GOVERNANCE QUALITY, FINANCIAL PERFORMANCE, AND POLICY FRAMEWORKS IMPACT ON FOREIGN DIRECT INVESTMENT INFLOWS: EVIDENCE FROM INDIA

PROJECT

Submitted in fulfillment of the requirement of

INTERNSHIP

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CERTIFICATE

30/06/2024

This is to certify that Ishan Kumar Sarraf, a student of IIT Kanpur, has satisfactorily concluded the research report titled "Governance Quality, Financial Performance, And Policy Frameworks Impact On Foreign Direct Investment Inflows: Evidence From India" as part of the internship program at the National Centre for Good Governance (NCGG) under my mentorship.

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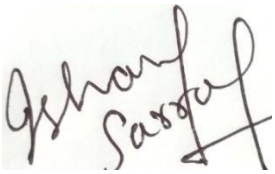

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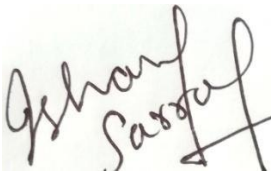

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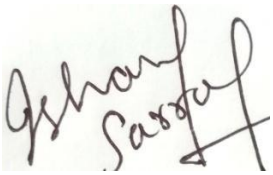

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ABSTRACT

This research explores the effect of governance quality, financial development, and particular policy frameworks on Foreign Direct Investment (FDI) inflows into India, one of the world's top beneficiaries of FDI, with an influx of $84.5 billion in 2022. Employing the six governance indicators created by the World Bank—Political Stability, Government Effectiveness, Regulatory Quality, Rule of Law, Control of Corruption, and Voice and Accountability—the study explores how these governance dimensions affect FDI. Additionally, the research investigates the influence of financial development, such as financial institution access, depth, and efficiency, measured yearly by the International Monetary Fund (IMF) in boosting India's attractiveness to international investors. To give a thorough study, the research also examines the success of significant policy initiatives such as the Production Linked Incentive (PLI) initiative, Make in India policy, and Startup India policy in attracting FDI.

Our comprehensive analysis investigating the factors influencing Foreign Direct Investment (FDI) inflows in India has highlighted the significant roles played by governance quality, financial performance, and policy frameworks. Our results demonstrate strong statistical significance by employing rigorous statistical methods such as unit root tests to verify data stability, correlation assessments, regression analysis to establish linkages, and residual studies to confirm model reliability.

Government Effectiveness (GE), Rule of Law (RL), and Voice and Accountability (VA) are the primary governance variables that positively influence the FDI inflows in India. These components underline the need for strong and effective institutions, legal frameworks, and participative governance in attracting foreign investments. Likewise, Financial Institutional Access (FIA) also plays a significant influence, demonstrating that broader access to financial services and capital is vital for establishing an environment friendly to foreign investment. Moreover, the Production Linked Incentive (PLI) scheme, aimed at strengthening India's manufacturing capabilities through fiscal incentives, has contributed significantly to attracting FDI. This fits with several policy efforts by the Government of India emphasizing sector-specific reforms, increasing India's appeal as an investment destination.

KEYWORDS

Governance Quality, Foreign Direct Investment (FDI), Financial Development, Policy Frameworks, Regression Analysis

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LIST OF ABBREVIATIONS

ASEAN :	Association of Southeast Asian Nations
CC :	Control of Corruption
DPIIT :	Department for Promotion of Industry and Internal Trade
EoDB :	Ease of Doing Business
FDI :	Foreign Direct Investment
FIA :	Financial Institution Access
FID :	Financial Institution Depth
FIE :	Financial Institution Efficiency
FIPB :	Foreign Investment Promotion Board
GDP :	Gross Domestic Product
GE :	Government Effectiveness
GI :	Geographical Indication
GIFT City :	Gujarat International Finance Tech City
GST :	Goods and Services Tax
IBC :	Insolvency and Bankruptcy Code
IPR :	Intellectual Property Rights
MENA :	Middle East and North Africa
MI :	Make in India Policy
NCGG :	National Centre for Good Governance
NSWS :	National Single Window System
NWP :	National Monetization Pipeline
ODOP :	One District One Product
OECD :	Organization for Economic Cooperation and Development
ONDC :	Open Network for Digital Commerce
PLI :	Production Linked Scheme
PS :	Political Stability
RL :	Rule of Law
RQ :	Regulatory Quality
SAARC :	South Asian Association for Regional Cooperation
SEZ :	Special Economic Zones
SI :	Startup India Policy
SSA :	Sub-Saharan Africa
VA :	Voice and Accountability
WTO :	World Trade Organization

CHAPTER 1: INTRODUCTION

Since the late 1990s, academic research has proven a correlation between robust governance frameworks and Foreign Direct Investment (FDI) inflows. It has been demonstrated that foreign direct investment is inherently sensitive to host nations' political risk profiles. Thus, countries equipped with solid laws, regulations, and institutional efficacies are more effective in attracting FDIs, and the opposite also holds evident (Mody & Srinivasan, 1998; Hall & Jones, 1999; Stevens, 2000; Roll & Talbott, 2001; Globerman, and Shapiro 2003; Albuquerque, 2003; Acemoglu et al., 2005; Li & Filer, 2007). The literature extensively investigates the relationship between FDI and economic progress, which offers a clearer picture. While a large body of research suggests that FDI has a positive impact on economic growth (de Mello, 1999; Yao & Wei, 2007; Vu & Noy, 2009), a subset of empirical studies either disputes this impact or claims that the growth-promoting effects of FDI only occur under certain conditions (Herzer et al., 2008; Beugelsdijk et al., 2008; Carkovic & Levine, 2002; Blomstrom et al., 1992; Balasubramanyam et al., 1996).

Foreign Direct Investment (FDI) is highly impacted by the transaction costs involved with investments, meaning the propensity for capital to flow toward countries giving attractive financial returns (Coase, 1937; North, 1990; King & Levine, 1993; La Porta et al., 1998; OECD, 2001). Transparency, accountability in operations, considerable law enforcement, and ease of economic activity are essential governance factors for minimizing transaction costs. Consequently, these features attract investors to allocate their resources toward other economies. Furthermore, trust and confidence in a government's fiscal and monetary policies and a nation's macroeconomic stability strongly impact investor views and, by extension, FDI flows (Brewer, 1993; Dunning, 2002; Acemoglu & Johnson, 2005). A well-established governance infrastructure decreases corruption and transaction costs. It prevents government seizure of capital, making a nation more desirable for investment ventures.

FDI plays a crucial element in the economic progress of developing economies like India, with these nations accounting for more than half of global FDI inflows in 2010, according to the World Investment Report 2011 (CNUCED, 2012). This paradigm shift toward emerging countries regarding international consumption and production has driven multinational corporations (MNCs) to explore efficiency and market possibilities. The empirical evidence reveals a substantial positive correlation between FDI and economic development, proving that FDI is a cornerstone of global financial advancement (Adhikary, 2011; Bhavan et al., 2011; Azam, 2010). The debate on the link between Foreign Direct Investment (FDI) and economic growth highlights the crucial role of financial development as a channel for enhancing the

growth consequences of FDI. Hosein (2015), Gulcin (2014), and Mahesh (2014) all concluded that FDI has a beneficial impact on economic growth as long as the host country's development conditions are sustainable. In contrast, research by Herzer et al. (2008), Beugelsdijk et al. (2008), and Carkovic & Levine (2002) presents a counter-narrative, indicating an unimportant or conditional relationship between FDI and growth, showing the complexity of the FDI-growth interaction.

FDI enhances investment and capital stock, offers employment opportunities, and expands production capacity. Furthermore, FDI raises government revenue via taxes and fosters financial stability. It acts as a conduit for infrastructure development, linking with local enterprises for raw materials and supporting the economy. Transferring intangible assets like technology and managerial knowledge to host nations is crucial. Furthermore, FDI provides fresh technology, methods, items, and organizational and management skills, encouraging economic backward and forward linkages (Ho & Rashid, 2011). Policymakers must identify the key drivers of FDI to simplify its facilitation and better understand the quantity and direction of FDI flows.

According to De Mello (1999), FDI inflows have a universally significant impact on production growth across varied sectors, showing that the sound effects of FDI extend beyond country-specific factors such as institutions, trade regimes, political risk, and policy frameworks. This assertion supports the view that foreign direct investment is a valuable economic growth tool. The notion of good governance, which is crucial for the effective running of market economies, has recently returned to being a critical point in conversations about economic development. The capacity of governments to create a favorable atmosphere for FDI is crucial, enabling multinational corporations to grow by developing political and financial institutions that foster FDI. However, macroeconomic instability, political unpredictability, and corruption significantly harm the investment environment.

FDI has a wide-ranging influence, including higher GDP, living standards, per capita income, and economic growth and development. However, it is vital to highlight that industrialized nations have superior marginal capital productivity than emerging economies and, consequently, have higher return expectations from investors, meaning reciprocal advantages in capital transfers between countries via FDI. Zidi & Ali's (2016) research on the link between foreign direct investment and Governance indicates that in the Middle East and North Africa (MENA) region, FDI inflows are positively influenced by Governance, underlining the necessity of strong governance practices in attracting and keeping FDI.
According to Azam & Lukman (2008), FDI is a vital instrument for developing countries as it helps them enjoy the advantages of globalization. Hossain & Rahman (2017) concur that improving governance

factors support FDI inflows in emerging nations. Furthermore, political stability, effective law enforcement, peaceful social and cultural circumstances, the availability of natural and labor resources, and strong government economic policies all play critical roles in attracting foreign investment (Bénassy-Quéré et al., 2007). Similarly, financial crises tend to adversely impact FDI inflows, whereas institutional dynamics have a unique and favorable effect (Globerman & Shapiro, 2002).

The quantity of FDI hinges on the host country's government quality, supporting policies, and infrastructure (Globerman & Shapiro, 2003). Corruption drastically affects FDI, while democracy, governmental stability, peace and order, civil liberties, and political freedoms considerably promote it (Hassen & Anis, 2012)**.** Likewise, Asiedu (2002) underlines the role of policy changes, especially openness to FDI and corporation tax rates, in affecting FDI inflows in developing nations. When creating infrastructure, FDI enhances economic development and liberalizes trade regulations (Mishra & Daly, 2007). Government initiatives enticing investors, such as tariff reductions and tax concessions, could enhance foreign capital inflows. Campos & Kinoshita (2002) demonstrated that FDI strongly impacts Governance, primarily when technology is transmitted to the host country. Multinational corporations seek investment opportunities with attractive institutional frameworks (Morisset, 2000). At the same time, global investors favor nations with clear institutional structures and coherent governments.

Numerous studies have demonstrated a positive connection, attributing development in recipient countries to technological advancements and cross-sectoral benefits facilitated by FDI (Vu & Noy, 2007; Elsadig, 2012; Liu, 2002; Chakraborty & Nunnenkamp, 2008). In contrast, another body of evidence implies that FDI may have a negative economic effect (Elia et al., 2009; Doytch & Uctum, 2011), while another collection of studies finds no significant association between FDI and economic growth (Beugelsdijk et al., 2008; Temiz & Gokmen, 2013; Yalta, 2013). The scholarly consensus highlights the relevance of the recipient country's absorptive capabilities in mediating the favorable benefits of foreign direct investment (FDI) on economic development. The sound impacts of FDI rely on various factors, including the connections between FDI and foreign trade flows, spillovers and externalities, and the host economy's structural characteristics (OECD, 2002). Alfaro et al. (2009) stress the relevance of the local environment in reaping the benefits of foreign direct investment. Their study demonstrates that although FDI may enhance total factor productivity and speed capital accumulation, these advantages are only achieved when the host country has the required absorptive capacity.

Financial development is regarded as an absorptive ability, vital for avoiding market imperfections and increasing the realization of FDI's growth-enhancing consequences. According to Levine (2005), the rise

of financial institutions and markets has resulted in higher savings mobilization and enhanced monitoring and risk management strategies among banking firms. Such advances in financial efficiency reflect a more developed financial environment, which corresponds favorably with the capacity to leverage FDI for development. Empirical evidence supports this assertion, with various studies demonstrating a positive relationship between financial development and the FDI-growth nexus, indicating that a sophisticated financial system significantly contributes to the beneficial impact of FDI on economic growth (Choong, 2012; Ang, 2009; Lee & Chang, 2009; Azman-Saini et al., 2010; Hosein, 2015).

While the academic environment is replete with analyses of FDI's impact on economic growth, the use of intermediate factors still needs to be explored. The International Monetary Fund (IMF) identifies financial depth, access, and efficiency as essential intermediaries, and this study proposes that these financial characteristics considerably boost the favorable association between FDI inflows and economic advancements. Between 1985 and 1994, Chauhan et al. (1996) found that foreign direct investment is less variable and responds more slowly to variations in other capital inflows in emerging and industrial countries. Chuhan et al. (1996) and Bird & Rajan (2002) indicated that economies relying heavily on FDI to cover current account deficits are more resilient to financial crises, as demonstrated by Malaysia's balance of payments studies.

Given its irreversible short-term implications, FDI's long-term financing status makes it a more stable investment than other capital flows despite its associated risks. Albuquerque (2003) emphasized the risk-sharing benefits of FDI, which are linked to the imperfect enforcement of financial contracts and the inalienability of investments, lowering default premiums and sensitivity to financing limitations. As a result, Albuquerque (2003) suggests that financially strapped governments use FDI to borrow, citing better stability and developmental spillovers. Yao & Wei (2007) argue that foreign direct investment positively impacts growth, particularly in rapidly industrializing nations. Their examination of FDI's impact on 29 Chinese provinces and municipalities from 1979 to 2003 indicates how FDI has helped these places catch up with more advanced economies by increasing production efficiency and expanding production frontiers. In contrast, Vu & Noy (2009) provide a more complex view of FDI's effect. Their sectoral analysis in six OECD nations demonstrates that, although FDI generally boosts economic development, the effects vary by country and industry. This version highlights the complexities of FDI's effect, suggesting that some sectors may not profit from it similarly to others.

These different results highlight the complex nature of FDI's effect on economic development. The prevalent expectation is that there will be a good consequence. However, the degree and uniformity of

this impact are currently being contested. This means that the relationship between FDI and economic growth is impacted by a range of variables, including but not limited to sectoral composition, the economy's absorptive capabilities, financial institutional robustness, policy measures, and the political environment. The center of the dispute is the receiving country's absorptive capabilities, with economic development emphasized as a crucial aspect. Hermes & Lensink (2003) and Alfaro et al. (2004) discovered that FDI's contribution to growth in less developed countries (LDCs) is reliant on the complexity of local financial institutions. Azman-Saini et al. (2010) support this notion, saying that the excellent growth consequences of FDI appear only after a certain degree of economic development.
This narrative is backed by Choong (2012) and Chee & Nair (2010), who suggest that a well-developed local banking system is essential for FDI to drive economic growth. Sghaier & Abida (2013) share this approach, highlighting the significance of domestic finance system development in harnessing FDI's growth potential in North African states.

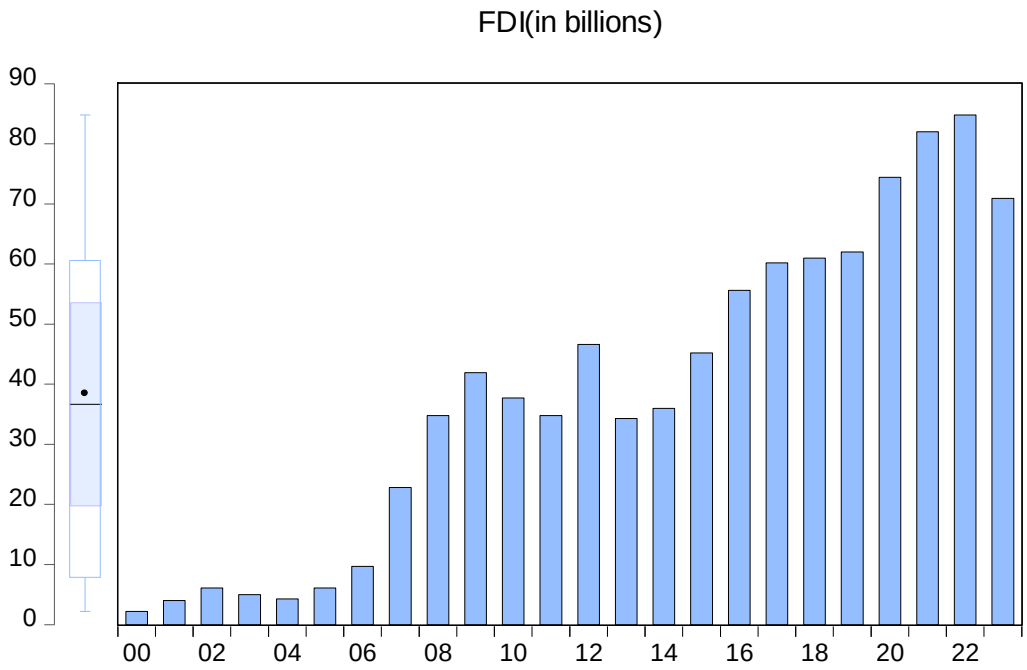
Financial independence is highlighted as a driver of economic success. Sohrabian (2014) and Sufian et al. (2008) study the link between financial institution robustness and economic development, indicating that more financial autonomy boosts bank profitability, especially in Islamic banks in the MENA region. This is predicated on the notion that fewer government intrusions and improved financial security bode positively for economic progress. Merter Akıncı et al. (2015) underline the significance of financial freedom and central bank independence in promoting national output. They support economic liberalization and central bank autonomy to preserve price stability and enhance GDP growth.

To conclude, combining financial independence with a developed financial sector emerges as a particular absorptive capacity crucial for optimizing FDI growth gains. This synthesis of concepts gives a more nuanced view of the FDI-growth nexus, highlighting the necessity of financial development to fulfill the economic potential of FDI inflows. This research contributes to the current literature by evaluating the function of governance indicators and financial developments on FDI inflows in India to understand the impact of Governance on FDI in the Indian context. This analysis is crucial given the need for a study on the association between robust Governance and financial growth and FDI inflows in emerging countries such as India and the moderating role of the policy initiatives. By identifying good management practices, this study will give appropriate policy ideas to increase India's FDI attractiveness, governance reform, and restructuring paths to promote FDI inflows.

BRIEF ON INDIA'S FOREIGN DIRECT INVESTMENT (FDI) INFLOW

The landscape of foreign direct investment (FDI) in India has changed dramatically since the liberalization of its economy in 1991, with significant improvements in the investment environment primarily attributable to the easing of FDI rules. This achievement has moved India to the top 100 countries in the Ease of Doing Business (EoDB) Index, with 63rd place, up from 142nd in 2023. An examination of FDI inflows indicates a solid upward trend, with an intake of $36 billion in fiscal year 2014-15. The sum has continually climbed, reaching a historic annual high of $82 billion in fiscal year 2021-22.

Figure 1: FDI Inflow in India (2000-2023)



(Source: Author's Calculation from EViews; World Bank, 2023)

Longitudinal research from April 2000 to December 2023 demonstrates a tremendous accumulation of FDI in India, reaching $922.4 billion. Notably, a significant amount of this investment, $448.896 billion, or roughly 67%, was received throughout the nine years from April 2014 to December 2023. This phase signals a more favorable investment environment.

In the fiscal year 2023-24, we had total FDI inflows of $70.96 billion, with equity inflows accounting for $11.54 billion. An examination of the geographical origins of these equity inflows shows Mauritius

(26%), Singapore (23%), the United States (9%), the Netherlands (7%), and Japan (6%) as the leading contributors for the fiscal year 2023-24 (Invest India, 2024). This distribution indicates an international belief in India's market potential and strategic investment prospects.

The services sector comprises finance, banking, insurance, non-financial/business services, outsourcing, research and development (R&D), courier services, technology testing, and analysis, accounting for 16% of total FDI equity inflows in the fiscal year 2023-24. This is closely followed by the computer software and hardware sector (15%), commerce at 6%, telecommunications at 6%, and the automotive industry at 5% (Invest India, 2024). These sectors illustrate India's dynamic economy and countless expansion and investment potential. Regionally, Maharashtra, Karnataka, Gujarat, Delhi, and Tamil Nadu are the primary recipients of FDI equity inflows for the fiscal year 2023-24, accounting for 30%, 22%, 17%, 13%, and 5% of total equity inflows, respectively (Invest India, 2024). This distribution depicts the different economic conditions and investment potential across India's states, underlining the country's diversified appeal to overseas investors.

POLICY MEASURES TO ATTRACT FOREIGN DIRECT INVESTMENTS (FDI) IN INDIA

The Indian Government has strategically implemented vital policy measures such as Make in India, the Production-Linked Incentive (PLI) Scheme, and Startup India to increase foreign direct investment (FDI) into the country, intending to establish India as a global manufacturing hub and foster innovation-driven entrepreneurship. The Make in India initiative, launched in 2014, aims to improve manufacturing capabilities across 25 industries, streamline investment procedures, and leverage the demographic dividend to create large-scale job opportunities.

Figure 2: Key Government Initiatives to Attract FDI

In addition, the PLI Scheme incentivizes companies in critical sectors such as electronics, pharmaceuticals, and automobiles to increase their manufacturing output by providing benefits proportional to production increments, attracting significant FDI, and aiming to make Indian manufacturers globally competitive. In addition to these efforts, Startup India, launched in 2016, has built an ecosystem that fosters innovation and entrepreneurship through financing assistance, incentives, and compliance easing, making India a compelling destination for venture capital and foreign investment. Collectively, these policies have played an essential role in improving India's investment appeal, resulting in a significant rise in FDI inflows and placing India as an attractive investment destination on an international level.

1990s: Opening Up and Sectoral Reforms

- **1991:** India's economic reforms began, marking a shift towards a more open economy
- **2000:** The government introduced the "automatic route" in FDI, allowing foreign investment without prior approval in all sectors except a small negative list.
- **2001:** Removal of quantitative restrictions on imports under the WTO commitments, making it easier for multinational companies to set up export-oriented units in India.
- **2003:** Establishment of Special Economic Zones (SEZs) to promote export-oriented growth, offering tax holidays and other fiscal incentives.
- **2005:** Introduction of VAT, replacing sales tax and creating a more uniform market, indirectly benefiting foreign investors by simplifying the tax structure

2010s: Consolidation and Further Liberalization

- **2012:** Allowed FDI up to 51% in multi-brand retail under government approval. FDI cap in single-brand retail increased from 51% to 100% under the automatic route. The broadcasting sector saw an increase in FDI cap to 74% in various services.
- **2014:** FDI cap in the defense sector increased from 26% to 49% under the automatic route to boost domestic industry. Up to 100% of FDI is allowed in railway infrastructure, excluding operations.
- **2015:** The launch of the 'Make in India' initiative to turn India into a global manufacturing hub, improving ease of business. FDI norms relaxed in construction development, agriculture, and aviation.
- **2016:** FDI norms further liberalized insurance, pension, other financial sectors, and broadcasting. Introducing the bankruptcy code improved the business environment and provided a faster mechanism for resolving insolvencies.
- **2017:** Abolition of the Foreign Investment Promotion Board (FIPB), signaling a move towards more automatic approvals. The introduction of the Goods and Services Tax (GST) created a unified tax regime and enhanced the ease of business.

2020s: Strategic and Digital Focus

- **2020:** New FDI policy to curb opportunistic takeovers/acquisitions of Indian companies due to the COVID-19 pandemic, especially from neighboring countries. PLI Scheme Launched: Production Linked Incentive (PLI) schemes have been introduced in sectors like electronics manufacturing to attract investments and boost domestic production. FDI in defense increased up to 74% under the automatic route to promote 'Atmanirbhar Bharat' (Self-Reliant India).
- **2021:** FDI in insurance increased to 74% from 49%, allowing foreign ownership and control with safeguards. Incentives for electronics, pharmaceuticals, and telecom equipment manufacturing were introduced under the PLI (Production Linked Incentive) schemes.
- **2022:** Further PLI schemes launched targeting high-growth sectors to attract investment in manufacturing.
- **2023:** Liberalized drone policies to enhance FDI in the nascent drone industry. Promotion of semiconductor manufacturing through significant government subsidies and incentives under a specific PLI scheme.

Chart 1: Key Initiatives Undertaken to Attract FDI in India

(Invest India, 2024; India Brand Equity Foundation, 2024; Ministry of Commerce & Industry, 2023)

CHAPTER 2: LITERATURE REVIEW

When firms contemplate investing in a foreign nation, they look attentively at the political climate. Factors like a government seizing ownership of a company's assets, massive demonstrations, or stringent rules might push corporations away from investment in a particular country. When a country has political concerns, substantial multinational corporations could refuse to invest since operating their company successfully might be too challenging (Daniels et al., 2002; Dupasquier & Osajwe, 2006; Zenegnaw, 2010). Furthermore, Li (2008) also discovered that nations experiencing armed conflicts tend to attract fewer international investments.

If a country's institutions, encompassing everything from its government to its legal system, must be mended, international corporations may not want to invest there. This is because corporations prefer to know that the regulations are transparent, fair, and consistently followed (Gastanaga et al., 1998; Campos et al., 1999; Asiedu & Villamil, 2000; Wei, 2000; Asiedu, 2006; Ting & Tang, 2010). However, if a country's institutions are solid and efficient, it seems considerably more enticing to enterprises, particularly industrial ones (Mehic et al., 2009). Mohamed & Sidiropoulos (2010) pointed out that this is particularly true for nations in the Middle East and North Africa (MENA).

Corruption is another huge concern. It is like a hidden additional cost that makes things less transparent and more complex, and it might make international firms apprehensive about whether they can trust local enterprises or receive a fair share in legal disputes. While some studies, like Habib & Zurawicki (2002) and Smarzynska & Wei (2002), have shown that corruption drives investors off, others, like Wijeweera & Dollery (2009), have failed to establish a substantial relationship. This implies that the impact of corruption on investment may vary. People typically measure the strength of a country's institutions by how much corruption there is and how healthy contracts are enforced.

Singh & Jun's (1995) study on why firms invest in emerging nations is informative. They explored how political risks and economic considerations, such as how large a nation's economy is, trade levels, and budget practices, might make a country more or less appealing to foreign investors. Studying data from 31 developing nations from 1970 to 1993 revealed how significant these criteria are for bringing in foreign investment. Wang & Swain (1997) also spoke about how political instability, financial issues, corruption, and unclear institutions might force multinational corporations away, resulting in decreased investment. Morisset (2000) agreed that corruption and bad Governance might raise corporate expenses, driving off international investors. This view is confirmed by previous research, demonstrating how critical political

and institutional circumstances are for bringing foreign investment into developing countries (Stein & Daude, 2001; Stevens, 2000).

Globerman & Shapiro (2002) examined how effectively a nation like the United States maintains its rules and regulations, indicating that when a country makes it obvious who owns what and keeps government activities public, it is more likely to attract money from other countries. They suggest that a comprehensive framework for handling these items is crucial to securing foreign direct investment (FDI). Continuing this approach, Globerman & Shapiro (2003) highlighted that investment is more tempting for major firms from foreign nations when a country has good institutions. They employed a unique math approach, a probit model, to analyze how excellent Governance leads American corporations to invest in underdeveloped nations, stressing that solid management drives investment.

Asiedu (2005) looked at what makes Africa appealing to foreign investors, finding from polls that high obstacles to investment, economic shakiness, corruption, and political issues are huge turn-offs. However, studying data from 22 African nations from 1984 to 2000, Asiedu showed that having a considerable market, abundant natural resources, educated people, sturdy infrastructure, minimal corruption, political stability, and dependable laws all assist in attracting FDI. Bénassy-Quéré et al. (2007) focused on how the strength of a country's institutions impacts its potential to attract foreign investment, looking at data from 52 nations. Their investigation employed a unique French Ministry of Economy and Finance dataset and a panel gravity model. Their research showed that the quality of institutions has a significant impact on FDI, stating that even when you consider how big a country's economy is, good institutions that fight corruption, ensure transparency, protect ownership, deliver justice, manage financial activities, and have an efficient tax system are crucial.

Mishra & Daly (2007) explored how the quality of institutions in OECD and Asian nations influenced FDI from 1991 to 2001. Using the International Guide of Country Risk, they determined that superior institutions significantly promote FDI, particularly those that respect individual rights, have a sound and fair legal system, and are politically stable. Samimi & Ariani (2010) focused on the Middle East and North Africa (MENA) area, studying data from 16 nations between 2002 and 2007. They looked at three governance indices - political stability, corruption control, and the rule of law - from the World Resources Institute. They observed that greater Governance leads to increased FDI in MENA nations and proposed that these areas should enhance Governance to attract more foreign investment.

Adhikary (2011) took a thorough look at how effective administration in a nation (Governance), the flow of money from other countries (FDI), and how well a country's economy performs (economic development) are all related in 15 countries in Asia from 1996 to 2008. To find this out, he employed a complicated sort of arithmetic (the random effect of generalized least squares and Prais-Winsten estimate models). He observed that the nation is administered well, has political stability, and is peaceful; it is more likely to prosper economically since more foreign money flows in.

Mengistu & Adhikary (2011) also looked into this issue. Still, they focused on six methods to discern whether a nation is adequately governed: how effective its administration is, how stable and peaceful it is, how well it respects the rule of law, and how little corruption it has. They examined these parameters in the same 15 Asian nations from 1996 to 2007. Their study, which entailed evaluating lots of data in a particular method (using a panel data model with fixed effects), indicated that these six strong management indications are vital for recruiting foreign money.

Hassen & Anis (2012) changed the emphasis to Tunisia, studying how foreign money influenced the country's economic development from 1975 to 2009. They detected foreign money, how sophisticated the country's financial system is, how educated its people are, and how open it is to trade with other nations. Its total economic health (real GDP) is all bound together in the long term. For Tunisia's economy to flourish, a combination of foreign investment, decent education, open commerce, and a stable banking system are required.

Understanding how solid institutions and Governance function as a foreign capital magnet is crucial. Some recent studies have zoomed in on how the quality of a country's institutions and how effectively it is managed might attract more foreign direct investment (Wei, 2000; Ali et al., 2010; Buchanan et al., 2012). If a nation is well-run and has strong Governance, it is more likely to attract foreign corporations to invest (Globerman & Shapiro, 2002; La Porta et al., 1999; Wasnik & Sarraf, 2023). However, if the Governance is solid and can safeguard investments, that is an issue. Corruption, political freedom, and how effectively property rights are protected substantially attract international investment (Bergara, 1998; Richards & Nwankwo, 2005).

Interestingly, the favorable impacts of high-quality institutions on attracting FDI are noticeable in rich nations but less in developing ones (Peres et al., 2018). In areas like Pakistan, excellent institutions are crucial to bringing in foreign investment and have a lasting influence on the quantity of investment the country obtains (Ahmad et al., 2018). On the other hand, whether a government adopts International

Financial Reporting Standards (IFRS) does not immediately affect FDI in poor nations. However, countries implementing IFRS, assuming they also have good institutions, receive more substantial FDI inflows (Owusu et al., 2017).

Alfaro & Chauvin (2016) took a deeper look at how foreign investments impact the economic development of the nations receiving these investments and how local financial markets might assist in optimizing these advantages. They handled this from the host country's standpoint rather than from the individual corporations making the investments. They underlined how the financial health of a country may impact the amount of FDI it obtains, alter how foreign businesses operate there, and decide how much local companies can learn and develop from the presence of these foreign ones.

Manasseh et al. (2017) examined how a country's institutions' quality is connected to its stock market's growth. They looked at how much corruption is controlled, how responsible the government is, and the effectiveness of its bureaucracy. Similarly, Nguyen & Cao (2015) observed that in Vietnam, the quality of institutions, including political stability, the lack of violence, sound regulatory standards, and regulating corruption, has a significant influence in attracting foreign direct investment (FDI). Conversely, Nondo et al. (2016) investigated the situation in Sub-Saharan Africa (SSA). They discovered that the relationship between institutional quality and FDI could not be clearer-cut, demonstrating no substantial correlation. Aidt et al. (2008) highlighted that corruption lowers when politicians are held responsible, which helps the economy flourish. Moussa et al. (2016) observed that higher economic freedom leads to increased FDI, implying that more foreign investors are attracted when firms have more flexibility to operate.

Hugill & Siegel (2014) looked at how firms in developing regions are improving at corporate Governance, which helps them distinguish themselves from local competition. Ullah & Khan (2017) concluded that excellent institutional elements are vital in luring FDI to South Asian nations, notably in the ASEAN area, compared to Central Asia and the SAARC regions. Alfaro & Chauvin (2017) studied how FDI flows and the growth of financial sectors interact in Central and Eastern European Union nations, finding a short-term one-way boost from financial sector development to FDI inflows.

Rei & Bhattacharya's (2008) study examined Greece's difficulty collecting taxes, which promoted the grey economy, making it harder for the government to stabilize it. Globerman et al., 2006 studied how corruption and Governance affect foreign capital influx and outflow. Likewise, Boschini et al. (2007) suggested that although natural resources frequently bring conflict and negative repercussions to a society, effective institutions may transform these drawbacks into benefits. Hout (2007) connected poor

Governance with corruption, skewed government budgets, and unfair growth, stating that corruption erodes public faith in authority. Lastly, Fan et al. (2009) demonstrated that more comprehensive governance reforms, beyond merely looking at corruption, may dramatically improve investment levels and attract FDI by making the business climate more lucrative.

RESEARCH GAP AND NOVELTY OF RESEARCH

There is much potential for research into the relationships between policy frameworks toward attracting FDI, financial growth, Governance, and FDI inflows, particularly in emerging countries like India. Few studies directly examine the relationship between Governance, financial development, and FDI inflows into India, even though FDI plays a vital role in speeding economic growth. This gap is pronounced in light of the current wave of policy reforms aimed at attracting foreign direct investment (FDI); hence, it is vital to investigate how these measures for financial development, policy frameworks, and Governance impact FDI trends.

The relationship between governance, financial development, and foreign direct investment (FDI) inflows in India has yet to be thoroughly examined, especially in light of new datasets that show the government's active attempts to enhance the investment climate. Although considerable research has been conducted to investigate the link between financial development and Governance and foreign direct investment (FDI), these studies usually have several limitations. First and foremost, they typically employ outdated data, obscuring the impact of more recent policy changes. Furthermore, the present body of research generally adopts a broad perspective, ignoring the subtle ways financial institutions and Governance influence FDI inflows into India.

Furthermore, compared to the overall economic consequences of FDI, the relationship between Governance and FDI in India has gotten less attention. With the Indian government implementing many efforts to improve and streamline the investment climate, this monitoring is critical. Examples include the Production-Linked Incentive (PLI) Scheme, the Made in India campaign, and significant company taxation and law improvements. These policy reforms, aimed at attracting more foreign direct investment, represent a substantial shift in governance philosophy and practice. However, further study is required to understand the specific implications of these financial and policy developments and governance enhancements on FDI inflow

PROBLEM STATEMENT

We want to analyze how well the policy frameworks, financial development, and Governance impact India's foreign direct investment (FDI) inflow and assess their combined implications on its ability to attract foreign investments. Furthermore, we will examine the governance and financial development factors that investors assess before investing in India. Additionally, we will examine the effectiveness of policy frameworks such as the Make in India program, Startup India, and Production-Linked Incentive (PLI) Scheme in attracting foreign investment to India and their role in the broader governance and financial development environment.

RESEARCH HYPOTHESIS

Governance and FDI Inflow:

Our Null Hypothesis (H0) is that there is no relationship between Governance and the FDI inflow in India while our Alternate Hypothesis (H1) is that there is a relationship between Governance and the FDI inflow in India.

When our null hypothesis (H0) comes to be true, it signifies that the Governance Indicators, i.e., Voice and Accountability (VA), Political stability (PS), Government effectiveness (GE), Regulatory quality (RQ), Rule of law (RL) and Control of corruption (CC) have no relationship in the FDI inflows in India. Suppose our alternate hypothesis (H1) stands to be true. In that case, it signifies that the Governance Indicators, i.e., Voice and Accountability (VA), Political stability (PS), Government effectiveness (GE), Regulatory quality (RQ), Rule of law (RL), and Control of corruption (CC) have a relationship in bringing in FDI in India.

Financial Development and FDI Inflow:

Our Null Hypothesis (H0) is that there is no relationship between Financial Development and the FDI inflow in India while our Alternate Hypothesis (H1) is that there is a relationship between Financial Development and the FDI inflow in India.

When our null hypothesis (H0) comes to be true, it signifies that the Financial Development Indicators, i.e., Financial Institution Access (FIA), Financial Institution Depth (FID) and Financial Institution Efficiency (FIE) have no relationship in the FDI inflow in India. When our alternate hypothesis (H1) comes to be true, it signifies that the Financial Development Indicators, i.e., Financial Institution Access (FIA), Financial Institution Depth (FID), and Financial Institution Efficiency (FIE) have a relationship with the FDI inflow in India.

Policy Frameworks and FDI Inflow:

Our Null Hypothesis (H0) is that there is no relationship between Policy frameworks such as the PLI Scheme, Make in India Scheme, and Startup India scheme with the FDI inflow in India while our Alternate Hypothesis (H1) is that there is a relationship between Policy frameworks such as the PLI Scheme, Make in India Scheme, and Startup India scheme with the FDI inflow in India.

When our null hypothesis (H0) comes to be true, it signifies that Policy frameworks such as the PLI Scheme, Make in India Scheme, and Startup India scheme have no relationship with the FDI inflow in India. When our alternate hypothesis (H1) comes to be true, it signifies that Policy frameworks such as the PLI Scheme, Make in India Scheme, and Startup India scheme have a relationship with the FDI inflow in India.

CHAPTER 3: RESEARCH METHODOLOGY

DATA

The dataset under consideration offers a complete, longitudinal perspective for research, encompassing the years 2002 through 2023. 2002 marked a period of rapid economic reforms and liberalization in India, following the early 2000s global economic conditions and the IT boom. This year was a pivotal baseline for analyzing governance and financial development trends. Over two decades, India's economic and policy landscape evolved with the introduction of significant reforms such as the Goods and Services Tax (GST), the Insolvency and Bankruptcy Code (IBC), and the Production-Linked Incentive (PLI) scheme. Analyzing these years allows for evaluating FDI trends in response to these policy milestones. The timeframe from 2002 to 2023 offers a mature dataset, including pre-and post-reform periods, providing a robust platform for statistical analysis. The period also covers critical global economic events, such as the 2008 financial crisis and the COVID-19 pandemic, which have profoundly impacted global investment flows and economic policies. The selected years also encompass significant technological advancements and market evolution, such as the digital revolution and the expansion of financial services in India.

This study takes a quantitative approach, utilizing statistical and mathematical models to examine the dynamics at work comprehensively. Linear regression analysis, which allows us to investigate the relationship between a dependent variable and one or more independent variables over a specific period, is an essential component of our technique. Using the regression analysis, we want to evaluate and grasp complicated interactions across time and provide an accurate, quantitative evaluation of the patterns and changes in the data. This quantitative approach gives significant outputs on the underlying patterns and causes influencing the FDI inflows in India, also allowing systematic investigation of the interconnection of the variables.

RESEARCH DESIGN

Table 1: Research Design

Sr. No	Dependent/Independent Variable	Name of the variable	Measured
1	Dependent	FDI Inflow	*FDI Inflows (current US $) provided by The World Bank annually*
2	Independent	Governance	*Governance Indicators by The World Bank:* - Voice and accountability (VA) - Political stability (PS) - Government effectiveness (GE) - Regulatory quality (RQ) - Rule of law (RL) - Control of corruption (CC) (Kaufmann et.al, 2011)
3	Independent	Financial Development	*Financial Development Indicators by IMF:* - Financial Institution Access (FIA) - Financial Institution Depth (FID) - Financial Institution Efficiency (FIE) (Svirydzenka, 2016)
4	Independent	Policy Framework	*Schemes initiated by the Government of India to attract foreign investments:* - Make in India Policy (MI) - Production Linked Incentive Scheme (PLI) - Startup India Policy (SI)

VARIABLE DESCRIPTION

- **FDI Inflow:** The term FDI inflow refers to the foreign direct investment (FDI) a country receives from investors in other countries. Foreign corporations and individuals can invest in new or existing enterprises, infrastructure projects, or real estate. FDI inflows are a significant measure of a country's investment climate. They can have various advantages, including access to new technology, improved job possibilities, and increased global competitiveness. International institutions such as the World Bank track and report on FDI inflows, and governments actively analyze them to guide investment promotion and economic development policies.

- **Voice and accountability (VA):** The extent to which citizens may participate in selecting their government while also enjoying freedom of expression, association, and free media. In other words, VA assesses individuals' capacity to influence how they are governed and how their government runs. A country with a high VA score will have free and fair elections, independent media, and a robust civil society capable of holding the government responsible for its acts.

- **Political stability & Absence of Violence (PS):** A metric assesses a country's political instability and violence risk, including terrorism. A country with a high PS score will have a stable political climate, including peaceful power transitions and a low likelihood of violent conflicts or terrorist attacks.

- **Government effectiveness (GE):** Government effectiveness assesses the quality of public services, the civil service's independence from political pressures, and the legitimacy of government programs. A country with a high GE score will have efficient and effective public services, a competent and independent civil service, and a government that carries out policies its citizens believe are credible.

- **Regulatory quality (RQ)** measures a government's capacity to establish and enforce solid rules and regulations that encourage private sector development. A country with a high RQ score will have clear, predictable policies promoting a business-friendly environment and economic growth.

- **Rule of law (RL):** It evaluates the extent to which agents trust and follow societal rules, such as the quality of contract enforcement, property rights, the police, and the courts. A high RL score indicates that a country's legal system is fair, unbiased, and accessible to all and that individuals trust the government to implement the law and safeguard their rights.

- **Control of corruption (CC):** Control of corruption examines how public authority is used for private benefit, encompassing both minor and significant corruption and the "capture" of the state by elites and corporate interests. A country with a high CC score will have a transparent and responsible government, with minor corruption and strong ethical standards for public officials.

- **Financial Institution Access (FIA)**: It refers to the availability of financial services to individuals and enterprises from banks and other financial organizations. The accessibility and simplicity of using loans, opening bank accounts, and other financial services and items are discussed here. FIA is often determined using the fraction of the population with access to financial services, financial institutions, and branches in a specific area.

- **Financial Institution Depth (FID):** This refers to how financial institutions may serve clients with a wide range of monetary goods and services. This comprises various services such as financial aid, insurance goods, and specialized loan choices. FID is often assessed by the breadth of monetary goods and services offered by institutions and the expertise and specialty of financial professionals.

- **Financial Institution Efficiency (FIE):** It refers to how efficiently and effectively financial institutions offer financial goods and services to their customers. This includes the speed and accuracy of transactions and the level of customer service provided. FIE is frequently measured using customer satisfaction, transaction processing times, and error rates.

MODEL OF THE THEORY

We use a statistical model that includes a set of governance, financial, and policy indicators as independent variables and FDI inflows as the dependent variable. The model can be specified as follows:

FDI = f (Governance Indicators, Financial Indicators, Policy Frameworks)

The aim is to estimate the coefficients of the independent variables and their impact on FDI inflows.

The model includes several governance indicators, such as control of corruption (CC), government effectiveness (GE), political stability (PS), the rule of law (RL), and voice and accountability (VA), as well as financial development indicators such as financial institutional access (FIA), financial institutional depth (FID), financial institutional efficiency (FIE) and policy such as Make in India, Production Linked Scheme and Startup India.

By estimating the coefficients of these indicators, we can determine the extent to which each variable affects FDI inflows. The model also includes an intercept ($\beta 0$) and an error term (εt) that captures any unexplained variation in FDI inflows.

MODEL SPECIFICATION

1. BASIC MODEL

$$FDI_t = f(CC, GE, PS, RQ, RL, VA, FIA, FID, FIE, MI, PLI, SI)_t$$ ---------- **Equation: 1**

2. ECONOMETRIC MODEL

Governance Quality and Financial Development

$$FDI_t = \beta_0 + \beta_1(CC)_t + \beta_2(GE)_t + \beta_3(PS)_t + \beta_4(RQ)_t + \beta_5(RL)_t + \beta_6(VA)_t + \beta_7(FIA)_t + \beta_8(FID)_t + \beta_9(FIE)_t + \varepsilon_t$$ ---------- **Equation: 2**

Governance Quality and Policy Measures

$$FDI_t = \beta_0 + \beta_1(CC)_t + \beta_2(GE)_t + \beta_3(PS)_t + \beta_4(RQ)_t + \beta_5(RL)_t + \beta_6(VA)_t + \beta_7(MI)_t + \beta_8(PLI)_t + \beta_9(SI)_t + \varepsilon_t$$ ---------- **Equation: 3**

Governance, Financial, and Policy Measures

$$FDI_t = \beta_0 + \beta_1(CC)_t + \beta_2(GE)_t + \beta_3(PS)_t + \beta_4(RQ)_t + \beta_5(RL)_t + \beta_6(VA)_t + \beta_7(FIA)_t + \beta_8(FID)_t + \beta_9(FIE)_t + \beta_{10}(MI)_t + \beta_{11}(PLI)_t + \beta_{12}(SI)_t + \varepsilon_t$$ ---------- **Equation: 4**

Where,

β_0 is the intercept, and β_1 to β_{12} are the coefficients of the governance, financial development, and policy indicators, whereas $\boldsymbol{\varepsilon_t}$ represents the error in the model

CHAPTER 4: RESULTS AND DATA INTERPRETATION

DESCRIPTIVE STATISTICS

Table 2: Descriptive Statistics

	FDI	CC	GE	PS	RL	RQ	VA	FIA	FID	FIE
Mean	35.71	-0.40	-0.01	-1.11	0.00	-0.34	0.40	0.17	0.31	0.58
Median	36.00	-0.41	0.00	-1.11	-0.03	-0.36	0.43	0.16	0.32	0.59
Maximum	74.40	-0.23	0.38	-0.77	0.18	-0.13	0.46	0.26	0.38	0.61
Minimum	4.30	-0.56	-0.22	-1.51	-0.09	-0.48	0.13	0.10	0.21	0.51
Std. Dev.	21.86	0.10	0.16	0.20	0.08	0.10	0.08	0.06	0.05	0.03
Skewness	-0.08	0.09	0.69	-0.01	0.75	0.52	-2.49	0.28	-0.69	-1.05
Kurtosis	1.94	1.83	2.94	2.14	2.17	2.59	8.69	1.39	2.71	3.28
Jarque-Bera	0.91	1.11	1.51	0.59	2.35	0.98	45.22	2.28	1.58	3.57
Probability	0.63	0.57	0.47	0.75	0.31	0.61	0.00	0.32	0.45	0.17
Sum	678.50	-7.64	-0.12	-21.15	0.08	-6.49	7.64	3.31	5.85	10.97
Sum Sq. Dev.	8604.08	0.18	0.47	0.76	0.13	0.19	0.11	0.07	0.04	0.01

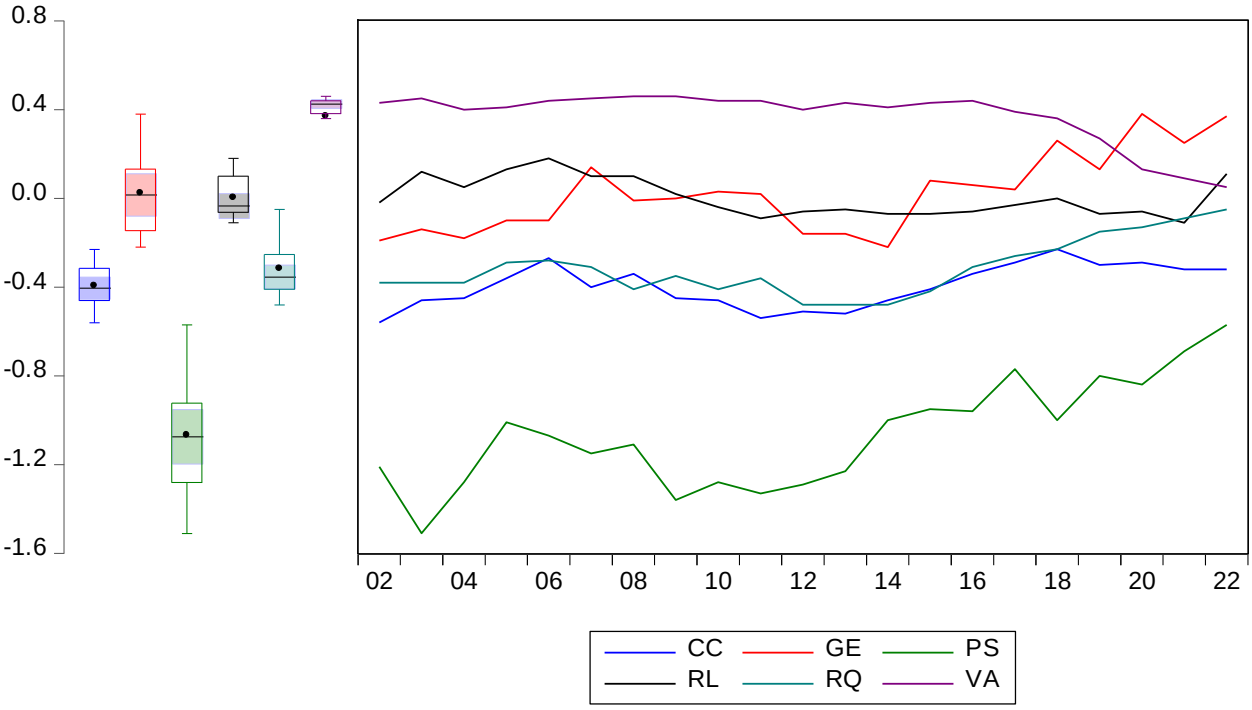
(Source: Author's Calculation from EViews)

The maximum value for the FDI is $74.40 billion, CC is -0.23, GE is 0.38, PS is -0.77, RL is 0.18, RQ is -0.13, VA is 0.46, FIA is 0.26, FID is 0.38, FIE is 0.61. While the minimum value for the FDI is $4.30 billion, CC is -0.56, GE is -0.22, PS is -1.51, RL is -0.09, RQ is -0.48, VA is 0.13, FIA is 0.10, FID is 0.21, FIE is 0.51.

The Jarque-Bera value for the FDI is 0.91, CC is 1.11, GE is 1.51, PS is 0.59, RL is 2.35, RQ is 0.98, VA is 45.22, FIA is 2.28, FID is 1.58, FIE is 3.57. Except for VA, which has a high value of 45.22, indicating a significant departure from normality, most other indicators generally display values close to or less than 3, suggesting a relatively normal distribution. This normality is crucial for further parametric statistical tests assuming a normal data distribution.

Before Estimating the impact, the time series variables should be stationary, which is confirmed by the Augmented Dickey-Fuller (ADF)/Unit Root test.

Figure 3: India's Performance on World Governance Indicators



(Source: Author's Calculation from EViews; WDI, 2023)

The World Bank's Worldwide Governance Indicators (WGI) were used to collect governance data for this study. The WGI encompasses six governance dimensions: Voice and Accountability (VA), Political Stability and Absence of Violence (PS), Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL), and Control of Corruption (CC) (Kaufmann et al., 2011). The World Bank's governance indicators are measured on a scale from -2.5 to 2.5, where higher values indicate more robust governance performance.

The governance data for India from 2002 to 2020 presents a mixed picture, with indicators like Government Effectiveness (GE) and Rule of Law (RL) showing moderately positive values, suggesting some degree of robustness in government operations and legal frameworks. However, challenges remain evident in Political Stability & Absence of Violence (PS), and Control of Corruption (CC), where negative values indicate periodic terrorism and corruption issues. Financial development indicators like Financial Institutions Access (FIA), Depth (FID), and Efficiency (FIE) show positive but varying degrees, highlighting progress in the financial sector but also pointing towards areas that might benefit from further development and regulatory enhancements.

UNIT ROOT TEST

Table 3: Unit Root Test

		I(0)			I(1)	
		T-statistics	**Probability**		**T-statistics**	**Probability**
FDI		-0.591	0.850		-4.016	0.008*
CC		-3.750	0.015		-2.911	0.069**
GE		-1.261	0.624		-5.976	0.000*
PS		-1.447	0.536		-6.121	0.000*
RQ		-0.288	0.909		-3.862	0.011*
RL		-1.533	0.495		-5.832	0.000*
VA		-1.434	0.543		-3.941	0.009*
FIA		-0.886	0.767		-5.577	0.000*
FID		-1.733	0.399		-3.192	0.039*
FIE		-1.269	0.223		-4.570	0.003*
MI		-0.696	0.824		-4.123	0.006*
PLI		-0.585	0.856		-4.690	0.001*
SI		-0.523	0.865		-4.123	0.001*

*, ** shows significance at 5% and 10% respectively.

(Source: Author's Calculation from EViews)

In econometrics and time series analysis, the concept of stationarity is crucial. A stationary time series is one whose statistical properties, such as the mean and variance, remain constant over time (Gujarati, 2014). Making accurate predictions or drawing meaningful conclusions can be difficult if a time series is not stationary. The level of integration of a time series refers to the number of times the data must be differenced to make it stationary. A time series is said to be integrated of order 1, or I(1) if it becomes stationary after being differenced once. Similarly, a time series is integrated of order 2, or I(2), if it becomes stationary after being differenced twice.

The Unit root test estimates show the stationary estimates for the variables, i.e., FDI, VA, PS, GE, RQ, RL, CC, FIA, FID, FIE, MI, PLI, and SI. The test shows that at a 10% significance level, all variables are stationary at the first difference, i.e., they follow the I(1) level of integration. This implies that any deviations from their long-run equilibrium level are temporary, and they will eventually revert to their equilibrium level.

CORRELATION MATRIX

Table 4 Correlation Matrix

Correlation/ Probability	FDI	CC	GE	PS	RL	RQ	VA	FIA	FID	FIE	SI	PLI	MI
FDI	1												

CC	0.489	1											
	0.033*	-----											
GE	0.754	0.631	1										
	0.000*	0.003	-----										
PS	0.626	0.720	0.515	1									
	0.004*	0.000	0.023	-----									
RL	-0.541	0.264	-0.213	-0.245	1								
	0.016*	0.274	0.379	0.310	-----								
RQ	0.428	0.752	0.739	0.598	0.081	1							
	0.067**	0.000	0.000	0.006	0.739	-----							
VA	-0.549	-0.440	-0.615	-0.566	0.333	-0.692	1						
	0.014*	0.058	0.005	0.011	0.163	0.001	-----						
FIA	0.798	0.465	0.577	0.739	-0.685	0.392	-0.571	1					
	0*	0.044	0.009	0.000	0.001	0.096	0.010	-----					
FID	0.805	0.493	0.715	0.426	-0.209	0.398	-0.339	0.479	1				
	0*	0.031	0.000	0.068	0.388	0.090	0.155	0.037	-----				
FIE	-0.444	-0.663	-0.522	-0.740	0.242	-0.629	0.455	-0.728	-0.225	1			
	0.056*	0.002	0.021	0.000	0.317	0.003	0.049	0.000	0.354	-----			
SI	0.643	0.695	0.686	0.716	-0.354	0.756	-0.651	0.799	0.410	-0.841	1		
	0.003*	0.000	0.001	0.000	0.136	0.000	0.002	0	0.080	0	-----		
PLI	0.484	0.274	0.579	0.322	-0.186	0.502	-0.831	0.323	0.363	-0.154	0.394	1	
	0.035*	0.255	0.009	0.177	0.444	0.028	0	0.177	0.126	0.528	0.094	-----	
MI	0.702	0.560	0.537	0.805	-0.523	0.452	-0.544	0.924	0.361	-0.788	0.782	0.308	1
	0.000*	0.012	0.017	0	0.021	0.0519	0.015	0	0.128	0.000	0.000	0.198	-----

*, ** shows significance at 5% and 10% respectively. (Source: Author's Calculation from EViews)

The correlation matrix shows that there is a highly positive correlation between FDI and CC (0.489), GE(0.754), PS (0.626), RQ (0.428), FIA (0.798), FID (0.805), SI (0.643), PLI (0.484), MI (0.702). It indicates that foreign investors are likely drawn to India's improving administrative capabilities, political environment, and accessible financial services. Likewise, policies like SI, PLI, and MI have been crucial in attracting FDI into the country. These aspects create a conducive atmosphere for investment, enhancing investor confidence.

There was a negative correlation between FDI and VA (-0.549), RL (-0.541), and FIE (-0.444). These findings suggest that while India attracts FDI, it may be doing so at the expense of broader democratic processes and legal frameworks or that the efficiency of financial institutions is not yet a priority for incoming investors. This could imply a focus on sectors or regions where these factors are less critical, or it might reflect investor tolerance for certain governance deficiencies in exchange for other market advantages such as size or growth potential.

REGRESSION ANALYSIS

Table 5: Regression Analysis Output

Dependent Variable: Foreign Direct Investment (FDI)			
	Model 1	**Model 2**	**Model 3**
Independent Variables	**Coefficient (Probability)**	**Coefficient (Probability)**	**Coefficient (Probability)**
CC(-1)	-0.5 (0.514)	180.4**(0.008)***	67.9(0.240)
GE (-1)	0.5**(0.096)****	54.1**(0.044)***	48.6**(0.073)****
PS (-1)	0.6**(0.010)***	3.7(0.331)	10.4(0.406)
RQ (-1)	-0.8(0.110)	-35.0(0.415)	-34.0(0.351)
RL (-1)	1.6**(0.071)****	-217.4**(0.002)***	-50.5(0.422)
VA (-1)	-1.4**(0.062)****	175.1**(0.058)***	255.9**(0.038)***
FIA (-1)	4.0**(0.005)***	-	460.0**(0.029)***
FID (-1)	4.3**(0.000)***	-	-0.047(0.999)
FIE (-1)	5.9**(0.002)***	-	-132.9(0.389)
MI	-	7.3(0.331)	-19.0(0.117)
PLI	-	32.6**(0.033)***	46.1**(0.026)***
SI	-	-15.9(0.126)	-26.9(0.106)
C	5.7	32.7	-29.0
R-squared	**0.981**	**0.955**	**0.987**
Adjusted R-squared	**0.960**	**0.904**	**0.957**
S.E. of regression	0.068	6.564	4.378
Sum squared resid	0.037	344.731	95.867
Log likelihood	29.962	-52.112	-40.594
F-statistic	47.013	18.910	32.956
Prob(F-statistic)	**0.000**	**0.000**	**0.000**
Mean dependent var	10.414	37.355	37.355
S.D. dependent var	0.345	21.252	21.252
Schwarz criterion	-1.723	7.396	6.597
Hannan-Quinn criter.	-2.149	6.969	6.043
Durbin-Watson stat	**2.002**	**2.418**	**2.931**

*, ** shows significance at 5% and 10%, respectively.

(Source: Author's Calculation from EViews)

In the regression analysis of **Model 1 (Governance and Financial Indicators)**, FDI inflow serves as the dependent variable, with a set of governance and financial development indicators functioning as independent variables. These include CC, GE, PS, RQ, RL, VA, FIA, FID, and FIE. The analysis yields significant positive coefficients for GE, PS, RL, FIA, FID, and FIE, indicating that any improvements in these areas are associated with proportional increases in FDI inflows into India.

Specifically, a unit increase in GE, PS, RL, FIA, FID, and FIE increases FDI inflows by factors of 0.5, 0.6, 1.6, 4.0, 4.3, and 5.9, respectively. Conversely, the model reveals a negative relationship between VA and FDI inflows, with a unit increase in VA associated with a 1.4-fold decrease in FDI. Statistical significance levels underscore the reliability of these relationships. GE, RL, and VA demonstrate significance at the 10% level, PS, FIA, FID at the 5% level, and FIE at the 10% level. In contrast, CC and RQ do not exhibit a statistically significant relationship with FDI inflows, as indicated by p-values exceeding the 10% threshold.

The model's R-squared value of 0.981 suggests a high degree of variance in FDI inflows explained by the independent variables. Additionally, the Prob(F-statistics) effectively at 0.000 confirms the overall model's statistical significance, while a Durbin-Watson statistic of 2.002 indicates no substantial autocorrelation among the residuals.

In the regression analysis of **Model 2 (Governance and Policy Measures)**, FDI inflow serves as the dependent variable, with a set of governance and policy framework indicators functioning as independent variables. These include CC, GE, PS, RQ, RL, VA, MI, PLI and SI. The analysis yields significant positive coefficients for CC, GE, RL, VA, and PLI, indicating that any improvements in these areas are associated with proportional increases in FDI inflows into India.

Specifically, a unit increase in CC, GE, VA, and PLI increases FDI inflows by factors of 180.4, 54.1, 175.1, and 32.6, respectively. Conversely, the model reveals a negative relationship between RL and FDI inflows, with a unit increase in RL associated with a 217.4-fold decrease in FDI. Statistical significance levels underscore the reliability of these relationships. VA demonstrates significance at the 10% level, and CC, GE, and RL at the 5% level. In contrast, PS, RQ, MI, and SI do not exhibit a statistically significant relationship with FDI inflows, as indicated by p-values exceeding the 10% threshold.

The model's R-squared value of 0.955 suggests a high degree of variance in FDI inflows explained by the independent variables. Additionally, the Prob(F-statistics) effectively at 0.000 confirms the overall model's statistical significance, while a Durbin-Watson statistic of 2.418 indicates little to no substantial autocorrelation among the residuals.

In the regression analysis of **Model 3 (Governance, Financial, and Policy Measures)**, FDI inflow serves as the dependent variable, with a set of governance, financial development, and policy framework indicators functioning as independent variables. These include GE, VA, FIA, and PLI. The analysis yields significant positive coefficients for GE, VA, FIA, and PLI, indicating that any improvements in these areas are associated with proportional increases in FDI inflows into India.

Specifically, a unit increase in GE, VA, FIA, and PLI increases FDI inflows by 48.6, 255.9, 460.0, and 46.1 times, respectively. Statistical significance levels underscore the reliability of these relationships. GE demonstrates significance at the 10% level and VA, FIA, and PLI at the 5% level. In contrast, CC, PS, RQ, RL, MI, FID, FIE, MI, and SI do not exhibit a statistically significant relationship with FDI inflows, as indicated by p-values exceeding the 10% threshold.

The model's R-squared value of 0.987 suggests a high degree of variance in FDI inflows explained by the independent variables. Additionally, the Prob(F-statistics) effectively at 0.000 confirms the overall model's statistical significance, while a Durbin-Watson statistic of 2.93 indicates little to no substantial autocorrelation among the residuals.

Across all models, we find out that the Government Effectiveness (GE), Rule of Law (RL), Voice and Accountability (VA), Financial Institutional Access (FIA), and Production Linked Incentive (PLI) scheme has significantly affected the FDI inflows in India.

RESIDUAL ANALYSIS

Residual analysis in regression is a critical diagnostic tool used to assess the validity and reliability of a regression model. Residuals are the differences between observed values of the dependent variable and those predicted by the regression model. We check whether our residuals are normally distributed or not through the Histogram normality test.

Hypothesis:

Null Hypothesis (H0): The residual is normally distributed (Skewness = 0 and Kurtosis = 3)
Alternate Hypothesis (H1): The residual is not normally distributed (Skewness ≠ 0 and Kurtosis ≠ 3)

Figure 4: Residual Analysis of Model 1

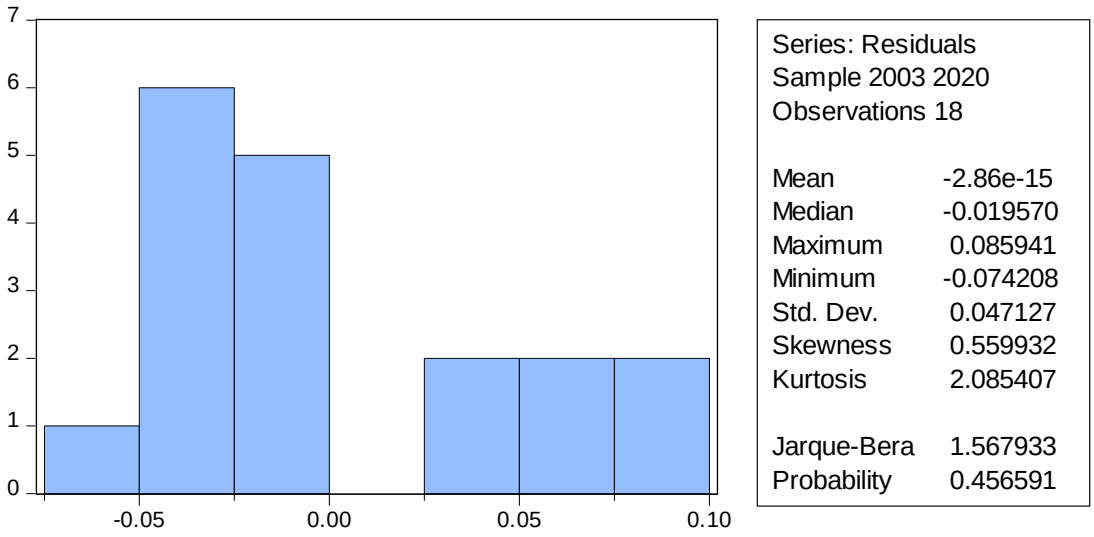
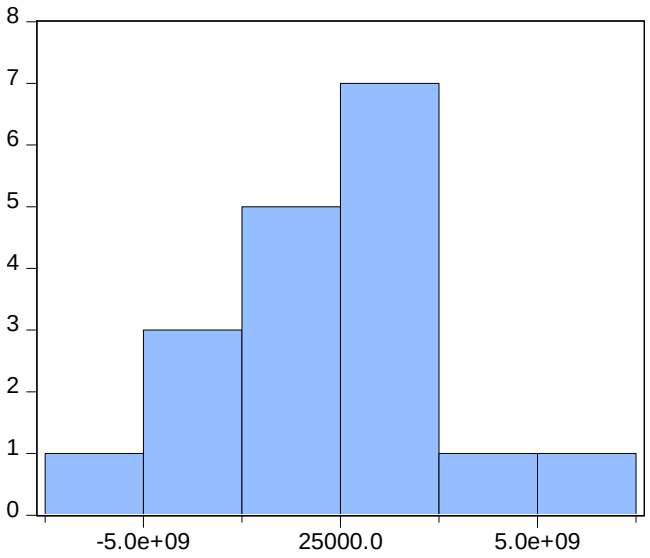
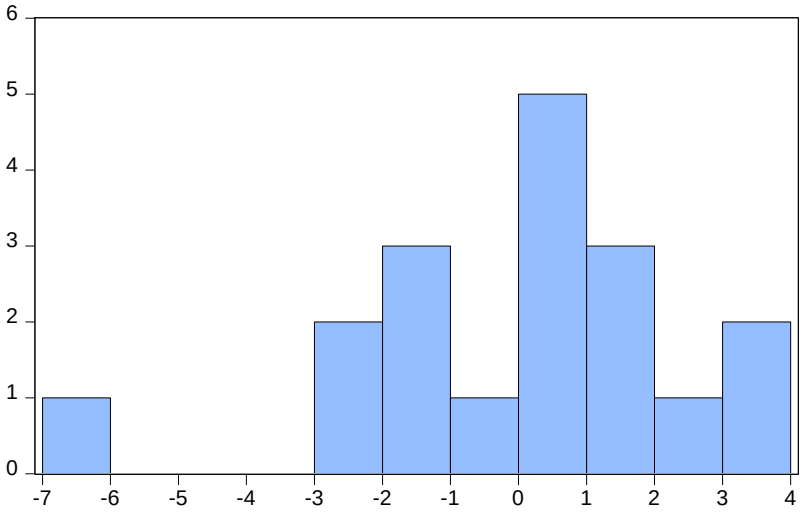


Figure 5: Residual Analysis of Model 2



Series: Residuals	
Sample 2003 2020	
Observations 18	
Mean	-4.56e-06
Median	-2.59e+08
Maximum	6.02e+09
Minimum	-5.43e+09
Std. Dev.	2.87e+09
Skewness	0.226814
Kurtosis	2.770703
Jarque-Bera	0.193767
Probability	0.907662

Figure 6: Residual Analysis of Model 3



Series: Residuals	
Sample 2003 2020	
Observations 18	
Mean	1.85e-14
Median	0.407688
Maximum	3.950407
Minimum	-6.338250
Std. Dev.	2.374719
Skewness	-0.814162
Kurtosis	4.056389
Jarque-Bera	2.825545
Probability	0.243467

(Source: Author's Calculation from EViews)

Since our Probability values for all the models, 2 and 3, are 0.45, 0.99, and 0.24, respectively, which is more significant than 0.05 at a 95% significance value, we accept our null hypothesis and reject the alternate hypothesis, confirming our residuals are normally distributed. Additionally,

- It ensures that the p-values associated with the tests, like the t-tests for coefficients and the F-test for overall model significance, are valid.
- It also underpins the accuracy of confidence intervals and prediction intervals derived from the regression model. These intervals are used to express the uncertainty around estimated coefficients and predictions. Normality ensures that these intervals are symmetric and likely to contain the true values.
- It indicates that the model has adequately captured all the linear relationships between the dependent and independent variables without leaving out any systematic information. It suggests that the model's error terms (residuals) exhibit random variation around zero without any pattern, which is ideal for producing unbiased and efficient estimates.

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

CONCLUSION

Our comprehensive analysis investigating the factors influencing Foreign Direct Investment (FDI) inflows in India has highlighted the significant roles played by governance quality, financial performance, and policy frameworks. Our results demonstrate strong statistical significance by employing rigorous statistical methods such as unit root tests to verify data stability, correlation assessments, regression analysis to establish linkages, and residual studies to confirm model reliability.

Government Effectiveness (GE), Rule of Law (RL), and Voice and Accountability (VA) are the primary governance variables that positively influence the FDI inflows in India. These components underline the need for strong and effective institutions, legal frameworks, and participative governance in attracting foreign investments. Likewise, Financial Institutional Access (FIA) also plays a significant influence, demonstrating that broader access to financial services and capital is vital for establishing an environment friendly to foreign investment. Moreover, the Production Linked Incentive (PLI) scheme, aimed at strengthening India's manufacturing capabilities through fiscal incentives, has contributed significantly to attracting FDI. This fits with several policy efforts by the Government of India emphasizing sector-specific reforms, increasing India's appeal as an investment destination.

These findings underline the importance of governance, financial development, and policy interventions in shaping FDI landscapes, and they give actionable insights for policymakers attempting to optimize these frameworks to drive more robust FDI inflows into India.

POLICY IMPLICATIONS

From the output of the paper, the Government should emphasize enhancing its effectiveness to attract the FDI inflow. The measure would be creating a digital portal to support services and provide permit approvals quicker. It can also work on implementing regular training for government employees under initiatives like 'Karmayogi Bharat' for continuous learning. The 'National Centre for Good Governance (NCGG)' can support these efforts by serving as a think tank and training hub.

It has also been learned that the Government should work on enhancing the rule of law by developing a fast-track system for commercial disputes and raising investment to improve the legal infrastructure. It can implement centralized KYC and PAN as a Single Business Identity under Ease of Doing Business (EoDB) reforms to enhance regulatory processes. India will emerge as an attractive investment destination by enhancing Intellectual Property Rights (IPR) and Geographical Indication (GI) protections. Promoting Voice and Accountability is also crucial in attracting FDI, which can be worked upon by establishing public engagement platforms for direct input on economic and investment policies. The work should be done to enhance transparency by regularly publishing audit reports and enabling independent reviews. Initiatives like the DPIIT's Open Network for Digital Commerce (ONDC) and One District One Product (ODOP) significantly support the open trading networks and regional development by emphasizing local products.

Expanding access for financial institutions by reducing technological barriers, tailoring localized financial products, and broadening business service options will be crucial for the FDI inflows. Work can be done to implement targeted financial literacy initiatives to help SMEs, farmers, and women access financial products better. Banks should be mandated to allocate a specific percentage of total loans to these groups and bolster entrepreneurship with the 'Pradhan Mantri MUDRA Yojana.' This will promote the interest of foreign investors and an opportunity to be part of this growth story through investments.

Enhancing the Production Linked Incentive (PLI) Scheme by evaluating its current performance, pinpointing booming sectors, and extending incentives to other promising areas is crucial. We can

conduct sector-specific analyses to tailor policies and incentives that address foreign investors' unique challenges and needs. The emphasis should be on developing industry clusters in high-growth areas like electronics, pharmaceuticals, and renewables, offering targeted infrastructure and tax benefits. Prioritize sectors such as semiconductors, automobiles, defense, cybersecurity, and big data to maximize economic impact and job creation, preparing India for future challenges and opportunities. It can be facilitated by streamlining the application and approval processes to boost transparency and ease administrative burdens. Support can be extended with aligned campaigns like 'Make in India,' 'Skill India,' and the 'Start-up India' initiative to foster broader economic growth.

The boost in the investment in crucial transport and digital infrastructure will improve logistics and internet access across India. The focus should be developing a clear, funded roadmap through public, private, and public-private partnerships, engaging in initiatives like 'Gati Shakti' and the 'Industrial Corridor Programme' to develop advanced industrial cities comparable to global manufacturing hubs. This strategy includes projects like Dholera Special Investment Region, Gujarat International Finance Tech (GIFT) City, and Shendra Bidkin Industrial Area, enhancing employment and economic growth.

The Government can increase its efforts to enhance bilateral and multilateral trade relations by refining trade agreements with investment guarantees to boost FDI inflows. The focus should be on strengthening economic diplomacy through Indian embassies and consulates, promoting India as a prime investment destination. We can utilize the National Single Window System (NSWS) to streamline G2B clearances, offering approvals from Central Ministries/Departments and States/UTs, reducing process duplication, and simplifying investor interactions by auto-filling form fields based on investor profiles.

An effort can be made to establish a multi-lingual, centralized FDI Facilitation Hub to provide foreign investors comprehensive support from regulatory guidance to market integration. This hub will offer tailored assistance for significant investments, including site selection, tax planning, and connections with local suppliers. 'Invest India,' the national investment promotion and facilitation agency, can facilitate the process.

LIMITATIONS OF THE STUDY

We could have included other indicators that directly affect the FDI inflows, like interest rates in the foreign and host countries, which directly impact the ability of the investors to borrow and invest in the country. Another indicator that impacts the nation's FDI inflow is the GDP growth rate, which investors stress before deciding on investment prospects. We could not see the impact of the other initiatives that have positively impacted the FDI inflows, like Special Economic Zones (SEZs), PM Gati Shakti, National Monetization Pipeline (NMP), and the National Single Window Clearance (NSWC) Policy, to name a few. The Government recently adopted these initiatives, and hence, establishing a concrete relationship would be at a nascent phase. There is also the impact of political leadership in the country, which significantly shapes the perception and confidence of foreign investors. Stable Government and continuity of the initiatives post-leadership change is crucial for investors to safeguard their investment interests. Hence, we could have observed the effect of the current and previous governments on the FDI inflows. We observed the impact of a few policies, such as PLI, Make in India, and Startup India, in our paper, which was introduced as early as 2015, so it is early to observe the effect of these policies on the FDI Inflows in India. These shortcomings can be incorporated into future research.

FUTURE SCOPE FOR STUDY

Future researchers can undertake the stated indicators for future research. The combined effect of the indicators on the FDI will help establish a more precise relationship between these significant factors and the FDI inflows in India. Furthermore, researchers can build on these research outcomes to observe the impact of the FDI inflows on other indicators such as GDP, Per Capita Income, and Innovation, to name a few, wherein governance quality and financial development and policy frameworks play the moderating role on the FDI.

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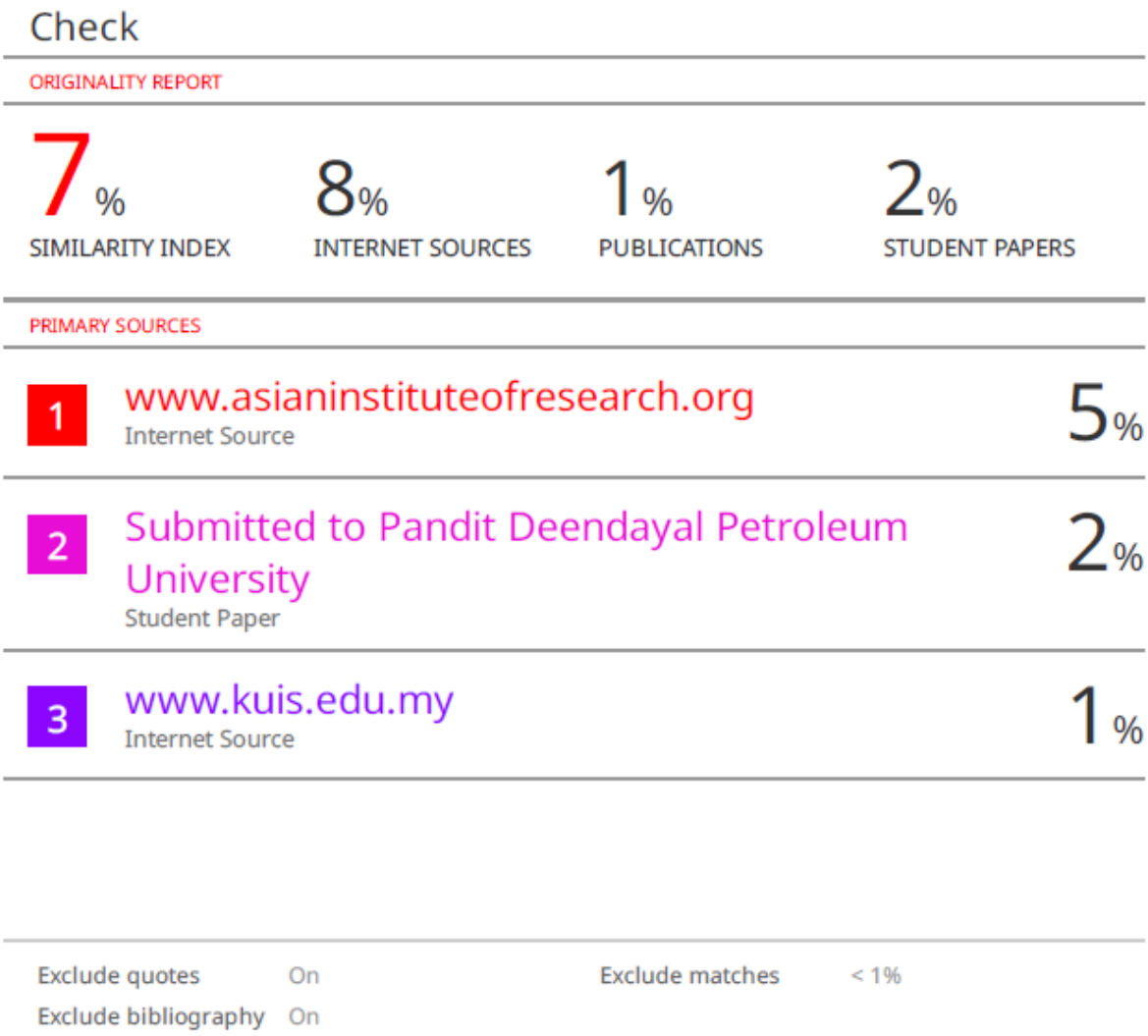
ANNEXURE

Plagiarism Report:



Tools deployed:

- EViews 10. For Quantitative Outputs and Visualization. https://eviews.com/home.html
- Mendely Desktop. For Referencing and Citations. https://www.mendeley.com/
- Grammarly. For Grammar Check. https://www.grammarly.com/
- Turnitin. For Plagiarism Check. https://www.turnitin.com/
- Google Scholar. For Scholarly Research. https://scholar.google.com/