A Study on Trend and Growth of FDI in Indian Tourism Sector

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Abstract

One of the most striking developments during the last two decades is the spectacular growth of FDI in the global economic landscape. This unprecedented growth of global FDI in 1990 around the world make FDI an important and vital component of development strategy in both developed and developing nations and policies are designed in order to stimulate inward flows.

Tourism is one of the most rapid growing industries in the world. Many developing countries consider it as possibility for raising foreign exchange earnings. This study aims to analyze the impact of change in Government FDI policy in early 2000s on inbound foreign direct investment in Indian tourism industry. The study focuses on the need of FDI in Indian tourism sector and growth in inbound FDI in tourism industry.

Key words: FDI, Tourism in India, Growth.

Introduction

Foreign direct investment (FDI) is defined as foreign investors moving their assets into another country where they have control over the management of assets and profits (Graham & Spaulding, 2005). It is generally true that the more FDI a country acquires, the more local economic growth and transformation can develop, because foreign companies often bring to the country large sum of funds and new technologies, as well as advanced management skills which allow local industries and regions to gain a lot of experience (OECD, 2003).

Table1

FDI INFLOWS IN INDIA

Year	Amount (In Rs.Crore)
2005-06	24584
2006-07	56,390
2007-08	98,642
2008-09	123,025
2009-10	123120
2010-11(Jan'11)	77902
Compound Growth Rate	26.88%

Source: Department of Industrial Policy and Promotion, Ministry of Commerce and Industry.

Tourism appears to many developing countries a promising source of economic development. In some places, it is already worth more, in terms of export revenues and share of GDP, than traditional commodity-based or manufacturing exports, and seems to offer opportunities for employment, earning foreign exchange and encouraging investment and economic growth. Many developing countries, therefore, are prioritizing attracting foreign direct investment ("FDI") in their tourism sectors. However, this form of FDI is complex, and its dynamics and impacts are not well understood.

Literature Review

A lot of research has already been done on various aspects of FDI which can be categorized as follows:

Dunning John H.14 (2004) in his study "Institutional Reform, FDI and European Transition Economics" studied the significance of institutional infrastructure and development as a determinant of FDI inflows into the European Transition Economies. The study examines the critical role of the institutional environment (comprising both institutions and the strategies and policies of organizations relating to these institutions) in reducing the transaction costs of both domestic and cross border business activity. By setting up an analytical framework the study identifies the determinants of FDI, and how these had changed over recent years.

Tomsaz Mickiewicz, Slavo Rasosevic and Urmas Varblane73 (2005), in their study, “The Value of Diversity: Foreign Direct Investment and Employment in Central Europe during Economic Recovery”, examine the role of FDI in job creation and job preservation as well as their role in changing the structure of employment. Their analysis refers to Czech Republic, Hungary, Slovakia and Estonia. They present descriptive stage model of FDI progression into Transition economy. They analyzed the employment aspects of the model. The study concluded that the role of FDI in employment creation/ preservation has been most successful in Hungary than in Estonia. The paper also find out that the increasing differences in sectoral distribution of FDI employment across countries are closely relates to FDI inflows per capita. The bigger diversity of types of FDI is more favorable for the host economy. There is higher likelihood that it will lead to more diverse types of spillovers and skill transfers. If policy is unable to maximize the scale of FDI inflows then policy makers should focus much more on attracting diverse types of FDI.

Emrah Bilgic18 (2006) in her study “Causal Relationship between Foreign Direct Investment and Economic Growth in Turkey”, examines the possible causal relationship between FDI and Economic Growth in Turkey. The study finds out that there is neither a long run nor a short run effect of FDI on economic growth of Turkey. Thus the study could not find any patterns for each hypothesis of “FDI led Growth” and “Growth driven FDI” in Turkey. The main reason of this result is that the country had unstable growth performances and very low FDI inflows for the period under analysis. The study suggests that in order to have a sustained economic development the government should improve the investment environment with the ensured political and economic stability in the country.

Balasubramanyam V.N Sapsford David4 (2007) in their article “Does India need a lot more FDI” compares the levels of FDI inflows in India and China, and found that FDI in India is one tenth of that of china. The paper also finds that India may not require increased FDI because of the structure and composition of India’s manufacturing, service sectors and her endowments of human capital. The requirements of managerial and organizational skills of these industries are much lower than that of labour intensive industries such as those in China. Also, India has a large pool of well – Trained engineers and scientists capable of adapting and restructuring imported know – how to suit local factor and product market condition. All of these factors promote effective spillovers of technology and know- how from foreign firms to locally owned firms. The optimum level of FDI, which generates substantial spillovers, enhances learning on the job, and contributes to the growth of productivity, is likely to be much lower in India than in other developing countries including China. The country may need much larger volumes of FDI than it currently attracts if it were to attain growth rates in excess of 10 per cent per annum. Finally, they conclude that the country is now in a position to unbundle the FDI package effectively and rely on sources other than FDI for its requirements of capital.

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 on. The literature review shows FDI is an engine of economic growth and development. It has potential to generate employment, raise productivity enhancing competitiveness, enhance exports and contribute long term economic development of the world’s developing countries. Tomasz Mickiewicz, Slavo Rasosevic and Urmas

Varblane73 (2005), in their study, "The Value of Diversity: Foreign Direct Investment and Employment in Central Europe during Economic Recovery" focused on role of policy makers in attracting FDI in one country. In 2001 for example, 71 countries made 208 changes in their FDI regulatory regimes, out of which 194 have been done to attract FDI. This study is focusing this gap only with respect to India. Liberalization in industrial policy which was initiated in 1991 has continued to become more and more open year by year. In this process during mid 2000s Govt of India came out with radical changes in FDI policy which included declaring tourism sector as priority sector with 100% FDI permissible. Thus, the present study is an endeavor to discuss the impact liberalization of FDI policy on tourism industry of India.

Objectives of the Study

The study covers following objectives

1 To study the need of FDI in Tourism Sector.

2 To study the growth of inbound FDI in tourism sector after change in Government FDI policy for tourism sector.

Purpose of the Study

It is apparent from the above discussion that FDI is a predominant and vital factor in influencing the contemporary process of global economic development. The study attempts to analyze the important dimensions of FDI in tourism sector of India. The study works out on growth of FDI in Indian tourism sector after liberalization of Government FDI policies in early 2000. The period under study is important for a variety of reasons. First of all, it is from 2006 onwards when Government of India has relaxed the inbound FDI policies. Second from 2006 onwards a fast growth of inbound FDI has been witnessed.

RESEARCH METHODOLOGY

DATA COLLECTION

This study is based on secondary data. The required data and information have been collected from various sources i.e. various Bulletins of Reserve Bank of India, publications from Ministry of Commerce, Govt. of India, Economic and Social Survey of Asia and the Pacific, United Nations Country Reports on Economic Policy and Trade Practice- Bureau of Economic and Business Affairs, and various websites. It is a time series data and the relevant data have been collected for the period 2008-Jan 2011.

Tools used are

a) Annual Growth Rate
   AGR = (X2- X1)/ X1
   Where X1 = first value of variable X
   X2 = second value of variable X

b) **Compounded Annual Growth Rate is worked out using the following formula**
   CAGR: =((End Value/Start Value)^(1/(Periods - 1)) -1

Need of FDI in Tourism Sector

Foreign tourist arrivals were expected to grow to 10 million by 2010-12 and the domestic tourism is expected to increase by 15% to 20% over the next five years as per the Ministry of Tourism expectations basing on the growth in the last one decade. There is a rapid growth in average room rates and is expected to continue until sufficient new supply comes on stream (average increase is 21% since 2004-06 in 4 & 5 star segment).Government of India is allowing 100% FDI in Hotels and Tourism, through the automatic route and also identified the investment opportunity of about $8-10 billion in the next 5 years in tourism sector. India has significant potential for becoming a major global tourist destination. It is estimated that tourism in India could contribute Rs.8,50,000 crores to the GDP by 2020 (approx. 1800 million USD) if our country properly plans to develop and invest on Connectivity Infrastructure, Tourism Infrastructure, Tourism Products, Capacity Building and Promotion & Marketing (WTTC report). It is estimated there is a need of around 10 Billion US $ required for development of tourism as per the different state tourism estimates for the next five years. When one thinks about the long term capital requirement of all states, it is estimated around 56 billion US $ for the next 20 years.

A rapidly growing middle class, the advent of corporate incentive travel and the multinational companies into India has boosted prospects for tourism. India's easy visa rules, public freedoms and its many attractions as an ancient civilization makes tourism development easier than in many other countries. In order to attract more visitors, India needs to increase room supply, open further its skies to increase air capacity, and upgrade its airports, roads and other infrastructure to global standards. Also tourism development needs to be pursued with a focus on sustainability.

The Indian tourism industry is interwoven with the country's monetary development. As GDP continues to mature, it increases deals in fundamental infrastructure like transportation systems, which is necessary to support the tourism industry. The hotel industry is directly connected to the tourism industry in India. Over the last decade, India has transformed into one of the most popular tourism destinations in the world, largely as a result of the government's "Incredible India" campaign which showed India in a new light to overseas tourists. In 2005, the appearance of global tourists improved by 16 percent, leading the resurgence of Indian tourism. As new destinations extend the tourist entry is likely to rise. Numerous measures have been taken in infrastructure, which will shine Indian hospitality for overseas guests.

Under the automatic path, 100 percent FDI is allowed in hotels and tourism. Travel and tourism is a US$32 billion business in India with an input of 5.3 percent of Indian GDP. Many worldwide hotel groups are setting up their businesses in India and many global tour operators are establishing operations in the country.

The International tourism; receipts (US dollar) in India was last reported at 14673000000* in 2010, according to a World Bank report released in 2011. The International tourism; receipts (US dollar) in India was 11509000000* in 2009, according to a World Bank report, published in 2010. The International tourism; receipts (US dollar) in India was reported at 12462000000* in 2008, according to the World Bank. International tourism receipts are expenditures by international inbound visitors, including payments to national carriers for international transport. These receipts include any other prepayment made for goods or services received in the destination country.

*Source: www.data.worldbank.org/indicator/ST.INT.RCPT.CD

Important changes in FDI policy of tourism sector from 2006 onwards

100% FDI is permissible in the sector on the automatic route. Tourism related industry include travel agencies, tour operating agencies and tourist transport operating agencies, units providing facilities for cultural, adventure and wild life experience to tourists, surface, air and water transport facilities to tourists, leisure, entertainment, amusement, sports, and health units for tourists and Convention/Seminar units and organizations.

For foreign technology agreements, automatic approval is granted if

i. up to 3% of the capital cost of the project is proposed to be paid for technical and consultancy services including fees for architects, design, supervision, etc.

ii. up to 3% of net turnover is payable for franchising and marketing/publicity support fee, and up to 10% of gross operating profit is payable for management fee, including incentive fee.

For investments under the Automatic Route, the RBI has issued general permission to companies to issue shares to the foreign investor, without any prior approvals. In the Notification No: GSR29(E) issued by the Board of Economic Affairs, Ministry of Finance, the words "non-convertible debentures/bonds" in Schedule 5, in paragraph 1 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 (Notification No. FEMA 20/2000-RB, dated 03 May 2000) have been substituted by the words "listed non-convertible debentures/bonds, commercial papers".

Foreign Direct Investment (FDI) is allowed for the development of tourism projects in the country. Hotel and Tourism sector is declared as high priority sector and FDI upto 100%, under the automatic route is permitted in 'Hotels & Tourism Sector', subject to applicable laws/ regulations, security and other conditional ties.

The FDI has been allowed with an objective to encourage investments in the hotel sector in India and to create job opportunities in hospitality sector.

Growth in Inbound FDI

The details of the FDI equity flows from April 2008 to January 2012 in the Hotel and Tourism sector are as follows:

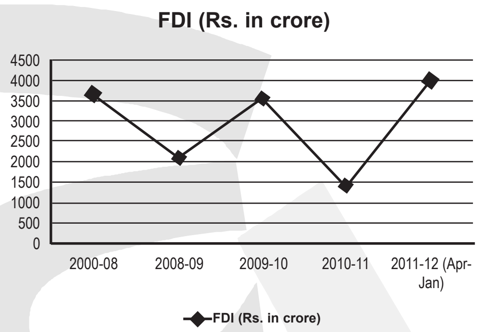
Table:2

Sl. No.	Year (April-March)	Hotel & Tourism Projects	FDI (in crore)
1	2000-08		3659.60
2	2008-09	489	2,098.23
3	2009-10	582	3,566.32
4	2010-11	403	1,405.15
5	2011-12 (Apr-Jan)	427	4,041.28
	Grand Total	1901	14,770.58

Source: Department of Industrial Policy and Promotion

The total inbound FDI in tourism sector of India (up to Jan'12) is 2.02% of total FDI received in India.

Figure 1



The **annual growth** of FDI has been calculated from the year 2008 onwards using mathematical tool of (X2-X1)/X1 and following result has been received. Where X2 is current year and X1 is previous year inflow of FDI

Year	Change in %	
2008-2009	69.97%	Growth
2009-2010	60.60%	Decline
2010-2011	187.60%	Growth

The **Compound Annual Growth** has been calculated between the year 2008 and 2012 taking value of 2012 as ending value and inflow of 2008 as starting value. For convenience of calculation, inflow in 2012 till January is considered as complete year FDI inflow of 2012. **The calculation gives CAGR as 24.42 %.**

Over the course of 4 periods FDI inflow grew from $2,098.23 to $4,041.28, its compound annual growth rate is 24.42%.

RBI fears.........

In spite of the fact that a new policy framework has expedited the inflow of FDI in tourism sector, a fears of funds diversion is creating real estate bubble. The Reserve Bank of India (RBI) has advised the government to impose strict new riders and set up a monitoring mechanism to prevent a real estate bubble. The Central Bank fears, diversion of foreign funds meant for hotels and tourism to acquisition of immovable property, circumventing foreign direct investment (FDI) rules. The new riders suggested by RBI include a lock-in period for the original investment, which means foreign investors cannot sell and walk out of the Indian company whenever they choose.

Highlights of RBI Suggestions

- Lock in Period for original investment which means investor cannot sell and walk out of Indian Company whenever they want.
- A monitoring mechanism to check FDI violation.

- A quarterly/annually reporting for foreign annual remittance and usage.
- Put onus of checking FDI violation on administrative ministry or states concerned.

Findings and Conclusion

Rapid Development in tourism sector and expected growth in future had created need for FDI in the sector. With the growing contribution of tourism sector into economic development and GDP has made the Government of India to think over the policy framework on FDI in tourism sector.

After liberalization the entry barrier for FDI had been relaxed, still the sector has witnessed a good growth only in last four years. Till 2008 FDI growth rate in tourism sector was very slow. According to CII estimates, an additional 1 million visitors can help generate revenues of Rs.4,300 crore annually. Thus, Government policies, which would focus at increasing tourist arrivals in the country and facilitate investments in tourism infrastructure, would lead to significantly higher multiplier effect on the key economic parameters of the Indian economy. So the inbound FDI in tourism sector can be attributed to significant changes in government policies.

The present 100 per cent FDI is allowed in the hotel and tourism sector through the automatic route. Presently, FDI in tourism sector is showing good growth. The growth in inbound FDI is more than the expected trend especially in the year 2011-12. Inflow of FDI has also increased the receipt of tourism sector.

The industry has witnessed a decline in inflow of FDI in 2010-11, According to RBI report, India has witnessed overall moderate FDI in 2010-11.The reason can be owed to widening of current account deficit in India beyond the perceived sustainable level of 3.0 per cent of GDP during April-December 2010. This also assumes significance as FDI is generally known to be the most stable component of capital flows needed to finance the current account deficit. Moreover, it adds to investible resources, provides access to advanced technologies, assists in gaining production know-how and promotes exports.

It can be concluded that the Indian Government policy framework on FDI has played a role of catalyst in facilitating FDI in the tourism sector. If Government of India pays attention to RBI advise and takes some precautionary steps while formulating FDI policy for tourism industry then the Travel and Tourism provides tremendous opportunity to India in terms of its contribution towards economic development.

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