

The FDI Bonanza

Retaining investor confidence

The government expects \$30 billion of FDI in the current fiscal, nearly double last year's figures. **Aju Joseph** examines the buoyant inflow of funds into the country.

FIVE years ago, in January 2003, some leading Indian businessmen, called for an image makeover to transform the country into the most-favoured investment destination. What spurred them then was the modest foreign direct investment (FDI) inflow of \$8 billion into the country in 2002, just around 1.7 per cent of gross domestic product (GDP), as compared to China's \$40-50 billion FDI inflows annually in the previous years.

That is the old story. India's FDI-scape has undergone a dramatic change since then. India has overtaken the US to become the second-most attractive destination for global FDI after China, according to a recent study by AT Kearney. "We are targeting \$30 billion of FDI for the current financial year," says Kamal Nath, the Union Minister for Commerce and Industry. "It's almost double from last year's \$15.7 billion."

Thanks to the fast-moving economic engine, with a thriving stock market and a handy regulatory regime, investments are just flowing. The strengthening rupee, riding the unprecedented dollar inflows, is hardly reining in the investments. "India remains a favourite FDI destination," says Nath. "And our FDI policy is perhaps one of the most liberal in the world."

A wide range of sectors are drawing the greenback – services, real estate and construction, infrastructure, manufacturing, transportation, electrical equipment, chemicals and IT and IT-enabled services... the list goes on. "Recent changes in India's regulatory environment and 9 per cent growth are attracting foreign investors in droves," says Tepasij Mishra, head of investment banking at Mumbai-based SSKI.

India will rank second, after China, in terms of FDI inflows, according to the World Investment Prospects Survey for 2007-2009, released recently by the United Nations Conference on Trade and Development (UNCTAD). What is more, India has been ranked "top reformer" in South Asia by the Washington-based International Finance Corporation (IFC) in its 2008 Doing Business Report, up 12 places from its 2007 rank.

According to top Finance Ministry officials, the government is all set to review

the FDI policy for some key sectors soon. The Centre is looking at altering restrictions relevant to oil refining, commodity exchanges and aviation services such as chartering planes and helicopters and ground handling facilities.

"The review of FDI policy is aimed at streamlining investment procedures in a comprehensive way, giving preference to sectors that generate more economic

activity and jobs," says Minister Kamal Nath.

Mauritius, a tax haven thanks to India's bilateral investment treaty, has remained India's largest source of FDI. Japan, Cyprus, the US and Singapore are the other leading investing countries, contributing to the bulk of FDI inflows into the country. According to the government, FDI inflows into India jumped 185 per cent to



ATTRACTING FDI: IT parks and complexes are among major draws for foreign investors



BOOST FOR INFRASTRUCTURE SECTOR: FDI into the infrastructure sector can create a trickle effect, benefitting the economy as a whole

CHANGING GLOBAL EQUATIONS

The world over, FDI is expected to increase across practically all sectors due to continued economic growth, high profitability, and the availability of external finance. The World Investment Prospects Survey for 2007-2009, released by UNCTAD, says investments into greenfield projects will be more commonly used as an entry mode into developing economies, while investments in developed countries will more frequently take the form of mergers and acquisitions (M&As).

Emerging markets, especially in Asia and Europe, are already seeing brisk inflow of funds. The UNCTAD survey has highlighted the role of South and East Asia, both of which will be increasingly attractive destinations for FDI. China and India are seen as the most favoured destinations by multinational corporations. The US is the third most favoured location in the world.

Vietnam is another rising star in Asia, ranked the sixth priority location in the world by MNCs. Two Western European countries – the UK and Germany – rank among the top 10, closely followed by France, while Poland is a rising

destination in Europe, according to the survey.

The survey has also highlighted Eastern Europe and the Commonwealth of Independent States (CIS) countries, which are increasingly preferred by foreign investors. The UNCTAD survey features Russia among the top 5 destinations. In Latin America, Brazil and Mexico are among the top 10 most favoured locations for FDI.

West Asia and Africa are expected to attract less interest despite investment niches in extractive industries and the recent growth of FDI in North Africa.

What are the main drivers of FDI growth?

Access to large and growing markets, a factor mentioned as a major investment determinant by more than half of MNC respondents in the UNCTAD survey, followed by access to resources, especially skilled labour. Access to low-cost labour was also mentioned by many MNCs surveyed. Some others also point out geopolitical and financial instability as the major uncertainties that could potentially hinder their FDI expansion.

\$4.9 billion in the first quarter (April-June) of 2007-08 compared to \$1.7 billion in the same quarter a year earlier.

Multinationals such as UK telecom major Vodafone (which took over Hutchison's stake in Hutch Essar) and Japanese Matsushita (which bought out Anchor) crowned the chart.

The future of India's FDI policy may also be decided based on the strengthening currency. Notes a senior official from Infrastructure Development Finance Corp (IDFC): "The government has identified some sectors like infrastructure – including power, roads and ports – and manufacturing as major recipients of FDI, since they create a trickle effect, and the economy benefits as a whole. There are some apprehensions about more FDI into some sectors such as real estate, which have seen rapid growth in the recent past"

According to Minister Nath "we are in the process of streamlining the policy and looking at how FDI can be looked at to generate more employment. The current year's FDI inflows were a huge jump. The most important thing is that these are largely first-mile investments and are obviously going to grow in geometric proportions."

Montek Singh Ahluwalia, the deputy



FOTOCOOP

SPEEDY CLEARANCE: Huge investments are flowing into the civil aviation sector as well

chairman of the Planning Commission, wants large investments into the country's infrastructure sector. "India needs to double spending on roads, ports and other infrastructure by 2012," he says. "We regard infrastructure as a critical constraint to growth. Investments into infrastructure now are not exactly a trickle, but a stream. It needs to become a flow."

In the past year, India has tripled its investment target for infrastructure to \$500 billion, or 9 per cent of gross domestic product. The Asian Development Bank (ADB) has estimated that India needs as much as \$1.6 trillion for infrastructure in the next 10 years, or about 11-12 per cent of GDP, to maintain the current growth.

The retail sector also offers oppor-

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tunities for FDI inflows. Currently, the government allows 100 per cent FDI in the wholesale cash-and-carry business and 51 per cent FDI in single-brand retail.

Multi-brand retailers can, however, set up shop through the franchise route, but not directly through their subsidiaries.

The retail industry, rated to be the country's second-largest employer after agriculture, is set for an accelerated growth as India's enormous consumer market increases its purchasing power. No wonder, many international players are waiting in the wings.

Among the leading players, Wal-Mart, Carrefour and Woolworths have announced that they would participate in India's food processing market as well. The FDI policy is expected to help reduce wastage of fruits and vegetables. According to industry estimates, the food processing sector has trebled in value in the past two years and is expected to treble again to over \$300 million in next



IN THE FAST LANE: International investors are eager to invest in expressways and highways

two years.

India is yet to open up FDI in multi-brand retailing. International retail giants have made an entry through cash and carry business, either directly (like Metro) or through partnerships (like Wal-Mart with Bharti Enterprises), and through retail franchise agreements (like Marks & Spencer).

The booming real estate market has seen huge FDI inflows into India over the last one year. Private equity deals have soared. The domestic market is expected to expand by \$50 billion over the next four years. ICICI Ventures, IL&FS, Citigroup and Kotak are among leading players who raised multi-million India-focused real estate funds from international investors.

"International investors are rushing in to invest in India's real estate sector," says an executive of Singapore-based

The retail industry, the second largest employer after agriculture, is set for rapid growth.

CapitaLand. "The focus is slowly shifting from major cities such as Mumbai, Delhi, Bangalore and Hyderabad to various tier-II cities like Pune, Nashik, Kochi, Coimbatore and Chandigarh."

Foreign investors are also attracted by India's liberal policies relating to the setting up of special economic zones (SEZs).

International investors are also eager

to invest in the media sector. The government currently allows 26 per cent FDI in the TV news broadcasting section, 20 per cent in FM radio and 49 per cent in cable services. In the direct-to-home (DTH) segment, there is an overall ceiling of 49 per cent, comprising 20 per cent direct foreign holding, and the rest being foreign institutional investment (FII).

But 100 per cent FDI is allowed in the Internet service providers (ISPs) category and for non-news TV broadcasters. The Telecom Regulatory Authority of India (TRAI) has recommended allowing 74 per cent FDI in the broadcast sector, on par with telecommunications.

"A large number of international investors are waiting for the government to open up some segments, or issue clarifications," notes an industry official. "If India opens up the floodgates, FDI inflows will see a quantum jump." 🌈