BLOCK V:
Foreign Capital and Investment

Unit 1: Foreign Capital and Investment , New policy for FDI

Unit 2: Portfolio investment, foreign institutional investment-their advantages, External Commercial Borrowing and NRI Investment

Unit 3: Modes of entry of MNC's - MNC's in India

Unit 4: Foreign Trade Policy

Unit-1

Foreign Capital and Investment, New policy for FDI

Unit Structure:

1.1 Introduction
1.2 Objectives
1.3 Meaning of Foreign Investment
1.4 Different forms of Foreign Capital
1.5 FDI - Merits and demerits
    1.5.1 Merits of FDI
    1.5.2 Demerits of FDI
1.6 Government initiatives to boost FDI in India
    1.6.1 Sector-Wise incentives provided by the Government of India
    1.6.2 Steps taken by the RBI
1.7 Importance of FDI in a developing country.
1.8 Fundamentals of Foreign Direct Investment in India
    1.8.1 Foreign Direct Investment flows to India: Country Wise in (US $ million)
    1.8.2 Foreign Direct Investment flows to India: Sector/Industry wise in (US $ million)
1.9 Changes made recently to India's FDI policy
1.10 Summing Up
1.11 Model Questions
1.12 References and Suggested Readings

1.1 Introduction

The governments of all nations in the globe hope to draw in a suitable quantity of foreign investment since it helps the nation's economy grow. The inflow of money from other nations into the country of origin is what is meant by the term "foreign capital" in this context. In emerging nations like India, where indigenous capital often falls short of what is required for economic expansion, the need for foreign capital is a major factor. For the purpose of advancing the nation's development goals, it is believed that foreign capital can be used to bridge the gap between the domestically available savings, government revenue, and foreign exchange, as well as the planned investment. The 1999 Foreign Exchange Management Act (FEMA), the

Reserve Bank of India's (RBI) guidelines and regulations, the Department for Promotion of Industry and Internal Trade's (MoMCA) press releases and circulars (FDI Policy), and the Consolidated Policy on FDI are the main sources of regulation for foreign direct investment (FDI) into India. The 2019 Foreign Exchange Management (Non-Debt Instruments) Rules and the 2019 Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations jointly known as the NDI Rules are the two most important RBI regulations. The Foreign Direct Investment (FDI) Policy delineates several aspects such as investment limitations, qualifying instruments, investment restrictions, and entry channels for different industries (e.g., automatic or government permission). The NDI Rules are then used to put these policy requirements into effect.

1.2 Objectives

After going through this unit, you will be able to

- define Foreign Capital and Forign Direct Investment,
- understand the gaps that are filled by foreign capital,
- explain the various forms of foreign capital,
- understand the Advantages and Disadvantages of FDI,
- understand the Government initiatives to boost foreign direct investment in India,
- explain the importance of FDI in a developing country like India.

1.3 Meaning of Foreign Investment

Foreign investment is an integral part of every economy. It involves the process through which capital flows from one country to another. Through foreign investment, foreign investors get extensive ownership stakes in domestic companies. Capital is transferred from one nation to another through foreign investment, giving the foreign investors significant ownership holdings in local assets and businesses. Foreign investment signifies that foreign investors have a significant enough equity stake to be able to influence corporate strategy, or they have an active involvement in management as part of their investment.

Check Your Progress

1. Define Foreign Investment in a few words.

2. Mention about the gaps that foreign capital fills.

1.4 Different forms of Foreign Capital

The different forms of foreign capital are-

2.1.1 Foreign Investment: Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) are the two categories of foreign investments. The country is able to bridge the management, technological, skill, and entrepreneurial gap with the help of foreign investment.

- **Foreign Direct Investment (FDI) -** A foreign entity investing directly in a foreign company or organization is known as foreign direct investment, or FDI. This kind of investment is long-term and frequently calls for large initial outlays. It can manifest in a number of ways, including the founding of a new business, the acquisition of a foreign company, or the acquisition of real estate. Over the investment, the foreign firm has a substantial amount of ownership and control. For example, Toyota establishing manufacturing units in the United States.

- **Foreign Portfolio Investment (FPI) -** Stocks, bonds, and other securities purchased on the financial markets of another country are referred to as foreign portfolio investments, or FPIs. The ownership or control of the investment is not directly transferred to FPI, as contrast to FDI. Rather, the goal of FPI investors is to profit from price fluctuations by purchasing and selling shares on the open market. For example, acquiring stock in a foreign company that is listed on a stock exchange.

2.1.2 Non-Concessional Assistance: This category of foreign capital includes loans from foreign governments, deposits from non-resident Indians (NRIs), and external commercial borrowings (ECBs). A large number of emerging nations use non-concessional funding to cover a portion of their development requirements. Formerly solely dependent on concessional financial support, low-income countries (LICs) are now aggressively utilizing less concessional forms of finance, such as funds raised from international bond markets and multilateral, bilateral, and commercial creditors. Concessional loans are described as follows by the Organization for Economic Co-operation and Development (OECD): "loans that are

extended on terms substantially more generous than market loans. Either interest rates below market rates, grace periods, or a combination of these are used to achieve concessionality."

Usually, concessional loans have lengthy grace periods.

2.1.3 Concessional Assistance: Concessional Assistance refers to grants and loans that have long maturities and low interest rates. Usually, this kind of support is given bilaterally or through multilateral organizations like the World Bank, International Development Association (IDA), International Monetary Fund (IMF), etc. In most circumstances, loans must be returned in foreign currency; however, the donor may permit the receiving nation to repay in its own currency.

Check Your Progress

1. What is Foreign Investment?
2. What are the various forms of foreign capital?
3. Note down the meaning of FDI & FII.

1.5 FDI - Merits and demerits

Purchasing an asset in another nation that grants the buyer direct control over the asset is referred to as a foreign direct investment (FDI) (e.g. acquisition of land and construction). Put otherwise, it refers to an investment made by a foreign corporation that takes a controlling stake in a company, a piece of real estate, or an industrial asset like a factory located in another nation.(Source:) The idea of direct control so sets it apart from a foreign portfolio investment or foreign indirect investment. The concept of an FDI is unaffected by the investment's source; it might be made "inorganically" by purchasing a company in the target nation or "organically" by growing an already-existing business there.

1.5.1: Merits/Advantages of FDI

(1) Economic Development

The most evident benefit of foreign direct investment (FDI) is the creation of jobs, which is one of the main reasons a country (particularly a developing one) will seek to attract FDI. Increased manufacturing and service sector

growth brought about by FDI lowers the nation's unemployment rates by generating jobs. An increase in employment raises wages and gives people more purchasing power, which strengthens a nation's economy as a whole.

(2) Development of Human Capital

The workforce's skill and expertise comprised human capital. Employee training and experience can improve a nation's human capital and level of education. It can teach human resources in other industries and businesses through a cascading effect.

(3) Access to the latest Technology

The newest finance instruments, technology, and operational procedures from around the globe are made available to the targeted nations and businesses. The use of more recent and improved technologies causes businesses to be distributed throughout the community, which boosts the industry's productivity and efficacy.

(4) Rise in exports

Global markets exist for many FDI-produced items in addition to domestic use. FDI investors are aided in increasing exports from other nations by the establishment of 100% export-oriented enterprises.

(5) Stability in Exchange Rate

Foreign direct investment (FDI) into a nation results in a steady flow of foreign exchange, which supports the Central Bank of that nation in maintaining a healthy foreign exchange reserve and stable exchange rates.

(6) Improved capital inflow

Capital inflows are especially helpful to governments with little resources at home and little options for raising capital on international financial markets.

(7) Competitive market creation

Foreign Direct Investment (FDI) serves to break domestic monopolies and foster competition by facilitating the entry of foreign businesses into the domestic marketplace. Healthy competition encourages businesses to constantly improve their operations and line of products, which promotes innovation. Customers can now choose from a greater selection of reasonably priced goods.

(8) Combating climate change

The UN has also encouraged foreign direct investment (FDI) to help fight climate change globally.

Stop to Consider

(1) Foreign Direct Investment vs Foreign Portfolio Investors vs Foreign Institutional Investors (FDI vs FPI vs FII) FDI includes investments in assets with high yield, including a company's plant and machinery.Financial asset investments (FII) comprise equities, mutual funds, insurance firms, and other financial assets.The group of investors that assists a nation in bringing in the FPI receives advice from FII.Rights to ownership and management are granted by this type (FDI) of investment.Rather than management, investors simply receive the right to ownership in case of FPI.Investors simply receive the right to ownership rather than management in case of FII as well.Take part in how the company makes decisions in FDI.Excluded from the company's decision-making process in FPI.FIIs also do not take part in company's decision making process.These investors (FDI) come into a nation with the long-term goal of turning a profit and helping it develop.Though they typically have short-term intentions, these investors (FPI) are capable of long-term planning.These investments (FPI) aid in the growth of the economy's capital markets.Due to the high expense involved, it is difficult for the Foreign Direct investors to leave the nation.Since stocks and bonds are liquid investments, Foreign Portfolio investors can easily leave the nation.Since FIIs are in charge of bringing in FPIs, they are comparable to FPI.**Since FDI is a form of long-term investment in the economy, it is the most significant type of investment for any given economy, followed by FPI and FII. The investors can leave the country at any time when discussing about FPI.**

1.5.2 Demerits/Disadvantages of Foreign Direct Investment

Foreign direct investment does, however, have certain drawbacks as well. To name a few:

(1) Impedes the flow of domestic capital

FDI can occasionally hinder domestic investment. Local businesses in those nations begin to lose interest in investing in their own products as a result of FDI.

(2) Political Changes

The political landscape of other nations is subject to frequent changes, which could prove be detrimental to investment.

(3) Negative rates of exchange

Exchange rates can occasionally be impacted by foreign direct investments in a way that benefits one nation while harming another.

(4) Greater expenses

It may occur to investors that investing in foreign countries is more costly than exporting commodities. Frequently, capital expenditures on machinery and intellectual property surpass wages for local workers.

(5) Lack of economic viability

Because foreign direct investments may need a large amount of capital from the investor, they might occasionally be extremely hazardous or not economically feasible.

(6) Confiscation

Expropriation/Take over may result from ongoing political changes. In this scenario, the governments of those nations will be in charge of the assets and property of investors.

(7) Contemporary economic colonization

Many third-world nations, or at least those with a colonial past, are concerned that foreign direct investment could lead to a form of contemporary economic colonialism that exposes host nations and leaves them open to abuse by multinational corporations.

(8) Poor working conditions

The unfavorable working conditions in overseas industries have been attributed to multinational corporations.

Check Your Progress

1. Mention the advantages & drawbacks of FDI.
2. Mention any three differences between FDI & FPI.

1.6 Government Initiatives to Boost Foreign Direct Investment in India

India's appeal as a location for foreign direct investment (FDI) has increased dramatically as a result of the adoption of advantageous government policies. With a focus on developing industries like real estate, R&D, and military production, the nation has implemented a number of programs and regulations that have greatly increased FDI. Notable government programs in this area consist of:

- Raising the cap at 74% through the automatic method and 100% through the government route, the Indian government is encouraging foreign direct investment (FDI) in the defense sector.
- Foreign Direct Investment (FDI) in Life Insurance Company is now allowed through the automatic method up to 20 percent according to amendments to the Foreign Exchange Management Act (FEMA).
- Regarding some FDI from nearby nations, the government is thinking about relaxing regulations.
- It is expected that measures like the creation of a land bank mapped using GIS, single window clearance, and PM Gati Shakti will encourage more foreign direct investment.
- Regulating foreign direct investment in the Indian space industry, the Space Activity Bill is anticipated to be introduced in 2022.
- India and the UK decided in September 2021 to boost bilateral relations and trade by investing more money in each other.
- September 2021 saw the announcement by the Union Cabinet that 100% FDI in the telecom industry will be permitted through an automated method.
- FDI limits in the insurance industry were increased by 74% in August 2021 as a result of changes made to the Foreign Exchange Management Rules.
- First-five-year tax exemptions are offered by Special Economic Zones (SEZs), which have been developed with elite facilities.
- In an effort to boost business incentives and profitability, labor restrictions have been loosened.
- Campaigns for "Make in India" and "Atmanirbhar Bharat": These programs have encouraged domestic industry and self-reliance, which has drawn FDI inflows, coupled with attempts to integrate India into international supply networks.
- The government is implementing a number of reforms to boost export and encourage foreign direct investment (FDI) in the textile industry, including the Silk Samagra-2 scheme, the National Technical Textiles program, the Production Linked Incentive (PLI) Scheme for Textiles to promote the production of Man-Made Fibre (MMF) Apparel, MMF Fabrics and Products of Technical Textiles, and more.

- The investment process is now more streamlined as there is no longer a need for government permission for FDI up to 100% in real estate broking services.

1.6.1 Sector-Wise Incentives Provided By the Government of India

The Pharmaceutical Sector

The Indian government has taken the some steps in reaction to the COVID-19 pandemic to protect the country's leading position in the pharmaceutical industry. Projects involving bulk medication intermediates and active pharmaceutical ingredients (APIs) will be granted environmental clearances more quickly. The export policy for many APIs, such as the vitamins B1, B6, and B12, tinidazole, metronidazole, acyclovir, progesterone, and chloramphenicol, has been updated by the Directorate General of Foreign Trade (DGFT), and the previous limitations have been lifted.

Medical Equipments

The COVID-19 epidemic has caused previously unheard-of changes in the medical device industry's operational tempo. This industry includes small and medium-sized businesses (SMEs) as well as large international corporations with vast service networks in India. According to estimates, the Indian market for medical equipment is currently worth $11 billion.The Government of India has launched the following programs to encourage more growth in this industry:

1) In Special Economic Zones (SEZs), more than 280 units have been established with an emphasis on producing essential items including medications and medical equipment.

2) Up until September 2020, basic customs tax and health cessation will not apply to imports of vital goods such as masks, ventilators, test kits, personal protective equipment (PPEs), or their manufacturing inputs.

3) The Ministry of Electronics and Information Technology (MEITY) has launched three programmes to help realise the objectives stated in the National Policy on Electronics (NPE) 2019 and position India as a global centre for Electronics System Design and Manufacturing (ESDM). The MEITY notified the public in April 2020 about these programs, which are the Modified Electronics Manufacturing Clusters Scheme (EMC 2.0), the Production Linked Incentive Scheme (PLI), and the Scheme for Promotion of Manufacturing of Electronic Components and Semiconductors (SPECS).

Scheme for Production-Linked Incentive (PLI)

In order to encourage large investments from foreign investors in the electronics value chain, which includes mobile phones, electronic components, and ATMP units, the Production Linked Incentive Scheme (PLI) for Large Scale Electronics Manufacturing was created. The program offers assistance to food manufacturing companies who meet the needed minimum sales thresholds and are prepared to invest the necessary minimum funds to increase their processing capacity and market their brands globally. Over a five-year period, the government wants to award Production Linked Incentives totaling INR 40,951 crores.

Scheme for Promotion of Manufacturing of Electronic Components and Semiconductors (SPECS)

Enhancing the manufacturing ecosystem for semiconductors and electronic components is the aim of the Scheme for Promotion of Manufacturing of Electronic Components and Semiconductors (SPECS). In order to meet domestic demand and generate jobs in this industry, the program seeks to stimulate the manufacturing of semiconductors and electronic components. Incentives up to INR 3,285 crore would be given out under this initiative over an eight-year period.

1.6.2 Steps Taken by the RBI

The Reserve Bank of India (RBI) has taken a number of actions to increase inflows of foreign currency, or forex. Among these measures are:

- The requirements for the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) are waived for incremental deposits made into Foreign Currency Non-Resident (Bank) [FCNR (B)] and Non-Resident (External) Rupee (NRE) accounts.
- Allowing banks to raise new FCNR (B) and NRE deposits through the end of October 2022 without following current interest rate regulations.
- Comprising all recently issued government securities (G-Secs) for foreign portfolio investors (FPIs) through the Fully Accessible Route (FAR) with tenors of seven and fourteen years.
- Releasing FPIs from the short-term cap on corporate debt and G-Sec investments made through October 31, 2022.

- Enabling commercial paper and non-convertible debentures having an initial maturity of up to one year to be invested in by Foreign Portfolio Investors (FPIs).
- The cap on external commercial borrowings (ECBs) under the automatic route would be temporarily raised to US$ 1.5 billion from US$ 750 million or its equivalent every financial year.
- Increasing the maximum total cost by 100 basis points under the ECB framework, provided that the borrower has an investment-grade rating.
- Allowing foreign currency borrowings from overseas to be used by Authorized Dealer Category-I (AD Cat-I) banks for lending in foreign currency to entities for a wider range of end-use purposes, other from exports.

1.7 FDI's Importance in a Developing Country Like India

Beyond averting the financial crisis, foreign direct investment (FDI) has other advantages. Let's examine FDI in India and its significance.

- *The inflow of capital:* A corporation receives an inflow of funds in exchange for portion of its equity or holdings from foreign investors or companies.
- *Technology:* As new technology is introduced to developing nations by investors, they also get access to it. As a result of this cutting-edge, contemporary technology, local economies gradually see increased production and efficiency.
- *Economic expansion and job creation:* The recipient nation's economy grows as a result of foreign direct investment. Both the services sector and the development industry benefit from increased FDI. This boosts a nation's employment rate by providing skilled youth and professionals with opportunities.
- *Increasing exports:* This is one of FDI's most significant effects in India. Goods are produced for international markets in addition to domestic ones. Pharmaceuticals, medications, and vaccinations, for instance, are produced for the global market as well as the Indian one. India rose to prominence as a global exporter of vaccinations and medications during the Covid-19 epidemic.

- Open market: When foreign businesses enter the market, foreign direct investment, or FDI, helps create an environment where native companies' monopolies are shattered. With the FDI, customers may choose from a variety of high-quality, reasonably priced products.
- *Human resource development:* The ability, know-how, and competency of a workforce are components of human capital. The knowledge and skills acquired via training and experience contribute to raising the recipient nation's educational and human capital standards. It is also possible to train human resources in other industries through FDI.

1.8 Fundamentals of Foreign Direct Investment in India

To facilitate foreign direct investment, India's business sectors can be categorized into three groups: ***Sectors that are forbidden from obtaining foreign direct investment*** covers the production of tobacco products, atomic energy, real estate, lotteries, gaming, and betting; ***automated route:*** no prior government approval is needed to receive FDI includes industrial parks, building, mining, airports, manufacturing, and IT; also, there is a ***government clearance route*** that must be followed in order to receive FDI consists of public sector banks, print media, satellites, and air transportation. Regardless of whether a sector is covered by the automatic route or the government approval route, the FDI Policy also sets sector-specific FDI thresholds based on the sensitivity of the sector. Usually speaking, they are: Up to 74% of FDI is permitted in the pharmaceutical and defense industries; up to 49% of FDI is permitted in the aviation and private banking sectors; up to 26% of FDI is permitted in the print media industry. Up to 100% of FDI is permitted in the manufacturing, construction, and IT industries. For any sector, 100% FDI through the automatic route is permitted if neither the FDI Policy nor the NDI Rules expressly specify any requirements. An Indian entity's investment in another Indian business shall be regarded as downstream foreign investment and be subject to the FDI Policy and NDI Rules if the other entity is neither "owned" nor "controlled" by resident Indian nationals. Regarding the NDI Regulations, "owned" denotes a beneficial ownership of over 50% of an organization's equity instruments, while "controlled" denotes the authority to select the majority of directors or to dictate the management or policy decisions of the corporation. Any investments made in equity instruments of Indian enterprises by a person residing outside of India are considered FDI under the NDI

Rules. FDI is defined as investments made by listed firms that account for at least 10% of their post-issue paid-up capital. Investment in the following is permitted by the NDI Rules:

preference shares that are fully and mandatorily convertible and fully paid; convertible debentures that are fully and mandatorily convertible; equity shares (including partly paid equity shares, provided that at least 25% of the consideration is received upfront and they are fully called-up within 12 months of issuance); and share warrants, for which at least 25% of the consideration is to be received upfront and the balance is to be received within 18 months of issuance.

1.8.1:FOREIGN DIRECT INVESTMENT FLOWS TO INDIA: COUNTRY-WISE in (US $ million)

Country	Year (US $ Million)								(US$ billion)	
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Mauritius	3,695	5,878	7,452	13,383	13,415	6,570	7,498	5.6	9.4	6.1
Singapore	4,415	5,137	12,479	6,529	9,273	14,632	12,612	15,908	15.9	17.2
U.S.A	617	1,981	4,124	2,138	1,973	2,823	3,401	13,204	10.5	6.0
Cyprus	546	737	488	282	290	161	657	0.4	0.2	1.3
Japan	1,795	2,019	1,818	4,237	1,313	2,745	2,308	1,794	1.5	1.8
Netherlands	1,157	2,154	2,330	3,234	2,677	2,519	5,295	2,138	4.6	2.5
United Kingdom	111	1,891	842	1,301	716	1,211	1,125	779	1.6	1.7
Germany	650	942	927	845	1,095	817	443	626	0.7	0.5
UAE	239	327	961	645	408	853	323	4,071	1.0	3.4
France	229	347	392	487	403	357	1,167	810	0.3	0.4
Switzerland	356	292	195	502	506	280	140	188	4.3	0.4
Hong Kong SAR	85	325	344	134	1,044	598	678	----	----	----
Spain	181	401	141	213	243	109	83	425	----	----
British Virgin Island	0	30	203	212	21	290	250	----	----	----
China	121	505	461	198	350	229	162	----	----	----
Belgium	66	47	57	172	213	56	388	246	----	----
Cayman Islands	-----	72	440	49	1,140	863	3,496	2,558	3.8	0.8
Malaysia	113	219	73	----	----	----				
South Korea	189	138	241	466	293	982	777	400	0.3	0.3
Italy	185	167	279	364	308	-----	-----	----	----	----
Luxembourg	539	204	784	99	243	251	252	267	0.5	0.5
Others	1,249	1,250	2,016	1,109	1,889	2,768	1,796	1,604	3.1	2.3

Source-Compiled from Annual Reports, RBI

The table above reveals that Mauritius, Singapore, USA, Netherlands and Japan have highly contributed to the foreign direct investment in India respectively.

1.8.2: FOREIGN DIRECT INVESTMENT FLOWS TO INDIA: SECTOR/INDUSTRY-WISE in (US $ million)

Industry/ Sectors	Year (US $ Million)								(US$ billion)	
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Manufacture	6,381	9,613	8,439	11,972	7,066	7,919	8,153	6,739	16.3	11.3
Construction	1,276	1,640	4,319	5,876	4,070	6,372	6,838	1,746	3.2	1.4
Financial Services	1,026	3,075	4,141	3,732	8,809	5,365	4,914	2,728	4.7	6.8
Real Estate Activities	201	202	3,998	2,771	4,478	4,311	4,326	401	0.1	0.1
Electricity and other Energy Generatio, Distribution & Transmission	1,284	1,284	3,547	2,684	3,173	3,453	4,104	989	2.2	3.3
Communication Services	1,256	1,075	3,031	1,937	3,005	2,597	3,684	2,314	6.4	4.5
Business Services	521	680	2,638	1,816	1,870	2,427	2,546	1,750	2.5	2.0
Miscellaneous Services	941	586	1,364	1,722	1,281	2,009	2,333	671	1.0	1.2
Computer Services	934	2,154	1,363	1,564	835	1,226	1,937	23,050	9.0	5.6
Restaurants & Hotels	361	686	1,022	891	1,267	1,019	1,906	278	0.7	0.2
Retail & Wholesale Trade	1,139	2,551	889	430	452	749	564	2,960	5.1	5.3
Mining	24	129	596	141	82	247	217	186	0.4	0.2
Transport	311	482	394	141	82	247	443	7,584	3.3	1.7
Trading	0	228	0	0	0	0	0	0	0.0	0.0
Education, Research& Development	107	131	394	205	347	736	528	963	3.6	1.9
Others	293	232	215	470	226	102	137	187	0.4	0.5

Source-Compiled from Annual Reports, RBI

From the above table, it can be seen that highest FDI has come from the manufacturing, Construction and Electricity and other Energy Generation, Distribution & Transmission sectors and which is constantly increasing for the last one decade. Communication sector has also attracted FDI in India.

Check Your Progress

1. Mention any two GOI initiatives to boost up FDI inflow
2. Mention the categories of Indian business sectors to facilitate FDI.

1.9 India's Latest FDI Policy in Brief

The Foreign Direct Investment (FDI) Policy was revised by the Indian government on April 17, 2020, to require FDI from nations that "share a land border" with India, such as China, Bangladesh, Pakistan, Bhutan, Nepal, Myanmar, and Afghanistan, to have government clearance. Although the stated goal of the action was to "curb opportunistic takeovers/ acquisitions," it has been widely believed that the real motivation was to restrict the amount of Chinese investment as FDI from Bangladesh and Pakistan was already subject to such limitations. This legislation has limited foreign direct investment (FDI) intake from these nations; as of July 2022, only 80 out of 388 bids received had been approved In line with a request made under the Right to Information Act (RTI) that The Hindu filed. Apart from this protective constraint, India has been pursuing liberalization since 1991. As recently as 2021, India implemented relaxations in a number of important areas, defying the current protectionist trends, including: **insurance:** Under the automatic route, the FDI limit in the insurance business was increased from 49% to 74%. **Defense:** By increasing the FDI ceiling for investment via the automatic route from 49% to 74%, the FDI limit in the defense sector was considerably liberalized. **Telecoms:** Under the automatic approach, the government raised the foreign direct investment (FDI) restriction from 49% to 100%, providing much-needed support to India's telecom industry. **Oil and gas:** Though the overall cap on foreign direct investment (FDI) into the sector stays at 49% under the automatic route, a window has been established for 100% FDI in PSUs (public sector undertakings) in the oil and gas industry that have received 'in-principle approval' for strategic disinvestment from the government. Furthermore, the "Start-up India Initiative" has implemented two more reforms aimed at start-up investment in accordance with government policy to establish an ever-burgeoning start-up ecosystem in India. While FDI is typically only allowed through equity instruments, eligible start-ups can take advantage of the option to issue convertible notes (CN), which are documents that prove the receipt of funds initially as a debt and that can be repaid at the holder's discretion or convertible into a certain number of equity shares of the

company upon the occurrence of certain events and in accordance with other terms and conditions specified in the document. A single investor must contribute a minimum of INR 25 lakhs (about US$ 30,000) in a single tranche for start-ups to be qualified to issue CNs. A CN's conversion or payback period cannot be longer than ten years. Under the Income Tax Act, eligible start-ups can also take advantage of the "angel tax" exemption provided that their total paid-up share capital and share premium following the issuance or intended issuance of shares do not surpass INR 25 crores, or approximately US$3 million. There are end-use restrictions on investments made on certain assets when utilizing the angel tax exemption. The angel tax exemption will not apply if the investment is in the form of shares and stocks, bullion, archaeological collections, works of art, or capital contributions made to any other business. The Indian government has implemented a liberal policy that allows Foreign Direct Investment (FDI) up to 100% under the automatic route in the majority of sectors and activities in an effort to attract FDI. The Foreign Direct Investment (FDI) policy regime has undergone notable modifications in recent times to guarantee India's continued appeal as an investment destination. The Ministry of Commerce and Industry's Department for Promotion of Industry and Internal Trade (DPIIT) serves as the lead agency for developing the government's foreign direct investment (FDI) policy. In addition, it is in charge of managing and maintaining data on foreign direct investment (FDI) entering India, which is based on remittance reports from the Reserve Bank of India. Initiating Make in India, assisting champion sectors and subsectors, establishing an EGoS and Project Development Cells, establishing a GIS-based Industrial Information System, and establishing a National Investment Clearance Cell are just a few of the reforms and initiatives that DPIIT has been working on. The 2008-launched Scheme for Investment Promotion (SIP) is funding these initiatives. Through a notification dated November 29, 2021, the government has approved the continuation of SIP for a further five years (FY 2021–22 to 2025-26) at a cost of Rs. 9.70 billion. The Investment Promotion Section of DPIIT formed the Empowered Group of Secretaries (EGoS), which supports and facilitates investment in India and fosters growth in important industries of the economy. To expedite investment by facilitating collaboration between the federal and state governments, Project Development Cells have been established in 29 departments. The Cells improve India's pipeline of projects that can be funded, which boosts both inflows of foreign direct investment (FDI) and local investment. The Consolidated FDI Policy Circular, which is subject to periodic amendments,

contains the basis for FDI policy. DPIIT released the Consolidated FDI Policy Circular, which is presently in effect, on October 15, 2020. In order to stimulate economic growth, the goal of the FDI Policy is to draw in and encourage foreign direct investment to complement domestic capital, technology, and skill sets. FDI is contingent upon adherence to all applicable state/local laws and regulations as well as sector-specific laws, norms, and security requirements. The Consolidated FDI Policy Circular's Chapter 5 goes into detail about the sectoral caps for FDI. Up to 100% of FDI is allowed in industries and activities that aren't included in Chapter 5. Basically, there are two entry routes for FDI in India, which are **(1) Automatic Route and (2) Government Route.** For foreign direct investment (FDI) via the **automatic method,** no previous clearance is needed; the Reserve Bank of India (RBI) must only be notified within 30 days of inward remittances or the issuance of shares to non-residents. The appropriate responsible authority, Administrative Ministry, or Department reviews foreign investment proposals that are not covered by the "Automatic Route" for **government approval.**

Stop to Consider

In the upcoming years, a variety of government efforts are anticipated to increase foreign direct investment (FDI) inflows into India, which are as follows-

PM Gati Shakti Scheme

Launched in October 2021, the Prime Minister Gati Shakti scheme is hailed as a revolutionary plan for attaining economic development. It centers on various transportation modes and a logistics infrastructure, complemented by clean energy transmission, IT communications, and social infrastructure.

Single window Clearing Process

The National Single Window System (NSWS), which serves 32 central government departments and 31 state government departments nationwide, is an electronic platform created to streamline and simplify the application procedure for approvals for various enterprises. The NSWS includes a secure document repository, real-time approval application status tracking, fast query management for expeditious resolution of procedural questions or ambiguities, a database that

compiles all approvals into a single portal, eliminating the need for the end user to visit individual ministries and departments, and an easy-to-renew approvals system.

Divestment

The government unveiled a new disinvestment policy in its 2021–2022 budget that makes a distinction between "strategic" and "non-strategic" sectors. The goal of the government is to fully privatize the non-strategic industries while keeping PSUs mostly absent from the strategic industries. The government has successfully divested from two big PSUs in recent decades, which is noteworthy. Through sales of a 100% stake in Air India, a 50% stake in the ground handling services provider Air India SATS, and a 100% stake in low-cost carrier Air India Express, the government offloaded 3.5% of its 100% stake in the insurer through an initial public offering. Additionally, Life Insurance Corporation of India underwent an IPO. Approximately US$7.8 billion, or INR 65,000 crore, was the budgeted disinvestment aim for the fiscal year 2022–2023. According to reports in the local media, as of December 2022, the government had raised more than INR 28,000 crore from share sales.

PLI (Production Linked Incentive) program

Another new attempt by the Indian government that aims to create an economy that is self-sufficient is the PLI project. Financial incentives are given to qualifying enterprises under the initiative based on sales of products made in India. With a total budgeted outlay of about INR 200,000 crore (approximately US$24 billion), the scheme has been expanded to manufacturing-focused industries like autos, textiles, and pharmaceuticals.

Self Asking Questions

1) Explain the importance of FDI in a developing country like India.

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2) Explain the schemes taken up by the Government of India to boost up FDI in the country.

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1.10 Summing Up

- Foreign Capital is the capital transferred from one nation to another through foreign investment.
- Foreign Capital fills a number of economic gaps especially in a growing nation.
- Basically, there are three different forms of Foreign Capital, which are Foreign Investment, Non-Concessional Assistance & Concessional Assistance.
- When a corporation or individual from one nation invests in commercial ventures situated in another, this is known as foreign direct investment, or FDI. Growth in the economy is significantly fueled by FDI.
- FDI has its own advantages & disadvantages.
- There are significant differences among FDI, FII & FPI.
- Government of India has taken some initiatives to boost foreign direct investment in India, which are very significant from the country's inflow of foreign capital.
- In 2021, India implemented relaxations in a number of important areas, defying the current protectionist trends, which includes, insurance, defense, telecoms & oil & gas.
- The GOI has also undertaken some schemes to enhance inflow of foreign direct investment in the country.

1.11 Model Questions

1. Explain the role of FDI in India. Explain the various forms of FDI.
2. Discuss the advantages and disadvantages of FDI in host country.
3. Discuss about the recent changes incorporated to the FDI Policy of India.
4. What are the steps taken by RBI to boost FDI in India?
5. Discuss the various initiatives undertaken by Government of India to boost FDI.
6. Analyze the country-wise and sector-wise inflow of FDI in India.
7. Highlight the recent changes made in India's FDI Policy.

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Unit-2

Portfolio Investment, Foreign Institutional Investment-Their Advantages, External Commercial Borrowing and NRI Investment

Unit Structure:

2.1 Introduction
2.2 Objectives
2.3 Portfolio Investment Advantages
2.4 Foreign Institutional Investment (FII) Advantages
2.5 External Commercial Borrowing
2.6 NRI Investment
2.7 Summing Up
2.8 Model Questions
2.9 References and Suggested Readings

2.1 Introduction

Portfolio investments covers a wide range of asset class which may include stocks, government bonds, corporate bonds, real estate investment trusts, mutual funds, exchange traded funds and certificate of deposits. It may also include options, derivatives and physical investment such as commodities, real estate, land and timber. In other words, portfolio investment is an asset that is purchased in the expectation that it will earn a return or grow in value or both. It is a passive investment. Risk tolerance and time horizons are key factors in selecting a portfolio investment. An institutional investor in a financial market outside its official home country is called a foreign institutional investor and may include pension funds, investment banks, hedge funds and mutual funds

2.2 Objectives

After going through this unit, you will be able to–

- define portfolio investment,
- understand Foreign portfolio investment,
- explain External Commercial borrowing,
- analyze NRI Investment.

2.3 Portfolio Investment

A portfolio investment is a passive investment of securities in a portfolio; and it is made with an expectation of earning a return or capital gain or capital appreciation by way of sale of holding of securities in the secondary market. This expected return is directly correlated with the investment's expected risk. Portfolio investment in securities is subjected to a market risk. This risk is again classified as systematic risk and unsystematic risk. Portfolio investment is distinct from direct investment. Direct investment entails taking a sizeable stake in a target company and possibly it is involved with day to day management and proportionate control over the management of a given corporate entity. It can take part in the decision making process and may have a voice as a controlling interest in an entity.

Portfolio investment may comprise of a span of wide range of asset classes such as stocks, corporate securities, government bonds, treasury bills, real estate investment trusts (REITS), exchange traded funds (ETFs), mutual funds, certificate of deposits, etc, . Portfolio investment can also include options, derivatives, such as warrants and futures, and physical investment such as commodities, real estate, land and timber. The composition of investments in portfolio depends on a number of factors. Some of the factors include the investor's risk tolerance, risk absorption capacity, investment horizon and amount invested. For a young investor, for a retail investor with limited amount of investable resource, mutual funds or exchange-traded funds may be appropriate and suitable for them. Because the amount of investable resource is small, the ability to bear risk is limited they may be satisfied with small return and such return is more or less assured at a certain periodic intervals. Considering their risk bearing capacity, portfolio investors are classified as aggressive, conservative and moderate. For high net worth individual, portfolio investment may include stocks, bonds, commodities and rental properties.

Portfolio investment for the foreign institutional investors (FII) or large institutional investors, such as pension funds and sovereign funds include a significant proportion of infrastructure assets like bridges and toll roads. Portfolio investments for institutional investors generally need to have long lives so that the duration of their assets and liabilities match each other. The choice of portfolio in an investment package would depend on the investor's individual circumstances. Those with a greater risk tolerance may favour investments in corporate stocks, securities, real estate, international securities and options, derivatives; while the most conservative investors may opt for

government bonds, govt-backed gold bonds and the stocks of large well-known blue-chip companies. These risk preferences should also be weighed against the investor's goals and time horizon. A young person saving for retirement may have 30 years or more to save but is not comfortable with the risk of the stock market. This investor may have an ideal mix of both conservative as well as aggressive component of portfolio investments. Conversely, individuals with high risk tolerance may want to avoid large allocations to riskier growth stocks if they are nearing retirement age. A progression to a conservative portfolio of investment is generally recommended when the investment goal is nearing to achieve it. Investors saving for retirement should focus on a diversified mix of low-cost investment for their portfolio. Index funds, exchange traded funds (ETFs) have become popular in individual retirement accounts due to their broad exposure to a number of assets classes at a minimum expense level. These types of funds make ideal core holdings in retirement portfolios.

Advantages of Portfolio Investment

1. Risk mitigation : Portfolio investment helps in reducing single country exposure risk. Portfolio investment ensures minimum risk, maximizes return for investor's investment and increases their capital.
2. Diversification : Portfolio investment in diversifying over investments among best equity market around the world. Diversification into multiple classes of asset will protect us in the due course of time when one segment of the financial market collapses or does not perform accordingly.
3. Maximum return : Portfolio investment minimizes the risk factor which tends to maximize the return on investment. The diversification feature associated with portfolio investment leads to protect the investor by diversifying the investment into best financial market thus maximizing the return for the investors.
4. Right investment Choices : Portfolio management helps to make the right investment options. Portfolio is actually refers to the different segment of investment choices that investors uses to generate income, such as stocks, bonds, FDs.
5. Portfolio Management : Portfolio management tends to increase the financial knowledge's of various investors. It leads to build the

financial concepts of investors and helps to learn how a financial market works for which it will result in healthy decision making habit of investors in investing in financial market.

2.4 Foreign Institutional Investment (FII)

Foreign Institution means an entity established or incorporated outside India. When such institution proposes to make investment in India it is known as Foreign Institutional Investment. Foreign institutional investment (FII) is one of the mode of entry of foreign capital into the domestic economy. Foreign institutional investors (FIIs), foreign mutual funds (FMFs) are operating in Indian stock market by way of Portfolio Investment in security market. Their entry and operation in India is regulated by the Securities and Exchange Board of India (SEBI) under the SEBI Act 1992. Since 2003, as per said regulation ,the SEBI has been registering FIIs and monitoring investments made by them through the portfolio investment route under the SEBI (FII) regulations 1995. SEBI acts as the nodal point in the registration of FIIs. FMFs are allowed to invest in India subject to special rules and regulations. Before investing in stocks and in portfolios of securities market, foreign mutual funds (FMFs) are required to be registered in India. FIIs include the following foreign based categories such as: *Pension funds, Mutual funds, Investment trust, Insurance or reinsurance companies, Banks, Endowments, University funds, Foundations, Charitable trusts or Charitable Societies.* The entities proposing to invest on behalf of broad-based funds such as :Asset management companies (AMC), Institutional–Portfolio managers, Trustees, and Power of attorney holders are also eligible to be registered as FIIs.

Let’s try to understand what is a Sub-account, Designated Bank, Domestic Custodian and Broad based fund as regards to FIIs.

Sub-account includes those foreign corporations, foreign individuals and institutions, funds or portfolios established or incorporated outside India on whose behalf investments are proposed to be made in India by a FII.

Designated Bank : Designated bank means any bank in India which has been authorised by the Reserve Bank of India (RBI) to act as a banker to FII.

Domestic Custodian : Domestic custodian means any entity registered with SEBI to carry on the activity of providing custodial services in respect of securities.

Broad-based Fund : Broad based fund means a fund established or incorporated outside India, which has at least twenty(20) investors with no single individual investor holding more than 10% shares or units of the fund. Further it is provided that if the fund has institutional investors, it shall not be necessary for the fund to have twenty investors. Provided, further that if the fund has an institutional investor holding more than 10% of shares or units in the fund, then the institutional investor must itself be broad based fund.

Check Your Progress

1. Name the various categories of Foreign Institution Investment.
2. What is meant by Sub Account?
3. What is meant by designated Bank?

Who can get registered as Sub-account

The following entities can get registered as Sub-account:

- Institution or funds or portfolios established outside India, whether incorporated or not;
- Proprietory fund of FII; –Foreign Corporates;
- Foreign individuals.

Investment limits on equity investments by FII or Sub-account

FII, on its own behalf, shall not invest in equity more than 10% of total issued capital of an Indian company.Investment on behalf of each Sub-account shall not exceed 10% of total issued capital of an Indian company. For the Sub-account registered under Foreign companies or individual category, the investment limit is fixed at 5% of issued capital.These limits are within overall limit of 24% or 49% or the sectoral caps prescribed by Govt of India or Reserve Bank of India.

Investment limit on debt investments

The FII investment in debt securities are governed by the policy of the government of India. Currently following limits are in effect and are applicable:

For FII investments in govt debt, following limits are applicable :

100% debt route	US dollar 1.55 billion
70:30 route	US dollar 200 million
Total limit	US dollar 1.75 billion

For corporate debt the investment limit is fixed at US dollar 500 million.

FII applicant's eligibility:

The SEBI considers the following factors to decide upon the FII applicant's eligibility for registration.

- Applicant's track record, professional competence, financial soundness, experience, general reputation of fairness and integrity.
- The applicant should have been in existence for at least one year.
- Whether the applicant is registered with and regulated by an appropriate Foreign Regulatory Authority in the same capacity in which the application is filed with SEBI.
- Whether the applicant is a fit and proper person.
- An applicant is required to file an application in the form of 'Form A' prescribed by SEBI (FII) Regulations, 1995.

Financial Instruments available for FII investments :

The following financial instruments are available for FII investments.

- Securities in primary and secondary markets including shares, debentures and warrants of companies, unlisted, listed or to be listed on a recognised stock exchange in India;
- Units of mutual funds;
- Dated government securities;
- Derivatives traded on a recognised stock exchange;
- Commercial paper.

Advantages of Foreign Institutional Investment (FII):

1. Improved market efficiency : FII provides an appropriate pricing mechanism for securities which as a result leads to improve the market efficiency.

2. Increases liquidity : FII bring in capital to local securities markets, which can help to deepen liquidity and make it easier for companies to raise capital.
3. Economic growth : FII leads to economic growth by investing in new business and creating jobs. FII improves market liquidity and efficiency. It also reduces financial market volatile.
4. Diversification : FII helps to diversify our investment in the best financial market, which tends to minimize the risk factor i.e., diversification into multiple classes of asset will protect us in the due course of time when one segment of the financial market collapses or does not perform accordingly.
5. Access to foreign capital : FII can provide access to foreign capital for companies, Govt., investors, which can be especially important for developing countries.

2.5 External Commercial Borrowings (ECB)

Foreign capitals are of different types. FDI and foreign portfolio investment are common. Similarly there are other types of foreign capital like trade credit, NRI deposits and external commercial borrowings (ECB). ECB is basically a loan availed by an Indian entity from a non resident lender. Most of these loans are provided by foreign commercial banks and other institutions. It is a loan availed of from non resident lenders with a minimum average maturity of three years. The significance of ECBs is their size in India's balance of payment account. In the post reform period, ECBs have emerged as a major form of foreign capital like FDI and FII. During several years, contribution of ECBs was between 20 to 35 percent of the total capital flows into the country. Large number of Indian Corporate and PSUs has used the ECBs as sources of investment. Bulk of the overseas loans or ECBs into the country is obtained by private sector corporate. For the corporate ECB is a dependable, easy to obtain fund and helps them to undertake business expansion investment. ECBs include commercial bank loan, buyer's credit, suppliers' credit, securitised instruments such as Floating Rate Notes and Fixed Rate Bonds etc., credit from official export credit agencies and commercial borrowings from Multilateral Financial Institutions. ECBs are permitted by the Government as a source of finance for Indian corporate for expansion of existing capacity as well as for fresh investment. ECBs are in the form of foreign currencies, it thus enables the corporate to

have foreign currency to meet the expense of import of machinery. Many of the Indian corporate entities have overseas operation. The domestic financial market is not often able to provide big sized loans at competitive rate of interest to the corporate. Here, ECB has emerged as a valuable source of investible resource of funds for domestic companies.

Stop to Consider

The government follows a well designed ECB policy, putting restrictions on amount of loan that can be obtained by a company, end-user restrictions, interest rate ceiling for ECBs, maturity period etc. Similarly government puts ceiling for the total amount of ECBs that can be obtained by all Indian firms through the ECB route during a year. At present, this aggregate limit is 40 billion dollar.

ECB can be accessed under two routes namely : automatic route and approval route. ECB for investment in real sector -industrial sector, especially infrastructure sector-in India, are under Automatic Route, i.e. do not require RBI / Government approval. In case of doubt as regards eligibility to access Automatic Route, applicants may take recourse to the Approval Route.

ECB can be raised only for investment (such as import of capital goods, new projects and modernization and expansion of existing production units) in real estate sector, industrial sector including small and medium enterprises (SME) and infrastructure sector in India. For this purpose, infrastructure sector is defined as: *Power, Telecommunication, Railways, Road including bridges, Ports, Industrial parks, Urban infrastructure, water supply, sanitation and sewage projects*. The major contributors/lenders of ECB to Indian entity are Foreign Collaborator, Commercial Bank, Multilateral Financial institution, leasing company and Government owned Development Financial institution. On the other hand, the major borrowers of ECB in India are Financial Service Sector, Manufacturing Sector, Information service, warehousing, electricity and air transport.

Advantages of External Commercial Borrowing:

Advantages of an ECB are:

- Interest rates are lower, compared to the domestic funds
- ECBs provides an opportunity to borrow a large volume of funds
- The funds are available for a relatively long term

- Corporate can raise ECBs from internationally recognised sources, such as banks, export credit agencies, international capital markets etc.
- ECBs are in the form of foreign currencies. Hence, they enable corporate to have foreign currency to meet the import of machineries etc

2.6 NRI Investment

NRI stands for Non-Resident Indian. It is a term used for citizen of India who are currently living in foreign land. They are all people of India who live in other nations .A person who stayed away from India for more than 182 days in a calendar year known as NRI. They must hold an Indian passport and have Indian nationality. NRIs are also recognized as Overseas Indians or Expatriates. India has the second-largest NRIs in the globe after China, as per the Ministry of Overseas Indian Affairs report. An NRI may be out of the nation for work, education, residence or some other purpose.

NRI has basically three classifications:-

1) Central and State Govt. representative and public sector employees living overseas
2) Indian civilians working abroad in institution such as the IMF, UN, World Bank etc.
3) Indian resident who stays overseas for education, jobs, business or vacations.

Since the liberalization of Indian economy, the Indian Govt. has stressed the role of Indian Diasporas in economic development and has always tried to tap the investment from NRIs. The NDA govt. since 2014 has started to persuade the Indian Diasporas particularly the NRIs with renewed interest. It is estimated that the total assets of the Indian Diaspora around the world is close to $1 trillion, half of which are financial assets. This implies that if the Indian government can make the Indian Diaspora shift their focus towards their ancestral places, it would be a great change that they can bring to build India. And according to the International Monetary Fund (IMF) data, by 2017, Indian nominal Gross Domestic Product (GDP) was $2.46 trillion, while the annual income of the Indian Diaspora is estimated to be $400 billion, which is around 20 percent of the Indian GDP. This figure states that

the Indian Govt. should mobilize resources from the Indian Diasporas and make them participate in the Indian government development strategy.

According to the 2018 World Investment Report by the UN conference on trade and development (UNCTAD), global foreign direct investment (FDI) flows fell by 23 percent in 2017, i.e. $1.43 trillion from $1.87 trillion in 2016. Likewise, FDI flow to India also fell from $44 billion in 2016 to $40 bil-lion in 2017.The main reason behind such fall in FDI was the impact of Global recession of 2008. Thus, the slow growth nature of world economy, and pal-try foreign direct investment and investment crunch led to the end of many Indian development projects, and India needs to focus more on resources of the Indian diaspora who are scattered around the world in order to revive these projects. The Indian diaspora have settled in many parts of the world and have occupied key positions. Therefore, if India could mobilize the community, they would possibly invest in India to help accelerate the growth of the struggling Indian economy

In order to attract the interest of the Indian Diaspora, the Indian Govt. has offered significant places to them in its policy making apart from depending on their remittances. Some such examples are: 1) Dr Arvind Panagaria who worked as the Professor in Colombia University was made the vice chairman of NITI Aayog. 2) Arvind Subramanian who worked as an economist in International Monetary Fund was made the economic advisor to Indian Govt. Furthermore, to encourage the Indian Diaspora, Indian government has framed several attractive policies, for example, Made in India, and VAJRA (Visiting advanced joint research), Micro Units Development & Refinance Agency Ltd (MUDRA) scheme, and Digital India project, Minimum Referral wages and Know India Program etc

Check Your Progress

1. What is ECB?
2. Who are major contributors and borrowers of ECB
3. Identify the various classification of NRI

2.7 Summing Up

Portfolio investments covers a wide range of asset class which may include stocks, government bonds, corporate bonds, real estate investment trusts, mutual funds, exchange traded funds and certificate of deposits. Portfolio

investment may comprise of a span of wide range of asset classes such as stocks, corporate securities, government bonds, treasury bills, real estate investment trusts (REITS), exchange traded funds (ETFs), mutual funds, certificate of deposits, etc,. Foreign Institution means an entity established or incorporated outside India. When such institution proposes to make investment in India it is known as Foreign Institutional Investment. Foreign institutional investment (FII) is one of the modes of entry of foreign capital into the domestic economy. Foreign institutional investors (FIIs), foreign mutual funds (FMFs) are operating in Indian stock market by way of *Portfolio Investment* in security market. ECB is basically a loan availed by an Indian entity from a non resident lender. Most of these loans are provided by foreign commercial banks and other institutions. India has the second-largest NRIs in the globe after China, as per the Ministry of Overseas Indian Affairs report. An NRI may be out of the nation for work, education, residence or some other purpose.

2.8 Model Questions

1. What is Portfolio Investment?
2. What is Foreign Institutional Investment? Highlight the Financial instrument available for FII.
3. What is External Commercial Borrowing? What are the advantages of External Commercial Borrowing?
4. Why is NRI investment important for India?

2.9 References and Suggested Readings

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www.indianeconomy.net

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Unit-3
Modes of entry of MNC's – MNC's in India

Unit Structure:

3.1 Introduction
3.2 Objectives
3.3 Multinational Corporations (MNCs)
3.3.1 Advantages to host countries.
3.3.2 Disadvantages to host countries.
3.4 Modes of entry of MNCs
3.5 MNCs in India.
3.6 Summing Up
3.7 Model Questions
3.8 References and Suggested Readings

3.1 Introduction

A multinational corporation (MNC) is any corporation that is registered and has business operations in more that one country at a time which means it operates in at least one country other than its home country. Generally the corporation has its headquarters in one country and operates wholly or partially owned subsidiaries in other countries. Its subsidiaries report to the corporation's central headquarters. MNCs are basically large corporations that originate from one particular country and does business in several other countries. East India company was the first MNC established in 1600 whereas the Dutch East India (1602) company was the second MNC in India and the largest company. Some of the top MNC are Tata Group, Aditya Birla Group, Infosys, HCL technologies, Wipro, Google India, Amazon India, Apple India, Microsoft India, Nestle India, IBM, Cocacola. There are five major modes of entry of MNC's in a foreign market. (exporting, licensing, franchising, Joint venture, direct investment). (a) Exporting involves selling product or services to a foreign market from the home country. For eg, a tea producer and manufacturer in the India may export its products to retailers in Europe. (b) Licensing involves allowing a foreign company to use the company's intellectual property, such as trademarks or patents, in exchange for royalties or fees. For eg, a software company in Japan may license its technology to a company in Brazil to sell to its customers (c) Franchising involves allowing a foreign company to use

the company's brand, products, and processes in exchange for fees and royalties. For eg, a fast-food chain in the United States may franchise its brand to a company in India to open and operates restaurants. (d) Joint Venture involves Partnering with a local company is a foreign market to share the risks and rewards of the business. For eg, the joint venture of the Indian company Maruti with the Japanese Company Suzuki. (e) Direct investment means that the company has control and significant stake in its operations in other countries. The Complete form of participation in foreign countries is 100 percent ownership, which can be established as a start-up, or can be achieved by acquiring local companies. Acquisition of companies in foreign countries is a fast way to enter a new market. It provides the company ready access to a product portfolio, manufacturing facilities, customers, qualified employees, local management etc.

Some other modes of entry of MNC's in a foreign market are acquisition, contract manufacturer, wholly owned subsidiary, turnkey projects, direct investment, piggybacking, Greenfield investments, partnering.

3.2 Objectives

After going through this unit, you will be able to–

- understand Multinational Corporations (MNCs),
- explain the reasons for the growth of MNCs,
- understand the various modes of entry of MNCs,
- analyze the status of MNCs in India.

3.3 Multinational Corporations (MNCs)

According to *Britannica Encyclopedia* **MNC is '**any that is registered and operates in more than one country at a time. Generally the corporation has its headquarters in one country and operates wholly or partially owned subsidiaries in other countries. Its subsidiaries report to the corporation's central headquarters'. MNCs are basically large corporations that originate from one particular country and does business in several other countries. They are monitored and controlled by their head office/ headquarters in the host countries . ***According to an ILO Report***, the essential nature of the MNCs lies in the following :its managerial head quarter is located in one country (home country);While the enterprise carries out operations in a number of other countries (host countries);it controls production facilities in

more than one country; such facilities may be acquired through the process of FDI. However, firms that participate in international business, solely by exporting or by licensing technology are not MNCs. The following are some of the well known MNCs in the world: General Motors, ESSO, Ford, General Electric, IBM, ITT, DuPont, Honda, Apple Computer, BMW, IBM, ITC, Infosys, Microsoft, Maxis, Nokia, BP, Cadbury, Citi group, Coca-Cola company, Dell etc,.

3.3.1 Advantages to Host Countries

As regards to MNC's role in the host country, there are two schools of thoughts. No doubt MNC comes to the host countries with much needed FDI and solve some issues like unemployment, export promotion etc to some extent but those MNCs have their own motive of earning profits. And in pursuit of profits the MNCs may do much harm to the host countries like exploitation of natural resources, dumping of obsolete technology etc. So MNCs comes with both advantages and disadvantages:

The MNCs help the host countries in the following ways.

- MNCs help increase the investment level and thereby the income and employment in host country.
- The transnational corporations have become vehicles for the transfer of technology, especially to the developing countries.
- They introduce managerial revolution in the host countries through professional management and sophisticated management techniques.
- The MNCs enable the host countries to increase their exports and decrease their import requirements.
- They work to equalize the cost of factors of production around the world.
- MNCs provide an efficient means of integrating national economies.
- They allow companies to undertake heavy research and development system.

3.3.2 Disadvantages to Host Countries

The following points highlight the disadvantages of MNCs in a host country.

- Technology transfer is not always helpful to domestic country because the MNCs may come to the host countries(basically Third world countries) with obsolete technologies (technologies which is almost obsolete in developed countries)
- Because of the right to repatriate the dividend, royalty etc given to the MNCs, money goes outside the domestic country too.
- As a matter of fact, like any business, the sole objective of MNCs is profit. Development of host country is never their primary objective.
- MNCs exploit the natural resources of the host country.
- Because of the abundant financial resource, MNCs may try to influence the politics of the host countries.
- Presence of large MNCs is a disadvantage to the local enterprise and small domestic business.
- MNCs may promote regional imbalance by investing only in some large states of the host country.

3.4 Modes of Entry of MNCs

Mode of Entry in a Foreign Market for an MNC is discussed hereunder**.**

1. Indirect Exporting :

Companies can, while going international, use *domestically based agents* who operate on a commission basis without taking title to goods, or *merchants* who sell the products of the company in international markets (after taking title to the goods). They can also use the distribution facilities of other firms in the international markets.

Small firms that find it difficult to use any of the above means can sell their products via other organizations that export products on behalf of several small firms collectively. These are generally large trading concerns and export management companies that negotiate contracts on behalf of smaller exporters. Such companies can take up several activities such as market assessment, channel selection financing arrangements, documentation, etc., for the smaller exporters.

The scale of operations of the smaller exporters does not permit these firms to be able to manage such activities. Moreover, the larger companies have better access to information about international markets. The firm's involvement level with the foreign markets is lowest in this case. It may be

evaluating the attractiveness of the foreign market before increasing its stake. The investment involved in this effort is the least among all the other alternatives for expansion.

The main advantage of using this strategy is that the exporting company can utilize the expertise of the organization that has knowledge about the country in which the goods are being exported. The exporting company can also have good links with the organization that organizes such export activities, since both companies are located in the same country.

2. Direct Exporting :

A company may decide to export its products itself. The company develops overseas contacts, undertakes marketing research, handles documentation and transportation and decides the marketing mix. Companies can use foreign-based agents or distributors. An agent may agree to handle the company's product exclusively, or may handle products of other companies too. An agent does not take title to the products and works on commission.

Distributors take title to the products. Company appoints distributors when after-sales service is required as they are likely to possess the necessary resources. The advantages of foreign-based agents and distributors are that they are familiar with the market and have business contacts.

Their profit or commission is based on sales generated and they may not be interested in developing long-term market positions for the company. They may not be willing to put in extra efforts to sell new products and will give maximum attention to selling established products of the company which will generate maximum profit or commission for them.

They may consider themselves to be representatives of their customers than that of the company and may be reluctant to give market feedback to the company. The company has limited control over agents and distributors.

The company can employ its own salespersons who will scout for customers in the foreign market and sell to them. This method is recommended for expensive products and when the numbers of customers are limited.

The salesperson will pay attention to the development of the market. The possibilities for feedback and other information from the market are better. Thus, customers will be looked after better and the company's interest would be better served. This is an expensive method, so the order sizes have to be large.

The company may establish a sales and marketing office in the foreign market. This office monitors the marketing efforts of the company. They may use agents or distributors or may decide to develop their own distribution infrastructure and appoint their own salespersons. The idea is to take charge of the marketing operations of the company. This involves greater commitment of the organization than indirect exports.

3. Licensing:

Under licensing, a foreign licensor provides a local licensee with access to technologies, patents, trademarks, know-how or brand/company name in exchange for financial or some other form of compensation. The licensee has exclusive rights to produce and market the product in the specified area for a limited period. The licensor usually gets royalty or license fees on the sale of the product.

The advantage of licensing lies in the fact that the company (licensor) can enter a new market without making substantial investments. But the company losses control over production and marketing of the product. Further the reputation of the licensor is dependent on the performance of the licensee.

One danger of licensing is the loss of product and process know-how to third parties (licensee), who may become competitors once the agreement is over. A company can use licensing to exploit new technology simultaneously in many markets, if it lacks the necessary resources to set up manufacturing facilities and sell the products. Licensing is popular in R&D intensive industries where companies often license technologies which do not fit with their overall strategy.

Stop to Consider

Licensing agreements must ensure sustaining competitive advantage to the licensor. Adequate supervision of licensees is important. Exchange of new developments by the licensee with the licensor can also be made compulsory in the licensing agreement. A licensing agreement that goes bad can damage the brand equity of the licensor forever.

4. Franchising:

Franchising is a type of licensing agreement where packages of services are offered by the franchiser to the franchisee in return for a payment. The two types of franchising are product and trade name franchising and business format franchising. An example of product and trade name franchising is Pepsi Cola selling its syrup together with the right to use its trademark and name, to independent bottlers.

Business format franchising is used in service industries such as restaurants, hotels and retailing where the franchiser exerts a high degree of control on the franchisees based in the overseas market. In business format franchising, the franchiser, like McDonald's, lends operating procedures, quality control, as well as the product and trade name.

5. Joint Ventures:

The multinational corporation enters into a joint-venture agreement with a company from the target country market. Two types of joint venture are *Contractual and Equity joint ventures*. In contractual joint ventures, no joint enterprise with a separate identity is formed. Two or more firms enter into a partnership to share the cost of an investment, the risks and the long-term profits. The partnership can be formed for completing a project, or for a long term co-operative effort. In an equity joint venture, a new company is formed in which the foreign and local companies share ownership and control.

A joint venture may be necessary due to legal restrictions on foreign investment. A joint venture also reduces the investment required by a foreign firm, besides reducing risk. The danger of expropriation is less when a company has a national partner than when the foreign firm is the sole owner. Forming a joint venture with a local partner may be the only way of entering markets which are very competitive and saturated. The Japanese set up joint ventures in the US primarily for this reason. The foreign partner stands to gain from local expertise.

Both partners bring in their expertise in different areas that help in realizing the success of the venture. Both the partners can specialize in their particular areas of technological expertise. The foreign investor benefits from the local management talent and knowledge of local markets and regulations.

But such joint ventures face many hurdles. The local partner is satisfied if the joint venture is reasonably successful in the local market but the foreign investor has bigger targets. They want to dominate the local market and also want to extend operations to neighboring markets. Most local partners do not bring technology and money on the table, and are primarily valued because of their knowledge of the local system, culture, market and government policies and regulations.

Once the foreign investor gets sufficiently knowledgeable about the local conditions, they find no use for the local partner. Most of the joint ventures

formed with the purpose of entering a country market are dissolved, or the foreign investor buys out the local partner.

6. Direct Investment:

The company entering the foreign market invests in foreign-based manufacturing facilities. The company commits maximum amount of capital and managerial efforts in this mode of entry. The company can acquire a foreign manufacturer or facility, or build a new facility.

Direct investment means that the company has control and significant stake in its operations in other countries. The complete form of participation in foreign countries is 100 per cent ownership, which can be established as a start-up, or can be achieved by acquiring local companies.

Acquisition of companies in foreign countries is a fast way to enter a new market. It provides the company ready access to a product portfolio, manufacturing facilities, customers, qualified employees, local management, knowledge about local conditions and contact with local authorities.

In saturated markets, acquisition may be the only feasible way of establishing a manufacturing facility in a foreign market. But differing styles of management between foreign investors and local management teams may cause problems. In many countries, 100 per cent ownership by foreign companies may not be permitted due to government restrictions.

In direct investment, the foreign investor has greater degree of control than licensing or joint ventures. It is able to prevent leakage of proprietary information. The company is able to avoid tariff and non-tariff barriers. The distribution cost is lowered. Being based in the local market, the company is more sensitive to local tastes and preferences.

It is also easier now to establish links with local distributors. It is now in a better position to strengthen ties with the government of the host country. But direct investment is expensive and risky. If the venture fails, the foreign investor loses lots of money. And there is always a risk of expropriation, however minimal.

7. Green field investment

It is a form of FDI where the parent company builds its operatrions in a foreign country from the ground up (from scratch).In addition to the construction of new production facilities, these projects can also include the building of new distribution hubs, offices and living quarters.

As opposed to a ***brown field investment***, where leasing existing facilities and land results in relatively lower expenses, ***green field investments*** forwarded by MNCs entail higher risk and cost associated with building new factories or manufacturing plants.

Developing countries try to attract prospective companies with attractions like tax breaks, subsidies and other incentives to set up green filed investment.

The term 'green field investment' refers to a project where a company builds the entirety of its operations in a foreign market starting from scratch or green field. These projects are FDIs that provide high degree of control for sponsoring company.

The greatest risk in green field investment is the relationship with the host country. Any events that result in the company pulling out of a project at any time can be financially devastating.

Example: In April 2015, Toyota announced its first green field project in Mexico. In three years, a 1.5 billion dollar manufacturing plant was ready in Guanajuato in Mexico. The factory opened in 2019 with 2000 employees and capacity to produce 2 lakh cars per year. The purpose of setting up Green filed investment projects of car manufacturing facility in Mexico is attributed to be following reasons : low cost of **labour,** low manufacturing cost in Mexico, proximity to markets in the USA.

Check Your Progress

1. Define MNC.
2. Highlight the various modes of entry of MNCs.
3. What is Direct Exporting?
4. What is green field investment?
5. What is Brown field investment?
6. Write short notes on-

a) Licensing b) Franchising c) Joint Venture

3.5 MNCs in India

The degree of internationalisation of the economy all over the world is growing tremendously. This can be understood that today MNCs are emerging in numerous volumes in each and every part of the world. As such in India too

leading Multinational Corporations are eager to invest. In other words, India has become an attractive destination for leading MNCs across the world. India is a destination to some of the world largest MNCs such as Apple India PVT ltd, Amazon, Citibank, Coca Cola, Google, HP, IBM, Microsoft, PepsiCo, Sony etc. The main reason behind this increase in interest for investment in India might be its abundant population resources, a high potential workforce, and continuous improvements in the ease of doing business, and a dynamic consumer-oriented market that readily embraces innovation and services. India derives lots of benefits from MNCs operating in India such as higher level of investment, reduction in technological gap, optimum utilisation of natural resources, reduction in foreign exchange gap and boost to basic economic infrastructure. But roses do not come without thorns. Some disadvantages and threats from MNCs are also witnessed. These may include competition to SMEs, increased pollution and environmental hazards, improper diffusion of profits, forex imbalance, slow decision making and sometimes economic distress. However, every step has been taken by various governments from time to time to attract more FDI in the form of MNCs.The Indian government's initiatives to liberalize FDI norms, increase sectoral caps, and streamline the approval process demonstrate its commitment to creating a conducive environment for foreign investors. The legal framework for Foreign Investment in India comprises of : FEMA,1999, Reserve Bank Of India, Ministry of Commerce and Industry, SEBI and Dept for Promotion of Industry and Internal Trade

The Department for Promotion of Industry and Internal Trade (**DPIIT**) handles all foreign investment proposals and formulates policies related to foreign investment in India. The foreign investment proposals are considered by the Foreign Investment Facilitation Portal (**FIFP**), managed by DPIIT. The FIFP is an online platform that facilitates and streamlines the process of foreign direct investment in India and serves as a one-stop digital interface for investors to obtain information, apply for approvals, and access various services, including FDI consulting services, related to foreign investment.

3.6 Summing Up

A Multinational Corporation (MNC) is any corporation that is registered and has business operations in more than one country at a time which means it operates in atleast one country other than its home country.

Some of the advantages of MNC are it helps to increase the investment level and thereby the income and employment in host country, it works to equalize the cost of factors of production around the world, it provides an efficient means of integrating national economics, it allow companies to undertake heavy research and development system.

Some of the disadvantages of MNCs in a host country are (a) MNCs exploit the natural resources of the host country, (b) Presence of large MNCs is a disadvantage to the local enterprise and small domestic business, also it promote regional imbalance by investing only in some large states of the host country.

The major mode of entry in a foreign market for an MNC are Exporting (Indirect & Direct), licensing, Joint Venture, Direct Investment, Green field Investments, Partnering, Turnkey Projects etc.

India has become an attractive destination for leading MNCs across the world. India as a destination to some of the world largest MNCs such as apple India Pvt. Ltd., Amazon, Citibank, Cocacola, Google, HP, IBM, Microsoft, Pepsico, Sony etc. The main reason behind this increase in interest for investment in India might be its abundant population resources, a high potential workforce, and continuous improvement in the ease of doing business.

3.7 Model Questions

1. Discuss the advantages & disadvantages of MNCs.
2. Define MNCs & TNCs.
3. Discuss the various modes of entry of FDI.
4. Write the meaning of Green Field investment and Brown Field investment with examples.
5. Discuss the status of MNCs in India.

3.8 References and Suggested Readings

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Unit-4
Foreign Trade Policy

Unit Structure:

4.1 Introduction
4.2 Objectives
4.3 Objectives of FTP
4.4 Features of Foreign Trade Policy in India
4.5 Role of Foreign Trade Policy in Economic Development of India
4.6 Modifications incorporated to India's Foreign Trade Policy
4.7 Key Features of India's Recent Foreign Trade Policy
4.8 Strategies adopted by the Government of India to enhance Foreign Trade in India
4.9 Advantages of Foreign Trade Policy
4.10 Disadvantages of Foreign Trade Policy
4.11 Limitations of India's Foreign Trade Policy
4.12 Summing Up
4.13 Model Questions
4.14 References and Suggested Readings

4.1 Introduction

Foreign Trade Policy is a set of guidelines and instructions established by the DGFT (Directorate General of Foreign Trade) in matters related to the import and export of goods in India. The Indian government made brave moves in July 1991 when it introduced reforms, particularly in the areas of industrial, trade, and fiscal policy. In order to boost India's export share in the world market and find a long-term solution to the balance of payments dilemma, the trade policy changes sought to foster an environment that would enable exports to grow rapidly. To achieve this, the Export-Import (EXIM) Policy underwent considerable revisions, and measures were implemented to encourage exports in accordance with the needs of particular nations and commodities. You will discover the function of international commerce in the growth of economies, patterns in India's trading with the world, and the nature and content of exports and imports in this unit. The issues with India's international trade would also be familiar to you.

4.2 Objectives

After going through this unit, you will be able to–

- define Foreign Trade Policy,
- explain the role of FTP in economic development of India,
- understand the objectives of Foreign Trade Policy,
- understand the features of FTP,
- understand the Advantages and Disadvantages of FTP,
- analyze the Policies adopted by the GOI to boost Foreign Trade etc.

4.3 Objectives of Foreign Trade Policy

The following are the objectives of Foreign Trade Policy:

a) Promote exports: Increasing India's exports of goods and services to foreign markets is the main goal. This increases the country's foreign exchange profits.

b) Create jobs: By promoting exports, the country may create additional jobs and economic opportunities, primarily in sectors that are export-focused.

c) Industrial expansion: The government wants to promote industrial expansion, particularly for small and medium-sized businesses that are labor-intensive and provide jobs, by encouraging exports.

d) Increase export variety: The policy aims to increase and diversify the range of goods and services exported from India. This lessens reliance on a small number of important exports.

e) Boost competitiveness: To aid domestic companies and exporters in cost competition and production efficiency in international markets, the government offers a variety of incentives and subsidies.

f) Earn more foreign exchange: The primary objective is to increase export growth in order to generate more valuable foreign exchange that can be used for imports and economic expansion.

g) Technological advancement: The foreign trade policy promotes the adoption of new technology and innovation, which may increase competition for Indian exports on a worldwide scale.

4.4 Features of Foreign Trade Policy in India

The following are the features of foreign trade policy in India:

1) Trade in products and services: Trade in goods and services takes place between nations. A country trades commodities or services with another country and receives goods or services in return from the other country.

2) Utilizing several currencies: Since each country has a unique currency, foreign trade necessitates the use of various currencies for payments and settlements. It is crucial to consider exchange rates.

3) Involves cross-border movement: In order for international trade to take place, products and services must be transported physically from the exporting country to the importing country across international borders.

4) Trade agreements and policies: The trade policies and agreements of different countries regulate and guide international commerce. These regulations establish the permissible exports and imports of products as well as the trade taxes and tariffs.

5) Effective resource utilization: Proper utilization of resources is made possible through international trade, which enables countries to acquire commodities and resources that they lack but that are abundant in other countries. This improves the effective use of global resources.

6) Increases competition: Foreign commerce exposes home businesses to international competition, forcing them to improve on quality, efficiency, and innovation. Users gain from this.

7) Creates economic interconnectedness: When countries trade with one another often, they develop economic interdependence. Due to this, fostering positive trade partnerships becomes important.

8) Balance of trade and payments: Trade between countries' borders affects both the balance of trade (exports vs. imports) and the balance of payments (cross-border money flows). Governments work to strike a good balance.

Check Your Progress

1. Define Foreign Trade Policy in a few words.
2. Write any five objectives of Foreign Trade Policy.
3. Mention any four features of India's FTP.

4.5 Role of Foreign Trade Policy in Economic Development of India

The following are the role of foreign trade policy in Economic development of India:

- Increases exports: The primary objective of FTP is to increase Indian exports. A quicker pace of export growth benefits the economy by creating more jobs, generating more money abroad, and stimulating industrial development.
- Creates jobs: The FTP attempts to increase employment opportunities, particularly for small businesses and labor-intensive industries, by encouraging exports. This lowers unemployment.
- Enhances balance of payments: The FTP enhances India's current account balance and balance of payments situation because exports are growing faster than imports. The economy grows stronger as a result.
- Attracts FDI: As international investors search for opportunities in India's expanding export sectors, a proactive FTP that increases exports can also draw in additional FDI. It stimulates the economy.
- Benefits that are specific to each industry and sector: FTP supports important industries like textiles, pharmaceuticals, IT, and cars. Through incentives and subsidies, this promotes the quicker growth of certain industries.
- Promotes innovation and technology: To increase the competitiveness of Indian exports, FTP promotes innovation, the adoption of new technologies, and an improvement in production methods. Long-term, this helps the economy.
- Enhances competition: FTP subsidies and incentives support Indian exporters' cost-cutting efforts and increase their ability to compete on the world market.

- Economic growth: Economic growth is facilitated by the aforementioned elements, including increased exports, employment, investments, and competitiveness, which all contribute to the medium- to long-term expansion of the Indian economy.

4.6 Modifications to India's Trade Policy

- Prior to now, aiding merchandise exports was the main area of focus. Now, the emphasis is on services exports. A growing amount of attention is being paid to encouraging and advancing the export of services including IT, BPO, tourism, healthcare, etc.
- 'Make in India' is being given more attention as part of the current foreign trade policy, which aims to encourage import substitution and increase domestic value addition. This will lessen reliance on imports.
- Reforms that make doing business easier: Several reforms have been put in place to make it simpler for importers and exporters to conduct business. The processes have been mechanized and made simpler.
- Infrastructure development: In order to increase India's export competitiveness, more attention is being paid to the development of infrastructure connected to commerce, such as ports, highways, and railways.
- Export promotion for MSME: There is a stronger emphasis on increasing exports for micro, small, and medium-sized businesses. Numerous programs have been introduced specifically for MSMEs.
- Export diversification: The government is working to expand India's export base beyond its traditional exports of textiles, jewelry, and stones. New industries are being supported.
- Promoting R&D and innovation: In order to hasten the growth of exports, more emphasis is now being placed on fostering R&D, innovation, and the adoption of new technology.
- International investment regulations are being liberalized in order to draw in more international capital and advance technology to increase exports.

Check Your Progress

1. Mention any four major roles played by the FTP in Economic Development of India.

2. Write any two latest modifications made to the India's FTP.

4.7 Key Features of India's Recent Foreign Trade Policy

The following are the key features of India's recent foreign trade policy:

- Focus on lowering import dependence and increasing self-sufficiency: Through the Atma Nirbhar Bharat project, the FTP seeks to lower import dependence and stimulate indigenous production.
- Export incentives and subsidies: To improve exports and competitiveness, a number of incentives and subsidies have been established for manufacturers and exporters.
- Export promotion for agriculture and fisheries: Export promotion for agricultural, fisheries, organic, and bamboo products is given more attention.
- Incentives for labor-intensive industries: The policy offers more incentives for employment growth in labor-intensive industries like textiles, leather, food processing, etc.
- R&D and technology incentives: Businesses who invest in R&D and those that provide technological solutions will receive larger export incentives.
- Measures to make conducting business easier: The policy maintains a number of past improvements to streamline export-import processes and facilitate cross-border trade.
- Focus on district-level exports: Through a variety of programs, the policy aims to increase exports from all of India's districts, not just a select few important cities.
- In order to lower logistics costs, there is a focus on constructing trade-related infrastructure, such as ports, motorways, rail, and warehouses.

Stop to Consider

The FTP 2023 is built on four pillars: Emerging Areas, Export Promotion through Collaboration, Incentive to Remission, and Ease of Doing Business.

1. Remission Incentives: In order to encourage corporate exports, FTP 2023 includes a number of incentive programs and remissions. The Remission of Duties and Taxes on Exported Products (RoDTEP) plan replaces the current rebate programs and provides an all-inclusive, streamlined method for exporters to get timely and adequate support.

2. Collaboration for Export Promotion: In order to establish a climate that is favorable for exports, the policy encourages cooperation among stakeholders, including federal and state governments, industrial associations, export promotion councils, and Indian Missions. India will be able to find new prospects, investigate undiscovered markets, and diversify its export portfolio thanks to this unified effort.

3. Reduced transaction costs and ease of doing business: By streamlining procedures, lowering transaction costs, and implementing IT-based solutions, FTP 2023 places a high priority on exporters' ability to conduct business easily. The policy proposes initiatives including streamlining export promotion programs like EPCG and Advance Authorization and a one-time Amnesty Scheme for pending authorizations.

4. Emerging Sectors: Focus areas of FTP 2023 include simplifying the SCOMET policy, Districts as Export Hubs (DEH) projects, and E-commerce exports. The policy aims to boost the consignment cap, integrate courier and postal exports with ICEGATE, support local trade ecosystems, and collaborate with State governments.

India's exports are expected to reach $2 trillion by 2030, according to FTP, 2023. The FTP 2023 provides a number of new programs, including a one-time amnesty program allowing exporters to finish up any outstanding authorizations and begin again. Additionally, it promotes the recognition of exporters through the Status Holder Scheme and new communities through the communities of Export Excellence Scheme. Process automation and re-engineering are two of the FTP 2023's primary goals in order to make it easier for exporters

to conduct business. The policy places a focus on using automated IT systems with risk management systems for different approvals and codifies implementation methods in a paperless, online environment. The FTP 2023 emphasizes the promotion of exports from the district level as well as promoting the growth of the local trade ecosystem. In order to identify export-worthy goods and services and address issues at the district level, the strategy establishes partnerships with state governments and advances the Districts as Export Hubs (DEH) project. India is becoming increasingly integrated with nations that have export controls, and the regulatory framework has been strengthened to better carry out international agreements. To achieve compliance with international norms, the FTP 2023 calls for greater outreach and comprehension of Special Chemicals, Organisms, Materials, Equipment and Technologies (SCOMET) among stakeholders.

4.8 Strategies adopted by the Government of India to enhance Foreign Trade in India

The following are the strategies that are adopted by the Govt. of India to enhance Foreign trade in India:

- Government incentives and rebates include a variety of tax breaks, rebates, and incentives for exporters. This increases the competitiveness of Indian exports on the world market.
- Infrastructure construction - The government concentrates on building the essential transportation infrastructure, such as ports, highways, railroads, and storage facilities. This lowers the cost of logistics and increases export competitiveness.
- Modernization of technology - The regulation encourages businesses to innovate, embrace new technologies, and enhance their manufacturing procedures. As a result, Indian exports will meet international norms.
- Reforms to make conducting business easier - The government has made it easier to export and import goods and to clear customs. International trade is made simpler for firms as a result.
- A larger emphasis is being placed on encouraging exports from industries that create a lot of jobs, such as textiles, leather, gems and jewelry, food processing, etc.

- Export diversification: The government is encouraging the export of new commodities from promising industries including electronics, pharmaceuticals, engineering, agriculture, etc.
- Promoting the services sector - In addition to promoting India's exports of goods, the policy also aims to encourage and grow its exports of services like IT, BPO, tourism, education, health care, etc.
- Creating international strategic alliances - To improve market access for its exports, India is creating trade agreements and strategic alliances with major trading partners and economic blocs.

Check Your Progress

1. Write any four strategies adopted by the GOI to enhance Foreign Trade.

2. Mention the four pillars of the Foreign Trade Policy of India, 2023.

4.9 Advantages of Foreign Trade Policy

The following are the advantages of Foreign Trade Policy:

- Supports exports: The FTP strives to encourage India's exports of goods and services by offering a range of incentives and subsidies. This increases employment and foreign exchange revenues.
- Increased export growth encourages the expansion of industrial capacity as well as the expansion of the manufacturing and service sectors. This helps the economy as a whole grow.
- Employment-producing sectors are a priority of the FTP since they create a lot of jobs. As a result, it lowers unemployment.
- Enhances balance of payments: The FTP boosts India's current account balance and overall balance of payments situation by causing export growth to outpace import growth.
- Technology advancement: To increase export competitiveness, the FTP encourages businesses to invest in R&D, innovation, and new technologies. Long-term, this aids in the advancement of technology.

- Foreign trade exposes home industries to international competition, which forces them to raise their standards and become more inventive, efficient, and cost-effective. Consumers profit from this.
- Infrastructure development is promoted by the FTP in order to increase exports by fostering the growth of necessary trade-related infrastructure. As a result, the economy benefits.
- Economic growth: All of the advantages, such as increased exports, employment, technology, competition, and efficiency, ultimately lead to the country's higher long-term economic growth.

4.10 Disadvantages of Foreign Trade Policy

The following are the disadvantages of Foreign Trade Policy:

- Exports are highly dependent on foreign demand; therefore any slowdown in the world economy or in trade tensions could have a negative influence on India's FTP export growth targets.
- Greater reliance on imports: The FTP's incentives and subsidies primarily promote exports. As a result, there may be a greater reliance on imports to satisfy domestic needs.
- Threat from low-cost imports: Because of liberal trade rules, domestic industries are also vulnerable to competition from low-cost imports. Some domestic sectors' growth may be hampered as a result.
- Increased imports brought on by trade policy may lead to the closure of certain domestic industries and the loss of jobs for those sectors' employees.
- Budget and financial resources of the government are being taxed by the different FTP incentives and subsidies. This could reduce funding for other crucial industries.
- Costs to the environment and resources: Export-driven economic expansion can also result in resource depletion and environmental damage.
- Regional imbalance: Only a few big cities and commercial centers primarily profit from the export boom encouraged by FTP. Not every region benefits equally from it.

- Inequality: Large enterprises typically profit more from FTP's economic growth advantages. The policy may need to treat workers and small firms more equally.

4.11 Limitations of India's Foreign Trade Policy

The following are the limitations of India's Foreign Trade Policy:

- India's export growth is highly dependent on the stability of the world economy and global commerce, so any significant global uncertainty may have an influence on the FTP targets.
- Slow diversification of exports: India still needs to expand its exports beyond traditional industries. As a result, exports are susceptible to changes in the demand for a few key goods.
- Infrastructure constraints: In spite of efforts to improve trade-related infrastructure, crucial bottlenecks like ineffective ports and shoddy road and rail connections continue to drive up logistical costs and reduce export competitiveness.
- Adoption of new technologies and inadequate R&D are both problems faced by Indian businesses. Technology adoption is still difficult, which limits the production of competitive, superior export goods.
- Issues with bureaucracy and compliance: Despite FTP's reforms to make doing business easier, exporters still need to catch up on bureaucratic red tape and challenging regulatory compliance.
- Limited participation in global production networks and global value chains, which provide access to larger export markets, is a problem for Indian enterprises.
- Dependence on a small number of markets: India continues to focus its exports in industrialized nations like the USA and the EU. Diversifying export destinations beyond a few of key markets requires greater attention.
- Increasing input costs: The competitiveness of exports is challenged by India's rising costs of power, labor, raw materials, etc. The FTP incentives might not be sufficient to make up for this.

Check Your Progress

1. Mention any four advantages and Disadvantages of Foreign Trade Policy.

2. Write any five limitations of Foreign Trade Policy.

4.12 Summing Up

Indian exports and trade with other countries are to be promoted through the country's foreign trade policy. The many goals, plans, and incentives outlined in the strategy are designed to increase export growth, create jobs, support industrial expansion, increase competitiveness, and support economic development. The policy does, however, have some restrictions and drawbacks. The world's uncertainties continue to threaten India's exports. Competitiveness is impacted by problems including shoddy infrastructure, expensive inputs, red tape, and regulatory requirements. The benefits of increased exports do not accrue to all industries and areas equally. Risks include a greater reliance on imports as well as the threat of inexpensive imports. Foreign Trade Policy is a very important tool to boost import and exports of a country. The Government of India has already taken some crucial steps to boost up foreign trade in our country.

Self Asking Questions

1) Explain the need and importance of Foreign Trade Policy in a developing country like India.

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2) What do you mean by FTP? Explain the key features of the recent FTP of India.

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4.13 Model Questions

1. Explain the role of Foreign Trade Policy in Economic Development of India
2. Explain the advantages and disadvantages of Foreign Trade Policy. Critically examine the limitations of India's Foreign Trade Policy.
3. Explain the modifications initiated by the GOI to the Foreign Trade Policy in India.

4.14 References and Suggested Readings

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