

# IMPACT OF FOREIGN DIRECT INVESTMENT DETERMINANTS ON ECONOMIC GROWTH

## Abstract

This research is based on the impact of foreign direct investments on India's economic growth. Foreign direct investment decisions are influenced by several factors. It includes the country's political stability, exchange rates, foreign reserves, investment policies, GDP and regulations, economic stability, investment policies, inflation rate, and economic and investment stability. Additionally, foreign direct investments support increased trade and the provision of financial help. Foreign direct investment has helped the Indian economy's balance of payments issues. This paper's main objective is to analyse how foreign direct investment affects the growth of the Indian economy. The Gross Domestic Product (GDP), Population, Inflation, Foreign Exchange Rate, Trade, and Net Foreign Direct Investment Inflows are used as the study's variables. The influence of foreign direct investments on the Indian economy is examined using the Multiple regression method. The analysis is based on secondary data gathered from 1991 to 2022 from the various reports of UNCTAD and fact sheets of World Investment. The empirical findings indicate that foreign direct investments are important for the expansion of the Indian economy and that there is a strong correlation between FDI and GDP.

**Keywords:** Foreign Direct Investment (FDI), Gross Domestic Product (GDP), Determinants, Economic Growth.

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## I. INTRODUCTION

The rapid growth in Foreign Direct Investment (FDI) by multinational enterprises can be attributed to significant technological advancements, increased trade, liberalization of investment regimes, and market deregulation and privatization in many nations, particularly emerging ones like India (Adhana& Saxena, 2016). According to the IMF's Balance of Payments Manual Fifth Edition (BPM-5) definition, FDI comprises three components: stock, reinvested earnings, and other capital. The two other elements that make up equity FDI are Greenfield investments and mergers and acquisitions (M&A) (Adhana& Saxena, 2016).

FDI is a preferred method for capital inflow into an economy, contributing to economic growth and facilitating the transfer of technology and knowledge (Adhikary, 2012). In the case of India, FDI plays a significant role in the economy, generating returns in production and promoting sustainable growth through positive externalities (Fonseka, 2020). India has become a popular destination for FDI, attracting substantial investments due to factors like low-wage labour, a skilled workforce with high literacy rates and communication skills, access to cheap resources and raw materials, and favourable policies (Fonseka, 2020).

Recent examples of FDI in India include Byju's contribution of USD 500 million and Cashaa's USD 5 million investment for the expansion of the cryptocurrency sector. Additionally, the Singaporean government provided USD 63.84 million for Phoenix Mills' construction, and Coralogix invested USD 30 million (Fonseka, 2020).

Given that FDI plays a crucial role in boosting economic growth, especially in nations lacking financial, human, and technological resources for progress (Adhikary, 2012), the Indian Government implemented economic reforms in 1991 to encourage foreign investments. As a result, India has emerged as the fourth-largest and second-fastest-growing economy in the world, making it one of the top achievers among global economies. The country is also the third-largest source of scientific and technical labour and the 11th-largest economy in terms of industrial production (Hooda, 2011).

In summary, FDI has become a key driver of economic growth in India, attracting significant investments due to its favourable economic environment and policies (Fonseka, 2020). The Indian Government's reforms have further contributed to the nation's economic success (Hooda, 2011).

## II. LITERATURE REVIEW

Numerous studies have been conducted covering various aspects of foreign direct investment (FDI). Some of the relevant studies relating to the present topic are being reviewed here as under:

**Table 1: Tabular Presentation of the Prior Literature**

<b>Title</b>	<b>Author/s &amp; Year</b>	<b>Objectives</b>	<b>Methodology</b>	<b>Findings</b>	<b>Research Gap</b>
<b>An Empirical Analysis of the Impact of Foreign Direct Investment on Economic Activity of India</b>	<b>Jayaraj et al. (2011)</b>	To investigate the co-movement and converging behaviour between the two the movement of FDI and GDP.	Granger Casualty Test	The study showed that FDI did not Granger cause GDP but interestingly GDP has Granger cause on FDI. Further study shows the inter-relationship between these two variables.	Researcher can use others determinants too.
<b>FDI and Its Impact on Indian Economy</b>	<b>Srikanth et al. (2012)</b>	To examine, both before and after the onset of the global financial crisis, the effects of foreign direct investment equity inflows on the Indian economy using monthly data from April 2005 to March 2011.	Granger Causality Test	According to the findings, there is a one-way causal relationship between FDI equity inflows and IIP and WPI, as well as between FDI and foreign exchange reserves.	In this paper old data was used for the study and researcher can apply other econometric test for cross verification.
<b>Foreign Direct Investment and economic growth literature review from 1994-2012</b>	<b>Mohammad et al. (2013)</b>	To examine the relationships between FDI and Economic Growth.	OLS, Granger Causality, Cointegration, Error correction models	The findings indicate that the FDI-EG relationship's primary finding is often considerable positivity, although occasionally it is negative or even nil. Several influencing elements, including acceptable levels of human capital, well-developed financial markets, complementarity between	

				local and international investment, and free trade regimes, exist within the relationship.	
<b>Relation Between Inflow of FDI and The Development of India's Economy</b>	<b>Arora (2013)</b>	The paper aims to find out the impact of economic reforms on FDI in India. The study also examines the constraints in increasing the level of FDI in India	Chi-Square and Karl Pearson's Coefficient of Correlation	The study revealed that there is a positive relationship between the inflow of FDI and the development of India's economy.	The Scope of this research paper is limited only in two banks of the Delhi state. Therefore, researchers can include additional banks and states for in-depth studies in the future.
<b>Foreign Direct Investment: Impact on Indian Economy</b>	<b>Malhotra (2014)</b>	<ul style="list-style-type: none"> <li>To study the trends and pattern of flow of FDI</li> <li>To assess the determinants of FDI inflows</li> <li>To evaluate the impact of FDI on the Indian economy</li> <li>To know the flow of Investment in India.</li> </ul>	Trend Analysis, Percentage method	Foreign Direct Investment has positive impact on Indian economy. FDI inflow supplements domestic capital, as well as technology and skills of existing companies. It also helps to establish new companies. All of these contribute to economic growth of the Indian economy	The study highlights the difficulties in understanding FDI statistics in India and outlines the main policy ramifications of this research.
<b>Foreign Direct Investment and Economic Growth in India: A sector-specific</b>	<b>Jana et al. (2019)</b>	To investigate how, in the context of a rising economy like India, sector-specific FDI inflows might influence the development of	Johansen Cointegration test, Vector error correction	Results showed that inward FDI is non-contributive to agricultural output growth, but reverse causality is observed, with agricultural	

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<b>Analysis</b>		corresponding sectors.	model, Granger causality test	output attracting more FDI. The manufacturing sector has shown positive effects from FDI inflows, while the service sector confirmed a bi-directional causality between FDI and growth	
<b>Impact of FDI on Indian Economic Growth</b>	<b>Fonseka et al. (2020)</b>	To analyze the impact of foreign direct investment towards the growth of the Indian Economy	Simple Regression and Pearson's Correlation	Study reveals that Foreign Direct Investments are significant for the growth of the Indian Economy and the positive association between FDI and GDP	There are limited variables, and the study period is up to 2019. Further COVID-19 impact studies should be done by the researcher.
<b>Determinants of FDI and its Impact on Indian Economy Growth</b>	<b>Mahapatra (2020)</b>	To investigate the relationship between FDI inflow and Gross Domestic Product in service sector.	Statistical model	This analysis has revealed that Foreign Direct Investment has positive and significant impact on GDP.	Study is limited on a single variable that is GDP, we can include other important factor in future study
<b>Determinants of FDI and its Impact on Indian Economy Growth</b>	<b>Baalark (2020)</b>	To study FDI determinants and how they affect economic expansion.	Content analysis	Study revealed that, the majority of FDI inflows are in sectors like manufacturing, financial services, telecommunication, construction activities and computer software and hardware in India.	

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<b>Impact of Foreign Direct Investment on Economic Growth in India</b>	<b>Shrivastava et.al (2021)</b>	To study the impact of FDI inflow on the GDP growth rate from 1970 to 2019	Simple Regression	Study discovered that the FDI inflow has a favourable impact on the nation's economic expansion. To draw the inflow to a significant level, the model's R2 indicated a tremendous demand for FDI inflow into the economy as well as improvements to other parameters. The factors' association revealed that they favourably complement one another.	Study is limited on a single variable that is GDP, we can include other important factor in future study.
<b>Economic Factors and Foreign Direct Investment in India: A Correlation Study</b>	<b>Dhingra (2022)</b>	To investigate the degree of connection between FDI inflow in India and various economic indicators, including exchange rate, GDP, and openness of trade.	Pearson Correlation	The present study revealed that determinants of FDI inflow in India and several economic factors like exchange rate, GDP, openness of trade etc. are positively correlated with each other.	

The above review of literature proves beneficial in identifying the research issues and the research gaps, which are mainly the edifices on which the objectives of the present study are based. There is hardly any study in India which documents the impact of the FDI on the economic growth of India. Thus, the present study is an Endeavour to discuss the influencing determinants of FDI and their impact on the economic growth in India. The present study tries to find out the major factors of foreign direct investment and then find out their positive as well as negative impact on Indian Economic Growth. The foremost topic of this study is based on the “Impact of foreign direct investment determinants on economic growth.” This dispenses the empirical results on how Foreign Direct Investment affect the economic growth in India with the help of data from 1991 to 2022. Further, this study helps to find out the determinants and role of FDI on flourishing economic growth.

### **III. THE SIGNIFICANCE OF THE STUDY**

The impact of Foreign Direct Investment (FDI) on the economic growth of India is multifaceted. To begin with, FDI has emerged as a critical driver of economic development in many countries, especially those lacking sufficient financial, human, and technological resources for progress (Adhikary, 2012). Understanding the determinants that influence FDI inflow and their effects on economic growth can provide valuable insights for policymakers and investors in India, facilitating an environment conducive to attracting more FDI. Moreover, India has become a prominent destination for FDI, witnessing substantial investments in diverse sectors like manufacturing, financial services, telecommunications, and more (Fonseka et al., 2020; Baalark, 2020). Examining the impact of these FDI inflows on India's economic growth can shed light on the efficacy of policies and initiatives implemented by the Indian Government to attract foreign investments.

Additionally, the study's analysis of FDI determinants, including exchange rates, GDP, openness of trade, and others, offers valuable insights into the factors influencing foreign investors' decisions. Understanding these determinants can aid policymakers in identifying areas for enhancement to make India a more appealing destination for FDI and formulating targeted strategies to boost economic growth. Furthermore, considering the evolving global economic landscape, exploring the trends and patterns of FDI inflows over the years and their impact on economic growth can provide essential lessons and insights for policymakers in India to adapt to changing market conditions and remain competitive in attracting foreign investments. Lastly, the findings of the study can significantly contribute to the existing body of knowledge on FDI and economic growth in India. By reviewing prior literature and identifying research gaps, this study aims to build upon previous research and provide a comprehensive analysis of the subject matter.

### **IV. OBJECTIVES OF THE STUDY**

The study specifically encompasses its scope. The following objectives are there:

- To analyze determinants which influence the Foreign Direct Investment inflow in India.
- To examine the impact of Foreign Direct Investment on the economic growth of the country.
- To give suggestions to policymakers to attract more FDI.

## V. RESEARCH METHODOLOGY

Data collection of information has been based on secondary data. To achieve the objectives data has been collected from various UNCTAD (world investment reports) from 1990-2022. There are six variables used to measure the impact on Economic Growth. FDI is taken as the independent variable whilst GDP, Trade, population, exchange rate, and inflation are taken as the dependent variable. And lastly, we have given suggestions on the basis of our study.

## VI. DATA ANALYSIS AND INTERPRETATION

The Multiple Regression Model is used to measure the impact of Foreign Direct Investments on Indian Economic Growth. Economic growth is measured by Exchange Rate, Gross Domestic Product, Trade, Inflation, and population. The multiple Regression Model can be mentioned as follows.

$$Y = b_0 + b_1X_1 + b_2 X_2 + b_3X_3 + b_4X_4 + b_5X_5 + \dots + b_nX_n + U_t$$

FDI inflows in India =  $b_0 + b_1$  Trade +  $b_2$  population +  $b_3$  exchange rate +  $b_4$  inflation +  $b_5$  GDP.

To check the impact of independent variables on FDI inflows in India, the following hypothesis has been formulated:

$H_{0(1)}$ : There is no significant impact of independent variables on the dependent variable.

$H_0: b_1 = b_2 = b_3 = 0$ , where  $b$  is the slope of the regression line or regression coefficient.

$H_{a(1)}$ : There is a significant impact of independent variables on the dependent variable.

$H_a: b_1 \neq b_2 \neq b_3 \neq 0$ , where  $b$  is the slope of the regression line or regression coefficient.

**Table 2: Descriptive Statistics**

Variables	Mean	S. D	N
FDI Inflows	29191.1250	28048.16074	32
Trade	412169.4806	344431.57362	32
Population	1171.1769	163.90588	32
Exchange Rate	49.4275	14.81704	32
Inflation	7.1642	2.99654	32
GDP	1357646.7625	1034030.40767	32

Source: SPSS Multiple Regression Output.

Table 2 depicts the analysis of descriptive statistics of independent and dependent variables of India, like mean and standard deviation. The mean value of FDI inflow in India is 29191.1250, along with the standard deviation is 28048.16074. The mean values of independent variables, namely, Trade, Population, exchange rate, inflation and GDP of India are 412169.4806, 1171.1769, 49.4275, 7.1642, and 1357646.7625 respectively along with their standard deviation of 344431.57362, 163.90588, 14.81704, 2.99654, and 1034030.40767 respectively.



**Table: 3 Correlations Matrix**

	<b>Fdi Inflows</b>	<b>Trade</b>	<b>Population</b>	<b>Exchange Rate</b>	<b>Inflation</b>	<b>GDP</b>
Fdi Inflows	1.000					
Trade	0.621	1.000				
Population	0.535	0.631	1.000			
Exchange Rate	0.591	0.459	0.843	1.000		
Inflation	-0.258	-0.184	-0.392	-0.501	1.000	
GDP	0.460	0.567	0.537	0.761	-0.279	1.000

Source: SPSS Multiple Regression Output

The correlation matrix, shown in Table 3, shows the correlations between any two pairs of variables. Except for exchange rate and population and GDP and exchange rate, all pairings of independent variables have correlations that are less than 0.75, indicating that the analysis is not multicollinear except in this one instance.

Additionally, Table 3 demonstrates that for all independent variables, the variance inflation factor (VIF) index is less than 10. As a result, the regression model's multicollinearity assumption is satisfied, and there is no multicollinearity in the data.

**Table 4: Model Summary<sup>b</sup>**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.976 <sub>a</sub>	0.953	0.944	6636.52882	0.953	105.544	5	26	0.000	1.478

Source: SPSS Multiple Regression Output.

- Predictors: (Constant), TRADE, POPULATION, EXCHANGE RATE, INFLATION, GDP
- Dependent Variable: FDI

Multiple regression model statistics are shown in Table 3. The calculated value of the regression coefficient is 0.976, while the calculated value of the R<sup>2</sup> coefficient is 0.953.

The value of the coefficient of determination R<sup>2</sup> explains that near about 95% of the variation in FDI inflows in India can be explained by Trade, Population, Exchange Rate, Inflation and GDP while the remaining 5 per cent variation in FDI inflows is explained by other factors which are not included in the model. The Durbin-Watson statistics are also obtained to examine the assumption of independence. The Value of Durbin Watson is 1.478 which falls between the accepted ranges of 1-3, indicating that there is no problem with autocorrelation. This simply means that the variables that belong to the model are not included in the error term, meaning that there is no specification error in the model.

**Table5: ANOVA<sup>a</sup>**

Model	Sum of Squares	DF	Mean Square	F	Sig.
Regression	23242547562.833	5	4648509512.567	105.544	.000 <sup>b</sup>
Residual	1145131382.667	26	44043514.718		
Total	24387678945.500	31			

Source: SPSS Multiple Regression Output.

- Dependent Variable: FDI Inflows
- Predictors: (Constant), GDP, Inflation, Population, Exchange Rate, Trade

The F-test determines that at least one of the regression coefficients is different from zero and explains the overall relevance or validity of the model. Table 5 shows that the computed F-value is 105.544, rejecting the null hypothesis, and the corresponding p-value is 0.000. As a result, it can be inferred that at least one independent variable significantly correlates with the Foreign Direct Investment, and analysis supports the validity or statistical significance of the entire regression model.

**Table 6: Coefficients<sup>a</sup>**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	-121022.759	29010.2348		-4.172	0.000		
Trade	-0.059	0.019	-0.720	-3.105	0.005	0.034	9.737
Population	133.298	33.181	0.779	4.017	0.000	0.048	6.818
Exchange Rate	-717.367	353.059	-0.379	-2.032	0.053	0.052	3.262
Inflation	817.885	566.252	0.087	1.444	0.161	0.493	2.026
GDP	0.035	0.007	1.299	5.307	0.000	0.030	9.193

Source: SPSS Multiple Regression Output.

- Dependent Variable: FDI Inflows
- Predictors: (Constant), TRADE, POPULATION, Exchange Rate, INFLATION, Gross Domestic Product

The aforementioned Table presents the output relating to the significant linear relationship between individual independent variables and Foreign Direct Investment inflow in India. The standardised Beta – coefficient shows the relative contribution or importance of Trade, Population, Exchange rate, Inflation and GDP in predicting the value of Foreign Direct Investment inflows in India. The analysis reveals that the population of India (0.779) is

the most important variable in attracting FDI inflows in India, followed by inflation (0.087) and GDP (1.299). While other independent variables such as trade (- 0.720), and exchange rate (-0.379) have an inverse impact on Foreign Direct Investment inflows in India.

The analysis indicates that the regression coefficient of inflation in India is 817.885, which is positive and statistically significant. Results state that with a one per cent increase in inflation, the FDI inflows in India will increase by 817.8 per cent by holding other variables constant, which is more than proportionately. The positive and significant value of the coefficient populations (133.298) illustrates that with a one per cent increase in the population, the FDI inflows in India will tend to increase by 133.2 per cent at the increasing rate, by holding other factors constant. GDP has also a positive influence on the FDI inflow in India, one per cent increase in the GDP, and the Foreign Direct Investment inflows in India will increase by 0.035 per cent also plays an important role in the policy formulation of the nation and also in the FDI policy of the respective country. The regression coefficient GDP (0.035) is positive and significant at a 10 per cent level of significance. This indicates that the GDP of India plays a positive and significant role in attracting FDI inflows. This implies that with a one per cent improvement in GDP, the FDI inflows tend to increase by 0.035 per cent at an increasing rate.

The regression coefficient of Trade (-0.059) and exchange rate (-717.367) are negative and significant, which shows that with a 1 per cent increase in Trade and exchange rate, the inflows of FDI in India will decrease by 0.059 per cent and 717.367 per cent respectively. The impact of inflation on FDI in India is positive (817.8), but the insignificant p-value does not support the argument.

## VII. CONCLUSION

The study aimed to analyze the impact of Foreign Direct Investment (FDI) on Indian Economic Growth and identify the significant determinants affecting FDI inflows in India. The multiple regression model was utilized to measure the relationship between FDI inflows and independent variables, including Trade, Population, Exchange Rate, Inflation, and GDP. Foreign direct investments are made from one country to another with a variety of expectations. The growth of the Indian economy is significantly influenced by foreign direct investments. Foreign direct investments can affect an economy in both positive and negative ways. Most of the time, it promotes economic expansion. Employment opportunities are increased by FDIs. With the aid of foreign reserves, the local currency is also strengthened. However, there are also a lot of negative impacts of Foreign Direct Investment on economic growth. Foreign direct investments cause the domestic producers' level of competition to decline. on the other hand, FDI concentrated on the country's growth aspect and does not take the country's development into account. The empirical analysis clearly demonstrated that foreign direct investments in India had a considerable impact on gross domestic product. Simple regression analysis has shown that changes in foreign direct investments account for the majority of variations in the gross domestic product. Several factors influence the direction of FDI inflows in India, including market size, the host nation's policies, socioeconomic conditions, managerial expertise, technology, financial strength, skilled labour availability, human development, and GDP growth. The determinants of FDI may evolve over time, underscoring the need for continuous monitoring and adaptable policies to attract and retain foreign investments.

**Key findings from the study include:**

1. The coefficient of determination (R<sup>2</sup>) indicated that approximately 95% of the variation in FDI inflows in India can be explained by the independent variables: trade, Population, Exchange Rate, Inflation, and GDP. The remaining 5% may be influenced by other factors not included in the model.
2. The analysis reveals that the population of India (0.779) is the most important variable in attracting FDI inflows in India which means the demand for the product or services is high in the country (Sulaiman, 2016) & (Tiwari & Mutascu, 2011), followed by inflation (0.087) and GDP (1.299) supported our study result by other studies (Jadhav, 2012), Erel, Liao & Weisbach, (2012).
3. Trade and Exchange Rates showed negative correlations with FDI inflows, suggesting that increased imports resulting from trade liberalization might discourage multinational companies from investing in domestic industries. Exchange rate volatility, contrary to the usual negative correlation, displayed a positive relationship with India's FDI during the studied period.
4. High exchange rates will decrease the return on foreign investment, boost foreign output, and cause economic distortions in the host nation. Due to volatility, a negative correlation between the exchange rate and the flow of foreign capital is typically predicted; however, the present results indicate a positive correlation between India's FDI and the exchange rate for the time period under consideration.
5. Foreign Direct Investment and Gross Domestic Product growth displayed a positive association during the period 1991–2022, further validating the importance of FDI in driving economic growth (Kumar and Karthika, 2010).
6. The analysis demonstrated that the explanatory variables used in the study sufficiently explained FDI inflows to India, and multicollinearity was not a significant issue, except for exchange rate and population and GDP and exchange rate.
7. The analysis revealed that the model had a high coefficient of determination (R<sup>2</sup>) of 0.953, indicating that approximately 95% of the variation in FDI inflows in India can be explained by the independent variables. The F-test further supported the model's validity, demonstrating that at least one independent variable significantly correlates with FDI inflows.
8. Among the independent variables, Population, GDP, and Inflation were found to be positively and significantly related to FDI inflows in India. A one per cent increase in Population, GDP, and Inflation correspondingly led to significant increases in FDI inflows. On the other hand, Trade and Exchange rates showed negative relationships with FDI inflows, meaning that a one per cent increase in Trade and Exchange rates resulted in reduced FDI inflows.

**VIII. RECOMMENDATIONS**

Based on the study's findings, the following recommendations are proposed to enhance FDI inflows and foster economic growth in India:

1. **Population Management:** Given the positive impact of population on FDI inflows, policymakers should focus on measures to manage population growth effectively. Investments in education and healthcare can lead to a skilled and healthy workforce, which is attractive to foreign investors.

2. **Promoting GDP Growth:** Efforts to boost GDP growth should be prioritised through sustainable economic policies, infrastructure development, and support for industries with growth potential.
3. **Inflation Control:** Effective measures should be implemented to control inflation levels, as it has a significant positive impact on FDI inflows. Maintaining price stability can instil confidence in foreign investors.
4. **Trade Facilitation:** Despite the negative relationship with FDI inflows, trade remains an essential aspect of economic development. Policymakers should focus on promoting trade facilitation measures and reducing trade barriers to enhance India's global competitiveness.
5. **Exchange Rate Management:** The negative impact of the exchange rate on FDI inflows suggests the need for careful management of currency fluctuations. Ensuring exchange rate stability can bolster investor confidence.
6. **Policy Reforms:** Policymakers should continuously review and reform investment policies to make India a more attractive destination for FDI. Streamlining bureaucracy, reducing red tape, and offering incentives can encourage greater foreign investment.
7. **Sector-Specific Strategies:** Identifying and promoting sectors with high potential for FDI can attract targeted investments. Tailored policies and incentives for industries like technology, manufacturing, and services can yield positive results.
8. **Global Collaboration:** Collaboration with other nations and international organisations can create opportunities for increased FDI inflows. Engaging in trade agreements and investment partnerships can strengthen India's position in the global market.

By implementing these recommendations, India can further capitalise on the benefits of FDI, foster sustainable economic growth, and solidify its position as an attractive destination for foreign investors.

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