries are quite often fond of investing in those countries where infrastructure facilities are found to be most suitable.
By their very nature, infrastructure projects (power, railways, ports, civil aviation, roads and telecommunication) demands for huge initial investments at high risk levels and with long gestation periods. Infrastructural bottlenecks had remained the biggest concern for the industrial progress of the country, even though; the demand for the same had increased rapidly after industrialization of the Indian economy. (Bhasin, 2008)

Japanese FDI inflows to India had been seen as a victim of this problem since very long. India’s infrastructure has been pointed out as a major problem, along with others, which need serious hearing by the governments – Central government and the State governments.

While going through various literature studying Indo-Japan economic relations, infrastructure has been often found as a major impediment for higher JFDI in India. For example, Uemura and Others (2007) in their study posed lack of infrastructure as a matter of concern. Accordingly, insufficient infrastructure, which is frequently pointed out as a major problem in doing business in India since very long time, has been posed as an issue for Japanese investors as well. Though, construction of high-quality highways between cities attempts to resolve the problem, the current situation is not likely to change much until the roads within the cities are improved. In addition to this, shortage of electrical power and an unstable power supply is also a problem for Japanese manufacturing companies. Even, issue of the lack of adequate infrastructure that is frequently talked about refers to an unstable power supply and poor sewerage service, rather than referring to deficiencies in terms of high-quality highways, airports and ports. (Uemura & Others, 2007)

Ranjan (2011), in his article stated that Japanese companies are concerned about issues related to infrastructure. Kojima (2011) also forwarded similar views in his study, wherein poor infrastructure constitutes the most formidable barrier keeping the Japanese companies away from investing in India.

Masanori (2012) in his study also pointed out underdeveloped infrastructure as one of the problems faced by Japanese corporate investment in India. Similar views were forwarded by Potdar (2012) in his article, wherein, infrastructure was carved out as a
major hurdle for Japanese investment in India. **Kanwar (2013)** in his study expressed the view that Japanese have been exasperated by the poor infrastructure in India.

Not just the studies revealed infrastructure as a hurdle for JFDI in India. Japanese officials and delegates are of the similar views, as they were found to be revealing their concern about India's poor infrastructure. For example, **Japanese Foreign Minister, Koichiro Gemba**, in an interview to CNN-IBN's deputy foreign editor Suhasuni Haider, in 2012, mentioned that “**while talking with the business managers in Japan it was revealed that infrastructure in India is still underdeveloped and poses serious challenges for the Japanese businesses**” (ibnlive.in.com, 2012). Even, an investment delegation to India by Japanese External Trade Organization (JETRO), during January 9-13, 2013, recognized vulnerable infrastructure as a challenge faced by Japanese businesses.

**5.2.2 Legal and Regulatory Bottlenecks**

Legal and Regulatory Bottlenecks are another major issue that had been acting as a nightmare for Japanese investment in India. The issue had not just found place in official conversations, but also in various literature. For example, **Williams (2010)** in his article stated that regulatory restrictions on Japanese investment in India are hampering possibility of building-up of factories and plants in India.

In an interview to Business Standard, **Hiroshi Watanbe**, President and CEO of Japan Bank for International Cooperation (JBIC), mentioned tighter regulations as a hurdle for Japanese investment in India. Even, an article in Japan Times, **Reform and we'll invest, India told** (2013), stated Indian regulations as an area which needs to be improved in order to increase Japanese investment in India.

Moreover, an article entitled ‘**Our laws can help Japan’s investors**’ (2013), not just raised this issue, but also, comprehensively provided reason for this problem. Accordingly, it was stated that existence of certain key legal and regulatory issues had been hampering cross-border Japanese investments into India. Difference in governance between the two countries is the most probable reason for emergence of this problem, as unlike Japan, which follows a continental civil law system, India follows a quasi-federal governance system, which is a combination of legislation and judicial precedent (case law) with the Central government and the State, both
legislating on subjects as laid out in the Indian Constitution (which is similar to that of the US). Henceforth, there are plenty of legislations and authorities, which make the practice of Indian law both complex and well-laid out; and Japanese companies would not only need to adhere to federal laws but also State-specific laws, depending upon the location of business operations. (www.thehindubusinessline.com, 2013)

5.2.3 Institutional deficiencies

Japanese FDI in India is also handicapped of various institutional deficiencies that prevail in the system. Institutional deficiencies in its realm cover number of issues which either related to procedural-hassles, uncertainty with policy matters or bureaucratic 'red-tape'. Since institutional deficiencies had affected, and is likely to affect investment plans of Japanese investors, it had, thus, got due consideration not just by Japanese government, but also, by the number of studies conducted over Indo-Japan economic relations.

As such, Japan Chamber of Commerce and Industry in India (JCCID), in 2009, mentioned custom clearance as a major problem among the 61 issues raised by it. Ranjan (2011) also highlighted concern of Japanese companies over the issue of custom clearance. On the other hand, Masanori (2012), in his study stated bureaucratic ‘red-tape’ with other problems have ceased to have higher Japanese investment in India.

Japanese Foreign Minister, Koichiro Gemba, in an interview to CNN-IBN’s deputy foreign editor Suhasini Haider (in 2012) highlighted institutional deficiency as another major challenge for Japanese business (ibnlive.in.com, 2012). Similar views were presented by Potdar (2012) in his study, who found institutional deficiency as a major hurdle for Japanese FDI in India.

Kanwar (2013) have mentioned in his study that Japanese have also been exasperated by bureaucratic ‘red-tape’. However, Tamaki Tsukada (Economic Minister) at Embassy of Japan in India (while speaking at Electronics Manufacturing Industry round-table organized by industry body Associated Chambers of Commerce and Industry of India (ASSOCHAM) cited a quote from Japanese technology giant Hitachi that, “There are some obstacles that we need to remove before we embark on some
meaningful investment, uncertainty in policy matter is an issue." (articles.economictimes.indiatimes.com, 2013)

5.2.4 Taxation System

India’s taxation system had been another factor that had troubled smooth and surged FDI inflows to India from Japan. Japan had also shown concern over India’s complex taxation system on many occasions, as also, it had found place among the major concerns for Japanese companies while planning for investment in India. JCCII, finding Indian taxation system too complicated from investment perspective, raised its concern over the issue. Similar views were presented by Ranjan (2011), who in his study, highlighted taxation system of India as an issue affecting Japanese investment in India.

Moreover, investment delegation by JETRO during January 9-13, 2013, recognized complicated tax system as a major challenge, among others, for Japanese investment in India. Even recently, Japanese Prime Minister, Shinzo Abe, in a meeting with India’s Finance Minister, P. Chidambaram – as reported by Japan Times in its article, ‘Reform and we’ll invest, India told’ (2013) – raised the issue of tax system in India.

5.2.5 Land Acquisition and Utilization

Due to various problems faced with land acquisition and its utilization, it has emerged as an issue of concern for Japanese investors, thus, keeping them doubtful towards India, leading to lower JFDI in India, even after sharing rich history of bilateral economic ties. JCCII, in this regard, is of the opinion that ‘land acquisition and utilization is a complicated and a major obstacle to facilitate Japanese investment in India (www.indiaonestop.com, 2009).’ The view was later supported by Ranjan (2011) through his study, wherein land acquisition was identified as an obstacle to facilitate Japanese investment in India. Even, in a recent study by Masanori (2012), land acquisition disputes were revealed as a problem, among various others, faced by Japanese investors in India.

5.2.6 Corruption

Corruption, as an issue of concern, albeit existed since long, has risen to limelight quite recently. Corruption is one of the problems that had been found significantly
affecting foreign investment in any country and India had been no exception to it, even in case of JFDI. Japan had been found to strongly raise the issue of Corruption as it is an issue which has been taken hood-off by the Japanese investors while taking investment decision in other countries. In this regard, taking reference of results of Heritage Foundation’s report, Ranjan (2011) held corruption as an issue of serious concern for India as it has been significantly affecting JFDI in India. Likewise, Dun & Bradstreet, in its report, ‘India Outlook 2012’, mentioned recent spurt in corruption cases, were among the various factors that have been hampering JFDI inflows in India. Tuke (2012) in her article also mentioned that recent high-profile cases of corruption had tainted India’s image as an investment destination. Even, in a recent study, Kanwar (2013) stated corruption, alongwith others, as a reason for lower JFDI in India. Thus, it can be forwarded that Japanese investors are more concerned over the issue of corruption while deciding on making investment in India.

5.2.7 Labour Problems

Another factor that had been on the concern radars of Japanese investors is the labour problems. According to the study made by Uemura and Others (2007), labour unionism in India acted as an area of concern for Japanese businesses. Albeit, Japanese had been successful in resolving the problem to a greater extent, the recent cases in Maruti, Honda and Toyota factories had raised the problem as an area of major concern. In a recent study by Masanori (2012), it had been found that labour problem was among the various problems faced by Japanese investors in India.

5.3 PROSPECTS FOR JAPANESE FDI IN INDIA

In the above section, it was analyzed that Japanese companies had to face number of problems while making investment in India. Still, Japanese investors are in high spirits, as investments from Japan to India had surged with leaps and bounds within last few years. Japanese companies see brighter prospects by making investment decision in favour of India. The Indo-Japan Comprehensive Economic Partnership Agreement (CEPA), which came into force on August 1, 2011, gave boost to the investment relations of the two countries. However, there are views that problems faced by Japan on internal front (funds amounting to US $ 2.4 trillion lying useless (Zhang, 2013), ageing population, soaring yen, high production cost within Japan
and earthquakes & tsunami in the recent past) and external fronts (especially tussle with China), had encouraged it to invest in more safer and trustworthy destination – “India”.

The growing interest of Japanese investors towards India can be highlighted from the example of ‘India-day’ event organized by Dentsu.

“When Dentsu, Japan’s biggest ad agency, organised an ‘India-Day’ at Tokyo, the organisers were surprised at the turnout of 400 senior executives from 130-odd Japanese companies. In the interactions that followed, the most frequently asked questions were: which of their businesses should be brought to India; whether they should be niche players or take a top-down approach; how they could tackle challenges of doing business in tier 2 and 3 cities”. (Kakkar & Subramaniam, 2012) (para 9)

The above example clearly gives an evidence of growing keenness of Japanese investors towards India, and their desire to ensure its noticeable presence in India. In addition to this, viewpoints of distinguished dignitaries is of great relevance to exhibit Japan’s growing enthusiasm for India due to prospects available for Japan to ensure its noteworthy presence in India. For example, Japanese Prime Minister, Shinzo Abe, in his book, “Towards a Beautiful Country,” made a statement expressing Japan’s national interests with India by strengthening its ties with India. He, in his book argued: “It will not be a surprise if in another decade Japan-India relations overtakes Japan-US and Japan-China ties” (Kanwar, 2013) (para 8). Masaki Ida, Chief Director General, JETRO India put, “Don’t compare with China, the story is of renewed interest in India. We will cross 1,000 [Japanese Firms in India] very soon” (Kakkar & Subramaniam, 2012). Hiroshi Takashina, Managing Director, Nikon India Private Limited, said, "Compared with even the other prospective markets like China or Russia or Brazil, we strongly believe India is the most prospective market for us." (www.thv11.com, 2012)

Similarly, in the words of Professor Shujiro Urata, Waseda University, “Though India was trailing behind China in terms of attracting FDI, it was fast catching up with its neighbour; and with quite substantial investments over the years will be No.
1 in the next 10 years” (articles.economictimes.indiatimes.com; 2011) (para 2). Akihiko Ikeya, Managing Director, Yamaha Music India said, “Japan saw more opportunities in china during the 1990s. But, we could not continue to ignore the big Indian market.” (Kakkar & Subramaniam, 2012)

The growing enthusiasm of Japan in India had been just one side of the coin as on the other side the similar expressions can be seen as portrayed by India too. Since India sees brighter and better future through this engagement, it can be seen working hard, every now and then, in making efforts with intent to entice Japan. In this regard, words of India’s Ex-Prime Minister, Manmohan Singh, holds great relevance, who, in his address at business luncheon hosted by Nippon Keidanren, Tokyo on October 22, 2008, said:

“We welcome Japanese investment in our efforts to build a new dynamic India. We have begun to attract investment from Japan but it is much less than its full potential. To Japanese investors I would say – India today provides a large, growing and young market. The creativity of its people and their rising aspirations will drive the real economy in the foreseeable future to scale new heights”. (pmindia.nic.in, n.d.) (para 20)

Looking for the reasons to the question –“Why the two countries holds hope with each other?” it was found that the expected benefits that India and Japan can provide to each other had made the countries to exhibit zeal towards each other, thereby, benefitting itself as well as the other. In this regard, Japan can help India by providing huge investment, via, FDI or by providing necessary technological transfer/collaboration, which presently, are among the dire needs of the country.

Under-mentioned are the various sectors/industries where lies the strong prospects for Japanese companies and chance to ensure its strong presence in India by making FDI, or technology transfer/collaboration, or both.

5.3.1 Information Technology/Information Technology Enabled Services (IT/ITES)
India’s IT/ITES sector stands in a bee-line with some of the most prominent sectors in India that hold prospects for the Japanese investors. Even though India had acquired the tag of IT superpower in the recent past and had been providing ITES in almost
whole of the world; it had not been able to transmit the same into the industrial set up of its own country. A look at the Indian industrial set-up exhibits that it mainly consists of small and medium scale enterprises (SMEs). More appropriately, the SME sector in India is termed as a triad of Micro, Small and Medium Enterprises (MSME). The main feature of MSME is the use of self-developed technology, and therefore, the sector show signs of high heterogeneity in terms of the size of the enterprises, variety of products and services produced and the levels of technology employed. Statistically, less than 2 percent of the Indian MSMEs were found to be among those that possess and are making use of technical know-how from foreign forces. (Bhardwaj, n.d.)

The issue of technological deficit in India had been raised by various speakers at the Maharashtra State Technology Summit and Technology Platform organized by the Confederation of Indian Industry (CII) on September 3, 2013. As such, ‘in addition to current account and fiscal deficit, India has a technology deficit too.’ (Business Line, 2013)

Thus, there lie excellent opportunities for Japanese companies to exploit the prevailing scenario in India’s MSMEs. Japan, who has made its presence in the world as the global leader in the field of high-end and efficient technology, can make phenomenal contribution to Indian MSMEs through technological transfer/collaboration. Through this effort India would be able to acquire high-end and efficient technology. By attempting upon these options at the earliest, both countries would remain with handful of benefits. As such, on the one hand, Japanese companies would be able to ensure its strong foothold in India’s MSME sector; and on the other hand, a large number of Indian MSMEs would enjoy the benefit of latest technology and know-how in their production process in order to produce goods that are able to accomplish the dual objective of competing at global arena, alongwith, serving the domestic demand. (Bhardwaj, n.d.)

Need for cooperation of Japan in the field of IT had been raised by Manish Tiwari, Ex-Minister of Minister of Information and Broadcasting(India), in a seminar titled "India-Japan Bilateral Portrayals: Mutual Perception and Image Formation" (December 6, 2012), conducted by Observer Research Foundation and Japanese
Embassy (New Delhi), on the occasion of 60 years of diplomatic relation between India and Japan.

Earlier, Indian Ex-Prime Minister, Dr. Manmohan Singh, in his address at business luncheon hosted by Nippon Keidanren, Tokyo on October 22, 2008, favoured Japanese cooperation in high-technology areas and the building of a knowledge economy through transfer of technology. According to him, ‘Japan can become our preferred partner in areas of established Japanese competence such as energy efficient technologies, etc’ (para 21). Even, Anand Sharma Ex-Commerce, Industry and Textile Minister (India) and P. Chidambaram, Ex-Finance Minister (India), expressed hopes for Japanese technological cooperation with India on different occasions.

5.3.2 Infrastructure

India, though able to put itself among the fastest growing economies of the world, its growth story had found to be hindered by the problem of infrastructure deficit on various occasions (Goyal, n.d.). Given the fact that strong infrastructure facilities form the backbone of a nation’s economy, the Indian government began to shift its focus towards infrastructure development. The Planning Commission, during its 10th and 11th Five Year Plan study, identified that economic growth of the country had been seriously affected due to inadequacy of efficient infrastructure facilities. Hence, it persuaded the government with the expectation that government will take hood-off of the problems and will take some lucrative initiatives to resolve this problem. To ensure effective initiatives from the government, the Planning Commission framed number of provisions during the two plan periods to clearly edifice India’s dire need and desire to have presence of efficient infrastructure facilities to entice FDI. One of the remarkable initiatives, in this regard, came in the form of efforts to allow private sector investments in country’s infrastructure sector through the means of public private partnerships (PPPs). (IBEF, 2013)

Various government reports exhibits that the estimated investment in India’s infrastructure is likely to be over US$ 1 trillion, half of which is expected to come from private sector. While government investment in infrastructure would continue, it is not feasible to fund very large investment requirements of these projects fully from the budgetary resources of the government. Henceforth, India, not just encourages,
but also warmly welcomes investment in infrastructure sector (which includes Ports, Power, and Roads & Highways) by the private players, by allowing FDI up to 100% under the automatic route for: Construction and Maintenance of Ports and Harbours; in Generation, Transmission, Distribution and Trading in power sector; and in road sector’. (Goyal, n.d.)

Considering that Japanese firms quite often raise the issue of poor infrastructure as a hurdle for investment in India, they can see enormous opportunity in this sector. Japan had been contributing commendably in developing India’s infrastructure, especially in Building highways. Even recently, Japan has expressed their desire to build high-speed rail networks in India, for which a joint feasibility study is likely to be soon underway (Raghavan, 2013). All these efforts of Japan are with the expectation that the development of infrastructure will open new avenues for Japanese investment in India’s huge market.

Development of infrastructure is such a crucial issue not just for India, but also for Japan; that the government heads and other ministers of both the countries had shown their willingness to fund India’s need for infrastructure development.

In the words of India’s Ex-Prime Minister, Manmohan Singh (P.M. address at business luncheon hosted by Nippon Keidanren, Tokyo on October 22, 2008):

“Our infrastructure financing requirements over the next five years are estimated at 500 billion US Dollars. Financing this level of investment presents a special challenge in view of the uncertainties now prevailing in capital markets of the world. Upgrading of India’s infrastructure through more effective use of public-private partnerships and joint ventures requires looking for new sources of finance. And Japan here becomes very important for us.”(pmindia.nic.in, n.d.) (para17)

This shows that India sees a major role for the Japanese companies in years to come, in its infrastructure projects – both by way of technology and investment (Goyal,
2012). Even, Japan is also looking determined to contribute to India’s efforts in developing its infrastructure, as *Japanese Prime Minister, Shinzo Abe*, has shown his ‘willingness to cooperate in developing infrastructure in India’. Moreover, India’s Finance Minister, P. Chidambaram, expressed hope that ‘*Japan will cooperate in developing India’s infrastructure by utilizing Japanese technologies.*’ (www.japantimes.co.jp, 2013)

5.3.3 Auto-Components

India’s auto-component manufacturing industry, which was established on the recommendations of Tariff Commission (1953), opened up in 1980s and entered into joint ventures with the Japanese companies, as encouraged by the establishment of many Japanese Original Equipment Manufacturer (OEMs) in the passenger car; two-wheeler and Light Commercial Vehicle (LCV) industry in the country. The foundation stone of the development of Indian auto-component industry was laid in 1980s when The Phased Manufacturing Programme (PMP) was introduced in the sector. The PMP paved the way for the modernization of the technology used so far in the sector, improving the quality of the components produced and to imbibe good manufacturing and shop-floor practices. Moreover, PMP was also supposed to fulfill the aim of transforming the auto-component sector of the country into a highly capable sector of the industry, alongwith, ensuring its contribution in localizing country’s component base. The success of PMP was registered in 1990s, when global OEMs and Tier I suppliers initiated upon their business operations in the country. *(Ministry of Heavy Industries & Public Enterprises, 2006)*

Since growth in automobile industry is the harbinger of growth of the auto component industry, the prospects for future growth of the industry seems to be very bright as Indian automobile industry has come a long way since its establishment. Today, in the global automobile industry, India holds 6th position in car manufacturing, as also, it is the 6th largest auto market in the world. In case of tractor manufacturing, India is the market leader, and in case of manufacturing of two-wheelers, it has been placed as 2nd largest producer. Moreover, it is 8th largest manufacturer of commercial vehicles; and due to the growing demand of small size vehicles, it is fast emerging as the *World’s ‘Small Vehicle Manufacturing Hub’*. The auto-component manufacturing industry, henceforth, had emerged as
one of the most preferred sourcing destination for many global players; and continues to make significant contribution in country’s economic growth. (L.B. Associates Pvt. Ltd., 2012)

At present, the Indian auto-component sector consists of over 500 organized players and about 5000 unorganized sector players, which manufactures wide range of products in India for both domestic consumption and exports. The total size of the component industry is close to US$ 14 billion which includes domestic OEM market, domestic aftermarket and the direct exports of components. Being one of the fastest growing segments of auto industry, it had, over the years, developed the holistic capability to manufacture the entire range of auto-components e.g. Engine parts, Drive, Transmission Parts, Suspension & Braking Parts, Electricals, Body and Chasis Parts, Equipment etc., required to manufacture vehicles. (Ministry of Heavy Industries & Public Enterprises, 2006)

According to the data provided by ACMA, the turnover of the Indian auto-component industry is expected to reach a marked height of US$ 40.6 billion by the year 2012-13, and by the year 2020-21, the turnover is expected to reach the mark of US$ 115 billion. In case of growth rate in the industry, there are high expectations that the compound annual growth rate (CAGR) will remain around 14 percent during the year 2013-21; and on the exports front, there are projections that the industry will touch the mark of US$ 30 billion by 2020-21. (www.ibef.org, 2013)

Thus, the flourishing future prospects and presence of such a huge potential has been enticing companies from around the global to look for the prospects by setting up their manufacturing bases in India, complemented by the courage of many Indian companies to invest in capacity expansion, in research & development (R&D) and in product innovation. (L.B. Associates Pvt. Ltd., 2012)

Japanese companies had been in existence in India’s automobile sector for quite long time with companies like Suzuki, Honda, Toyota, Yamaha, etc., and have strong presence in India. Japanese companies are also having their presence in the auto-component industry of India as well. However, while Japanese companies have been a renowned name in the global automobile industry and had built their strong presence in India’s automobile sector, they can see India’s growing auto-component sector as another prospective sector for investment prospects.
5.3.4 Steel Industry

Indian steel industry plays a significant role in the country’s economic growth (RNCOS, 2011) with its strong forward and backward linkages (Ministry of Steel, 2011). As the steel industry is having a stronghold in the traditional sectors, such as infrastructure & constructions, automobile, transportation, industrial applications etc. (RNCOS, 2011), the industry today directly contributes 2 per cent of India’s Gross Domestic Product (GDP) and its weightage in the official Index of Industrial Production (IIP) is 6.2 per cent. This had transformed the country into world’s 4th largest producer of crude steel preceded only by China, Japan and USA from a country which was having capacity of one million tonnes at the time of Independence (Ministry of Steel, 2011). Moreover, it had been struggling hard to become the second largest producer in the coming years. (RNCOS, 2011)

While comparing India’s steel consumption with other steel majors of Asia namely, China, Japan and South Korea, the consumption seems to be much lower. Hence, the industry holds immense scope for future growth. In addition to this, factors such as, rapid pace of population growth, urbanization process, production of agricultural and industrial product, and improvement in the living standard of the population had opened the doors of opportunity for the growth and development of Indian steel industry, wide open. (Pal, 2013)

Provisions had been made in the country’s 12th five year plan to make massive investments to the extent of US$ 1 trillion in the infrastructure sector. The move will provide opportunity for the expansion of the base of steel consumption in the economy. Roughly, the annual demand of steel will surge to approximately 40 million tonnes during 2012-13 to 2016-17 (Ministry of Steel, 2011). Similarly, the expected growth in the auto-component sector is likely to contribute to the increased demand of the steel in the country.

Considering the expected growth in India’s infrastructure (construction) and auto (auto-component) sector, there exists flourishing prospects for Japanese steel majors, which in order to remain competitive in the new world order in the steel industry, are looking for new markets and consumers (Thomas, 2011). With this intention, by 2010, all four major Japanese steel companies; JFE, Kobe, Nippon and Sumitomo Metals had tied up with Indian firms. (Masanori, 2012)
5.3.5 Drugs and Pharmaceuticals

As India registers growth in its population and in its economy, there is emergence of large middle class which are equipped with the resources to afford costly Western medicines; which were at one time were far away from their affordability limits. With the shift in demographic, epidemiological and economic profile of India, country’s population had become prone to the diseases that most commonly trouble the people living in the developed world; and with the shift in country’s economic profile, demand for drugs to cure these ailments is likely to increase (McKinsey & Company, n.d.). All these factors, collectively, gives imprints that India is undoubtedly a representation of a promising potential market for global pharmaceutical manufacturers. (PwC, 2010)

The Indian pharma industry has grown and expanded so much that, today, it is the third largest market globally in terms of volume and 14th largest by value. The growing impetus of India’s pharma industry among foreign investors can be explained by the growth prospects estimated by the PricewaterhouseCooper (PwC) in its report entitled, ‘Capitalising on India’s growth potential’, in respect to the industry. Accordingly, the industry is expected to grow at Compound Annual Growth Rate (CAGR) of 15 to 20% annually and will become a US$ 49 billion to 74 billion market by 2020.

With the changes taking place in the pharmaceuticals industry around the world, Indian generic pharma companies had started taking initiatives to cater to the needs of price sensitive India market and global generics market. In this respect, attempts have been made by the Indian generics pharma companies to stress upon strong product development skills. In addition to this, the pharma industry has not just established world-class Active Pharma Ingredients (API), but also, formulated manufacturing facilities for the same. Majority of these companies rules the domestic market of India by developing network of its large sales force, in conjunction with, strong relations with physicians and medical institutions (PwC Pvt. Ltd., 2011). Even, in case of production of generics and vaccines, some of the Indian pharma majors shares the stage with the world leaders. The changes in the Indian pharma industry has raised the hope that India is expected to emerge as a strong competitor of global pharma in some of the key areas and a potential partner in some other areas (PwC, 2010). The
expectation has encouraged Indian pharma companies to take initiatives to attract foreign investment and to move up the value chain to drug discovery and development by leveraging country’s scientific talent. (PwC Pvt. Ltd., 2011)

This had altered the picture of pharmaceutical sector in the country as companies are now looking to transform their R&D divisions into separate units, thus, opening new avenues for foreign players. Moreover, introduction of a new patent regime is providing better protection of intellectual property rights, even if, there is existence of some issues. Procedure for carrying out clinical trials has also been made much more cost effective compared to many developed nations. Developing of required expertise by some of the local companies, along with the above factors, has added up to a strong case for partnering with Indian companies around R&D, including clinical testing (PwC, 2010). Henceforth, MNCs operating in the sector in distinct countries has started to explore opportunities in India too. For the purpose, they are looking at the options of co-developing drugs, buy or in-license molecules. Expectations are high that, if successful, then the same will help India in shedding the tag of a ‘cheap manufacturing base’ and gaining the title of a ‘genuine intellectual contributor.’ (PwC Pvt. Ltd., 2011)

Contrary to this, Japan is an upcoming market for collaboration. The Japanese largely innovator-based pharmaceutical market stands at US$ 96.5 billion. The generics component of the Japanese pharma sector alone contributes about 25% of sales by volume. Even, Japanese pharma companies seems to be in hurry in shifting its focus towards generics due to opening-up of generics market by means of providing number of incentives by their government to the pharma industry and physicians. The problem of ageing population in the country had also contributed to this paced process. This shift is likely to result in increased partnerships between Japanese pharma companies and Indian generics manufacturers, with an expectation that the collaboration will help in bringing various benefits. Such as, the market will see on the table new products, latest technology, higher investments, quality systems, knowledge of regulatory processes, local market knowledge, cost advantage and local scientific talent. Such alliances, thus, is expected to benefit both the parties, and at large the society, by introduction of new drugs and therapies to the market and increase patient’s awareness about ailments and availability of variety of treatments. (PwC Pvt. Ltd., 2011)
Need of Japanese investment in Indian pharma sector has been appreciated by various Indian ministers on different occasions. For example, on the occasion of 60 years of diplomatic relations between India and Japan, Manish Tiwari, Ex-Minister of Information and Broadcasting (India), in a seminar in New Delhi titled "India-Japan Bilateral Portrayals: Mutual Perception and Image Formation" (December 6, 2012) hosted by Observer Research Foundation and the Japanese Embassy, called for Japanese collaboration in Indian pharma industry. (www.observerindia.com, 2012)

5.3.6 Food-processing Industry

A view of India’s agricultural profile reveals that it is full of contrasts as far as its food industry is concerned (L.B. Associates Pvt. Ltd., 2012). India stands at the top in case of production of fruits and vegetables, livestock and milk. In case of agricultural production, arable land, agro-climatic diversity etc., it is among the top three. Most importantly, considering the present scenario, India is also an emerging food and beverage market, especially for branded, health and convenience food. (Verma, 2012)

Statistics reveal that agriculture, albeit employs majority of the Indian population, its percentage contribution in country’s GDP is not as per the expectations. As such, while the agriculture employs 58 percent of the country’s working population; the contribution of agriculture to country’s GDP accounts to a meager percentage of just 14.3 percent. Moreover, despite the fact that India predominantly had been an agrarian economy, the growth of agri-economy within the country had not been able to meet the demands of the country. The major bottleneck in this regard seems to be slow growth rate of the sector. Agriculture sector of the country, on an estimate, is growing at the rate of 2 – 3 percent. The dwindled condition of the agriculture sector has opened substantial scope for further growth of the sector in the country (Verma, 2012); and for the potential investors to seek out for the prospects available for them.

Within the agriculture sector of the country, food products constitutes single largest component which yields largest amount of private consumption expenditure, as the expenditure in this case approximately accounts 49 percent of the country’s total spending (L.B. Associates Pvt. Ltd., 2012). The existing scenario of the country’s processed food-industry reveals that it is on a fast growth track and, in the coming
years, it is likely to become one of the most enduring consumer markets to allure major players of the industry around the world (Deloitte Touche Tohmatsu India Private Limited, 2009). A major contribution in this regard is likely to come because of the changing social scenario of the country. As the country registers upward mobility of income classes of the country’s population (L.B. Associates Pvt. Ltd., 2012); increase in the population of working women; and increase in nuclear double income families in urban areas (Deloitte Touche Tohmatsu India Private Limited, 2009), the need for convenience and hygiene food products has surged, thereby, increasing the demand for perishables and non food staples, as well as, processed foods in the country. (L.B. Associates Pvt. Ltd., 2012)

A look of the India’s food industry reveals that it is predominantly unorganized with 75 percent of the processing units being operated by the unorganized players in the industry, which are not registered and are basically household/cottage industries having only local presence. In contrast, is the organized category which, though small, is growing at fast pace. Many of the companies in the sector are small/medium sized and hence face problems associated to investment in technology, sanitary/Phyto-sanitary measures. Among the organized sector, small scale industries (SSIs) constitute around 33% of the total number of companies operating in the industry, with investment of less than Rs. 1 crores in fixed assets. The scenario in dairy sector is much more soothing due to existence of cooperatives in Dairy sector. The processing level of milk, in particular, is comparatively much higher with around 35 percent, compared to other products produced by the industry which averages around 7 percent. (Deloitte Touche Tohmatsu India Private Limited, 2009)

Since contribution of food processing is the largest to agribusiness, it can play a pivotal role in transforming the picture of overall agriculture sector of the country, and contribute to the growth of the overall agri-business of the country. Expectations are very strong that the food-processing sector, which presently stands at US$ 40–50 billion, will grow upto US$ 300–350 billion by 2020. In addition to this, the contribution of the packaged food industry in the country’s overall food industry during 2009-10 was around 2.9 percent with market size of Rs. 310 billion. Since the packaged food-industry has an anticipated growth rate of about 25 percent per year, it is expected that the share of country’s packaged food industry will reach to the level of 7 percent by 2015. (Verma, 2012)
Henceforth, here lies the opportunity for Japanese companies as Japan’s major chunk of FDI outflows through the food-processing industry. Anand Sharma, Ex-Commerce, Industry and Textile Minister (India), while speaking at a luncheon meeting in the presence of Japan’s visiting Prime Minister Mr. Yoshihiko Noda (2011), also supported this view. According to him:

“We are focusing on agriculture, agro-processing and food-processing to build an entire integrated value chain. We will be developing 46 fully-equipped agro-processing zones or parks (in India). This is one area where Japanese technology, knowledge and experience could be of much help.” (thehindubusinessline.com, 2011) (para2)

5.4 CONCLUSION

From the study of the existence of various problems hampering Japanese FDI inflows to India, it may be concluded that, albeit Japan and India share a rich history of bilateral relations over various aspects, thereby, being termed as “Natural Ally”, the relations have not reached up to the expectations of the two ends. Much of the effect of the same can be seen on Japanese FDI inflows to India. Existence of various problems highlighted through distinct studies, as also, indicated by various country officials on various occasions are the main reason behind this. These problems includes infrastructure bottlenecks, legal and regulatory bottlenecks, institutional deficiencies, taxation system of India, problems with land acquisition and its utilization, corruption and labour problems. However, it was revealed that the problems are in existence on both fronts, India holds much more problems as far as JFDI inflows are concerned. These problems are considered as fierce issue in low level of FDI relations and demands for immediate efforts to resolve these issues.

Albeit number of problems exists with making investment in India, the prospects are also quite alluring. There are number of sectors/industries wherein the Japanese investors can look for their presence. Presence of these prospects had enticed Japanese companies to turnaround to India, even after facing number of problems, and even if, present Japanese business establishments in India and prospective Japanese investment are feeling the heat of it.
5.4 NOTES

1. Percentage of Japanese foreign direct investment in India, out of its global investment, has been calculated on the basis of the data as provided by JETRO.
CHAPTER SIX

CONCLUSIONS AND SUGGESTIONS
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6.1 INTRODUCTION

The previous chapter, under its ambit, embraced various problems faced by Japanese investors even after sharing a rich past in terms of political, cultural and economic relations. As such, there exists a range of problems impeding the Japanese investment in India – directly or indirectly. Previous chapter also highlighted various sectors where lies the prospects for Japanese investors; investment in which may help Japanese investors in extracting innumerable benefits. Thus, the chapter assisted in concluding that even after coming up with numerous reforms and provisions, in general and for Japanese investors in particular, India had not been successful in alluring the expected amount of foreign direct investment (FDI) from Japan. However, even after existence of numerous problems, there lie prospects for Japanese investors in distinct sectors of the country. To reap benefits by increased investment in these sectors from Japan, India had to make certain alterations in the policies and procedures laid by the government for promoting FDI from Japan towards India.

Within this realm, the present chapter embraces the conclusions of the study conducted. On the basis of the problems faced by the Japanese investors various suggestive measures that may be adopted by India to overcome these problems and subsequently help in increasing the quantum of FDI from Japan has also been enlisted. Moreover, some other suggestions that may help in increasing the quantity and flow of Japanese FDI towards India has also been made. Lastly, direction for future research has been laid down which will help the future researchers to further explore out the study.

6.2 CONCLUSIONS

The present study explored that with the transformations in the human civilization, ages by ages, there were transformations in the activities as performed by the humans as well. Within the realm of economic activities, the transformation predominantly constituted emergence of trade between humans, via. Barter system. As the developments in the world took place, there roused political frontiers among the nations as seen in the present scenario. With the creation of political frontiers between the nations, there aroused another set of transition where, at the outset, emergence of trade relations, and thereafter, emergence of investment relations took place. Among
the two, FDI got applause from all-around the world, and thus, between the countries FDI, in particular, captured the centre-stage in the economic activities of the countries. Moreover, with the emergence of political frontiers leading to creation of nations, there took place feeling of getting excellence over other nations. This feeling of excelling over other nations encouraged countries to outperform other competitors by performing activities which were far more novel and progressive than others. These activities resulted in division of the world into the “developed” and “developing” worlds. Whilst, developed world was equipped with all the up-to-date facilities, as also, sufficient financial resources; developing countries were deprived-off of these peculiar advantages and had to stare towards developed countries for providing assistance to satiate their unfulfilled wants. Resultantly, between some countries there emerged strong bonding, thereby, enhancing the extent of their relationship in distinct spheres, in addition to trade and investment relations.

Among all the assistances provided by the developed world, the utmost importance was granted to FDI because of number of physical benefits provided to both the home and the host countries. Since, in the present world order, FDI constitutes an important source of external finance for India as well; by highlighting the need and importance of the same for India, the present study attempts to analyze and interpret the economic relations, within the realm of FDI, between the two economic giants of the developed and developing worlds, Japan and India, who not just share age-old relationship; but also share the common feature of “Respect for All”.

The study, with an attempt to satiate the general objective of developing clear knowledge about FDI, had undertaken in its purview aspects like, concept, components, theories, and costs and benefits of FDI. Moreover, to satiate the specific objectives set out in the study, the study attempts to bring out various aspects that not just roused the two countries, Japan and India, as the two economic giants in the global panorama – one being among the top most investors around the globe (Japan); and other being one among the most favoured investment destinations for almost whole world (India) – but also brought them in close economic and other strategic relations. The study while analyzing the historical facts, explored out that the two countries had written an ‘unprecedented history’ of their success after rising from their own ashes. Japan, after being severely ruined by the incidents of mass-massacre at Hiroshima and Nagasaki, roused emphatically through its untiring and dedicated
efforts on global panorama and stood in the line of developed world. The sense of being part of developed world created zest to engage itself in economic activities as performed by most of the countries of the developed world during that time. Japan exhibited intellect by adopting the policy of economic reforms in a phased manner. Accordingly, there were continuous initiatives by the Japanese government to overhaul its Foreign Exchange Law after World War II. Though Japanese companies had been granted permission to make investments outside its own country since 1951, the restrictions imposed by BoPs crisis kept the numbers and value of Japanese FDI almost negligible until 1960s. With the radical shift in Japanese growth in the late 1960s and early 1970s, the manufacturing costs in neighbouring countries reduced comprehensively making them palpable choice for investment by Japanese investors during that phase. During 1980s, Japan implemented liberalization of foreign exchange controls and financial regulations, encouraging its financial and insurance industry to expand overseas. As such, there were three phases through which Japan expanded and liberalized its economy and diversified economic activities around the world. Thus, due to its untiring efforts, Japan was easily able to adapt itself to the changing global scenario, thereby, becoming one of the top global investor, which let the entire world see outflows of bulk of FDI from Japan, and whom the entire world is attempting to mesmerize to extract huge funds for investing in their country. Though, bulk of Japanese FDI was being hosted by the developed countries all around the world; Asian continent, in particular, got the opportunity to host maximum quantum of the same only since 1990s.

The emergence of India as a major investment destination for financial rich countries is as astonishing as emergence of Japan as a major investment provider for financial scarce countries. India was tortured during the rule of British Empire and was left empty-handed after independence. However, India’s zeal to be in the league of global ‘super powers’, made it to get involved in untiring efforts to allure huge investment from all-around the world by bringing its activities in synchronization with the dynamism of the global economy. During these years, Japan was among the early birds, which came forth to provide financial assistance to India. Albeit, due to policy constraints much of the investment in India could have been possible only in the form of Official Development Assitances (ODAs), for decades; the advent of the year
1991, let India see a new dawn of liberalization of its economy resulting in opening up of its long held closed economy for foreign investment.

With the adoption of liberalization by India, countries of the developed world from all around the globe started considering the prospects available for them in India. Japan, which had been providing financial assistance to India through ODAs, since 1950s, though also invested through the route of FDI, after this event, but doesn’t look much mesmerized, and henceforth, the quantum of FDI from Japan was much less as compared to other countries. FDI flows from Japan started to increase with the adoption of the reforms which further liberalized the Indian economy, and were termed as the “second generation reforms.” Thus, even if Japan had been sharing its economic ties with India since 1950s through ODAs, efforts like, adoption of economic planning and reforms thereof, could not be of much help in attracting, and more appropriately, encouraging FDI from Japan. Moreover, the economic liberalization of India in 1991, which enticed almost the whole world, was not able to mesmerize Japan to a greater extent. The turnaround in the perception of Japan only emerged when India adopted further liberalization in 2000. Hence, even though India opened up its economy in 1991, Indo-Japan investment relation reached new pinnacle only a decade later, when the world saw not just turnaround of the century, but also further liberalization of India. Since then, Indo-Japan economic partnership has been adding new pages to the history of economic relations of the two countries. As also, FDI from Japan to India started to increase. The two countries seems to be deeply interested in making this bilateral economic relations more and more stronger, that they had been consistently involved in taking initiatives for the same. In this regard, a Joint Study Group was set up by the Prime Minister of the two nations in November 2004, to make recommendations for strengthening the prevailing scenario of the economic relations between the two countries. The recommendations of the group lead to the creation of Joint Task Force (JTF) in 2009 for creation and implementation of Comprehensive Economic Partnership Act (CEPA), which took material shape and finally came into effect in February, 2011 after comprehensive efforts of almost 7 years. Moreover, India and Japan also entered into Strategic and Global Partnership in December 2006 to give further boost to their existing relations. The result of these initiatives has come up in the form of cumulative FDI of US$ 13,578 million (Rs. 66,185 Crores) for the period ranging August 1991 to March 2014. Out of this, the
massive amount of US$ 11,867 million (Rs. 59,115 Crores) had flown into the
country only since 2003-04. This investment from Japan had its presence in number
of sectors; prominent among these are Drugs & Pharmaceuticals; Automobile
Industry; Services Sector; Metallurgical Industries; and Electrical Equipments.
(DIPP, 2012)

The present scenario of Japanese FDI in the country is a symbol of extreme belief in
each other as there had been phenomenal growth in Japanese investment since the
inception of the 21st century. This had been a case when the Japanese investors are
facing number of problems while operating in India or while attempting to enter in
India. These problems includes issues like, problem of efficient infrastructure, high-
end technology, regulatory bottlenecks, bureaucratic hassles, etc. and need immediate
and effective hearing from the Indian government. However, even if investors from
Japan are feeling the heat of adverse business milieu, availability of prospects in
spheres like, Automobile, Infrastructure, Steel, Drugs & Pharmaceuticals, etc. had
compelled the present investors to remain in the country; as also, the prospective
investors to enter in the country, though, with calculated risk. Since, the availability of
prospects cannot alone drive the flow of FDI from Japan, India need to take certain
initiatives to ensure that Japan feel more interested in making investment decisions in
India. Since, Japanese investors seems to be more interested beyond the investment-
friendly claims, therefore, rather than just portraying itself as an investment-friendly
country and cashing-out on the basis of availability of prospects within the country;
India had to take certain concrete steps to ensure maximum possible benefits to the
foreign investors, in particular, the investors from Japan.

Compendiously, it can be said that albeit the two countries have came a long way in
their long-held economic relations, wherein India emerged as one of the most
favoured investment destination, at present, from being the largest aid-receiver,of the
past. Both the countries had taken number of relevant steps to overcome the troubles
that came in their way. However, they still had to take some more steps in this
direction, wherein, India had to play a role of protagonist by being on the driving seat
as they are in requirement of huge investments for their developmental programmes
for which it is looking towards Japan, one of the oldest allies of the country.
6.3 SUGGESTIVE MEASURES TO PROMOTE JAPANESE FDI

The study have, so far, revealed that Japan, in past, had been a vital partner for India in distinct facets; and is expected to play similar role in the coming ages as well. One of such aspect is economic ties, particularly the FDI. Japan had been making investment in India much before it adopted economic liberalization, though, the investment was by way of aids provided by the Japanese government, via. ODAs. India emphasized upon increased FDI inflows from Japan with the inception of “Look-East Policy”. Though FDI inflows from Japan surged in effect of these changes; further liberalization by India in 2000, gave boost to the flow of FDI from the same. Looking at the mesmerizing prospects present in India, Japan seems to be equally desirous to invest more in India, as India is to ensure higher and higher presence of Japanese FDI. But, Japan is concurrently concerned about various hurdles encountered by it in India during the three phases of investment making process – before, during and after investment. This calls for enactment of certain measures to be considered to escape Japanese FDI from being paralyzed of these problems. Various suggestive measures that may be undertaken to overcome these problems include:

6.3.1 Building Efficient Infrastructure

The fiercest problem faced by Japanese investors is the infrastructure bottlenecks. It has been observed that infrastructural bottlenecks have not just taken the present investors, but also the prospective investors, away from India as they are hesitant in pouring their huge investment in an infra-deficient country. Since Japanese investors can often be seen making hoopla about India’s deterrent infrastructure, the foremost requirement on India’s part is to tackle this problem at the earliest, in order to promote development of industries within the country. To fulfill this purpose, India had to built-up efficient and effective network of infrastructure. This may include construction and/or development of quality roads, ports, railways, civil aviation and telecommunication, along with construction and/or development of logistics and industrial parks. Moreover, it also includes ensuring uninterrupted electricity supply to the business houses operating in the country of exhibiting interest of making investment.
Among these, utmost focus should be put over construction of roads and focus should not remain limited to building only highways, but it should be extended towards building the link roads as well. Moreover, focus should also be laid upon maintaining the quality of infrastructure. While building and maintaining infrastructure, it should be taken hood-off that such activities should not remain the sole responsibility of central government and state governments should also make contributions to the same by making efforts in sync with the central government, with the expectation that such coordination would portray glittering position of the country among Japanese investors, thereby, lending a crucial helping hand to the government at centre in alluring higher FDI inflows from Japan towards India.

Another major issue within infrastructure bottlenecks, often pointed out by Japanese investors, is the non-availability of electricity. Japanese investors had been found facing the problem of non-availability of electricity in most parts of the country. Moreover, if they are provided with the better facility of electricity supply, they had faced problem associated to frequent cut-outs, high electricity tariffs, etc. Thus, electricity supply is the another major problem which requires efforts both by the central government and respective state government – constituting increase in the capacity of electricity production, alongwith, efforts to escape from frequent cut-outs, high electricity tariffs, etc.

6.3.2 Use of High-end IT/ITES in Industries

In today’s well-developed business milieu, technology plays a crucial role in the growth and development of every company, and resultanty, of the country. In the globalized world, every country is required to acquaint itself with cutting-edge technology to allow its companies to fight the global competition. In case of India, albeit, it had achieved the tag of ‘superpower’ in the service sector, the same has not reaped expected benefits due to lack of expertise in hardware to complement India’s software competence. Deficiency in this respect has been acting as a catalyst for the investors, most importantly the Japanese, who are being recognized as world’s superpower in the creation and use of novel cutting-edge technology.

Use of high-end technology, in terms of both hardware and software, is the most widespread attribute of the Japanese companies and while investing abroad the investors from Japan look for the similar facilities in the host country, thus, being
resistant to India, even if, it is in the list of most preferred nations for the investment purposes.

Henceforth, enactment of significant reforms in the field of IT/ITES would also be required by India to entice investors from Japan. India should look for initiatives to acquire appropriate hardware that will not only complement the present investors, but also the prospective investors from Japan leading to even more inflows of FDI from the country.

6.3.3 Mitigate Policies and Procedures linked to FDI

Any country’s policies and procedures, regarding FDI, acts as the foundation stone to ensure that the country becomes host to bulk of FDI from countries who are fund efficient. Japan, who is sitting on huge funds amounting to around US$ 2.4 trillion (Zhang, 2013) lying useless, is in quest of investment opportunities in the outside world due to lack of investment opportunities within their own country. Thus, countries attempting to host Japanese investment had been found to be engaged in framing more relaxed policies or easing provisions of current policies to bring them in parity with the requisites of the investing country.

India, which is in requirement of bulk of funds for its large-scale developmental programmes, has also been involved in easing-out its policies and procedures to allure foreign investors, as its internal sources of finance are not sufficient to meet-out its requirements. However, even after being involved in such activities, Japanese investors had pointed out India’s FDI policies and procedures not up to the expectations and, resultanty, seem to have either ceased-off or deferred their investment plans in India.

Since, Japanese investors see India’s FDI policies and procedures as a deterrent for its investment plans in the respective country, India had to explore out the ways to deal with this problem. Considering the requirements of the Japanese investors, India had to address the issue of “policy-paralysis” by making efforts regarding establishment of “fast-track” process for approval of investment projects so that investors may find themselves at ease by escaping from the cumbersome process of obtaining permission and other policy requirements that also took much of their time and efforts.
Moreover, India also had to direct its efforts to eliminate any possibility of “red-tapism” that seems to be prevalent in almost every investment proposal. Henceforth, India should look for the possibility of investment of “single-window” clearance system to by-pass the problems arising from “red-tapism” and to provide required assistance and advisory services, covering distinct spheres, to the investors for bringing direct investment into the country.

6.3.4 Removal of Regulatory Bottlenecks

Another important issue that had been on the concern radars of Japanese investors is the regulatory bottlenecks. Japanese investors are concerned about the dispersion of India’s jurisdiction between the Centre and the States, as this poses serious problems to them on frequent occasions. In this regard, while Central Government enjoys control over aspects like finance, defence, trade, telecommunications, FDI policy, and to certain extent infrastructure; State Governments too enjoys control over distinct aspects that holds extreme importance to States’ as well as country’s investment climate. These aspects include power, agriculture land, state investment, police, etc. Thus, Indian government – both Central and State – had to find a compromised path that along with providing, atleast, minimum individual benefits to both, provide convenient business milieu free from regulatory tussle between the two ends of power – the Central government and the State governments.

Japan had also exhibited its concern over the issue of India’s complex taxation system due to different tax rates between the states prevailing within the country. Japan is, thus, much concerned about the timeframe within which regulations like, General Anti-Avoidance Regulation (GAAR) and Goods and Services Tax (GST) will be implemented; and has henceforth, put hold on its prospective investments that should have, otherwise, flown into India much earlier. Thus, India should try to address implementation of GAAR at the earliest, if possible, which is presently scheduled to be implemented with effect from April 1, 2016. Along with, India should also ensure early implementation of GST, implementation of which has been pending since April, 2010 and is likely to be implemented from 2014-15, as announced by India’s Ex-Prime Minister, Dr. Manmohan Singh.

In addition to this, India should also make attempt to find ways to escape from frequent policy amendments that had been characteristic of distinct sectors, like retail,
defence, etc., in the past and should look for bringing transparency in its FDI policies and procedures. Thus, transparency and consistency should become the heart and soul while framing FDI norms.

6.3.5 Removal of Bureaucratic Hassles

The ‘bureaucratic structure’ of India had also seemed to paralyze the investment prospects in India. This had become a curse to such an extent that even the country’s Ex-Prime Minister, Manmohan Singh, in his address, identified it as a major hurdle in the intrusion of FDI in even the sectors/industries where there is urgency for huge funds to meet its financial requirements (www.thehindu.com, 2014). Bureaucrats are often found to be passive or lethargic over the issue of approval to the projects bringing foreign investment. As such, number of infrastructure projects of extreme importance remains in waiting list for approval. In addition to this, wherever approvals are granted, bureaucrats are found to be involved in “cat-fight” over the issue of FDI norms and one can easily enlist number of incidences when bureaucratic tussle had not just ceased-off opportunities of hosting bulk of foreign investment, but also in draining-off of foreign investment out of the country. For example, in case of FDI in Defence, National Security Council (NSC) and Department of Industrial Policy and Promotion (DIPP) were found to be on two different poles of viewpoints over the issue of FDI in the sector. Bureaucratic hassles also affect the business milieu by affecting smooth working of the business enterprises. Thus, investors are always found to be concerned of the bureaucratic interferences that had unwillingly been portrayed as the highlighting feature for almost every investment project coming from abroad.

Bureaucratic hassles had been on the concern radars of Japanese investors as well, as they are habitual of working in a smooth and hassle-free business environment. Henceforth, it is required that India, not just address the issue, but also, ensure effective efforts in eradicating any possibility of bureaucratic hassle, at the grass root level, so that business milieu could be made even more conducive and harmonious to the Japanese investors, thereby, ensuring that Japanese investors always enjoy bumpy-free journey while investing and operating in India.
6.3.6 Removal of Labour Problems

Seeing India as the “human-resource” rich country, majority of whom are young and is equipped with quality knowledge and skills, many companies have diverted direction of their investments towards India. Japan, which is facing the problem of ageing population and shrinking domestic market, seems to be in aggressive mood while making decisions with regard to investment prospects in the outside world; and India being able to meet the dual requisites of the Japan, had become one of the most prospective destination for Japanese investment among the developing world. India has been seeing rapidly growing enthusiasm among the Japanese investors. However, the incidences of labour problems faced in India by the Japanese auto-makers like Honda, Toyota and Suzuki, in the recent past, had emerged as another prominent problem that had gravelly shattered the expectations of the Japanese investors resulting in set back to the flow of JFDI in India that were in pipeline in the investment prospects of the Japanese investors. Moreover, to escape from the problem of labour unrest within their compounds, Japanese companies had shifted their initiatives towards setting up of “sales” units in India rather than “manufacturing” units.

India, henceforth, has to also address this issue, as well, as it has been affecting the present business operations of the Japanese companies; and by portraying a bad picture of India’s work culture, affecting the prospective arrival of many other Japanese affiliates’ intended to enter India via FDI. For the purpose, labour laws can be so framed that it replicates a friendlier scenario to both – the Japanese investors or the employers and their workers.

6.3.7 Other Measures

The above mentioned initiatives comprise of the suggestions to be undertaken to resolve the problems that were directly related to the concerns of the Japanese investors. In addition to this, India had to take bunch of other initiatives as well in order to consolidate economic relations with Japan through higher quantum of FDI inflows from it. These initiatives, though, not form part of the concerns of the Japanese investors at first sight; successful enactment of these is expected to yield unprecedented results in the economic ties of the two nations and might help in encouraging Japanese investors to look towards India with much more buoyancy
while investing or deciding upon making investment in the country. These initiatives can be listed as under:

➢ Achieving and sustaining high economic growth rate that had been a significant characteristic of the India economy some years ago, and that have enticed foreign investors not just from Japan, but all around the world.

➢ Analyzing and acting in accordance to the changing trends in the nature of Japanese investment. An examination of the trends related to direction of Japanese investment reveals that there had been a sharp shift in Japanese investment since the end of the decade 1990, being Japanese investment steeply shifted from manufacturing sector to service sector, like, finance, insurance, etc.

➢ Efforts which ensures creation of conducive business environment for Japanese investors by inculcating competitive spirit among all the states of the country.

➢ Address issues of “round-tripping” and “Double Tax Avoidance Agreements” (DTAA) which, in lieu of country’s aggressive policies, is taking away much of the FDI that otherwise might have flown directly into the country.

➢ Efforts to facilitate and encourage consistent bilateral exchange of views between the two countries on matters of investment or on matters that may encourage flow of investment from Japan to India.

➢ Lay due impetus on alluring such investments from Japan that encourage export-oriented manufacturing in India.

➢ Ensuring dedicated and consistent efforts that promote dissemination of detailed information to the Japanese investors on investment prospects in India, covering distinct aspects associated to both the Central government and the State governments.

➢ Establishment of such a mechanism that help in identifying and analysing the “best practices” adopted by each state that had resulted in higher Japanese
FDI in the state, and adoption of such policies by other states of the country, if possible.

➢ Enhancing cooperation in the field of promotion of skill enhancement through conducting training and certification programmes, corporate internship, etc.

➢ Laying focus on programmes that encourage students’ exchange, so that people could be made aware of the cultures of the two countries; and develop respect and understanding towards their cultures. This would also help in modifying the environment in such a manner that students of the two nations, as also the peoples of the two nations, find themselves at ease during their stay in other’s country.

➢ Attempts to embrace within its business culture qualities, like, mutual trust, confidence, faith and friendship, as these forms the four strong pillars which forms base on which Japanese society stands.

Thus, despite the fact that India is paralyzed of number of problems that have swallowed bulk of FDI coming from Japan and need serious attention from the Indian Government; it solely cannot be held responsible for lower volume of FDI from Japan in India. Existence of loopholes on the part of Japan is responsible for the present scenario of Japanese FDI in India during decades of their bilateral economic relations. These problems include number of issues and need vigilant concern from Japan in order to ensure strong and perpetual economic ties with India which will not only lead to increase in FDI from Japan to India, but also, its trade with India. In this regard, firstly, Japanese investors, while attempting to enter in India, should study India’s dynamic business milieu and consumer behaviour in a more comprehensive manner and accordingly adapt to it. This would be helpful in increasing the acceptability of the Japanese companies and their products among the Indian consumers. Secondly, Japanese companies had to take quick steps in moving away from traditional approach of controlling the management of their establishments in India through Japanese managers by looking forward, with immense confidence, the option of delegating complete autonomy to Indian managers for managing their Indian establishments. Thirdly, considering the growing interest of Japan in India, as represented by the trends of Japanese ODA disbursements in favour of India, Japan should look forth to
increase business with India in a considerable manner Japan should also look forward to convert its ODAs into FDI. However, in this regard, there are views that Japan’s economic cooperation with the world is a holistic system where public and private capital flows complement each other.

6.4 DIRECTION FOR FUTURE RESEARCH

The present study is an attempt to ordeal the point that if Japan and India holds one of the oldest and strongest bilateral relations, so much that they are regarded as the ‘natural ally’; the same has been reflected in their economic ties as well or not. Henceforth, the objectives of the study, specifically, attempted to bring out an inter-comparative study of Japanese FDI inflows to India with India’s total exports and imports by analyzing whether Japanese FDI (inflows to India) is co-integrated with India’s total exports and imports or not. The study also revealed granger-causality between Japanese FDI (inflows to India) and India’s total exports; and Japanese FDI (inflows to India) and India’s total imports.

There remains number of spheres uncovered in the present study, as inter-comparison of Japanese FDI inflows to India had been carried out with India’s total imports and exports. The further extension, in future, in the scope of the present study could be made by making an inter-comparison of Japanese FDI (inflows to India) with spheres like, India’s economic growth, trade balance, foreign exchange, etc. Efforts could also be made to bring inter-comparison between Japanese FDI inflows to India and Japanese ODA grants to India and Japanese FDI inflows to India and India’s total FDI inflows.
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[171] Revised Data on Foreign Direct Investment, n.d.


Annexure No. 1

Consolidated FDI Policy
(Effective from April 17, 2014)

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Sector/Activity</th>
<th>% of Equity/FDI Cap</th>
<th>Entry Route</th>
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<tbody>
<tr>
<td></td>
<td><strong>Agriculture</strong></td>
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<td></td>
</tr>
<tr>
<td>6.2.1</td>
<td><strong>Agriculture &amp; Animal Husbandry</strong></td>
<td>100%</td>
<td>Automatic</td>
</tr>
<tr>
<td></td>
<td>a) Floriculture, Horticulture, Apiiculture and Cultivation of Vegetables &amp; Mushrooms under controlled conditions;</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>b) Development and Production of seeds and planting material;</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>c) Animal Husbandry (including breeding of dogs), Pisciculture, Aquaculture, under controlled conditions; and</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>d) Services related to agro and allied sectors</td>
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<tr>
<td></td>
<td><strong>Note:</strong> Besides the above, FDI is not allowed in any other agricultural sector/activity</td>
<td></td>
<td></td>
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</table>

6.2.1.1 Other Conditions:

I. For companies dealing with development of transgenic seeds/vegetables, the following conditions apply:

   (i) When dealing with genetically modified seeds or planting material the company shall comply with safety requirements in accordance with laws enacted under the Environment (Protection) Act on the genetically modified organisms.

   (ii) Any import of genetically modified materials if required shall be subject to the conditions laid down vide Notifications issued under Foreign Trade (Development and Regulation) Act, 1992.

   (iii) The company shall comply with any other Law, Regulation or Policy governing genetically modified material in force from time to time.

   (iv) Undertaking of business activities involving the use of genetically engineered cells and material shall be subject to the receipt of approvals from Genetic Engineering Approval Committee (GEAC) and Review Committee on Genetic Manipulation (RCGM).

   (v) Import of materials shall be in accordance with National Seeds Policy.

II. The term “under controlled conditions” covers the following:

   (i) ‘Cultivation under controlled conditions’ for the categories of floriculture, horticulture, cultivation of vegetables and mushrooms is the practice of cultivation wherein rainfall, temperature, solar radiation, air humidity and culture medium are controlled artificially. Control in these parameters may be effected.
through protected cultivation under green houses, net houses, poly houses or any other improved infrastructure facilities where micro-climatic conditions are regulated anthropogenically.

(ii) In case of Animal Husbandry, scope of the term 'under controlled conditions' covers—

(a) Rearing of animals under intensive farming systems with stall-feeding. Intensive farming system will require climate systems (ventilation, temperature/humidity management), health care and nutrition, herd registering/pedigree recording, use of machinery, waste management systems as prescribed by the National Livestock Policy, 2013 and in conformity with the existing 'Standard Operating Practices and Minimum Standard Protocol.'

(b) Poultry breeding farms and hatcheries where micro-climate is controlled through advanced technologies like incubators, ventilation systems etc.

(iii) In the case of pisciculture and aquaculture, scope of the term 'under controlled conditions' covers—

(a) Aquariums

(b) Hatcheries where eggs are artificially fertilized and fry are hatched and incubated in an enclosed environment with artificial climate control.

(iv) In the case of apiculture, scope of the term 'under controlled conditions' covers—

(a) Production of honey by bee-keeping, except in forest/wild, in designated spaces with control of temperatures and climatic factors like humidity and artificial feeding during lean seasons.

<table>
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<tr>
<th>6.2.2</th>
<th><strong>Tea Plantation</strong></th>
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<tr>
<td><strong>6.2.2.1</strong></td>
<td>Tea sector including tea plantations</td>
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*Note: Besides the above, FDI is not allowed in any other plantation sector/activity.*

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<tr>
<th>6.2.2.2</th>
<th><strong>Other Condition:</strong></th>
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<tr>
<td></td>
<td>Prior approval of the State Government concerned is required in case of any future land use change.</td>
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<th>Mining and Petroleum &amp; Natural Gas</th>
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<tr>
<td>6.2.3</td>
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<td>6.2.3.1</td>
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<tr>
<th>6.2.3.2</th>
<th><strong>Coal and Lignite</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Coal &amp; Lignite mining for captive consumption by power projects, iron &amp; steel and cement units and other eligible activities permitted under and subject to the provisions of Coal Mines (Nationalization) Act, 1973.</td>
<td>100%</td>
</tr>
<tr>
<td>(2) Setting up coal processing plants like washeries</td>
<td>100%</td>
</tr>
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</table>
subject to the condition that the company shall not do coal mining and shall not sell washed coal or sized coal from its coal processing plants in the open market and shall supply the washed or sized coal to those parties who are supplying raw coal to coal processing plants for washing or sizing.

6.2.3.3 Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities

6.2.3.3.1 Mining and mineral separation of titanium bearing minerals & ores, its value addition and integrated activities subject to sectoral regulations and the Mines and Minerals (Development and Regulation Act 1957).

100%  Government

6.2.3.3.2 Other Conditions:

India has large reserves of beach sand minerals in the coastal stretches around the country. Titanium bearing minerals viz. Ilmenite, rutile and leucoxene, and Zirconium bearing minerals including zircon are some of the beach sand minerals which have been classified as “prescribed substances” under the Atomic Energy Act, 1962.

Under the Industrial Policy Statement 1991, mining and production of minerals classified as “prescribed substances” and specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953 were included in the list of industries reserved for the public sector. Vide Resolution No. 8/1(1)/97-PSU/1422, dated 6th October 1998, issued by the Department of Atomic Energy, laying down the policy for exploitation of beach sand minerals, private participation including Foreign Direct Investment (FDI) was permitted in mining and production of Titanium ores (Ilmenite, Rutile and Leucoxene) and Zirconium minerals (Zircon).

Vide Notification No. S.O.61(E), dated 18.1.2006, the Department of Atomic Energy re-notified the list of “prescribed substances” under the Atomic Energy Act 1962. Titanium bearing ores and concentrates (Ilmenite, Rutile and Leucoxene) and Zirconium, its alloys and compounds and minerals/concentrates including Zircon, were removed from the list of “prescribed substances”.

(i) FDI for separation of titanium bearing minerals & ores will be subject to the following additional conditions viz.:

(A) value addition facilities are set up within India along with transfer of technology;
(B) disposal of tailings during the mineral separation shall be carried out in accordance with regulations framed by the Atomic Energy Regulatory Board such as Atomic Energy (Radiation Protection) Rules, 2004 and the Atomic Energy (Safe Disposal of Radioactive Wastes) Rules, 1987.

(ii) FDI will not be allowed in mining of “prescribed substances” listed in the Notification No. S.O. 61(E), dated 18.1.2006, issued by the Department of Atomic Energy.

Clarification:

(1) For titanium bearing ores such as Ilmenite, Leucoxene and Rutile, manufacture of titanium dioxide pigment and titanium sponge constitutes value addition. Ilmenite can be processed to produce Synthetic Rutile or Titanium Slag as an intermediate
value added product.

(2) The objective is to ensure that the raw material available in the country is utilized for setting up downstream industries and the technology available internationally is also made available for setting up such industries within the country. Thus, if with the technology transfer, the objective of the FDI Policy can be achieved, the conditions prescribed at (i) (A) above shall be deemed to be fulfilled.

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<tr>
<th>6.2.4 Petroleum &amp; Natural Gas</th>
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<tbody>
<tr>
<td><strong>6.2.4.1 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, petroleum Product pipelines, natural gas/pipelines, LNG Regasification infrastructure, market study and formulation and Petroleum refining in the private sector, subject to the existing sectoral policy and regulatory framework in the oil marketing sector and the policy of the Government on private participation in exploration of oil and the discovered fields of national oil companies.</strong></td>
</tr>
<tr>
<td>100%</td>
</tr>
<tr>
<td>Automatic</td>
</tr>
</tbody>
</table>

| 6.2.4.2 Petroleum refining by the Public Sector Undertakings (PSU), without any disinvestment or dilution of domestic equity in the existing PSUs. |
| 49% |
| Automatic |

Manufacturing

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<thead>
<tr>
<th>6.2.5 Manufacture of items reserved for production in Micro and Small Enterprises (MSEs)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>6.2.5.1 FDI in MSEs (as defined under Micro, Small And Medium Enterprises Development Act, 2006 (MSMED, Act 2006)) will be subject to the sectoral caps, entry routes and other relevant sectoral regulations. Any industrial undertaking which is not a Micro or Small Scale Enterprise, but manufactures items reserved for the MSE sector would require Government route where foreign investment is more than 24% in the capital. Such an undertaking would also require an Industrial License under the Industries (Development &amp; Regulation) Act, 1951, for such manufacture. The issue of Industrial License is subject to a few general conditions and the specific condition that the Industrial Undertaking shall undertake to export a minimum of 50% of the new or additional annual production of the MSE reserved items to be achieved within a maximum period of three years. The export obligation would be applicable from the date of commencement of commercial production and in accordance with the provisions of section 11 of the Industries (Development &amp; Regulation) Act, 1951.</strong></td>
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</table>

Defence

<table>
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<tr>
<th>6.2.6 Defence</th>
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<tbody>
<tr>
<td><strong>6.2.6.1 Defence Industry subject to Industrial license Under the Industries (Development &amp; Regulation) Act, 1951</strong></td>
</tr>
<tr>
<td>26%</td>
</tr>
</tbody>
</table>
| Government route up to 26%
Above 26% to Cabinet Committee on Security (CCS) on case to case basis,
Note: (i) Investment by Foreign Portfolio Investors (FPIs/FIs) (through portfolio investment) is not permitted.

(ii) FPI/FII (through portfolio investment) in companies holding defence licence as on 22 August, 2013 (date of issue of Press Note 6 of 2013) will remain capped at the level existing as on the said date. No fresh FPI/FII (through portfolio investment) is permitted even if the level of such investment falls below the capped level subsequently.

6.2.6.2 Other Conditions:

(i) Licence applications will be considered and licences given by the Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, in consultation with Ministry of Defence.

(ii) The applicant should be an Indian company/partnership firm.

(iii) The management of the applicant company/partnership should be in Indian hands with majority representation on the Board as well as the Chief Executives of the company/partnership firm being resident Indians.

(iv) Full particulars of the Directors and the Chief Executives should be furnished along with the applications.

(v) The Government reserves the right to verify the antecedents of the foreign collaborators and domestic promoters including their financial standing and credentials in the world market. Preference would be given to original equipment manufacturers or design establishments, and companies having a good track record of past supplies to Armed Forces, Space and Atomic energy sections and having an established R & D base.

(vi) There would be no minimum capitalization for the FDI. A proper assessment, however, needs to be done by the management of the applicant company depending upon the product and the technology. The licensing authority would satisfy itself about the adequacy of the net worth of the non-resident investor taking into account the category of weapons and equipment that are proposed to be manufactured.

(vii) There would be a three-year lock-in period for transfer of equity from one non-resident investor to another non-resident investor (including NRIs & erstwhile OCBs with 60% or more NRI stake) and such transfer would be subject to prior approval of the Government.

(viii) The Ministry of Defence is not in a position to give purchase guarantee for products to be manufactured. However, the planned acquisition programme for such equipment and overall requirements would be made available to the extent possible.

(ix) The capacity norms for production will be provided in the licence based on the application as well as the recommendations of the Ministry of Defence, which will look into existing capacities of similar and allied products.

(x) Import of equipment for pre-production activity including development of prototype by the applicant company would be permitted.
(xi) Adequate safety and security procedures would need to be put in place by the licensee once the licence is granted and production commences. These would be subject to verification by authorized Government agencies.

(xii) The standards and testing procedures for equipment to be produced under licence from foreign collaborators or from indigenous R & D will have to be provided by the licensee to the Government nominated quality assurance agency under appropriate confidentiality clause. The nominated quality assurance agency would inspect the finished product and would conduct surveillance and audit of the Quality Assurance Procedures of the licensee. Self-certification would be permitted by the Ministry of Defence on case to case basis, which may involve either individual items, or group of items manufactured by the licensee. Such permission would be for a fixed period and subject to renewals.

(xiii) Purchase preference and price preference may be given to the Public Sector organizations as per guidelines of the Department of Public Enterprises.

(xiv) Arms and ammunition produced by the private manufacturers will be primarily sold to the Ministry of Defence. These items may also be sold to other Government entities under the control of the Ministry of Home Affairs and State Governments with the prior approval of the Ministry of Defence. No such item should be sold within the country to any other person or entity. The export of manufactured items would be subject to policy and guidelines as applicable to Ordnance Factories and Defence Public Sector Undertakings. Non-lethal items would be permitted for sale to persons/entities other than the Central of State Governments with the prior approval of the Ministry of Defence. Licensee would also need to institute a verifiable system of removal of all goods out of their factories. Violation of these provisions may lead to cancellation of the licence.

(xv) All applications seeking permission of the Government for FDI in defence would be made to the Secretariat of Foreign Investment Promotion Board (FIPB) in the Department of Economic Affairs.

(xvi) Applications for FDI up to 26% will follow the existing procedure with proposals involving inflows in excess of Rs. 1200 crore being approved by Cabinet Committee on Economic Affairs (CCEA). Applications seeking permission of the Government for FDI beyond 26%, will in all cases be examined additionally by the Department of Defence Production (DoDP) from the point of view particularly of access to modern and ‘state-of-art’ technology.

(xvii) Based on the recommendation of the DoDP and FIPB, approval of the Cabinet Committee on Security (CCS) will be sought by the DoDP in respect of cases which are likely to result in access to modern and ‘state-of-art’ technology in the country.

(xviii) Proposals for FDI beyond 26% with proposed inflow in excess of Rs. 1200 crores, which are to be approved by CCS will not require further approval of the Cabinet Committee on Economic Affairs (CCEA).

(xix) Government decision on applications to FIPB for FDI in defence industry sector will be normally communicated within a time frame of 10 weeks from the date of acknowledgement.

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<tr>
<th>Services Sector</th>
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<td><strong>Information Services</strong></td>
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<td>6.2.7.1</td>
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<td>6.2.7.3</td>
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<td>6.2.7.4</td>
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<td>6.2.7.5</td>
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<td>6.2.7.6</td>
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</table>
(i) The majority of Directors on the Board of the Company shall be Indian citizens.

(ii) The Chief Executive Officer (CEO), Chief Officer in-charge of technical network operations and Chief Security Officer should be resident Indian citizens.

Security Clearance of Personnel

(iii) The Company, all Directors on the Board of Directors and such key executives like Managing Director/Chief Executive Officer, Chief Financial Officer (CFO), Chief Security Officer (CSO), Chief Technical Officer (CTO), Chief Operating Officer (COO), shareholders who individually hold 10% or more paid-up capital in the company and any other category, as may be specified by the Ministry of Information and Broadcasting from time to time, shall require to be security cleared.

In case of the appointment of Directors on the Board of the Company and such key executives like Managing Director/Chief Executive Officer, Chief Financial Officer (CFO), Chief Security Officer (CSO), Chief Technical Officer (CTO), Chief Operating Officer (COO), etc., as may be specified by the Ministry of Information and Broadcasting from time to time, prior permission of the Ministry of Information and Broadcasting shall have to be obtained.

It shall be obligatory on the part of the company to also take prior permission from the Ministry of Information and Broadcasting before effecting any change in the Board of Directors.

(iv) The Company shall be required to obtain security clearance of all foreign personnel likely to be deployed for more than 60 days in a year by way of appointment, contract, and consultancy or in any other capacity for installation, maintenance, operation or any other services prior to their deployment. The security clearance shall be required to be obtained every two years.

Permission vis-à-vis Security Clearance

(v) The permission shall be subject to permission holder/licensee remaining security cleared throughout the currency of permission. In case the security clearance is withdrawn, the permission granted is liable to be terminated forthwith.

(vi) In the event of security clearance of any of the persons associated with the permission holder/licensee or foreign personnel being denied or withdrawn for any reasons whatsoever, the permission holder/licensee will ensure that the concerned person resigns or his services terminated forthwith after receiving such directives from the Government, failing which the permission/license granted shall be revoked and the company shall be disqualified to hold any such Permission/license in future for a period of five years.

Infrastructure/Network/Software related requirement

(vii) The officers/officials of the licensee companies dealing with the lawful interception of services will be resident India citizens.

(viii) Details of infrastructure/network diagram (technical details of the network) could be provided, on a need basis only, to equipment suppliers/manufactures and the affiliate of the licensee company. Clearance from the licensor would be required if such information is to be provided to anybody else.

(ix) The Company shall not transfer the subscribers’ databases to any person/place
outside India unless permitted by relevant law.

(x) The Company must provide traceable identity of their subscribers.

Monitoring, Inspection and Submission of Information

(xi) The Company should ensure that necessary provision (hardware/software) is available in their equipment for doing the lawful interception and monitoring from a centralized location as and when required by Government.

(xii) The company, at its own costs, shall, on demand by the government or its authorized representative, provide the necessary equipment, services and facilities at designated place(s) for continuous monitoring or the broadcasting service by or under supervision of the Government or its authorized representative.

(xiii) The Government of India, Ministry of Information & Broadcasting or its authorized representative shall have the right to inspect the broadcasting facilities. No prior permission/intimation shall be required to exercise the right of Government or its authorized representative to carry out the inspection. The company will, if required by the Government or its authorized representative, provide necessary facilities for continuous monitoring for any particular aspect of the company’s activities and operations. Continuous monitoring, however, will be confined only to security related aspects, including screening objectionable content.

(xiv) The inspection will ordinarily be carried out by the Government of India, Ministry of Information & Broadcasting or its authorized representative after reasonable notice, except in circumstances where giving such a notice will defeat the very purpose of the inspection.

(xv) The company shall submit such information with respect to its services as may be required by the Government or its authorized representative, in the format as may be required, from time to time.

(xvi) The permission holder/licensee shall be liable to furnish the Government of India or its authorized representative or TRAI or its authorized representative, such reports, accounts, estimates, returns or such other relevant information and at such periodic intervals or such times as may be required.

(xvii) The service providers should familiarize/train designated officials or the Government or officials of TRAI or its authorized representative(s) in respect of relevant operations/features of their systems.

National Security Conditions

(xviii) It shall be open to the licensor to restrict the Licensee Company from operating in any sensitive area from the National Security angle. The Government of India, Ministry of Information and Broadcasting shall have the right to temporarily suspend the permission of the permission holder/Licensee in public interest or for national security for such period or periods as it may direct. The company shall immediately comply with any directives issued in this regard failing which the permission issued shall be revoked and the company disqualified to hold any such permission in future for a period of five years.

(xix) The company shall not import or utilize any equipment, which are identified as unlawful and/or render network security vulnerable.
<table>
<thead>
<tr>
<th>Other Conditions</th>
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</thead>
<tbody>
<tr>
<td>(xx) Licensor reserves the right to modify these conditions or incorporate new conditions considered necessary in the interest of national security and public interest or for proper provision of broadcasting services.</td>
</tr>
<tr>
<td>(xxi) Licensee will ensure that broadcasting service installation carried out by it should not become a safety hazard and is not in contravention of any statute, rule or regulation and public policy.</td>
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<tr>
<th>6.2.8</th>
<th>Print Media</th>
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<tbody>
<tr>
<td>6.2.8.1 Publishing of newspaper and periodicals dealing with news and current affairs</td>
<td>26% (FDI and Investment by NRIs/PIOs/FII/FPI)</td>
</tr>
<tr>
<td>6.2.8.2 Publication of Indian editions of foreign magazines dealing with news and current affairs</td>
<td>26% (FDI and Investment by NRIs/PIOs/FII/FPI)</td>
</tr>
</tbody>
</table>

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<tr>
<th>6.2.8.2.1 Other Conditions:</th>
</tr>
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<tr>
<td>(i) ‘Magazine’, for the purpose of these guidelines, will be defined as a periodical publication, brought out on non-daily basis, containing public news or comments on public news.</td>
</tr>
<tr>
<td>(ii) Foreign investment would also be subject to the Guidelines for Publication of Indian editions of foreign magazines dealing with news and current affairs issued by the Ministry of Information &amp; Broadcasting on 4.12.2008.</td>
</tr>
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</table>

| 6.2.8.3 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 |

| 6.2.8.4 Publication of facsimile edition of foreign newspapers | 100% | Government |

<table>
<thead>
<tr>
<th>6.2.8.4.1 Other Conditions:</th>
</tr>
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<tbody>
<tr>
<td>(i) FDI should be made by the owner of the original foreign newspapers whose facsimile edition is proposed to be brought out in India.</td>
</tr>
<tr>
<td>(ii) Publication of facsimile edition of foreign newspapers can be undertaken only by an entity incorporated or registered in India under the provisions of the Companies Act, 1956.</td>
</tr>
<tr>
<td>(iii) Publication of facsimile edition of foreign newspaper would also be subject to the Guidelines for publication of newspapers and periodicals dealing with news and current affairs and publication of facsimile edition of foreign newspapers issued by Ministry of Information &amp; Broadcasting on 31.3.2006, as amended from time to time.</td>
</tr>
</tbody>
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| 6.2.9 Civil Aviation |
The Civil Aviation sector includes Airports, Scheduled and Non-Scheduled domestic passenger airlines, Helicopter services/Seaplane services, Ground Handling Services, Maintenance and Repair organizations; Flying training institutes; and Technical training institutions.

For the purposes of the Civil Aviation sector:

(i) "Airport" means a landing and taking off area for aircrafts, usually with runways and aircraft maintenance and passenger facilities and includes aerodrome as defined in clause (2) of section 2 of the Aircraft Act, 1934;

(ii) "Aerodrome" means any definite or limited ground or water area intended to be used, either wholly or in part, for the landing or departure of aircraft, and includes all buildings, sheds, vessels, piers and other structures thereon or pertaining thereto;

(iii) "Air transport service" means a service for the transport by air of persons, mails or any other thing, animate or inanimate, for any kind of remuneration whatsoever, whether such service consists of a single flight or series of flights;

(iv) "Air Transport Undertaking" means an undertaking whose business includes the carriage by air of passengers or cargo for hire or reward;

(v) "Aircraft component" means any part, the soundness and correct functioning of which, when fitted to an aircraft, is essential to the continued airworthiness or safety of the aircraft and includes any item of equipment;

(vi) "Helicopter" means a heavier-than-air aircraft supported in flight by the reactions of the air on one or more power driven rotors on substantially vertical axis;

(vii) "Scheduled air transport service" means an air transport service undertaken between the same two or more places and operated according to a published time table or with flights so regular or frequent that they constitute a recognizably systematic series, each flight being open to use by members of the public;

(viii) "Non-Scheduled air transport service" means any service which is not a scheduled air transport service and will include Cargo airlines;

(ix) "Cargo airlines" would mean such airlines which meet the conditions as given in the Civil Aviation Requirements issued by the Ministry of Civil Aviation;

(x) "Seaplane" means an aeroplane capable normally of taking off from and alighting solely on water;

(xi) "Ground Handling" means (i) ramp handling, (ii) traffic handling both of which shall include the activities as specified by the Ministry of Civil Aviation through the Aeronautical Information Circulars from time to time, and (iii) any other activity specified by the Central Government to be a part of either ramp handling or traffic handling.

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<tr>
<th>6.2.9.2</th>
<th>Airports</th>
</tr>
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<tbody>
<tr>
<td>(a) Greenfield projects</td>
<td>100%</td>
</tr>
<tr>
<td>(b) Existing projects</td>
<td>100%</td>
</tr>
</tbody>
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<tr>
<th>6.2.9.3</th>
<th>Air Transport Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline</td>
<td>49% FDI (100% for</td>
</tr>
<tr>
<td>NRIs</td>
<td></td>
</tr>
<tr>
<td>(2) Non-Scheduled Air Transport Service</td>
<td>74% FDI (100% for NRIs)</td>
</tr>
<tr>
<td>(3) Helicopter services/seaplane services requiring DGCA approval</td>
<td>100%</td>
</tr>
</tbody>
</table>

6.2.9.3.1 Other Conditions:

(a) Air Transport Services would include Domestic Scheduled Passenger Airlines; Non-Scheduled Air Transport Services, helicopter and seaplane services.

(b) Foreign airlines are allowed to participate in the equity of companies operating Cargo airlines, helicopter and seaplane services, as per the limits and entry routes mentioned above.

(c) Foreign airlines are also allowed to invest in the capital of Indian companies, operating scheduled and non-scheduled air transport services, up to the limit of 49% of their paid-up capital. Such investment would be subject to the following conditions:

(i) It would be made under the Government approval route.

(ii) The 49% limit will subsume FDI and FII/FPI investment.

(iii) The investments so made would need to comply with the relevant regulations of SEBI, such as the Issue of Capital and Disclosure Requirements (ICDR) Regulations/Substantial Acquisition of Shares and Takeovers (SAST) Regulations, as well as other applicable rules and regulations.

(iv) A Scheduled Operator's Permit can be granted only to a company:

   a) that is registered and has its principal place of business within India;

   b) the Chairman and at least two-thirds of the Directors of which are citizens of India; and

   c) the substantial ownership and effective control of which is vested in Indian nationals.

(v) All foreign nationals likely to be associated with Indian scheduled and non-scheduled air transport services, as a result of such investment shall be cleared from security viewpoint before deployment; and

(vi) All technical equipment that might be imported into India as a result of such investment shall require clearance from relevant authority in the Ministry of Civil Aviation.

Note: (i) The FDI limits/entry routes, mentioned at paragraph 6.2.9.3 (1) and 6.2.9.3 (2) above, are applicable in the situation where there is no investment by foreign airlines.

(ii) The dispensation for NRIs regarding FDI up to 100% will also continue in respect of the investment regime specified at para 6.2.9.3.1(c)(ii) above.

(iii) The policy mentioned at para 6.2.9.3.1 (c) above is not applicable to M/s Air India Limited.

6.2.9.4 Other services under Civil Aviation sector
| (1) Ground Handling Services subject to sectoral regulations and security clearance | 74% FDI (100% for NRIs) | Automatic up to 49% Government route beyond 49% and up to 74% |
| (2) Maintenance and Repair organizations; flying training institutes; and technical training institutions. | 100% | Automatic |

6.2.10 **Courier services** for carrying packages, parcels and other items which do not come within the ambit of the Indian Post Office Act, 1898 and excluding the activity relating to the distribution of letters.

100% Automatic

6.2.11 **Construction Development: Townships, Housing, Built-up infrastructure**

6.2.11.1 Townships, housing, built-up infrastructure and construction-development projects (which would include, but not be restricted to, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure) 100% Automatic

6.2.11.2 Investment will be subject to the following conditions:

1. Minimum area to be developed under each project would be as under:
   (i) In case of development of serviced housing plots, a minimum land area of 10 hectares
   (ii) In case of construction-development projects, a minimum built-up area of 50,000 sq.mts
   (iii) In case of a combination project, any one of the above two conditions would suffice.

2. Minimum capitalization of US $10 million for wholly owned subsidiaries and US $ 5 million for joint ventures with Indian partners. The funds would have to be brought in within six months of commencement of business of the Company.

3. Original investment cannot be repatriated before a period of three years from completion of minimum capitalization. Original investment means the entire amount brought in as FDI. The lock-in period of three years will be applied from the date of receipt of each installment/tranche of FDI or from the date of completion of minimum capitalization, whichever is later. However, the investor may be permitted to exit earlier with prior approval of the Government through the FIPB.

4. At least 50% of each such project must be developed within a period of five years from the date of obtaining all statutory clearances. The investor/investee company would not be permitted to sell undeveloped plots. For the purpose of these guidelines, “undeveloped plots” will mean where roads, water supply, street lighting, drainage, sewerage, and other conveniences, as applicable under prescribed regulations, have not been made available. It will be necessary that the investor provides this infrastructure and obtains the completion certificate from the concerned local body/service agency before he would be allowed to dispose of serviced housing plots.

5. The project shall conform to the norms and standards, including land use requirements and provision of community amenities and common facilities, as laid down in the applicable building control regulations, bye-laws, rules, and other regulations of the
(6) The investor/investee company shall be responsible for obtaining all necessary approvals, including those of the building/layout plans, developing internal and peripheral areas and other infrastructure facilities, payment of development, external development and other charges and complying with all other requirements as prescribed under applicable rules/bys-laws/regulations of the State Government/Municipal/Local Body concerned.

(7) The State Government/Municipal/Local Body concerned, which approves the building/development plans, would monitor compliance of the above conditions by the developer.

Note:
(i) The conditions at (1) to (4) above would not apply to Hotels & Tourism, Hospitals, Special Economic Zones (SEZs), Education Sector, Old Age Homes and investment by NRIs.
(ii) FDI is not allowed in Real Estate Business.

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<th>6.2.12</th>
<th>Industrial Parks -- new and existing</th>
<th>100%</th>
<th>Automatic</th>
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<tr>
<td>6.2.12.1</td>
<td>&quot;Industrial Park&quot; is a project in which quality infrastructure in the form of plots of developed land or built up space or a combination with common facilities, is developed and made available to all the allottee units for the purposes of industrial activity.</td>
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<td>&quot;Infrastructure&quot; refers to facilities required for functioning of units located in the Industrial Park and includes roads (including approach roads), water supply and sewerage, common effluent treatment facility, telecom network, generation and distribution of power, air conditioning.</td>
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<tr>
<td></td>
<td>&quot;Common Facilities&quot; refer to the facilities available for all the units located in the industrial park, and include facilities of power, roads (including approach roads), water supply and sewerage, common effluent treatment, common testing, telecom services, air conditioning, common facility buildings, industrial canteens, convention/conference halls, parking, travel desks, security service, first aid center, ambulance and other safety services, training facilities and such other facilities meant for common use of the units located in the Industrial Park.</td>
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<td>&quot;Allocable area&quot; in the Industrial Park means-</td>
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<td>(a) in the case of plots of developed land- the net site area available for allocation to the units, excluding the area for common facilities.</td>
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<td>(b) in the case of built up space- the floor area and built up space utilized for providing common facilities.</td>
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<td></td>
<td>(c) in the case of a combination of developed land and built-up space- the net site and floor area available for allocation to the units excluding the site area and built up space utilized for providing common facilities.</td>
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<tr>
<td></td>
<td>&quot;Industrial Activity&quot; means manufacturing; electricity; gas and water supply; post and telecommunications; software publishing, consultancy and supply; data processing, database activities and distribution of electronic content; other computer related activities; basic and applied R&amp;D on bio-technology, pharmaceutical sciences/life sciences, natural sciences and engineering; business and management consultancy activities; and architectural, engineering and other technical activities.</td>
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6.2.12.2 FDI in Industrial Parks would not be subject to the conditionalities applicable for construction development projects etc., spelt out in para 6.2.11 above, provided the Industrial Parks meet with the under-mentioned conditions:

(i) it would comprise of a minimum of 10 units and no single unit shall occupy more than 50% of the allocable area;

(ii) the minimum percentage of the area to be allocated for industrial activity shall not be less than 66% of the total allocable area.

6.2.13 **Satellites—establishment and operation**

| 6.2.13.1 | Satellites—establishment and operation, subject to the sectoral guidelines of Department of Space/ISRO | 74% | Government |

6.2.14 **Private Security Agencies**

| 6.2.14 | Private Security Agencies | 49% | Government |

6.2.15 **Telecom Services** (including Telecom Infrastructure Providers Category-I)

All telecom services including Telecom Infrastructure Providers Category-I, viz. Basic, Cellular, United Access Services, Unified License (Access Services), Unified License, National/International Long Distance, Commercial V-Sat, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS), All types of ISP licenses, Voice Mail/Audiotex/UMS, Resale of IPLC, Mobile Number Portability Services, Infrastructure Provider Category-I (providing dark fibre, right of way, duct space, tower) except Other Service Providers.

| 6.2.15.1 | Other Condition: FDI up to 100% with 49% on the automatic route and beyond 49% on the government route subject to observance of licensing and security conditions by licensee as well as investors as notified by the Department of Telecommunications (DoT) from time to time, except “Other Service Providers”, which are allowed 100% FDI on the automatic route. |

6.2.16 **Trading**

| 6.2.16.1 | Cash & Carry Wholesale Trading/Wholesale Trading (including sourcing from MSEs) | 100% | Automatic |

6.2.16.1.1 **Definition:** Cash & Carry Wholesale trading/Wholesale trading would mean sale of goods/merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinate service providers. Wholesale trading would, accordingly, imply sales for the purpose of trade, business and profession, as opposed to sales for the purpose of personal consumption. The yardstick to determine whether the sale is wholesale or not would be the type of customers to whom the sale is made and not the size and volume of sales. Wholesale trading would include resale, processing and thereafter sale, bulk imports with ex-port/ex-bonded warehouse business sales and B2B e-Commerce.

| 6.2.16.1.2 | Guidelines for Cash & Carry Wholesale Trading/Wholesale Trading (WT): |
(a) For undertaking WT, requisite licenses/registration/permits, as specified under the relevant Acts/Regulations/Rules/Orders of the State Government/Government Body/Government Authority/Local Self-Government Body under that State Government should be obtained.

(b) Except in case of sales to Government, sales made by the wholesaler would be considered as 'cash & carry wholesale trading wholesale trading' with valid business customers, only when WT are made to the following entities:

(I) Entities holding sales tax/ VAT registration/service tax/excise duty registration; or

(II) Entities holding trade licenses i.e. a license/registration certificate/membership certificate/registration under Shops and Establishment Act, issued by a Government Authority/Government Body/Local Self-Government Authority, reflecting that the entity/person holding the license/registration certificate/membership certificate, as the case may be, is itself/himself/herself engaged in a business involving commercial activity; or

(III) Entities holding permits/license etc. for undertaking retail trade (like tehabazari and similar license for hawkers) from Government Authorities/Local Self-Government Bodies; or

(IV) Institutions having certificate of incorporation or registration as a society or registration as public trust for their self-consumption.

Note: An entity, to whom WT is made, may fulfill any one of the 4 conditions.

(c) Full records indicating all the details of such sales like name of entity, kind of entity, registration/license/permit etc. number, amount of sale etc. should be maintained on a day to day basis.

(d) WT of goods would be permitted among companies of the same group. However, such WT to group companies taken together should not exceed 25% of the total turnover of the wholesale venture.

(e) WT can be undertaken as per normal business practice, including extending credit facilities subject to applicable regulations.

(f) A Wholesale/Cash & carry trader cannot open retail shops to sell to the consumer directly.

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<th>6.2.16.2</th>
<th>E-commerce activities</th>
<th>100%</th>
<th>Automatic</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.2.16.2.1</td>
<td>E-commerce activities refer to the activity of buying and selling by a company through the e-commerce platform. Such companies would engage only in Business to Business (B2B) e-commerce and not in retail trading, inter-alia implying that existing restrictions on FDI in domestic trading would be applicable to e-commerce as well.</td>
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<th>6.2.16.3</th>
<th>Single Brand product retail trading</th>
<th>100%</th>
<th>Automatic up to 49% Government route beyond 49%</th>
</tr>
</thead>
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<tr>
<td>6.2.16.3.1</td>
<td>Foreign Investment in Single Brand product retail trading is aimed at attracting investments in production and marketing, improving the availability of such goods for the consumer, encouraging increased sourcing of goods from India, and enhancing competitiveness of Indian enterprises through access to global designs, technologies and management practices.</td>
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</table>
(2) FDI in Single Brand product retail trading would be subject to the following conditions:
   (a) Products to be sold should be of a ‘Single Brand’ only.
   (b) Products should be sold under the same brand internationally i.e. products should be
       sold under the same brand in one or more countries other than India.
   (c) ‘Single Brand’ product-retail trading would cover only products which are branded
       during manufacturing.
   (d) A non-resident entity or entities, whether owner of the brand or otherwise, shall be
       permitted to undertake ‘single brand’ product retail trading in the country for the
       specific brand, directly or through a legally tenable agreement with the brand owner
       for undertaking single brand product retail trading. The onus for ensuring compliance
       with this condition will rest with the Indian entity carrying out single-brand product
       retail trading in India. The investing entity shall provide evidence to this effect at the
       time of seeking approval, including a copy of the licensing/franchise/sub-licence
       agreement, specifically indicating compliance with the above condition. The requisite
       evidence should be filed with the RBI for the automatic route and SIA/FIPB for cases
       involving approval.
   (e) In respect of proposals involving FDI beyond 51%, sourcing of 30% of the value of
       goods purchased, will be done from India, preferably from MSMEs, village and
       cottage industries, artisans and craftsmen, in all sectors. The quantum of domestic
       sourcing will be self-certified by the company, to be subsequently checked, by
       statutory auditors, from the duly certified accounts which the company will be
       required to maintain. This procurement requirement would have to be met, in the first
       instance, as an average of five years’ total value of the goods purchased, beginning
       1st April of the year during which the first tranche of FDI is received. Thereafter, it
       would have to be met on an annual basis. For the purpose of ascertaining the
       sourcing requirement, the relevant entity would be the company, incorporated in
       India, which is the recipient of FDI for the purpose of carrying out single-brand
       product retail trading.
   (f) Retail trading, in any form, by means of e-commerce, would not be permissible, for
       companies with FDI, engaged in the activity of single-brand retail trading.

(3) Application seeking permission of the Government for FDI exceeding 49% in a
    company which proposes to undertake single brand retail trading in India would be
    made to the Secretariat for Industrial Assistance (SIA) in the Department of Industrial
    Policy & Promotion. The applications would specifically indicate the product/product
    categories which are proposed to be sold under a ‘Single Brand’. Any addition to the
    product/product categories to be sold under ‘Single Brand’ would require a fresh
    approval of the Government. In case of FDI up to 49%, the list of products/product
    categories proposed to be sold except food products would be provided to the RBI.

(4) Applications would be processed in the Department of Industrial Policy & Promotion,
    to determine whether the proposed investment satisfies the notified guidelines, before
    being considered by the FIPB for Government approval.

| 6.2.16.4 Multi Brand Retail Trading | 51% | Government |

(1) FDI in multi brand retail trading, in all products, will be permitted, subject to the
following conditions:
   (i) Fresh agricultural produce, including fruits, vegetables, flowers, grains, pulses, fresh
       poultry, fishery and meat products, may be unbranded.
(ii) Minimum amount to be brought in, as FDI, by the foreign investor, would be US $ 100 million.

(iii) At least 50% of total FDI brought in the first tranche of US $ 100 million, shall be invested in 'back-end infrastructure' within three years, where 'back-end infrastructure' will include capital expenditure on all activities, excluding that on front-end units; for instance, back-end infrastructure will include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, ware-house, agriculture market produce infrastructure etc. Expenditure on land cost and rentals, if any, will not be counted for purposes of back-end infrastructure. Subsequent investment in back-end infrastructure would be made by the MBRT retailer as needed, depending upon its business requirements.

(iv) At least 30% of the value of procurement of manufactured/processed products purchased shall be sourced from Indian micro, small and medium industries, which have a total investment in plant & machinery not exceeding US $ 2.00 million. This valuation refers to the value at the time of installation, without providing for depreciation. The 'small industry' status would be reckoned only at the time of first engagement with the retailer, and such industry shall continue to qualify as a 'small industry' for this purpose, even if it outgrows the said investment of US $ 2.00 million during the course of its relationship with the said retailer. Sourcing from agricultural co-operatives and farmers co-operatives would also be considered in this category. The procurement requirement would have to be met, in the first instance, as an average of five years' total value of the manufactured/processed products purchased, beginning 1st April of the year during which the first tranche of FDI is received. Thereafter, it would have to be met on an annual basis.

(v) Self-certification by the company, to ensure compliance of the conditions at serial nos. (ii), (iii) and (iv) above, which could be cross-checked, as and when required. Accordingly, the investors shall maintain accounts, duly certified by statutory auditors.

(vi) Retail sales outlets may be set up only in cities with a population of more than 10 lakh as per 2011 Census or any other cities as per the decision of the respective State Governments, and may also cover an area of 10 kms around the municipal/urban agglomeration limits of such cities; retail locations will be restricted to conforming areas as per the Master/Zonal Plans of the concerned cities and provision will be made for requisite facilities such as transport connectivity and parking.

(vii) Government will have the first right to procurement of agricultural products.

(viii) The above policy is an enabling policy only and the State Governments/Union Territories would be free to take their own decisions in regard to implementation of the policy. Therefore, retail sales outlets may be set up in those States/Union Territories which have agreed, or agree in future, to allow FDI in MBRT under this policy. The list of States/Union Territories which have conveyed their agreement is at (2) below. Such agreement, in future, to permit establishment of retail outlets under this policy, would be conveyed to the Government of India through the Department of Industrial Policy & Promotion and additions would be made to the list at (2) below accordingly. The establishment of the retail sales outlets will be in compliance of applicable State/Union Territory laws/ regulations, such as the Shops and Establishments Act etc.

(ix) Retail trading, in any form, by means of e-commerce, would not be permissible, for
companies with FDI, engaged in the activity of multi-brand retail trading.

(x) Applications would be processed in the Department of Industrial Policy & Promotion, to determine whether the proposed investment satisfies the notified guidelines, before being considered by the FIPB for Government approval.

(2) List of States/Union Territories as mentioned in Paragraph 6.2.16.4(1)(viii)

1. Andhra Pradesh
2. Assam
3. Delhi
4. Haryana
5. Himachal Pradesh
6. Jammu & Kashmir
7. Karnataka
8. Maharashtra
9. Manipur
10. Rajasthan
11. Uttarakhand
12. Daman & Diu and Dadra and Nagar Haveli (Union Territories)

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<td><strong>6.2.17</strong> Financial Services</td>
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<td>Foreign investment in other financial services, other than those indicated below, would require prior approval of the Government:</td>
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<td><strong>6.2.17.1</strong> Asset Reconstruction Companies</td>
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<td>'Asset Reconstruction Company' (ARC) means a company registered with the Reserve Bank of India under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act).</td>
<td>100% of paid-up capital of ARC (FDI+FII/FPI)</td>
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<tr>
<td><strong>6.2.17.1.2</strong> Other Conditions:</td>
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<td>(i) Persons resident outside India can invest in the capital of Asset Reconstruction Companies (ARCs) registered with Reserve Bank, up to 49% on the automatic route, and beyond 49% on the Government route.</td>
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<td>(ii) No sponsor may hold more than 50% of the shareholding in an ARC either by way of FDI or by routing it through an FII/FPI controlled by the single sponsor.</td>
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<td>(iii) The total shareholding of an individual FII/FPI shall be below 10% of the total paid-up capital.</td>
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<tr>
<td>(iv) FII/FPIs can invest in the Security Receipts (SRs) issued by ARCs registered with Reserve Bank. FII/FPIs can invest up to 74 per cent of each tranche of scheme of SRs. Such investment should be within the FII/FPI limit on corporate bonds prescribed from time to time, and sectoral caps under extant FDI Regulations should also be complied with.</td>
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</table>
(v) All investments would be subject to provisions of section 3(3) (f) of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

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<th>6.2.17.2</th>
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<td>6.2.17.2.1</td>
<td>Banking- Private Sector</td>
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### Other Conditions:

1. This 74% limit will include investment under the Portfolio Investment Scheme (PIS) by FIIs/FPIs, NRIs and shares acquired prior to September 16, 2003 by erstwhile OCBs, and continue to include IPOs, Private placements, GDR/ADRs and acquisition of shares from existing shareholders.

2. The aggregate foreign investment in a private bank from all sources will be allowed up to a maximum of 74 per cent of the paid up capital of the Bank. At all times, at least 26 per cent of the paid up capital will have to be held by residents, except in regard to a wholly-owned subsidiary of a foreign bank.

3. The stipulations as above will be applicable to all investments in existing private sector banks also.

4. The permissible limits under portfolio investment schemes through stock exchanges for FIIs/FPIs and NRIs will be as follows:

   (i) In the case of FIIs/FPIs, as hitherto, individual FII/FPI holding is restricted to below 10 per cent of the total paid-up capital, aggregate limit for all FIIs/FPIs/QFIIs cannot exceed 24 per cent of the total paid-up capital, which can be raised to 49 per cent of the total paid-up capital by the bank concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body.

   (a) Thus, the FII/FPI/QFI investment limit will continue to be within 49 per cent of the total paid-up capital.

   (b) In the case of NRIs, as hitherto, individual holding is restricted to 5 per cent of the total paid-up capital both on repatriation and non-repatriation basis and aggregate limit cannot exceed 10 per cent of the total paid-up capital both on repatriation and non-repatriation basis. However, NRI holding can be allowed up to 24 per cent of the total paid-up capital both on repatriation and non-repatriation basis provided the banking company passes a special resolution to that effect in the General Body.

   (c) Applications for foreign direct investment in private banks having joint venture/subsidiary in insurance sector may be addressed to the Reserve Bank of India (RBI) for consideration in consultation with the Insurance Regulatory and Development Authority (IRDA) in order to ensure that the 26 per cent limit of foreign shareholding applicable for the insurance sector is not being breached.

   (d) Transfer of shares under FDI from residents to non-residents will continue to require approval of RBI and Government as per para 3.6.2 above as applicable.

   (e) The policies and procedures prescribed from time to time by RBI and other institutions such as SEBI, D/o Company Affairs and IRDA on these matters will continue to apply.
(i) RBI guidelines relating to acquisition by purchase or otherwise of shares of a private bank, if such acquisition results in any person owning or controlling 5 per cent or more of the paid up capital of the private bank will apply to non-resident investors as well.

(ii) Setting up of a subsidiary by foreign banks

(a) Foreign banks will be permitted to either have branches or subsidiaries but not both.

(b) Foreign banks regulated by banking supervisory authority in the home country and meeting Reserve Bank's licensing criteria will be allowed to hold 100 per cent paid up capital to enable them to set up a wholly-owned subsidiary in India.

(c) A foreign bank may operate in India through only one of the three channels viz.,

(i) branches
(ii) a wholly-owned subsidiary and
(iii) a subsidiary with aggregate foreign investment up to a maximum of 74 per cent in a private bank.

(d) A foreign bank will be permitted to establish a wholly-owned subsidiary either through conversion of existing branches into a subsidiary or through a fresh banking license. A foreign bank will be permitted to establish a subsidiary through acquisition of shares of an existing private sector bank provided at least 26 per cent of the paid capital of the private sector bank is held by residents at all times consistent with para (i) (b) above.

(e) A subsidiary of a foreign bank will be subject to the licensing requirements and conditions broadly consistent with those for new private sector banks.

(f) Guidelines for setting up a wholly-owned subsidiary of a foreign bank will be issued separately by RBI.

(g) All applications by a foreign bank for setting up a subsidiary or for conversion of their existing branches to subsidiary in India will have to be made to the RBI.

(iii) At present there is a limit of ten per cent on voting rights in respect of banking companies, and this should be noted by potential investor. Any change in the ceiling can be brought about only after final policy decisions and appropriate Parliamentary approvals.

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<th>6.2.17.3</th>
<th>Banking- Public Sector</th>
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<td>6.2.17.3.1</td>
<td>Banking- Public Sector subject to Banking Companies (Acquisition &amp; Transfer of Undertakings) Acts 1970/80. This ceiling (20%) is also applicable to the State Bank of India and its associate Banks.</td>
</tr>
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<th>6.2.17.4</th>
<th>Commodity Exchanges</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.2.17.4.1</td>
<td>(1) Futures trading in commodities are regulated under the Forward Contracts (Regulation) Act, 1952. Commodity Exchanges, like Stock Exchanges, are infrastructure companies in the commodity futures market. With a view to infuse globally acceptable best practices, modern management skills and latest technology, it was decided to allow foreign investment in Commodity Exchanges.</td>
</tr>
</tbody>
</table>

(2) For the purposes of this chapter,

(i) “Commodity Exchange” is a recognized association under the provisions of the Forward Contracts (Regulation) Act, 1952, as amended from time to time, to provide exchange platform for trading in forward contracts in commodities.

(ii) “recognized association” means an association to which recognition for the time
being has been granted by the Central Government under Section 6 of the Forward Contracts (Regulation) Act, 1952

(ii) "Association" means any body of individuals, whether incorporated or not, constituted for the purposes of regulating and controlling the business of the sale or purchase of any goods and commodity derivative.

(v) "Forward contract" means a contract for the delivery of goods and which is not a ready delivery contract.

(vi) "Commodity derivative" means-
- a contract for delivery of goods, which is not a ready delivery contract; or
- a contract for differences which derives its value from prices or indices of prices of such underlying goods or activities, services, rights, interests and events, as may be notified in consultation with the Forward Markets Commission by the Central Government, but does not include securities.

| 6.2.17.4.2 | Commodity Exchange | 49% (FDI + FII/FPI) [Investment by Registered FII/FPI under Portfolio Investment Scheme (PIS) will be limited to 23% and Investment under FDI Scheme limited to 26% ] | Automatic |

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<tr>
<th>6.2.17.4.3</th>
<th>Other Conditions:</th>
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<tbody>
<tr>
<td>(1) FII/FPI purchases shall be restricted to secondary market only.</td>
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<tr>
<td>(2) No non-resident investor/entity, including persons acting in concert, will hold more than 5% of the equity in these companies.</td>
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<tr>
<td>(3) Foreign investment in commodity exchanges will be subject to the guidelines of the Central Government/Forward Markets Commission (FMC) from time to time.</td>
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| 6.2.17.5 | Credit Information Companies (CIC) |
| 6.2.17.5.1 | Credit Information Companies | 74% (FDI+FII/FPI) | Automatic |

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<tr>
<th>6.2.17.5.2</th>
<th>Other Conditions:</th>
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<tbody>
<tr>
<td>(1) Foreign investment in Credit Information Companies is subject to the Credit Information Companies (Regulation) Act, 2005.</td>
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<tr>
<td>(2) Foreign investment is permitted subject to regulatory clearance from RBI.</td>
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<tr>
<td>(3) Investment by a registered FII/FPI under the Portfolio Investment Scheme would be permitted up to 24% only in the CICs listed at the Stock Exchanges, within the overall limit of 74% for foreign investment.</td>
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<tr>
<td>(4) Such FII/FPI investment would be permitted subject to the conditions that:</td>
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<tr>
<td>(a) A single entity should directly or indirectly hold below 10% equity.</td>
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<tr>
<td>(b) Any acquisition in excess of 1% will have to be reported to RBI as a mandatory requirement; and</td>
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<tr>
<td>(c) FII/FPIs investing in CICs shall not seek a representation on the Board of Directors</td>
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<tr>
<td>6.2.17.6</td>
<td>Infrastructure Company in the Securities Market</td>
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<tr>
<td>6.2.17.6.1</td>
<td>Infrastructure companies in Securities Markets, namely, stock exchanges, depositories and clearing corporations, in compliance with SEBI Regulations</td>
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6.2.17.6.2 Other Condition:

FII/FPI can invest only through purchases in the secondary market.

6.2.17.7 Insurance

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<td>(iv) Surveyors and Loss Assessors</td>
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<td>6.2.17.7.2</td>
<td>Other Conditions:</td>
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<tr>
<td>6.2.17.7.2</td>
<td>(1) FDI in the Insurance sector, as prescribed in the Insurance Act, 1938, is allowed under the automatic route.</td>
</tr>
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<td>6.2.17.7.2</td>
<td>(2) This will be subject to the condition that Companies bringing in FDI shall obtain necessary license from the Insurance Regulatory &amp; Development Authority for undertaking insurance activities.</td>
</tr>
<tr>
<td>6.2.17.7.2</td>
<td>(3) The provisions of paragraphs 6.2.17.2.2(4)(i) (c) &amp; (e), relating to ‘Banking-Private Sector’, shall be applicable in respect of bank promoted insurance companies.</td>
</tr>
<tr>
<td>6.2.17.7.2</td>
<td>(4) Indian Insurance Company is defined as a company:</td>
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<tr>
<td>6.2.17.7.2</td>
<td>(a) which is formed and registered under the Companies Act, 1956;</td>
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<tr>
<td>6.2.17.7.2</td>
<td>(b) in which the aggregate holdings of equity shares by a foreign company either by itself or through its subsidiary companies or its nominees, do not exceed 26% paid-up equity capital of such Indian insurance company;</td>
</tr>
<tr>
<td>6.2.17.7.2</td>
<td>(c) whose sole purpose is to carry on life insurance business or general insurance business or re-insurance business.</td>
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<tr>
<td>6.2.17.7.2</td>
<td>(5) As per IRDA (Insurance Brokers) Regulations, 2002, “insurance broker” means a person for the time-being licensed by the Authority under regulation 11, who for remuneration arranges insurance contracts with insurance companies and/or reinsurance companies on behalf of his clients.</td>
</tr>
<tr>
<td>6.2.17.7.2</td>
<td>(6) As per IRDA (TPA-Health Services) Regulations, 2001, “TPA” means a Third Party Administrator who, for the time being, is licensed by the Authority, and is engaged, for a fee or remuneration, by whatever name called as may be specified in the agreement with an insurance company, for the provision of health services.</td>
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<tr>
<td>6.2.17.8</td>
<td>Non-Banking Finance Companies (NBFC)</td>
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</table>
6.2.17.8.1 Foreign investment in NBFC is allowed under the automatic route in only the following activities:

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<td>(i)</td>
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<td>(iii)</td>
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<td>(iv)</td>
<td>Investment Advisory Services</td>
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<td>(v)</td>
<td>Financial Consultancy</td>
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<td>Venture Capital</td>
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<td>Custodian Services</td>
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<td>(x)</td>
<td>Factoring</td>
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<td>(xi)</td>
<td>Credit Rating Agencies</td>
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<td>(xii)</td>
<td>Leasing &amp; Finance</td>
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<td>(xiii)</td>
<td>Housing Finance</td>
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<td>Forex Broking</td>
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<td>Credit Card Business</td>
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<td>Money Changing Business</td>
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<td>(xvii)</td>
<td>Micro Credit</td>
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<td>(xviii)</td>
<td>Rural Credit</td>
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6.2.17.8.2 Other Conditions:

(1) Investment would be subject to the following minimum capitalisation norms:

(i) US $ 0.5 million for foreign capital up to 51% to be brought upfront.

(ii) US $ 5 million for foreign capital more than 51% and up to 75% to be brought upfront.

(iii) US $ 50 million for foreign capital more than 75% out of which US $ 7.5 million to be brought upfront and the balance in 24 months.

(iv) NBFCs (i) having foreign investment more than 75% and up to 100%, and (ii) with a minimum capitalisation of US $ 50 million, can set up step down subsidiaries for specific NBFC activities, without any restriction on the number of operating subsidiaries and without bringing in additional capital. The minimum capitalization condition as mandated by para. 3.10.4.1, therefore, shall not apply to downstream subsidiaries.

(v) Joint Venture operating NBFCs that have 75% or less than 75% foreign investment can also set up subsidiaries for undertaking other NBFC activities, subject to the subsidiaries also complying with the applicable minimum capitalisation norm mentioned in (i), (ii) and (iii) above and (vi) below.

(vi) Non-Fund based activities: US $0.5 million to be brought upfront for all permitted non-fund based NBFCs irrespective of the level of foreign investment subject to the following condition:

It would not be permissible for such a company to set up any subsidiary for any other activity, nor it can participate in any equity of an NBFC holding/operating company.
Note: The following activities would be classified as Non-Fund Based activities:
(a) Investment Advisory Services
(b) Financial Consultancy
(c) Forex Broking
(d) Money Changing Business
(e) Credit Rating Agencies
(vii) This will be subject to compliance with the guidelines of RBI.

Note: (i) Credit Card business includes issuance, sales, marketing & design of various payment products such as credit cards, charge cards, debit cards, stored value cards, smart card, value added cards etc.
(ii) Leasing & Finance covers only financial leases and not operating leases.
(2) The NBFC will have to comply with the guidelines of the relevant regulator/s, as applicable.

<table>
<thead>
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<th>Others</th>
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<tr>
<td>6.2.18 Pharmaceuticals</td>
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<td>6.2.18.1 Greenfield</td>
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<td>6.2.18.2 Brownfield</td>
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<td>6.2.18.3 Other Conditions:</td>
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<td>(i) ‘Non-compete’ clause would not be allowed except in special circumstances with the approval of the Foreign Investment Promotion Board.</td>
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<tr>
<td>(ii) The prospective investor and the prospective investee are required to provide a certificate along with the FIPB application as per Annex-11.</td>
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<td>(iii) Government may incorporate appropriate conditions for FDI in brownfield cases, at the time of granting approval.</td>
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<table>
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<th>6.2.19 Power Exchanges</th>
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<td>6.2.19.1 Power Exchanges registered under the Central Electricity Regulatory Commission (Power Market) Regulations, 2010.</td>
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<td>6.2.19.2 Other Conditions:</td>
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<td>(i) Such foreign investment would be subject to an FDI limit of 26 per cent and an FII/FPI limit of 23 per cent of the paid-up capital;</td>
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<td>(ii) FII/FPI purchases shall be restricted to secondary market only;</td>
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<td>(iii) No non-resident investor/entity, including persons acting in concert, will hold more than 5% of the equity in these companies; and</td>
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<td>(iv) The foreign investment would be in compliance with SEBI Regulations; other applicable laws/regulations; security and other conditionalities.</td>
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Source: Department of Industrial Policy and Promotion (DIPP) (2012, April 10); Consolidated FDI Policy; Ministry of Commerce and Industry, Government of India; PP 40-80
Annexure No. 2

Japanese Outward FDI: Stock

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Note: Variation in Total FDI is because of non-availability of Data in case of some country/countries of the region.

Sources: Prepared by JETRO from Ministry of Finance and Bank of Japan balance of payment and cross-border investment statistics and Bank of Japan foreign exchange rates.
Japanese Outward FDI: Flows

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<th>Europe</th>
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Note: Variation in Total FDI is because of non-availability of Data.

Sources: Prepared by JETRO from Ministry of Finance Balance of Payment statistics and Bank of Japan
foreign exchange rates.
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<thead>
<tr>
<th>Name of Indian Company</th>
<th>FDI Route</th>
<th>Name of Foreign Collaborator</th>
<th>RBI Regional Office</th>
<th>Item of Manufacture</th>
<th>Amount of FDI Inflows (In Rs crore)</th>
<th>Amount of FDI Inflows (In US$ million)</th>
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<td>Name of Indian Company</td>
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<td>Name of Foreign Collaborator</td>
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Annexure No. 4

Table for Quarterly Japanese FDI inflows in India; Total Exports from India and Total Imports in India

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<th>Years</th>
<th>JFDI</th>
<th>TEXP</th>
<th>TIMP</th>
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<tr>
<td>2006 - Mar</td>
<td>286</td>
<td>132270</td>
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<td>2006 - Jun</td>
<td>117</td>
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<td>2006 - Sep</td>
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<td>2007 - Mar</td>
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<td>2007 - Sep</td>
<td>508</td>
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<td>242014</td>
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<td>2007 - Dec</td>
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<td>2008 - Jun</td>
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<td>369333</td>
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<td>2008 - Sep</td>
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<td>421282</td>
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<td>2009 - Mar</td>
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<td>187835</td>
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<td>187231</td>
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<td>2009 - Dec</td>
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<td>291806</td>
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<td>Year</td>
<td>Month</td>
<td>Value 1</td>
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</tr>
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<td>2011</td>
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<td>1679</td>
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</tbody>
</table>

**Notes:** i) Quarterly data on Japanese FDI had been derived by adding up month-wise data of FDI inflows of the respective country for the respective quarter.

**Sources:**

i) For FDI Data: Department of Industrial Policy and Promotion (DIPP); Ministry of Commerce and Industry, New Delhi, Government of India.

ii) For Import-Export Data: Reserve Bank of India (RBI); Available at: http://dbie.rbi.org.in/DBIE/dbie.rbi?site=statistics
### Appendices 5: Lag Order Selection Criteria
(For Johansen Co-integration Test)

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*Note:* * represents acceptance of Lag length.

*Source:* Through E-Views.
## Appendices 6: Lag Order Selection Criteria
(For Dickey-Fuller Unit Root Test)

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*Note:* * represents acceptance of Lag length.

**Source:** Through E-Views.
Appendices 7: Lag Order Selection Criteria
(For Granger-Causality Test)

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* Note: * represents acceptance of Lag length.

*Source: Through E-Views.*
Impact of FDI on India’s GDP: An Inter-Comparative Study Between USA, UK and Japan

Bhawana Rawat

Abstract: Considering the growing importance of Foreign Direct Investment (FDI) in the present day well-knitted economic environment, this empirical study compares the impact of FDI inflows from Japan from those of United States of America (U.S.A.) and United Kingdom (U.K.) on India’s gross domestic product (GDP). The paper, by using sample data of FDI and India’s GDP from 1st April 2002 to 31st March 2011, makes use of Correlation and multiple regression for studying relationship between the variables. Moreover, t-test is being employed to test whether the results are significant or not. The results conclude that FDI from the respective countries individually do not significantly affect India’s GDP.

Keywords: Foreign Direct Investment (FDI), Gross Domestic Product (GDP), India, Japan, U.S.A., U.K.

1. Introduction

Dynamism of the business environment resulted in the integration of markets of various nations. Mesmerized by this dynamism most of the developed nations opened their economies to reap out the benefits from the opportunities generated there-from. Seeing the paybacks enjoyed by developed nations, many of the developing counterparts also got into bee-line.

One of the most talked benefits of FDI is the contribution to the host country’s gross domestic product (GDP). Analysis of the associated literature reveals that number of studies had been conducted which were found to be hovering around impact of FDI on GDP of the recipient country. For example, Abbas et al. (2011) found existence of positive relationship between GDP and FDI, when examined the impact of FDI in SAARC nations. In an attempt, made by Agrawal and Khan (2011), to investigate impact of FDI on economic growth of China and India, found that China’s growth is much affected by FDI as compared to India’s growth. In another study by Agrawal and Khan (2011), impact of FDI on economic growth was found to be positive, when analysis was made with respect to top 5 Asian economies. Dondeti and Mohanty (2007), examined the interrelationship among FDI, GDP, exports and imports of China, India, Malaysia and Singapore and found that FDI plays prominent role in promoting economic growth of these countries. When concentration was made on studies testifying impact of FDI with special reference to India, few studies were found to be related to this aspect. For example, Kumar and Dingra (2011) attempted to examine the growth in pre and post liberalized India, and found that FDI inflows have significant impact on growth in FDI inflows to India. Rangnath (2010) through his study found that impact of FDI vary across distinct sectors in India. Thus, these studies focus upon analyzing the impact from the recipient country’s point of view. Henceforth, taking references of these studies - that FDI do affect GDP significantly, this empirical study tries to analyze similar impact but from the aspect of the home country, i.e. impact of home country’s FDI (viz. U.S.A., U.K. and Japan) on GDP of host country (India).
Impact of FDI on India's GDP

2. India’s FDI inflows and GDP growth

Due to global transformations and internal predicament, India started to feel the heat of adapting to the global changes. As a corollary, world saw the adoption of Liberalisation, Privatisation and Globalisation regime by India during 1991, which not only helped the country in opening shackles restricting its growth and development, but also, in registering surge in FDI inflows, with an expectation of fulfilling aspirations of both the host and the home countries.

With each attempt of consistent, though vigilant, relaxation of the FDI regulations, India kept on emerging as one of the most obvious choices for investment, enticing the "Big-Wigs" to ensure their presence on India soil, preferably through FDI.

The country registered major shift in FDI inflows since 1991, and specifically after adoption of second generation reforms. The Annexure 1 shows trend in FDI inflows (and respective growth) in India from Japan, U.S.A. and U.K., which in India, are among the top ten foreign direct investment making countries, for the period ranging 2002-03 to 2011-12.

FDI inflows provides bunch of benefits to the Indian economy also. However, the most prominent benefit of FDI came in the form of surge in gross domestic product (GDP). Annexure 2 exhibits the trend in India's GDP growth.

3. Analytical results

This section attempts to compare the impact of FDI inflows from U.S.A., U.K. and Japan to India on India’s Gross Domestic Product (GDP). The results are depicted in table 1 and table 2 and the interpretations are made thereof.

In table 1 Karl-Pearson’s Correlation is being calculated to show the relationship between dependent variable (country-specific FDI inflows), and independent variable (India’s GDP), by separately comparing India’s GDP with FDI inflows of the countries under study.

Correlation of Japanese FDI inflows with India’s GDP works out to be highly positive with values ascertained at 0.752. The coefficient of determination ($r^2$) in this case is arrived to be 0.565, which signifies that 56.5% of the variance in the variables is explained by this relationship. Correlation in case of USA’s FDI inflows and India’s GDP is found to be 0.809, indicating existence of high degree of positive correlation. The coefficient of determination ($r^2$) in this case is found to be 0.654. While in case of UK, correlation is found to be 0.461, showing signs of relatively low degree of positive correlation. The coefficient of determination ($r^2$) is found to be 0.213 indicating that 21.3% of the variance is explained by this relationship.

<table>
<thead>
<tr>
<th>Country</th>
<th>R</th>
<th>R Square</th>
<th>Sig. (1-tailed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>0.752</td>
<td>0.565</td>
<td>0.010</td>
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<td>USA</td>
<td>0.809</td>
<td>0.654</td>
<td>0.004</td>
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<td>UK</td>
<td>0.461</td>
<td>0.213</td>
<td>0.106</td>
</tr>
</tbody>
</table>

Source: Through Annexure 1.
Bhawana Rawat

The significance level of correlation when compared with the critical value of 0.05, it was found that the correlations in case of U.K. is significant, while in case of Japan and U.S.A. it shows an insignificant relationship.

Table 2 enlists the results of multiple-regression. While analyzing impact, the value of the slope (or the beta coefficient) in case of Japanese FDI is found to be 196.924, signifying that for every unit change in FDI from Japan, there is a 196.924 unit’s change in India’s GDP. The value of the slope is 171.194 in case of U.S.A, while in case of U.K., value of the slope had been found as 110.629. On the other hand, intercept (constant) is peculiarly low at 2.22, which evidences that there exists host of micro and macro factors playing more prominent role in the movement of India’s GDP.

<table>
<thead>
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<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Sig.</th>
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<td></td>
<td>B</td>
<td>Std. Error</td>
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<tr>
<td>Constant</td>
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<td>Japan</td>
<td>196.924</td>
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<td>USA</td>
<td>171.194</td>
<td>96.680</td>
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<tr>
<td>UK</td>
<td>110.629</td>
<td>85.450</td>
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</tbody>
</table>

a. Dependent variable: GDPind.

*Source:* Through SPSS, from Annexure 1 and 2.

The significance values for FDI inflows from Japan, USA and UK had been arrived to be 0.113, 0.137 and 0.252 respectively. Since these values are higher than the critical value of 0.05, we can conclude that FDI inflows to India from all the three countries do not have significant impact on India’s GDP. In other words, the impact of FDI from US, UK and Japan on India’s GDP is not considerable, even if, they are among the top 10 investing countries - and there are indeed other factors also that drive the movement in India’s GDP.

4. Conclusion

In today’s well-knitted economic environment, there are several factors that affect the gross domestic product inflows of any country, particularly in case of developing nations. However, the present paper focuses on analyzing the impact of country-specific FDI inflows (viz. Japan, USA and UK) on GDP of the recipient country (India). The results reveal that the FDI inflows from the three countries do not significantly affect India’s GDP. Various studies suggest that India is still an explored market from FDI’s point of view and holds enormous opportunities for FDI. Intelligent intrusion of FDI, through effective policies, with not only benefit the investors, but will also reap benefits to India, ultimately contributing to realization of its desires. A new dimension to the study can be added by analyzing the impact on GDP by considering collectively the group of investing nations, like EU, TRIAD, etc.
Impact of FDI on India’s GDP

References


ANNEXURE 1: FDI Inflows to India from U.S.A., U.K. and Japan and their Growth Rates

<table>
<thead>
<tr>
<th>YEAR</th>
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<th>U.K.</th>
<th>Growth</th>
<th>Japan</th>
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Sources: (i) DIPP, Various issues;
          (ii) SIA, Various issues.
Bhawana Rawat

ANNEXURE 2: GDP and its Growth Rates

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<td>2003-04</td>
<td>2,402,727</td>
<td>8.37</td>
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<td>2004-05</td>
<td>3,242,210</td>
<td>34.94</td>
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<td>2005-06</td>
<td>3,544,348</td>
<td>9.32</td>
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<td>2006-07</td>
<td>3,872,974</td>
<td>9.27</td>
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<td>2007-08</td>
<td>4,253,185</td>
<td>9.82</td>
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<td>2008-09</td>
<td>4,462,967</td>
<td>4.93</td>
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<td>2009-10</td>
<td>4,869,315</td>
<td>9.1</td>
</tr>
<tr>
<td>2010-11</td>
<td>5,298,129</td>
<td>8.81</td>
</tr>
</tbody>
</table>

Notes: i) For 2004-05 to 2010-11: Quarterly data has been totaled for ascertaining yearly GDP.
Sources: i) Reserve Bank of India, India.

About the Author

Bhawana Rawat, presently, is a Research Scholar in Department of Commerce, Aligarh Muslim University, India. She holds degree of M.Com and B.Ed. She had also served as part-time lecturer in a degree college. Her area of interest is international business, specifically, Foreign Direct Investment (FDI).

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