The Tenuous Relationship between Make in India and FDI Inflows

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Four months after it took office in May 2014, The National Democratic Alliance (NDA) government unveiled the "Make in India" as its first major programme for transforming the Indian economy. The primary goal of this initiative was to make India into a global manufacturing hub, which was to be achieved by increasing the share of manufacturing in the country's GDP to 25 per cent in 2025, or by about 10 percentage points. In order to lend a better focus, the government identified 25 sectors. Interestingly, 13 of these are in the manufacturing sector[1], while the rest belong to the services and infrastructure.[2]

Although the statement of intent of "Make in India" (MII) speaks of encouraging both "multinational as well as domestic companies to manufacture their products within the country", liberalisation of foreign direct investment (FDI) policies that the NDA government began in August 2014, suggests a new level of confidence that it has developed in the ability of foreign companies to contribute to the "making of India". This was more than evident from the following unequivocal statement of the government: "FDI reforms reflect a decisive change in philosophy, from viewing FDI as a tolerable necessity to something to welcome". Operationally, FDI policy reforms were intended to "put more and more FDI proposals on automatic route instead of Government route where time and energy of the investors is wasted". In keeping with the critical role that it had visualised for FDI in the implementation of MII, the NDA government started the process of relaxing the FDI policies in August 2014. Until October 2016, 18 announcements were made for liberalising the policies applicable to various sectors.

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1 These are: automobiles, auto components, aviation, biotechnology, chemicals, defense manufacturing, electrical machinery, electronic system design and manufacturing, food processing, leather, oil and gas, pharmaceuticals and textiles.

2 These are: construction, IT and BPM, media and entertainment, mining, ports, railways, renewable energy, roads and highways, space, thermal power, tourism & hospitality and wellness.

In the aforementioned backdrop of an almost unregulated FDI regime towards which India has made major strides and the various attempts to relate the inflows to programme, this Policy Brief, which is based on a study[3] being conducted at the institute, looks at the magnitude and nature of FDI inflows into India since the MII programme was initiated. In the process it raises serious doubts about the reliability and suitability of the official data.

Broad Trends of FDI Inflows Since 2014

India's reported FDI inflows reached $55.5 billion in 2015-16. This was 23.1 per cent more than the inflows received in 2014-15, and was a new high for the country (*See Table-1*). The Government observed that FDI inflows in the 20 months since the launch of MII, *i.e.*, during October 2014 to May 2016, were 46 per cent higher than those in the immediately preceding 20 months[4]. Many commentators attributed the increase to the success of the programme. It was also pointed out that India had started attracting more FDI than China, notwithstanding the fact that the officially reported FDI into China in 2015 was a little more than three times that of India's. Predictions have also been made that the inflows during 2016 would surpass those in 2015. These claims, however, ignore the simple fact that decisions on long term investments will not be taken instantly and will be based on careful analysis of investors' future requirements and the relative advantages offered by alternative locations globally.

Dramatic Changes in Reported Inflows

In sharp contrast to the prevailing optimism, RBI reports that inflows declined sharply during the first half of 2016, after increasing in 2015. In fact, during this period of slump, equity inflows were back to the levels seen in Apr-Jun of 2014 (*See the Graph*). More importantly, FDI equity inflows through the automatic route, which allows foreign investors to take their own decisions without waiting for specific government approval, fell by almost 30 per cent during the first five months of the current year. This fall would not have occurred had the foreign investors responded consistently to the more liberal policy environment of the government.

The reported FDI inflows witnessed a revival after May 2016. As a result, equity inflows during the first nine months of 2016 rose by 21.3 per cent as compared to those in the corresponding months during 2015 (*See Table-2*). The extent of change that took place during the recent months can be seen from the fact that during the first five months they actually fell by 7.5 per cent. However, the overall increase during Jan-Sep 2016 was achieved in a large measure because of a huge jump in the acquisition of existing shares by foreign investors (M&As) *i.e.*, by displacing the existing investors: acquisitions contributed $3.6 billion to the total increase of $5.7 billion. At the same time, disinvestments and repatriation were also higher in 2016 and as a result, net inflows fell by 0.9 per cent.

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[3] K.S. Chalapati Rao and Biswajit Dhar, "Is It Apt to Credit the Surge in India's FDI Inflows to Make in India?" (Forthcoming January 2017).

[4] Rajya Sabha Unstarred Question No. 298, replied on July 20, 2016.

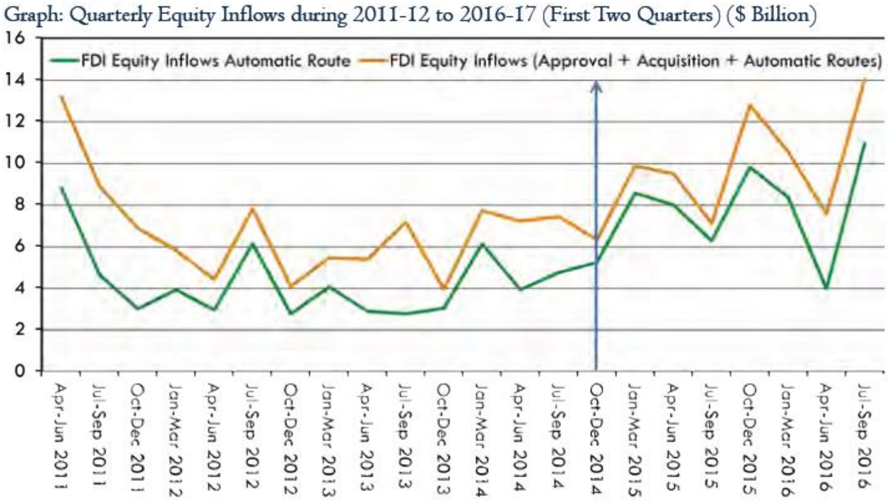
The major contributors to the observed sharp increase in inflows during Mar-Sep 2016 are: (i) the omnibus service sector ($5.3 billion); (ii) telecommunications ($2.8 billion); (iii) electrical equipments ($1.4 billion); and (iv) computer hardware & software ($1 billion). From the records of the Ministry of Corporate Affairs (MCA) we have found that Vodafone India received $2.4 billion during March 2015[5] to June 2016 and a further $5.6 billion during September 2016 – a total of Rs. 53,700 crore. It is quite possible that a part of the new FDI in Vodafone formed an overwhelming portion of the $2.8 billion in the telecommunications (not an MII sector). The new investment in Vodafone is broadly seen as a response to the entry of Reliance Jio into the telecom market and to meet the group's huge debt obligations (Rs. 45,700 crore at the end of December 2015). Unless one gets more details on the nature of investors, mode of investment and more importantly the actual time of remittance, it would be difficult to comment on the other major contributors.

Table-1: India's Gross FDI Inflows ($ Billion)

Financial Year	Total Inflows	Of which,			Increase/Decrease over the Previous Year (%)	
		Equity Inflows#	Reinvested Earnings	Others	Total	Equity
(1)	(2)	(3)	(4)	(5)	(6)	(7)
2007-08	34.8	26.9	7.7	0.3		
2008-09	41.9	32.1	9.0	0.8	20.4	19.3
2009-10	37.7	27.1	8.7	1.9	-10.0	-15.6
2010-11	34.8	22.3	11.9	0.7	-7.7	-17.7
2011-12	46.6	35.9	8.2	2.5	33.9	61.0
2012-13	34.3	22.9	9.9	1.5	-26.4	-36.2
2013-14	36.0	25.3	9.0	1.8	5.0	10.5
2014-15	45.1	31.9	10.0	3.2	25.3	26.1
2015-16	55.5	41.0	10.0	4.4	23.1	28.5

 # Inflows through government, acquisition and automatic routes as also equity capital of unincorporated bodies.
Source: Based on data provided by DIPP in the Quarterly Fact Sheet on Foreign Direct Investment (FDI) from April 2000 to March 2016.

Graph: Quarterly Equity Inflows during 2011-12 to 2016-17 (First Two Quarters) ($ Billion)



5 Shares allotted in March 2015 were not reported by the Department of Industrial Policy and Promotion (DIPP) till March 2016.

But, are comparisons of the above type, often made by many, valid? The observations presented a little later indicate otherwise. Further, irrespective of the validity of the comparisons, it needs to be underlined that disinvestment/repatriation accounted for as much as 38.9 per cent of total equity inflows so far in 2016 compared to 30.8 per cent in the corresponding period of 2015 (*See Table 2*). Such high and continuous drain has not been attracting the attention it deserves.

No Signs of Manufacturing Sector's Ascendancy

The publicly available official information indicates that the share of manufacturing sector, the core of MII, declined sharply in the face of increased inflows. While for the entire two years October 2014 -- September 2016, manufacturing sector had a share of 29.1 per cent, the share was 47.8 per cent during the previous two years. Services, Computer Hardware & Software, Trading and Construction occupy the top four positions followed at a distance by the automobile industry. Since the official classification is too aggregative, we made an attempt to classify the reported individual investee companies. In order to keep the exercise within manageable limits we have decided to first identify all those which received at least $5 million during October 2014 to March 2016[6]. There were 1,188 such companies (6,349 tranches of inflows) which accounted for 92 per cent of the total inflows during the period. The manufacturing sector accounted for a little more than one-fourth of the inflows; the transport equipment and allied products accounted for a large share of the inflows into manufacturing. Inflows into the chemicals sector were dominated by pharmaceuticals. But most of it went into the already taken over pharmaceutical companies. Radio, Television & Communication Equipment, Medical, precision & optical instruments, etc. and Office, Accounting & Computing machinery, which are technology intensive, together accounted for less than 1 per cent of the total inflows during the period. Defence industries on which much emphasis is being placed received a mere $0.18 million.

While services accounted for about three-fourths of the inflows, trading was the single largest sector within services. It accounted for as much as 15.7 per cent of the total inflows. Further, it was dominated by e-commerce. The influence of e-commerce can further be seen as its allied activities namely, logistics, electronic payment systems, etc. also attracted large sums. Unlike the official statistics which show computer software and hardware as the second top recipient, our study finds that far less amounts can be attributed to software development or BPO. There is a possibility of online payment services, some e-commerce related activities and app-based passenger transport having been clubbed together under computer software and hardware.[7] Besides transport, storage and communications, the construction sector attracted large inflows. Bulk of the FDI into the construction sector was, however, directed at housing, commercial complexes, malls, etc. Roads and bridges received only a small fraction of the inflows into the sector.

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6 Till the middle of this month the details beyond Match 2016 are not available.

7 DIPP, *Electronics and IT* Sector: *Achievements Report*, November 8, 2016, confirms such a classification. Snapdeal, Paytm and Ola figure at the very top of the list of recipients.

Table-2: India's FDI Flows during the First Nine Months of 2015 and 2016: A Comparison

SN	Item	2015 Jan-Sep ($ mn)	2016 Jan-Sep ($ mn)	Increase/Decrease (%) Jan-Sep	Jan-May
	(1)	(2)	(3)	(4)	(5)
1	Total Equity Inflows (2+6)	27,242	33,035	21.3	-7.5
2	Equity Inflows (3+4+5)	26,517	32,183	21.4	-8.3
3	• RBI Automatic Route	22,880	23,334	2.0	-29.6
4	• Acquisition of existing shares	2,169	5,738	164.5	222.4
5	• Approval Route (SIA/FIPB)	1,467	3,111	112.1	16.8
6	Equity Capital of unincorporated bodies	726	852	17.4	25.4
7	Other Capital	3,964	2,103	-46.9	-53.1
8	Reinvested Earnings	7,419	8,630	16.3	21.7
9	Total Inflows (1+7+8)	38,625	43,768	13.3	-7.3
10	Repatriation/Disinvestment	8,532	13,280	55.6	33.8
11	*Of which, Equity*	8,392	12,842	53.0	35.3
12	Direct Investment to India (9-10)	30,093	30,488	1.3	-18.9
13	Outward FDI from India	4,300	4,935	14.8	87.5
14	Net FDI (12-13)	25,793	25,553	-0.9	-32.2
	Ratio of Equity Disinvestment to Total Equity -- (11/1)x100	30.8	38.9		
	Share of Acquisitions in Equity Inflows -- (4/2))x100	8.2	17.8		

Source: Based on the data provided by the RBI on its website.

Further, a classification of the investors in these 1,188 companies shows that there was very little change in the structure of inflows in terms of the nature of foreign investors compared to the decade of 2004- 05 to 2013-14. Realistic FDI (RFDI)[8] accounted for about 58 per cent of the total while the rest is from foreign financial and India-related investors. Here again, MII did not seem to make much difference. The motives and impact of RFDI investors are vastly different from those of other investors. RFDI is a better indicator of efficacy of FDI policy because financial investors would not have lasting interest and India-related investors are unlikely to possess additional intangible assets. Some of them might even be bringing back the funds transferred out of the country by fair or foul means.

Far too Few Companies are Newly Incorporated

To be able to attribute the inflows to the new programme and policies a necessary condition is that the decision to invest should have been made in the new period. It has been observed that except for 44 companies,[9] the rest of 1,188 companies identified by us were incorporated prior to October 2014. Hence in their case either the decision to invest had already been made or foreign investors decided to takeover or buy into the existing companies. The corresponding numbers for the manufacturing sector are 8 and 442 respectively. The share of newly incorporated companies in inflows was 2.7 per cent overall and 1.6 per cent for the manufacturing sector. Instead of investing in one go, most investors bring funds in multiple tranches. It has been found that most of the 1,144 companies that were incorporated prior to October 2014 received inflows during 2004-2014, the period for which we

8 Classified as such when foreign investors invest in their respective lines of businesses. Excludes financial investments like private equity and round-tripped investments.

9 Excluding those that were incorporated to takeover the existing businesses.

have information on individual tranches of inflows. Of the remaining cases, non-RFDI inflows were predominant. The aforementioned suggests that if the new programme/ policies were decisive, the number of newly incorporated companies would have been far larger, especially in the manufacturing sector. The few companies that were incorporated since October 2014 would have most likely come into being even if the MII was not introduced.

Reliability and Suitability of Data on Inflows

Drilling deeper into the reported data on inflows, we have found serious limitations in this data. The limitations noticed by us are of three kinds. One, quite a few tranches of inflows are of questionable veracity: some entries are either inaccurate reporting or are duplicate entries. Two, there are delays in reporting the inflows (sometimes by many years). While some delay is built into the reporting requirements, for the purpose of assessing the impact of the new policies and programmes even a month's delay could alter the conclusions. It appears that investee companies might have accelerated the clearing of the backlog following the delegation of powers to compound contraventions of FEMA 1999, to the regional offices of the RBI in April 2014. Such inflows would not have anything to do with MII. And third, sector/activity classification of inflows at times is quite misleading.

The following cases illustrate the types of problems the FDI data suffer from[10]. The single largest tranche amounting to $2.25 billion (Rs. 15,000 crore), relating to Serene Senior Living during Oct- Dec 2015, could not be confirmed by us from the allotment of shares reported to the Ministry of Corporate Affairs (MCA) by the recipient company. In case of Keyman Financial Services what appears to be a Rs. 75 crore inflow, which came in 2007, was reported as Rs. 7,500 crore during 2015. Two large tranches of inflows into Triguna Hospitality, each amounting to more than Rs. 5,000 crore, could not be traced in the filings with the MCA. In case of Renault Nissan Automotive, ECBs made in 2011 were converted into shares in November 2014. We could not find the entries *corresponding* to the $675 million reported to have been received by Ford India in September 2014. The reported entire investment into Walmart India matches exactly with the amounts associated with allotment of shares prior to October 2014. In its case there were also two duplicate entries which together amounted to Rs. 1,951 crore. The $3 billion inflow on account of buyout of public shareholding of Hindustan Unilever, which specialises in detergents, cosmetics and toiletries, by its foreign parent company, was treated as belonging to the *food processing* sector.

Surprisingly major deficiencies in the official data of the kind we have pointed out have remained unnoticed till now. In view of the large number of cases of delayed reporting (whatever may be the proximate cause for the delays) and other serious inaccuracies, one is left wondering whether the unprecedented level of inflows reported for 2015- 16 did actually take place during this financial year! As a corollary, a question arises regarding the usefulness of official sectoral classification of inflows.

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10 These observations are based on a comparison of the inflows reported by the DIPP and the filings of respective companies with the MCA.

In-depth Analysis of FDI is Imperative

Our analysis of the inflows strongly suggests that, contrary to the optimism expressed by many, the MII programme may not have yet made an impact in terms of attracting FDI into the focus sectors. Further, the reported investments should be examined from the points of (i) adding fresh domestic production capacities (including meaningful indigenisation), (ii) net addition to capital instead of round-tripping of funds remitted abroad on one pretext or the other, (iii) the monetary value of all the incentives and exemptions availed and (iv) last but not the least, delayed reporting and gross inaccuracies. Acquisitions and disinvestments (not to speak of outward FDI) undermine the contribution of the inflows to new capacity creation in the economy. Statements regarding the contribution of FDI to India's development which ignore these critical features of FDI would be misleading, if not mischievous. India should start taking an objective view based on appropriate empirical evidence.

The problems noted by us are not specific to the present regime. They are a legacy of the past sustained by blind faith in the dominant global paradigm. India should not be swayed by the off-the-cuff explanations of and the indices constructed by international agencies. There are many nuances to the data on global FDI flows because of which they cannot be taken at face value.