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IMPACT ON FDI AND FII INTO THE COUNTRY WITH SPECIAL REFERENCE VOLATILITY OF EXCHANGE RATES

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Introduction

In India, during the first three decades of economic planning (1950 – 1980), the country remained trapped in a low level average GDP growth rate of 3.5% per annum. More distressing, however, was the niggardly growth of per capita income, a phenomenon directly out flowing from the rapid growth of population. During the same period, the population grew at an average rate of about 2% per annum. Thus, the rate of growth in terms of per capita income was around 1.5% per annum.

During the 1980's,'the Indian economy entered into the higher growth path of nearly 6% per annum the growth rate increased from 5.8% in the Seventh plan (1985 – 1990) to 6.8% in the Eighth plan(1997 – 2002) was 5.4%, lower than the plan target of 6.5%. The tenth plan aims at 8% average GDP growth for the plan period. It is clear that the Indian economy has come out of the Hindu growth rate syndrome after the introduction of economic reforms.

Investment in a country by individuals and organizations from other countries is an important aspect of international finance. This flow of international finance may take the form of portfolio investment (acquisition of securities) or direct investment (creation of productive facilities). Investment differs mainly from the perspective of the purpose for which the investment is made. Portfolio investment is made in a financial asset to earn better returns with no interest to take active part in the activities of the venture in which the investment is made. In fact a typical portfolio investment constitutes investments in a number of ventures. Foreign direct investment is made with business interest in venture in which the investment is made. Investment in an individual firm will be generally larger than that made under portfolio investment.

Review of Literature

John A. Carlson, (2007) explains the FDI potential contribution to the economic development of the host economy had two alternative conceptualizations. The first emphasizes the net addition of inputs that FDI may bring to the domestic economy. The second emphasizes the potentially distortionary impact that the FDI from imperfectly competitive international industries may have on the domestic economics that are themselves riddled with market imperfections.

Daniel Leaderman (2011) stated that one side effect of the Global financial crisis of 2008 – 2009 was the reason of a debate over exchange rates. The effect of exchange rate fluctuations and currency under valuations on exports is surprisingly ambiguous. Real Exchange rate devaluations might result in increases in FDI inflows, as investor can take advantage of changes in the foreign currency value of domestic assets. The author utilizes quarterly data on real effective exchange rates, FDI inflows and exports to explore the effects of large devaluations on FDI and exports from 1990 – 2010. It suggests that there were heterogeneous experiences regarding the timing and magnitude of subsequent changes in foreign direct investment and exports, but on average FDI inflows tended to precede export surges within two year horizons.

Dr.C.S. Ramanarayanan (2010) quoted that capital inflows play a substantial role in developing countries. Capital inflows are necessary for macroeconomic stability as capital inflows affects a wide range of macroeconomic variables such as exchange rates, interest rates, foreign exchange reserves, domestic monetary conditions as well as savings and investments. The main risk posed by large and volatile capital inflows is that they may resulted in crisis and destabilize macroeconomic management. The role of FII flows and its associated risks, the main purpose of this paper was to investigate the co integration and causality between the exchange rates and FII. The study found that fII series are co integrated and causality between them is bilateral.

Scope of FDI in India

India is the 3rd largest economy of the world in terms of purchasing power parity and thus looks attractive to the world for FDI. Even Government of India, has been trying hard to do away with the FDI caps for majority of the sectors, but there are still critical areas like retailing and insurance where there is lot of opposition from local Indians / Indian companies.

In last few years, certainly foreign investments have shown upward trends but the strict FDI policies have put hurdles in the growth in this sector. India is however set to become one of the major recipients of FDI in the Asia-Pacific region because of the economic reforms for increasing foreign investment and the deregulation of this important sector. India has technical

expertise and skilled managers and a growing middle class market of more than 300 million and this represents an attractive market.

The instruments for receiving Foreign Direct Investment in an Indian company

Foreign investment is reckoned as FDI only if the investment is made in equity shares, fully and mandatorily convertible preference shares and fully and mandatorily convertible debentures with the pricing being decided upfront as a figure or based on the formula that is decided upfront. Any foreign investment into an instrument issued by an Indian company which: gives an option to the investor to convert or not to convert it into equity or does not involve upfront pricing of the instruments a date would be reckoned as ECB and would have to comply with the ECB guidelines.

The FDI policy provides that the price/ conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the extant FEMA regulations [the DCF method of valuation for the unlisted companies and valuation in terms of SEBI (ICDR) Regulations, for the listed companies].

FDI Flows: For associates and subsidiaries, FDI flows consist of the net sales of shares and loans (including non-cash acquisitions made against equipment, manufacturing rights, etc.) to the parent company plus the parent firm´s share of the affiliate´s reinvested earnings plus total net intra-company loans (short- and long-term) provided by the parent company.

FDI flows with a negative sign (reverse flows) indicate that at least one of the components in the above definition is negative and not offset by positive amounts of the remaining components.

FDI Stock: For associate and subsidiary enterprises, it is the value of the share of their capital and reserves (including retained profits) attributable to the parent enterprise (this is equal to total assets minus total liabilities), plus the net indebtedness of the associate or subsidiary to the parent firm. For branches, it is the value of fixed assets and the value of current assets and investments, excluding amounts due from the parent, less liabilities to third parties.

Scope of the Study

- Keeping the objective in mind the researcher assessing the exchange rate towards the foreign investment.
- The descriptive research method helped to know about the causality of exchange rates towards investments which is helpful to avoid the uncertainties to investors.
- This study also helps to understand the FDI flows towards economy as well as towards the development in various sectors.

Objective of the Study

- To analyze the trends, growth and pattern of FDI and FII inflows, into the country with special focus on volatility of exchange rates.
- To find out the impact of exchange rates between major currencies i.e., Great Britain Pounds, US Dollar, Indian Rupee towards FDI.
- To suggest the strategy for policy measures to attract more FDI in the economy.

Research Methodology

- The data for study is collected from the secondary data.
- Sources of Data and Instruments used for collecting Data
- The secondary data are the data in which information is already collected and published. There are several sources, from which the secondary data will be collected. The data is collected from the period of 1991 to 2013. The Data's are Exchange rates between Indian rupee and US dollar, Great Britain Pound, Euro, FDI Inflows and Outflows, FII Inflows and Outflows and real GDP rate.

Analysis and Discussion

An augmented dickey fuller test is a test for a unit root in a time series sample. An augmented dickey fuller test is a version of the Dickey – fuller test for a larger and more complicated set of time series models. The augmented Dickey-Fuller (ADF) statistic, used in the test, is a negative number. The more negative it is, the stronger the rejections of hypothesis that there is a unit root at some level of confidence.

Sl. No.	Test	Tau – Statistic Value	Prob.*	Inference
1	Augmented Dickey Fuller Test - Euro at levels Further test statistic	-0.389	0.895	It explains whether there is a presence of unit root in the time series data related to exchange rate between Euro and Indian Rupees at levels. The calculated tau value is -0.389. And its probability value is above 0.05. Thus the null hypothesis cannot be rejected at 5% level of significance. Hence, it is inferred that the exchange rate between Euro and Indian Rupees is not stationary at their levels.
	Test Critical values:1% level 5% level 10% level	-3.770 -3.005 -2.642		
2	Augmented Dickey Fuller Test – Euro at Further test statistic	-5.526	0.0002	It explains whether there is a presence of unit root in the time series data related to exchange rate between Euro and Indian Rupees at first difference. The calculated tau value is -5.526 and its probability value is less than 0.05. Thus the null hypothesis can be rejected at 5% level of significance. Hence, it is inferred that the exchange rate between Euro and Indian Rupees is stationary at their first difference.
	Test Critical Values:1% level 5% level 10% level	-3.789 -3.012 -2.646		
3	Augmented Dickey Fuller Test – USD at Levels - Further test statistic	-1.161	0.6720	It explains whether there is a presence of unit root in the time series data related to exchange rate between US dollar and Indian Rupees at first difference. The calculated tau value is -1.161 and its probability value is 0.6720 which is greater than 0.05. Thus the null hypothesis can be accepted at 5% level of significance. It is inferred that the exchange rate between US dollar and Indian Rupees is non stationary at their levels.
	Test Critical Values:1% level 5% level 10% level	-3.769 -3.004 -2.642		
4	Augmented Dickey Fuller Test – USD at First difference	-3.552	0.0166	There is a presence of unit root in the time series data related to exchange rate between US dollar and Indian Rupees at first difference. The calculated t-Statistic value is -3.552 and its probability value is less than 0.05 that is 0.0166. Hence the null hypothesis cannot be accepted at 5% level of significance. It is quoted that the exchange rate between US dollar and Indian rupee is stationary at their first difference.
	Test Critical Values:1% level 5% level 10% level	-3.788 -3.012 -2.646		
5	Augmented Dickey Fuller Test – GBP at Levels	-1.201	0.6549	There is a presence of unit root in the time series data related to exchange rate between Great Britain Pounds and Indian Rupees at levels. The calculated tau value is -1.201. And its probability value is above 0.05. Thus the alternative hypothesis can be rejected at 5% level of significance. Hence, it is inferred that the exchange rate between GBP and Indian Rupees is not stationary at their levels.
	Test Critical Values:1% level 5% level 10% level	-3.769 -3.005 -2.642		
6	Augmented Dickey Fuller Test – GBP at First difference	-2.979	0.0534	The augmented dickey fuller test on GBP at first difference and checks if there is a presence of unit root in the time series data related to exchange rate between GBP and Indian Rupees at first difference. The calculated t-value is -2.979 and its probability value is 0.0534. Thus the Null hypothesis can be accepted at 5% level of significance. It is inferred that the exchange rate between GBP and Indian Rupees is not stationary at their first difference.
	Test Critical Values: 1% level 5% level 10% level	-3.788 -3.012 -2.646		
7	Augmented Dickey Fuller Test – Real Effective Exchange Rates at Levels	-1.054	0.7136	There is a presence of unit root in the time series data related to exchange rate between Real Effective Exchange Rate and Indian Rupees at levels. The t-statistic value is -1.054 and its probability value is 0.7136 which is great than 0.05. The Null hypothesis can be accepted at 5% level of significance. It is resulted that the exchange rate between real effective exchange rate and Indian rupee is non stationary at their levels.
	Test Critical Values:1% level 5% level 10% level	-3.788 -3.012 -2.646		

8	Augmented Dickey Fuller Test – Real Effective Exchange Rate at First Difference	-4.821	0.0013	There is a presence of unit root in the time series of data related to exchange rate between real effective exchange rate and Indian rupees at first difference. The t-value is -4.821 and its probability value is 0.0013 which is lesser than 0.05. Hence the alternative hypothesis is accepted at 5% level of significance and resulted that the exchange rate between real effective exchange rate and Indian rupee is stationary at first difference.
	Test Critical Values:1% level 5% level 10% level	-3.832 -3.030 -2.655		
9	Augmented Dickey Fuller Test - FDI Flows (Inflow – Outflow) at levels	-1.634	0.4459	There is a presence of unit root in the time series of data related to FDI flows (Inflows-Outflows) and Indian rupees at levels. The calculated t-statistic value is -1.634 and its probability value is 0.4459 which is greater than 0.05. Hence the null hypothesis cannot be rejected at 5% level of significance. It explains that a Net FDI flow and Indian rupee is non stationary at their levels.
	Test Critical Values:1% level 5% level 10% level	-3.857 -3.040 -2.660		
10	Augmented Dickey Fuller Test - Flows (Inflow – Outflow) at first difference	-3.539	0.0207	It explains that a Net FDI flows and Indian rupee is stationary at their first difference.
	Test Critical Values:1% level 5% level 10% level	-3.920 -3.065 -2.673		
11	Augmented Dickey Fuller Test – FII Net Flows at levels	-1.101	0.9954	There is a presence of unit root in the time series of data related to FII flows (Inflow – Outflow) and Indian rupees at levels. The calculated t-value is -1.101 and its probability value is 0.9954 greater than 0.05. Hence the alternative hypothesis is rejected at 5% level of significance. It stated that a Net FII flow and Indian rupee is non stationary at their levels.
	Test Critical Values:1% level 5% level 10% level	-3.920 -3.065 -2.673		
12	Augmented Dickey Fuller Test – FII Net Flows at first difference	-4.387	0.0177	There is a presence of unit root in the time series of data related to FII flows (Inflow – Outflow) and Indian rupees at first difference. Since the calculated tau value -4.387 and its probability value 0.0177 is less than 0.05, the null hypothesis is rejected and the alternative hypothesis is accepted at 5% level of significance. It stated that a Net FII flow and Indian rupee is non stationary at their first difference.
	Test Critical Values: 1% level 5% level 10% level	-4.728 -3.760 -3.325		

Table 2: Causality between Δ REER&ΔNet FDI

Causality between Δ REER&ΔNet FDI	Co - efficient	Std. Error	t-ratio	p-value
ΔNet FDI flows$_{t-1}$	-0.0003	0.000178	-1.699	0.112
ΔNet FDI Flows $_{t-2}$	0.000547	0.000179	3.054	0.009***
R-squared : 0.568			Adjusted R-squared: 0.445	
F-Value: 4.607			P-value(F): 0.0139	

Table 3:

YEAR	REER	REER Growth Rate	USD	USD Growth Rate	GBP	GBP Growth Rate	EUR	EUR Growth Rate	Net FDI Flows	Net FDI Growth Rate	Net FII Flows	Net FII Growth Rate	GDP	Net FDI	% of GDP on FDI	GDP	Net FII	% of GDP on FII
1991	107.6	-16.46	22.74	29.93	40.11	29.05	31.23	9.29	86	-52.77	2595.1	-	0.42333	86	20315.1	0.42333	-	0
1992	99.7	-7.34	25.92	13.97	45.49	13.41	43.59	39.91	223	165.12	6791.2	161.69	5.42041	225	4206.33	5.42041	-	0
1993	89.1	-10.63	30.49	17.65	45.73	0.54	40.51	-7.27	591.65	133.18	3853.8	-43.25	4.95494	591.65	10729.7	4.95494	2595.1	52373.59
1994	91.3	2.47	31.37	2.89	48.01	4.99	39.95	-1.38	892	67.73	10803.6	180.34	7.46363	892	11951.3	7.46363	6791.2	90990.53
1995	88.6	-2.95	32.43	3.36	51.17	6.58	43.95	10.01	2032	127.8	6207.3	-42.54	7.64576	2032	26576.8	7.64576	3858.5	50404.44
1996	87.4	-1.35	35.43	9.27	55.28	8.05	46.06	4.82	2285	12.45	-1479.9	-123.84	7.39467	2285	30900.7	7.39467	10803.5	146099.9
1997	94	7.55	36.31	2.48	59.45	7.54	41.7	-9.48	3506	53.44	6697.3	-552.55	4.47817	3505	78290.9	4.47817	6207.3	138612.4
1998	97.3	3.51	41.26	13.62	68.35	14.94	46.19	10.78	2586	-26.24	6510.9	-2.75	5.98737	2585	43190.9	5.98737	-1479.9	-24717
1999	97.3	0	43.07	4.4	69.38	1.54	45.7	-1.07	2088	-19.26	12494.8	91.91	7.12872	2088	29290	7.12872	6697.3	93943.11
2000	100	2.77	44.94	4.34	68.07	-1.89	41.5	-9.2	3073.54	47.2	3677.9	-70.56	4.03042	3073.54	76258.6	4.03042	6510.9	161544.1
2001	100.4	0.4	47.19	5	67.98	-0.13	42.29	1.92	4080.2	32.75	35153.8	855.81	5.2169	4080.2	78211.2	5.2169	12494.8	239506.2
2002	99.7	-0.7	48.6	2.99	73.03	7.42	45.94	8.63	3951.63	-3.15	42049.1	19.61	3.75677	3951.63	104903	3.76577	3677.9	97640.5
2003	99.3	-0.4	46.56	-4.21	76.15	4.28	52.69	14.68	2445.3	-38.12	41663.5	-0.92	3.37088	2445.3	29212	8.37088	35153.8	419953.6
2004	99.1	-0.2	45.33	-2.64	83.06	9.07	56.36	6.97	3602.44	47.32	40589.2	-2.55	5.29633	3602.44	43422.1	8.29633	42049.1	506839.7
2005	101.9	2.83	44.11	-2.68	80.22	-3.42	54.86	-2.66	4636.28	28.7	82914.8	99.35	9.28487	4635.28	49933.7	9.28487	41663.5	448724.5
2006	100.5	-1.37	45.33	2.77	83.65	4.28	57.01	3.93	6042.77	30.34	-41216	-150.94	9.26397	6042.77	65228.8	9.26397	40589.2	438140.7
2007	108.5	7.96	41.29	-8.91	82.65	-1.2	56.56	-0.79	8116.13	34.31	87987.6	-313.48	9.80135	8116.13	82806.2	9.80136	80914.3	825546.6
2008	102.9	-5.15	43.42	5.14	80.16	-3.01	63.72	12.65	25991.4	220.24	179675	104.2	3.83095	25991.4	567995	3.89296	-41216	-1059264
2009	105.1	2.14	48.35	11.36	75.87	-5.35	67.44	5.85	19626	-24.49	39352.8	-78.1	5.23823	19626	238230	8.23823	87987.6	1068040
2010	119.5	13.7	45.74	-5.4	70.68	-6.83	60.61	-10.13	5192.93	-73.54	163350	315.09	9.55287	5192.93	54359.9	9.55287	179675	1880844
2011	121.8	1.92	46.67	2.04	74.76	5.77	64.87	7.02	23734.3	357.05	62283	-61.87	6.85592	23734.3	346185	6.85592	39352.8	573997.1
2012	115	-5.53	53.49	14.62	84.74	13.34	68.68	5.88	16960.1	-28.54	-	-	3.95574	16960.1	425519	3.98574	163350	4058359
2013	-	-	58.53	9.6	91.83	8.37	77.94	13.49	-	-	-	-	-	-	-	-	-	-

Findings

- A test is made for a unit root in a time series sample and shows the result that Euro, Great Britain Pound, United States Dollar, Real effective exchange rate, Foreign Direct Investment Inflow, Foreign Institutional Investment Inflow are non stationary at their levels.
- Except Great Britain pounds and foreign institutional investments, other currencies and foreign direct investments are stationary at their first difference. It shows that there is a cause between exchange rates and the investment.
- FDI in services sector is high. A majority of FDI had gone into business services, data processing, financial services, architectural and engineering, engine architectural and other technical consultancy activities India has attracted significant overseas investment interest in services sector.
- The exchange rate made an impact of the investments made in the economy and the investors are very well aware about the risks. The short term investors who invests huge and get back their money within small duration can earn more gain.

- The volatility in exchange rates is viewed clearly by the huge investors and they check the research topics regarding the investments towards the causality between the currencies to avoid the risks.

Suggestions

Our Government should make necessary steps to liberalize the policies to attract the investments in the economy to gain the beneficiary aspects. It is necessary for the currency board to make their currency to keep in certain band which helps to compute the exchange rates between currencies in reasonable rates. It is essential to explain detailed about the foreign investment, because people are unaware and without knowing what its many people are opposing for the investment. The economist of the respective countries must check with the economic policies followed in the country, and helps the investors to retain FDI outflow. Simplification and modernization of laws, rules and regulations, elimination of controls and bans, introduction of modern and professional regulatory systems and other policy reforms will result in greater gross domestic investment besides increases the flow of FDI.

Conclusion

The competitions between the countries for earn the foreign investment into the country and liberalize the policies make the investor to choose the gaining environment and also would come to know when the investment is flows in higher and about the outflows are happened due to valid economic reasons in different periods. The investor waits for the period of changing nature of the exchange rates which gained them for certain time period. The possibilities are checked by the investors and the investment decision is made when the economy satisfy all the norms of the investor. A disquieting trend has been noticed in recent years that a sizeable amount of FDI is used for acquiring Indian companies rather than creating new productive assets. A foreign investment becomes meaningful only when new capacities are created in the economy or the existing capacities are made more efficient and competitive. India's skilled labour force has the potential for claiming the spot light as the country's most alluring characteristics for investment.

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