

**Impact of Foreign Direct Investments for the Successful Performance of the Special Economic Zones & SME'S In India – A Study**

**\*Dr.P.Krishnakumar**

**\*\*S.Sathiyaseelan**

\*Professor, Nehru College of Management, Coimbatore.

\*\*Research Scholar, Nehru College of Management, Coimbatore.

**Introduction**

A Special Economic Zone (SEZ) is considered the sensitive outer skin of its host country; it is also regarded as a barometer to anticipate impending macroeconomic trends. SEZs have generated interest in developing countries; for instance, countries pursuing an export-led growth strategy expect SEZs to stimulate external trade and encourage economic activity in the domestic market. This paper evaluated that the total export performance and contribution in Indian Economy.

**Objectives of the study:**

The present study covers the following objectives:

1. To study the problems faced by SME's, SEZ schemes, the origin and growth of the SEZs in India.
2. To study the relationship between the growth of Special Economic Zones, Economic Growth and FDI inflow into the country.
3. To evaluate the trend of economic growth before and after the introduction of Special Economic Zones
4. To study the impact of FDI on the Indian economy.

**Methodology:**

This study is based on the secondary data collected from various sources including Bulletins from Reserve Bank of India, Reports from Asian Development Banks, publications from Ministry of Commerce, Government of India, publications from Economic and Social Survey of Asia, etc.

**Special Economic Zone**

SEZs have been recognized as an important mechanism for trade and investment promotion, creation of infrastructure, employment generation, promotion of regional development, increase in foreign exchange earnings, improving export competitiveness and transfer of skills and technology. These are considered as growth drivers in the developing countries. The SEZs have been in existence for decades, but have attracted renewed attention world-wide in recent years due to globalization of trade and financial markets. Historically, SEZs were the result of the spurt in economic growth. It is well recognized that the SEZs are instrumental in developing local and regional infrastructure facilities, which in turn are necessary for overall economic development of a country.

SEZs attract export oriented FDI and promote other forms of collaboration between local firms and MNCs. For instance SEZs facilitate the insertion of domestic SMEs (Small and Medium Enterprises) into global value chains by offering them an enabling investment climate global standard, low cost competition and advances in technology raise challenges for the SEZ units comparing in global value chains. This simulates learning and innovation which are crucial aspects of human development.

SEZs in India have been dominated by domestic investment. The share of FDI in total investment is increasing slowly. However, it still remains around one fourth of total investment in the zone.

### **Small Medium Enterprises (SME's)**

SME's have also played a vital role for the growth of Indian economy by contributing 45% of industrial output, 40% of exports, employing 60 million people, create 1.3 million jobs every year and produce more than 8000 quality products for the Indian and international markets.

The contribution of Micro, Small and Medium Enterprises (MSME) sector, including service segment, to the country's GDP during 2012-13 was 37.54 per cent; while the total employment in the sector is 805.24 lakh; and the share of MSMEs in India's total export for the year 2014-15 was 44.70 per cent.

### **Statement of the Problem**

The key demand of Indian SME sector is the availability of adequate infrastructure, power and finance at reasonable rates. One of the major reasons why Indian SMEs, despite being so competitive, fail to compete effectively in the global market is the unavailability of adequate infrastructure and power, which are the keys for running business operations successfully.

Policy makers need to create an enabling environment by providing adequate infrastructure to attract foreign direct investments (FDI) in India, most importantly in the SME sector. Further, more emphasis needs to be given to the SME sector, by providing them with special schemes and incentives for new start-ups, young entrepreneurs as well as women entrepreneurs.

Indian SMEs continue to post their growth stories. Despite of this strong growth, there is huge potential amongst Indian SMEs that still remains untapped. Once this untapped potential becomes the source for growth of these units, there would be no stopping to India posting a GDP higher than that of US and China and becoming the world's economic powerhouse.

Strong business linkages with SEZs represent one of the best ways for SMEs to enhance their competitiveness and acquire a series of critical missing assets, such as access to international markets, finance, technology, management skills and specialized knowledge.

### **Objectives of the SEZ Scheme in India**

The main objectives of the SEZ Act are:

- Generation of additional economic activity
- Promotion of exports of goods and services
- Promotion of investment from domestic and foreign sources
- Creation of employment opportunities
- Development of infrastructure facilities

In addition, there would be many associated advantages accrued in the process and some of these are:

- Acquiring and upgrading labour and management skill.
- Attracting advanced technology.
- Development of the region with feeder industry
- Establishing linkage with rest of the economy

### **Facilities and Incentives for Units in SEZs**

- There is a duty free import/domestic procurement of goods for development, operation and maintenance of SEZ units.
- 100 per cent Income Tax exemption on export income for SEZ units under section 10AA of the Income Tax Act for first five years of operation, 50 per cent for next five years thereafter and 50 per cent of the ploughed back export profit for next five years.

- Exemption from Central Service Tax and Sales Tax.
- External commercial borrowing by SEZ units up to US\$ 500 million in a year without any maturity restriction through recognized banking channels.
- There is single window clearance for central and state level approvals.
- Exemption from state sales tax and other levies as extended by the respective state governments.
- Since SEZs are considered as “Public utility services” no strike would be allowed in such companies without prior notice.
- No license is required for import.
- FDI up to 100 per cent is allowed through the automatic route for all manufacturing activities in SEZs except few sectors.
- SEZ units are exempted from payment of stamp duty and registration fee on lease or license of plots.
- Setting up of Off-shore Banking Units (OBUs) are allowed in SEZs. These banks are virtually foreign branches of the banks but located in India. These OBUs are exempted from Cash Reserve Ratio (CRR), Statutory Liquidity Ratio (SLR) and would give financing facilities to SEZ units and SEZ developers at international rates.
- SEZ units are exempted from central excise duty on goods brought from DTA to SEZs.

#### **Facilities and Incentives for Developers of SEZs**

- SEZ developers are exempted from customs/excise duties for development of SEZs for authorized operations approved by Board of Approval (BOA).
- Exemption from Income Tax in terms of section 80AB of the Income Tax Act on export income for a block of 10 years in 15 years.
- SEZ developers are exempted from Central Sales Tax.
- Exemption from payment of Services Tax and Stamp duty.

#### **The SEZ Rules provide for:**

- a) Simplified procedures for development, operation, and maintenance of the Special Economic Zones and for setting up units and conducting business in SEZs;
- b) Single window clearance for setting up of an SEZ;
- c) Single window clearance for setting up a unit in a Special Economic Zone;
- d) Single Window clearance on matters relating to Central as well as State Governments;
- e) Simplified compliance procedures and documentation with an emphasis on Self-certification.

As on 31st March, 2015, there were 199 operational SEZs out of the 347 notified SEZs, which have been formally approved since February 2006. In addition, the southern states account for 46 per cent of the formally approved SEZs in the country

#### **FDI in India:**

FDI (Foreign Direct Investment) has been the most significant source of external resource flows for India over the years. It is believed to have increased the employment, augment in productivity, boost in exports and transfer of technology. It has helped in easing the access to new technologies, exploitation of local raw materials, modern techniques of management and access to new markets.

**TABLE 1.1 Volume of FDI Inflows During Setting Up On SEZ In India**

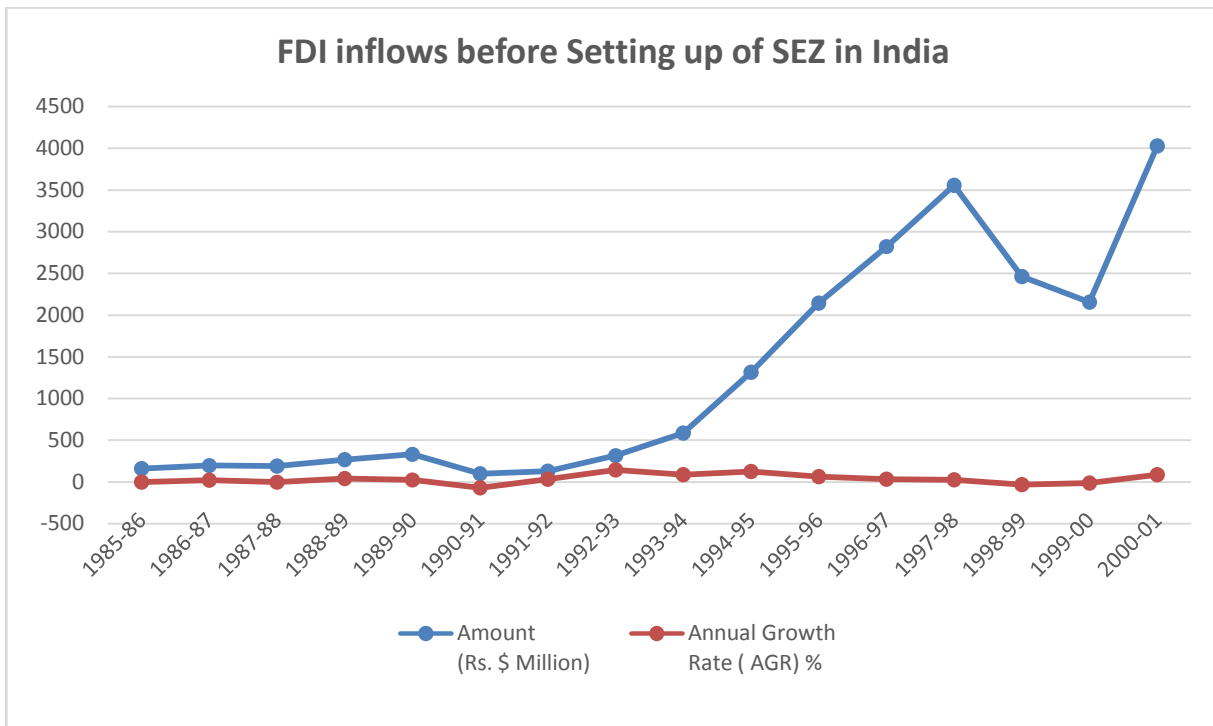
(AMOUNTS IN US \$ MILLION)

FDI inflows before Setting up of SEZ			FDI inflows after Setting up of SEZ		
Year	Amount (\$ Million)	Annual Growth Rate (AGR) %	Year	Amount (\$ Million)	Annual Growth Rate (AGR) %
1985-86	160	0			
1986-87	196	23			
1987-88	190	-3	2001-02	6130	52
1988-89	267	41	2002-03	5035	-18
1989-90	330	24	2003-04	4322	-14
1990-91	97	-71	2004-05	6051	40
1991-92	129	33	2005-06	8961	48
1992-93	315	144	2006-07	22826	155
1993-94	586	86	2007-08	34835	53
1994-95	1314	124	2008-09	35180	1
1995-96	2144	63	2009-10	37182	6
1996-97	2821	32	2010-11	178110	379
1997-98	3557	26	2011-12	172800	-3
1998-99	2462	-31	2012-13	165622	-4
1999-00	2155	-12	2013-04	160380	-3
2000-01	4029	87	2014-15	159161	-1
<b>CAGR</b>		<b>22%</b>	<b>CAGR</b>		<b>26%</b>

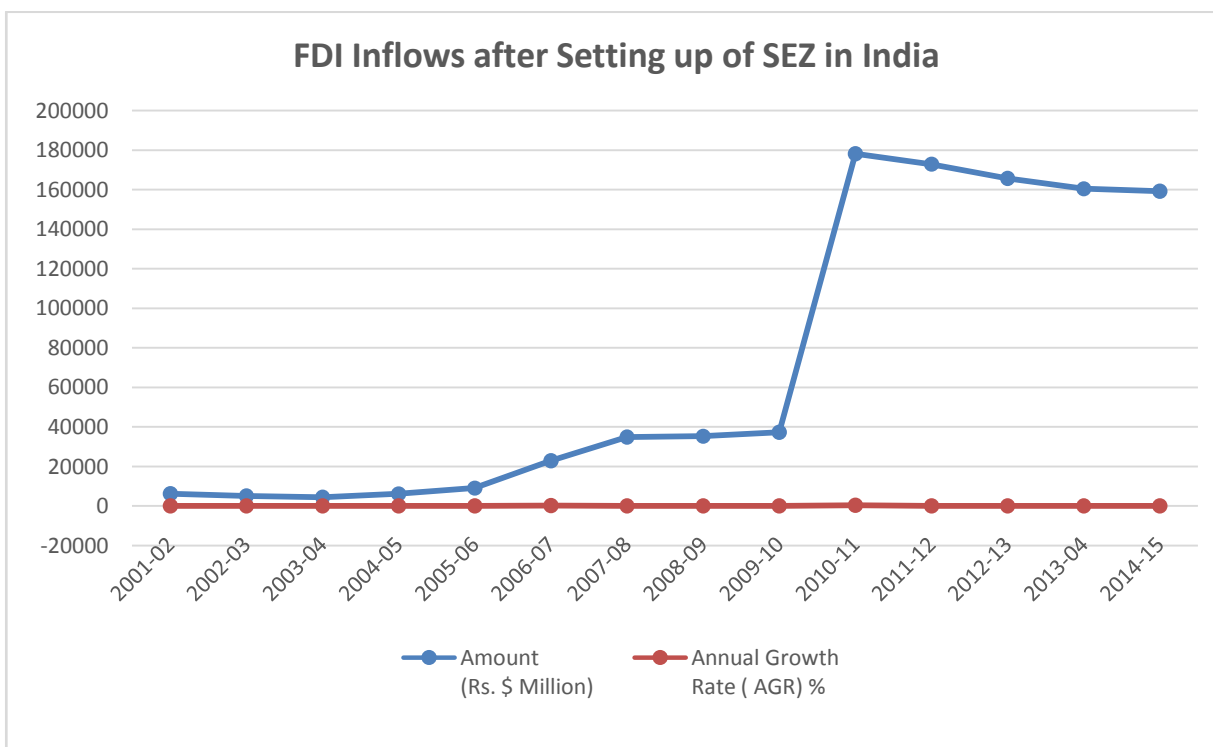
Source: SIA, News Letters, Various issues and compiled by the author

Table 1.1 shows the volume of FDI inflows before setting up of SEZs from 1985-86 to 2000-01 and the CAGR is 22%. The table also shows the volume of FDI inflows after setting up of the SEZs from 2001-02 to 2014-15 and the CAGR is 26% which has increased by 4% as compared to the CAGR before setting up of SEZs.

**CHART 1- FDI Inflows before Setting up of SEZ in India**



**CHART 2- FDI Inflows after Setting up of SEZ in India**



**TABLE 1.2 Share of SEZs Export in India's Total Exports (2000-01 TO 2013-14)**

<b>Sl.No</b>	<b>Year</b>	<b>India's Exports (Rs.Cr)</b>	<b>Annual Growth Rate (%)</b>	<b>Export from SEZs (Rs.Cr)</b>	<b>Annual Growth Rate (%)</b>	<b>Share of SEZs Export in India's Total Export (%)</b>
1	2000-01	203571	-	8552	-	24
2	2001-02	209018	3	9190	7	23
3	2002-03	255137	22	10053	9	25
4	2003-04	293367	15	13854	38	21
5	2004-05	375340	28	18309	32	21
6	2005-06	456418	22	22840	25	20
7	2006-07	571779	25	34615	52	17
8	2007-08	655864	15	66338	92	10
9	2008-09	840755	28	99689	50	8
10	2009-10	845533	1	220711	121	4
11	2010-11	1157474	37	315867	43	4
12	2011-12	1465959	27	364478	15	4
13	2012-13	1635261	12	476159	31	3
14	2013-14	1899730	16	494077	4	4
<b>CAGR</b>		<b>17%</b>		<b>33%</b>		

Source: 1. Govt. of India, Economic Survey 2009-10, P. 173.

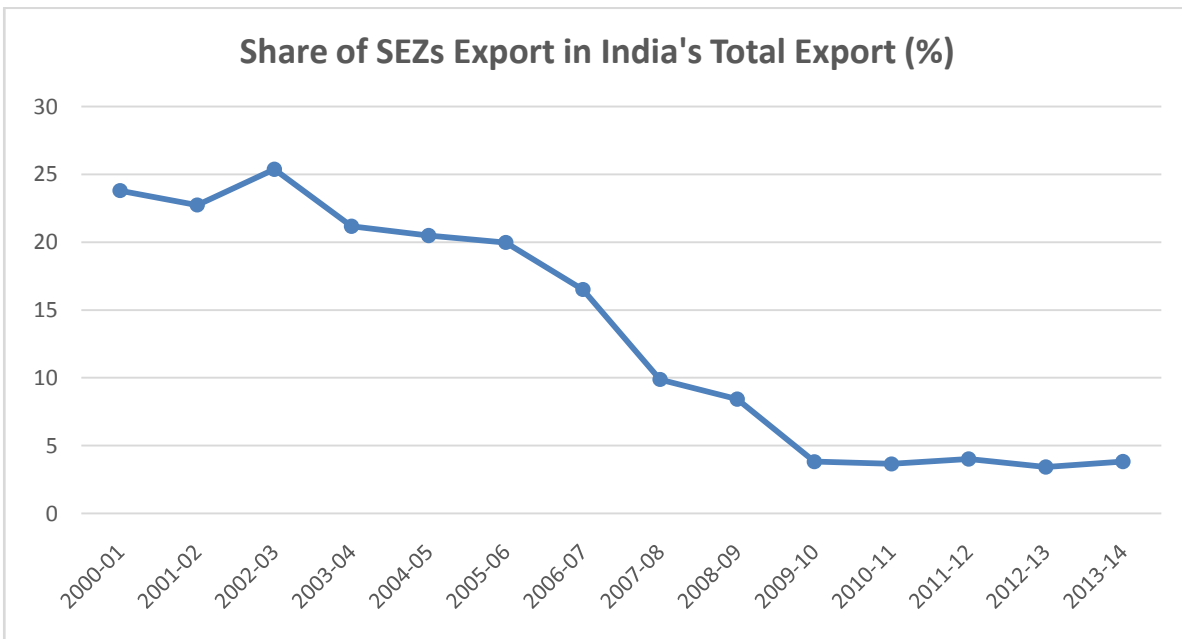
2. Govt. of India, Ministry of Commerce, Annual Reports, (Various Issues)

Table 1.2 shows the share of SEZs Exports to the total export of the country from 2001-02 to 2013-14. The CAGR of SEZ Exports is 33% as compared to the CAGR of total Exports of 17 %.

**CHART 3 Comparison Of India's Export Growth And SEZ Export Growth In India**



**CHART 4 Share of SEZS Export in India's Total Export (%)**



**TABLE 1.3 Relationship Between Exports, FDI, GDP And Exports From Special Economic Zones**

(Rupees in crores)

<b>Year</b>	<b>Export</b>	<b>FDI</b>	<b>GDP</b>	<b>SEZ Export</b>
2001-02	209018	19361	1972606	9190
2002-03	255137.3	14932	2048286	10053
2003-04	293366.8	12117	2222758	13854
2004-05	375339.5	14653	2971464	18309
2005-06	456417.9	24584	3390503	22840
2006-07	571779.3	56390	3953276	34615
2007-08	655863.5	98664	4582086	66338
2008-09	840755.1	142829	5303567	99689
2009-10	845534	123120	6108903	220711
2010-11	1157474	97320	7248860	315867
2011-12	1465959	165146	8391691	364478
2012-13	1635261	121907	9388876	476159
2013-14	1899730	147518	10472807	494077
2014-15	1738800	176000	10644000	463770

Source: Public Information Bureau, Govt.of India.

Table 1.3 shows the relationship between exports, SEZ exports, FEDI inflows and GDP from 2001-02 to 2014-15. Further the mean, Median, standard deviation, skewness and Kurtosis has been calculated for the above data.

One of the objectives is to study the impact of Exports, Exports from the Special Economic Zones and FDI on the GDP of the country and in order to study the same; the following analysis is carried out.



The following table gives the descriptive of the data under study:

Analysis Name	Export	FDI	GDP	Exports from SEZ
Mean	776086.2	75083.21	4994285	153909.4
Median	613821.5	76855	4267681	50476.5
Maximum	1899730	165146	10472807	494077
Minimum	203571	12117	1864301	8552
Std. Dev.	561856	58595.61	2915414	183424.6
Skewness	0.767882	0.166402	0.588496	0.874537
Kurtosis	2.297364	1.396158	2.03268	2.155144

From the table, it is understood that the

**Export**

Mean export during the period of study is 776086.2

Median export during the period of study is 613821.5

Maximum export during the period of study is 1899730

Minimum export during the period of study is 203571

Skewness export during the period of study is 0.767882

Kurtosis export during the period of study is 2.297364

The Skewness value indicate the variability (spread) is less

**FDI**

Mean FDI during the period of study is 75083.21

Median FDI during the period of study is 76855

Maximum FDI during the period of study is 165146

Minimum FDI during the period of study is 12117

Standard deviation FDI during the period of study is 58595.61

Skewness FDI during the period of study is 0.166402

Kurtosis FDI during the period of study is 1.396158

The Skewness value indicate the variability (spread) is less

**GDP**

Mean GDP during the period of study is 4994285

Median GDP during the period of study is 4267681

Maximum GDP during the period of study is 10472807

Minimum GDP during the period of study is 1864301

Standard deviation GDP during the period of study is 2915414

Skewness GDP during the period of study is 0.588496

Kurtosis GDP during the period of study is 2.03268

The Skewness value indicate the variability (spread) is less

**SEZ Export**

Mean SEZ Export during the period of study is 153909.4

Median SEZ Export during the period of study is 50476.5

Maximum SEZ Export during the period of study is 494077

Minimum SEZ Export during the period of study is 8552

Standard deviation SEZ Export during the period of study is 183424.6

Skewness SEZ Export during the period of study is 0.874537

Kurtosis SEZ Export during the period of study is 2.155144

The Skewness value indicate the variability (spread) is less

Since the objective is to establish the relationship between the export, FDI, GDP and SEZ export, the correlation technique is applied. The following table gives the co-relationship between the above said variables.

Variables	Export	FDI	GDP	SEZ Export
Export				
Pearson Correlation	1	.865	.995	.975
N	14	14	14	14
FDI				
Pearson Correlation	0.865	1	.883	.797
Sig (2 tailed)	.000		.000	.001
N	14	14	14	14
GDP				
Pearson Correlation	.995	.883	1	.973
Sig (2 tailed)	.000	.000		.000
N	14	14	14	14
SEZ Export				
Pearson Correlation	.975	.797	.973	1
Sig (2 tailed)	.000	.001	.000	
N	14	14	14	14

Correlation is significant at the 0.01 level (2 tailed)

**Export**

Export is correlated with FDI (.865, .000)

Export is correlated with GDP (.995,.000)

Export is correlated with SEZ Export (0.975, .000)

**FDI**

FDI is correlated with Exports (.865, .000)

FDI is correlated with GDP (.883, .000)

FDI is correlated with SEZ Export (.797, .001)

**GDP**

GDP is correlated with Exports (.995, .000)

GDP is correlated with FDI (.883, .000)

GDP is correlated with SEZ Exports (.973, .000)

**SEZ Export**

SEZ export is correlated with Exports (.975, .000)

SEZ export is correlated with FDI (.797, .001)

SEZ export is correlated with GDP (.973, .000)

The first value inside the bracket gives the correlation co-efficient and the second value gives the probability.

Since all the probability values are less than 0.05 level of significance, they are significant. The magnitudes are positive and high (closer to unity).

Hence, it is concluded that all these relationships are positive, high and significant.

To establish the relationship between

- a) Exports and SEZ Exports
- b) FDI and SEZ Exports
- c) GDP and SEZ Exports, the Regression Analysis is applied.

**Export and GDP:**

The following table gives the correlation coefficient and coefficient determination between GDP and Exports:

<b>R</b>	<b>R<sup>2</sup></b>
0.995(.000)	0.991

The correlation between Exports and GDP is (.995) positive, high and significant.

The coefficient of determination R<sup>2</sup>= .991 which indicates that 99.1%of changes in GDP due to change in Exports.

To establish the extent of dependence of GDP and Exports, Regression Analysis is applied.

**ANOVA**

Model	Sum of Squares	df	Mean square	F	Significance
Regression	109477801132958.000	1	109477801132958.000	1291.162	.000
Residual	1017481923987.810	12	84790160992.317		
Total	110495283056945.000	13			

The table significant (.000) <0.05, the level of significant says that the regression model fit is good.

The following table gives the regression coefficient between Exports and GDP:

Model	Unstandardized coefficient B	t	Significance
Constant	985836.691	7.248	.000
Export	5.165	35.933	.000

The regression equation fixed is

$$\text{Export} = 985836.691 + 5.165 \text{ GDP}$$

The coefficients in the equation are significant.

The regression coefficient 5.165 reveals that 100 units of change in Exports will cause 516.5 units change in the GDP.

**FDI and GDP:**

The following table gives the correlation coefficient and coefficient determination between GDP and FDI:

R	R2
0.883 (.000)	0.780

The correlation between FDI and GDP is (.883) positive, high and significant.

The coefficient of determination R2= .780 which indicates that 78.0%of changes in GDP due to change in FDI.

To establish the extent of dependence of GDP and FDI, Regression Analysis is applied.

**ANOVA**

Model	Sum of Squares	df	Mean square	F	Significance
Regression	86218061354827.900	1	86218061354827.900	42.617	.000
Residual	24277221702117.600	12	2023101808509.800		
Total	110495283056945.000	13			

The table significant (.000) <0.05, the level of significant says that the regression model fit is good.

The following table gives the regression coefficient between FDI and GDP:

<b>Model</b>	<b>Unstandardized coefficient B</b>	<b>T</b>	<b>Significance</b>
Constant	1694350.606	2.679	.020
FDI	43.950	6.528	.000

The regression equation fixed is  $FDI = 1694350.606 + 43.950 \text{ GDP}$

The coefficients in the equation are significant.

The regression coefficient 43.950 reveals that 100 units of change in FDI will cause 4395 units change in the GDP.

#### **SEZ Exports and GDP:**

The following table gives the correlation coefficient and coefficient determination between GDP and SEZ Exports:

<b>R</b>	<b>R2</b>
0.973(.000)	0.948

The correlation between SEZ Exports and GDP is (.973) positive, high and significant.

The coefficient of determination  $R^2 = .948$  which indicates that 94.8% of changes in GDP due to change in SEZ Exports.

To establish the extent of dependence of GDP and SEZ Export, Regression Analysis is applied.

#### **ANOVA**

<b>Model</b>	<b>Sum of Squares</b>	<b>df</b>	<b>Mean square</b>	<b>F</b>	<b>Significance</b>
Regression	104697114677757.000	1	104697114677757.000	216.683	.000
Residual	5798168379188.870	12	483180698265.739		
Total	110495283056945.000	13			

The table significant (.000) <0.05, the level of significant says that the regression model fit is good.

The following table gives the regression coefficient between SEZ Export and GDP:

<b>Model</b>	<b>Unstandardized coefficient B</b>	<b>T</b>	<b>Significance</b>
Constant	2613044.076	10.608	.000
SEZ Export	15.472	14.720	.000

The regression equation fixed is

$$\text{SEZ Export} = 2613044.076 + 15.472 \text{ GDP}$$

The coefficients in the equation are significant.

The regression coefficient 15.472 reveals that 100 units of change in SEZ Export will cause 1547.20 units change in the GDP.

**Conclusion:**

The SEZs are certainly engines for growth. They can be considered as a tool in a portfolio of mechanisms commonly employed to create jobs, generate exports and attract foreign investments, through the provisions of incentives, streamlined procedures and custom-built infrastructure, direct employment for skilled and unskilled labour, indirect employment and employment for women workers and offered a highly conducive investment scenario for developers.

The various tax benefits and the incentives offered to the developers as well as the units have motivated the growth of the SEZs in a positive manner. The attraction of the FDIs and promotion of other forms of collaboration between the local firms and the multi-national companies have helped the country for a rapid technological up gradation of the various products and processes. The exports have registered an impressive growth rate.

The SEZs in India have been successful in generation of additional economic activity, promotion of exports of goods and services, promotion of investment from domestic and foreign sources, creation of new and additional employment and development of infrastructure facilities.

Foreign Direct Investment (FDI) policy of India has been gradually liberalized to make the market more investor friendly. The results have been encouraging. These days, the country is consistently ranked among the top three global investment destinations by all international bodies, including the World Bank, according to a United Nations (UN) report. For Indian economy which has tremendous potential, FDI has had a positive impact, FDI inflow supplements domestic capital, as well as technology and skills of existing companies. It also helps to establish new technologies. FDI directly and indirectly helping India to lead the path of economic development.

Considering the challenges and issues faced by SME's that can set up more units with upgradable technologies, availing adequate tax benefits and acquire timely finance as Foreign Direct Investment.

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