Journal DOI: 10.36713/epra1013 | SJIF Impact Factor (2025): 8.619 ISSN: 2347-4378
EPRA International Journal of Economics, Business and Management Studies (EBMS)
Volume: 12 | Issue: 5 | May 2025 -Peer-Reviewed Journal

DOES INSTITUTIONAL QUALITY IMPACT ON FOREIGN DIRECT INVESTMENT OF ECONOMIC GROWTH IN INDIA- USING STRUCTURAL EQUATION MODELING

Dr Grace Ganta
Professor, Department of Management studies,
Swarnandhra College of Engineering and Technology, Narsapur, Andhrapradesh

Article DOI: https://doi.org/10.36713/epra21439
DOI No: 10.36713/epra21439

ABSTRACT

Purpose*: This empirical investigation based on the current stage of economic development indicates that FDI has important impact on the country of destination's stable, high-quality and healthy economic growth. Any nation that is involved in the process of economic globalization is therefore trying to develop a competitive business environment in the country to draw further foreign investments.*

Design/Methodology/Approach: *the main objective of this study is based on Institutional quality or Evidence and I selected 5 factors Institutional Metrics like Control of Corruption, Government Effectiveness, Political Stability, Regulatory Quality, Rule of Law from DPIIT website (Secondary Data) for the period 2018-2023. We are Using stalactitical tools like Unit root Test, ARDL Approach & SEM.*

Originality/Value*: This study applies Least Squares regression (OLS): The study examined the impact of institutional factors influence on the FDI flows. The study has considered the ordinary least square method to know the impact of institutional factors (independent variables) on FDI flows (dependent variable).*

Findings: *The study found with the help of ARDL model that the Institutional indicators had are having the positive coefficient value and stated that Institutional Metrics of corruption and Govt. effectiveness are institution indicators which shown short run association with FDI flows, The study examined that Political stability f-statistic value is falling above the upper peasant table (i.e., 7.4578 > 4.16) which states political stability has a long run association with FDI flows, Institutional Indicators such as Rule of law, Regulatory Quality and Voice & accountability had a long run association with FDI flows.*

KEYWORDS: *FDI, Institutional Metrics, Economy Growth, SEM Model.*
JEL Codes: *M18, M15, M96, M98.*

1. INTRODUCTION

Foreign direct investment (FDI) is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy.

Foreign direct investment (FDI) is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy. The current stage of economic development indicates that FDI has important impact on the country of destination's stable, high-quality and healthy economic growth. Any nation that is involved in the process of economic globalization is therefore trying to develop a competitive business environment in the country to draw further foreign investments.

Therefore, core determinants which have the greatest impact on FDI inflows and stability of these flows should be examined. As can be seen in the number of studies of international capital flows, the main motivation for making direct foreign investments exactly is historically the advantage of ownership, location benefit and the advantage of internationalization. It should therefore be noted that, as a favorable geopolitical location, considerable market size, abundance of natural resources has a significant effect on the attractiveness of investment in a country. In today's fierce competition to attract FDI, however, the determinants mentioned above

are not sufficient to ensure that a country is competitive on a world capital market. The regulatory framework built in a nation significantly decreases shareholders ' transaction cost, simplifies trade and, above all, offers safeguards and protects foreign investors. In addition, it should be noted that high institutional efficiency, together with the FDI attractiveness, is a necessary factor to draw not only FDI but also to gain potential advantages. We use institutional metrics from World Bank Worldwide Governance Metrics to evaluate the influence of organizations on FDI flows, which is the primary source for institutional empirical research. In this study the following Institutional indicators were included to know the association with the FDI flows,

- Control of Corruption
- Government Effectiveness
- Political Stability
- Regulatory Quality
- Rule of Law

2. REVIEW OF LITERATURE

- **Mazumdar (2020):** - The paper examined implication of capital flows in India and its implication for economic growth & argued that it was hoped that with the partial liberalization of the capital account in the-early 1990s, capital inflows would contribute towards India's economic growth. This paper reviews the role of capital flows into India and examines if such flows have in any way contributed to economic growth.
- **Mahajan and Agarwal (2020):** suggests that India can attract foreign investment by marketing. In order to make the foreign investment policy more transparent and less complex, the Government has done away with pre-equity approvals if a certain set of preconditions are met. This combines with other factors such as high economic growth in the main home and host countries, improvement in corporate profitability and higher stock valuation point would result to a recovery of FDI flows.
- **Click (2019):** examined the risk of US foreign direct investment over the period 1982-1998 in 59 host countries. The first part of the analysis built an empirical model to explain the time series and cross-country patterns of return on capital. The return on assets (ROA) has been used as a measurement of the return on capital. There are four main findings. First, the ROA in a majority of countries does not simply track the worldwide. Second, cross country differences are explained by financial risk. Third, unexplained country risk is qualitatively risk.
- **Bhaumik (2019)**: - The study argued while examining the banking sector he argues that the cost efficiency and profitability of the public sector banks have improved significantly, article argues that was time to bite the bullet and privatize the public sector banks and, in the interim, to reduce the risk associated with creation of bank assets by facilitating greater securitization of credit.
- **Nagesh Kumar (20018)**: The paper, "Liberalization of FDI Flows and Development-Indian Experience in the 1990's" reviews the Indian experience with FDI and its quality since 1991 & summarizes the evaluation of Indian Government policy towards FDI during 1948-2004 and examined the trends and patterns of FDI inflows in India in 1990's. The author has used only secondary data collected from the UNCTAD world investment database and the sources of Government of India.
- **Peng Hu (2017)**: - "Economic Crisis on the Operation Behavior of the Firms: Case of East Asia", some Finnish Firm, depending on their industrial and financial position, saw the Asian crisis as an ideal time to enter a new market in the region or expand existing operations there. There might be additional investment incentives available for the TNCs in the recovery phase. Altogether, the great majority of the world's largest firm kept their confidence in East Asian crisis countries as an investment destination unchanged during the Asian crisis.
- **Elissa Braum (2017)**: - The study presents a review of research and policy on the links between foreign private investment and development. This work provides broad and consistent evidence for the argument that growth leads to FDI rather than FDI leading to growth. The work also underscores the importance of economic policy context for gaining development benefits from FDI. Besides keeping the production costs low to attract more qualitative FDI, countries must also have adequate domestic capacities to benefit from FDI.
- **Subramanya and Bhuma (2016)**: - In the paper "Studying outward FDI by India", find that government expenses and labor outflows have significant elasticity with respect to remittances, & the level of overseas investments is closely related to the comfort level of the investors. The study contends that government expenditure to promote the tertiary education and increasing the pool of skilled man power and the number of people emerging has a direct bearing on the remittances.
- **Rajesh Narula and S. La1 (2016)**: - In the edited volume, find that understanding the factors that led to an optimization of the benefits from FDI for the host country. Despite the diversity of the countries covered and methodology used, the chapters in this volume point to a basic paradox, "With weak local capabilities,

Industrialization has to be more dependent on FDI. The studies here do not support the view that FDI is a sine qua non for economic development.

- **Karunagaran (2015)**: - The study examined the historical perspective of foreign banks & viewed the operations of foreign banks in historical perspective, and taking a cue there from, provides an analysis of contemporary policy that has promoted their aggressive expansion.
- **Vasudevan (2015)**: - The paper describes that there is no standard theoretical construct relating to portfolio flows. In the early literature, foreign investment was viewed essentially in terms of foreign direct investment (FDI), a view that was given, as economic historians would recall, policy relevance in the Leninist New Economic Policy for the erstwhile Soviet Union in 1924.

3.STATEMENT OF PROBLEM

In recent years emerging countries are attracting significant FDI inflows. The economic, social development appear to the growing economies considerable making effects to attract FDIs by focusing prospective sectors, institutional settings, policy changes. Regulatory liberalization, investor guarantees, incentives and concessions etc… but India lagging behind in attracting the sizable amount of FDI. Over the past decade china doubled its FDI and India over all FDI inflows show a significant growth trend. Despite the dynamism of the country with enormous potential and increasing importance for FDI but being the amount world's top fastest growing countries (BRICS) failed to achieve the expected FDI inflows compound with other sizable economic oriented countries.

4.RESEARCH GAP

Few studies have considered investigating the policy impact on FDI flows. Few studies considered investment decisions, technological issues, economic problems related to financial mobilization through foreign direct investment. The latest development in this regard has been examined by the govt. of India to attract the FDI flows. Most of the studies had tried to look at the regulatory bottle necks in foreign direct investment area. Overall, international, national, and local studies are already being done, with the help of reasonably large samples, had not given full justice to the growth of flows, issues, and issues related to foreign direct investment. Smaller counties are able to attract larger portion of FDI successfully than India, e.g., Belgium is 100% attracting FDI and highest FDI attracting country in the world. One of the major road blocks is observed to the institutional factors which are unable to pull the funds in to India.

5. OBJECTIVES OF THE STUDY

- To study the Role of Foreign Direct investment flows in to India.
- To study the institutional environment impact on Foreign Direct investment flows in to India.

6.HYPOTHESES OF THE STUDY

H0: There is no impact of dimensions of institutional metrics on FDI flows.
H1: There is an impact of dimensions of institutional metrics on FDI flows**.**

7.RESEARCH METHODOLOGY

Study Period

The period of the study is between the financial year 2022-23. And the data collected from DPIIT website and Few journals.

Stalactitical tools to be used

- Unit Root Test
- ARDL approach
- Least Squares regression (OLS)

8.SCOPE OF THE STUDY

To study the Impact of Foreign Direct investment flows on select sectoral growth in India and we consider Ten Institutional factors for economic growth of the country.

Journal DOI: 10.36713/epra1013 | SJIF Impact Factor (2025): 8.619 ISSN: 2347-4378
EPRA International Journal of Economics, Business and Management Studies (EBMS)
Volume: 12 | Issue: 5 | May 2025 -Peer-Reviewed Journal

9.RESULT AND DISCUSSION

❖ **To study the Role of Foreign Direct investment inflows in India.**

Share of Top Five Investing Countries in FDI Equity Inflow in April 2018 to March 2023

Rank	Country	FDI Equity Flow During2022-2023.	% Share in FDI Equity Flow During2022-2023.
1	Singapore	1,37,374	37 %
2	Mauritius	48,895	13 %
3	USA	48,666	13 %
4	UAE	26,315	7%
5	Netherland	19,855	5%

Share f Top Five Investing Sectors in FDI Equity Inflow in April 2018 to March 2023.

Rank	Country	FDI Equity Flow During2022-2023.	% Share in FDI Equity Flow During2022-2023.
1	Computer Software & Hardware	74,718	20 %
2	Service Sector	69,852	19 %
3	Trading Sector	38,060	10 %
4	Non-Conventional Energy	19,977	5%
5	Drugs & Pharmaceuticals	16,654	4%

Factors Affecting Foreign Investment

In the host country, foreign investment has so many impacts. Foreign investors are researching the obstacles of the host countries that impact foreign investors negatively because none of the companies wants a loss after investments Boopath, D. (2013)[6]. There are so many reasons for not investing in the host country as a foreign company.

- **Rate of Interest/ Foreign Exchange Rate:** The disparity in the rate of interest at different locations is one of the most important reasons for foreign capital movements. Some aspects are the same, capital continues to shift from a low interest rate country to a higher one. In this situation the foreign investment movement is very slow when the exchange rate is unstable and the possibility of a decline is in future.
- **Speculation:** Speculation regarding anticipated changes in interest rates can influence the short-term capital movements. The investment portfolio in the host country market is a form of speculation. If the host country market is strong in speculation, the investment is decreased by foreign investors. As a result, foreign investment movement in the host country is small.
- **Profitability:** The motive of profit influences the private foreign capital movement. Therefore, private capital will flow to countries with comparatively higher returns on investment.
- **Costs of Production:** Lower production costs in foreign countries encourage private capital movements. Two types of cost-saving investment can be distinguished. The first is because raw materials must be obtained in the outside world. These materials cannot be purchased at home or at very high costs, but they are important to the manufacture and sale of finished products at home or abroad. Opportunities to profit would be unexplored without them. Nevertheless, the fact that capital will enter the asset, the second cost-cutting expenditure of the product other than resources, primarily labor, is driven by large investments in the extractive industries.
- **Economic Conditions:** Private foreign investment is influenced by economic conditions, particularly market potential and infrastructure facilities. The population's size and country's income level have a significant impact on the market opportunities.
- **Government Policies:** The government policies are important factors that may affect foreign investment in a country, particularly in relation to foreign investment, foreign cooperation, transfer payments, revenues, taxations, exchange INSTITUTIONAL METRICS, tariffs and monetary incentives and other steps.
- **Political Factors:** Policy considerations such as political stability, political party structure and relations with other countries also affect movements of capital. Political influence on business practices such as tax changes and industrial policies have adverse effects on the movement of foreign investment in the country, on the other hand.

Journal DOI: 10.36713/epra1013 | SJIF Impact Factor (2025): 8.619 ISSN: 2347-4378
EPRA International Journal of Economics, Business and Management Studies (EBMS)
Volume: 12 | Issue: 5 | May 2025 -Peer-Reviewed Journal

❖ **To study the Impact of Foreign Direct investment flows on select sectoral growth in India.**

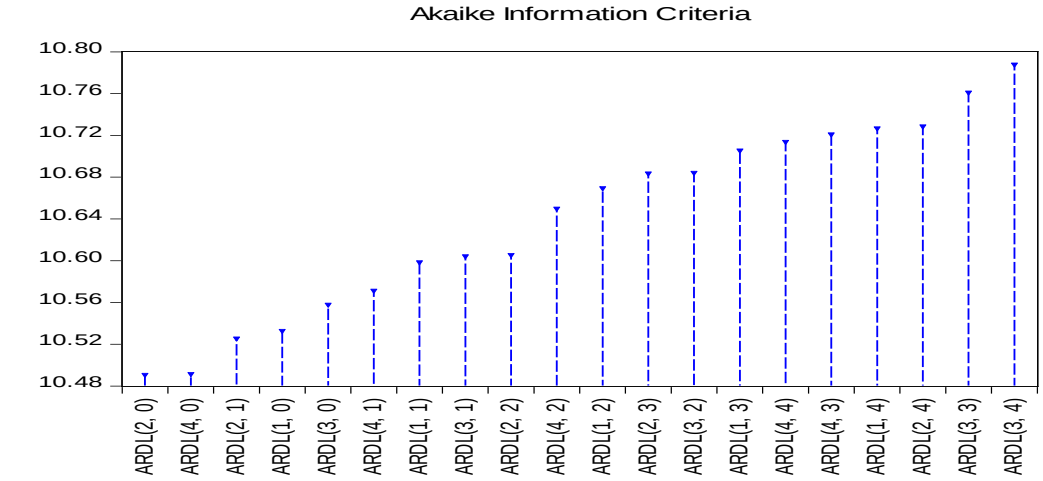
Unit Root test with Augmented Dickey Fuller

Institutional Indicators	Level	1st Difference	2nd Difference
Control of Corruption	0.0013*	-	-
Government Effectiveness	0.0000*	-	-
Political Right Index	0.0000*	-	-
Regulatory Quality	0.0030*	-	-
Rule of Law	0.0682	0.0000*	-

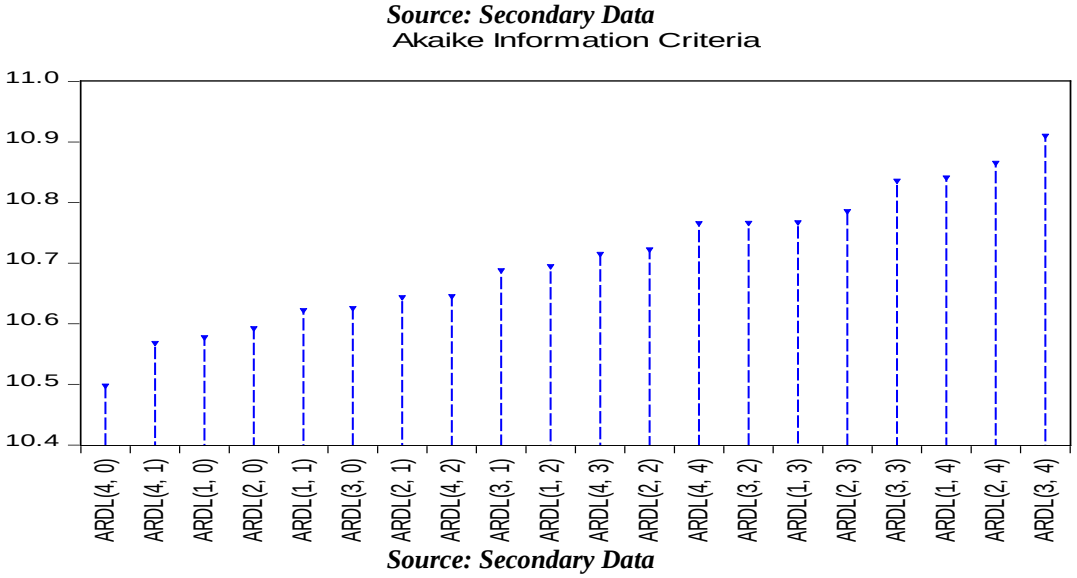
Interpretation

The table illustrates the unit root test result under the Augmented Dickey Fuller test for the sectoral investment factors of FDI are observed significant at the 5% level. The Rule of law, Civil Liberties and Women in Parliament are non-Significant at 5% level at 1st Difference and all are significant at with stationarity.

Akaike Information Criteria Graph for Institutional Metrics-Stationarities

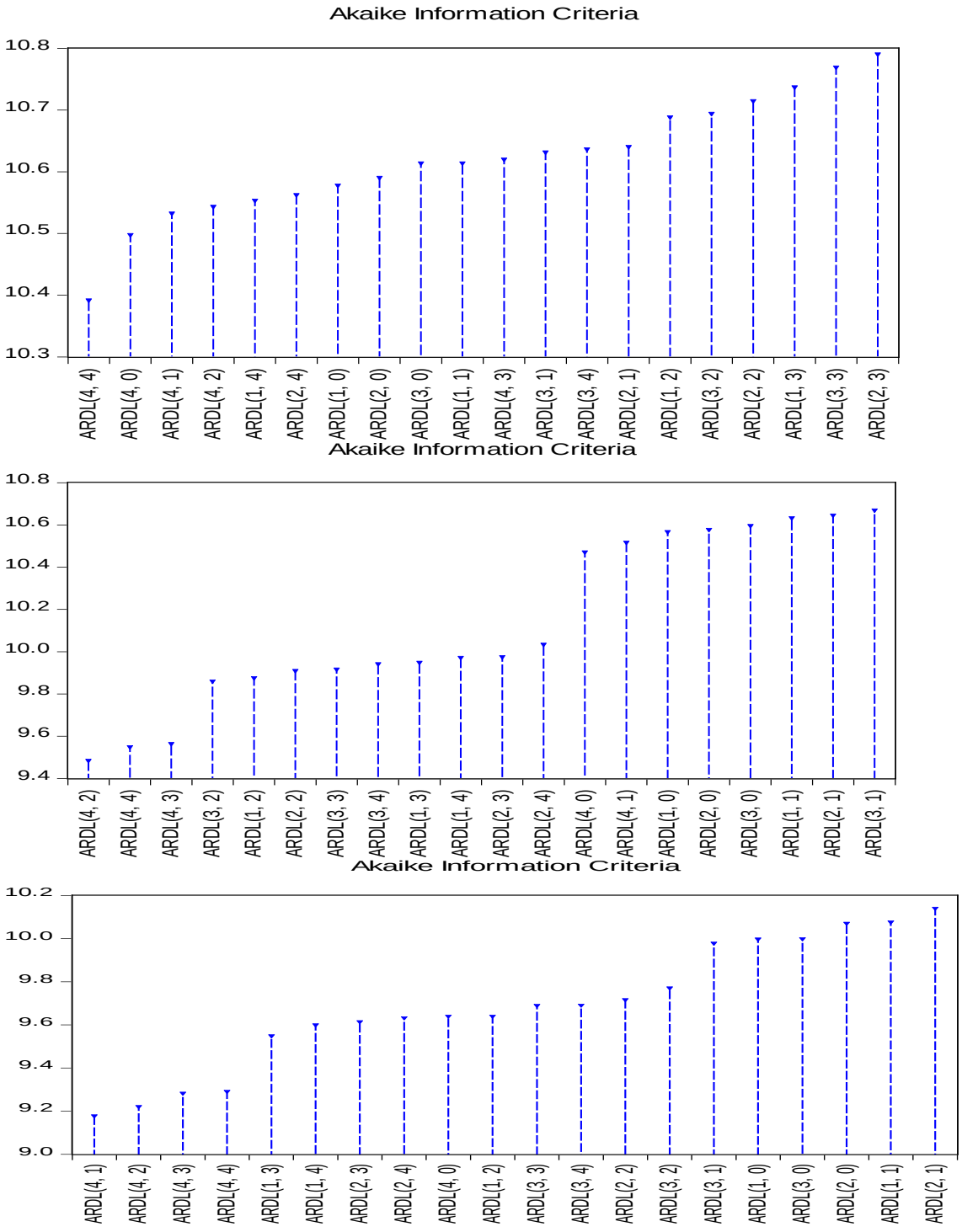


Source: Secondary Data



Source: Secondary Data

Journal DOI: 10.36713/epra1013 | SJIF Impact Factor (2025): 8.619 ISSN: 2347-4378
EPRA International Journal of Economics, Business and Management Studies (EBMS)
Volume: 12 | Issue: 5 | May 2025 -Peer-Reviewed Journal



Interpretation

The above Akaike Information Criteria graph illustrates the optimum selection criteria for the Autoregressive Distributed Lag model to check the association between Foreign Direct Investment and Institutional Metrics. The plot lines in the graph observed to have highest at lag period near to 10.7, there the independent variable (regulatory quality) seems to fit .

Journal DOI: 10.36713/epra1013 | SJIF Impact Factor (2025): 8.619 ISSN: 2347-4378
EPRA International Journal of Economics, Business and Management Studies (EBMS)
Volume: 12 | Issue: 5 | May 2025 -Peer-Reviewed Journal

Autoregressive Distributed Lag Model for Institutional Metrics

Dependent Variable: FDI				
Method: ARDL				
Sample (adjusted): 2022-2023				
Included observations: 25 after adjustments				
Dependent lags: 3 (Fixed)				
Dynamic repressors (4 lags, fixed): DINSTITUTIONAL METRICS_OF_METRICS				
Fixed repressors: C				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.***
FDI (-1)	0.128767	0.301813	0.426645	0.6753
FDI (-2)	0.210545	0.254029	0.828821	0.4194
FDI (-3)	-0.143687	0.248252	-0.578797	0.5708
DINSTITUTIONAL METRICS_OF_METRICS	234.9695	269.9449	0.870435	0.3969
DINSTITUTIONAL METRICS_OF_METRICS (-1)	37.04804	242.2193	0.152953	0.8803
DINSTITUTIONAL METRICS_OF_ METRICS (-2)	-140.0988	257.9650	-0.543092	0.5946
DINSTITUTIONAL METRICS_OF_ METRICS (-3)	87.73702	211.4545	0.414922	0.6837
DINSTITUTIONAL METRICS_OF_ METRICS (-4)	179.8736	192.4069	0.934860	0.3638
C	7.384580	17.97113	0.410914	0.6866
R-squared	0.537422	Mean dependent var		18.18908
Adjusted R-squared	0.543867	S.D. dependent var		43.41617
S.E. of regression	46.43434	Akaike info criterion		10.78767
Sum squared resid	34498.37	Schwarz criterion		11.22646
Log likelihood	125.8459	Hannan-Quinn criter.		10.90937
F-statistic	0.622682	Durbin-Watson stat		2.136874
Prob(F-statistic)	0.047304			
*Note: p-values and any subsequent tests do not account for model selection.				

Source: Secondary Data

Interpretation

The above table illustrates the results of Autoregressive Distributed Lag model which describes the direction of the depended variable with independent variable. As the coefficient values of the independent variable (Control of Corruption) and the coefficient values of the dependent variable (Foreign Direct Investment) are positive which indicates there is positive association between the variables. And, as the R-square is more than 0.30, independent variables explain more than 53% of variance experienced by the dependent variable.

Reliability Analysis

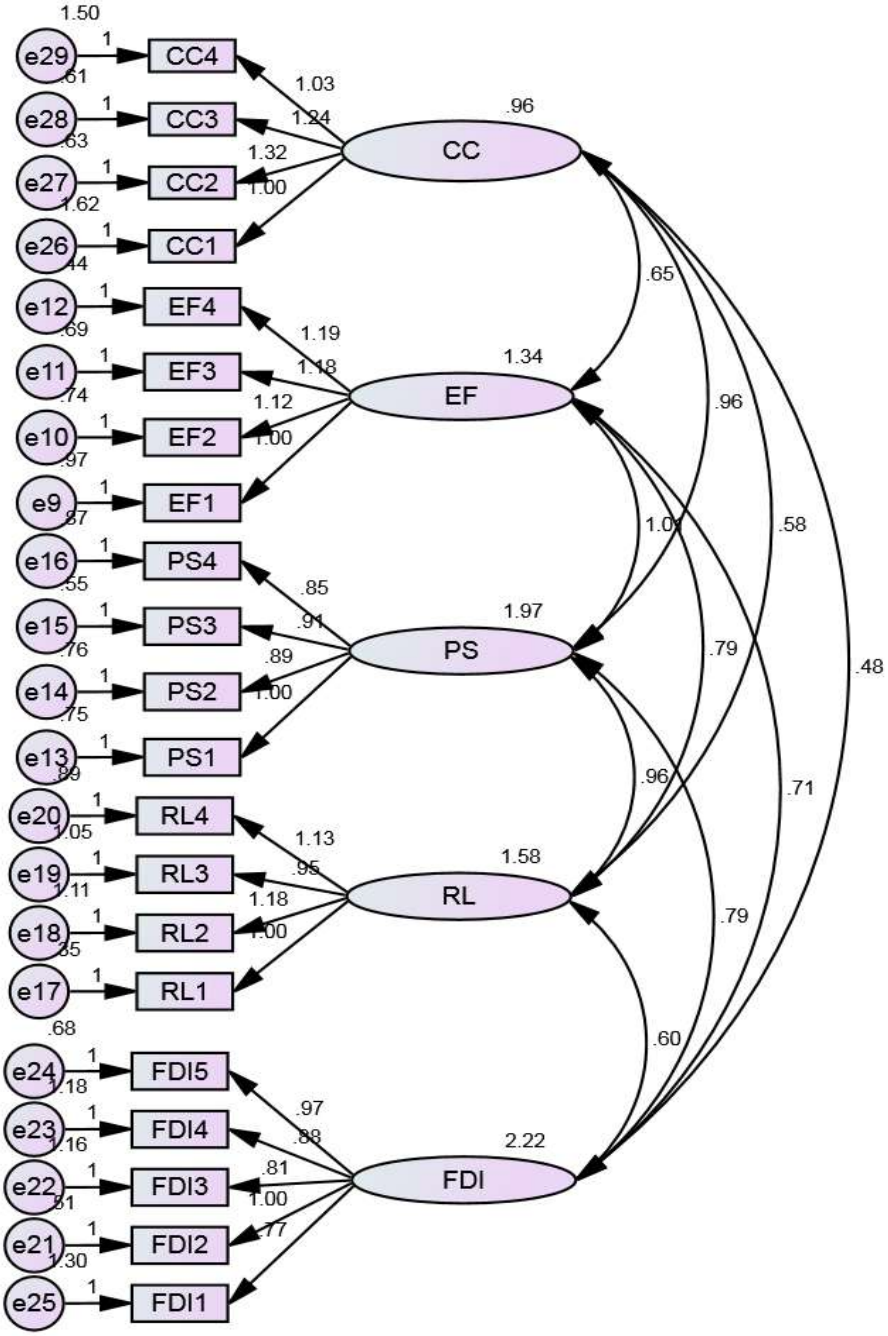
S. No	Construct	Reliability Values of Initial stage	Dimension	Loadings	Reliability Values	CR	AVE	No. of dimensions
1	CC	0.816	CC1	0.816	0.816	0.903	0.654	4
			CC2	0.727				
			CC3	0.732				
			CC4	0.795				
2	EF	0.892	EF1	0.892	0.892	0.827	0.549	4
			EF2	0.856				
			EF3	0.857				
			EF4	0.836				
3	PS	0.890	PS1	0.857	0.890	0.894	0.680	4
			PS2	0.859				
			PS3	0.839				
			PS4	0.876				
4	RL	0.888	RL1	0.836	0.888	0.893	0.676	4
			RL2	0.863				
			RL3	0.875				
			RL4	0.850				
5	FDI	0.893	FDI1	0.890	0.893	0.897	0.637	5
			FDI2	0.848				
			FDI3	0.877				
			FDI4	0.880				
			FDI5	0.852				
Total number of Dimensions								21

Journal DOI: 10.36713/epra1013 | SJIF Impact Factor (2025): 8.619 ISSN: 2347-4378
EPRA International Journal of Economics, Business and Management Studies (EBMS)
Volume: 12 | Issue: 5 | May 2025 -Peer-Reviewed Journal

Interpretation

The above table illustrates the results of Reliability Anlysis which describes the direction of the depended variable with independent variable.

CFA Overall Path Model



Fit indices values of CFA Path model

	χ2(df)	χ2/df	CFI	GFI	RMSEA
Model results	431.735(6)	284	0.927	0.979	0.035

Journal DOI: 10.36713/epra1013 | SJIF Impact Factor (2025): 8.619 ISSN: 2347-4378
EPRA International Journal of Economics, Business and Management Studies (EBMS)
Volume: 12 | Issue: 5 | May 2025 -Peer-Reviewed Journal

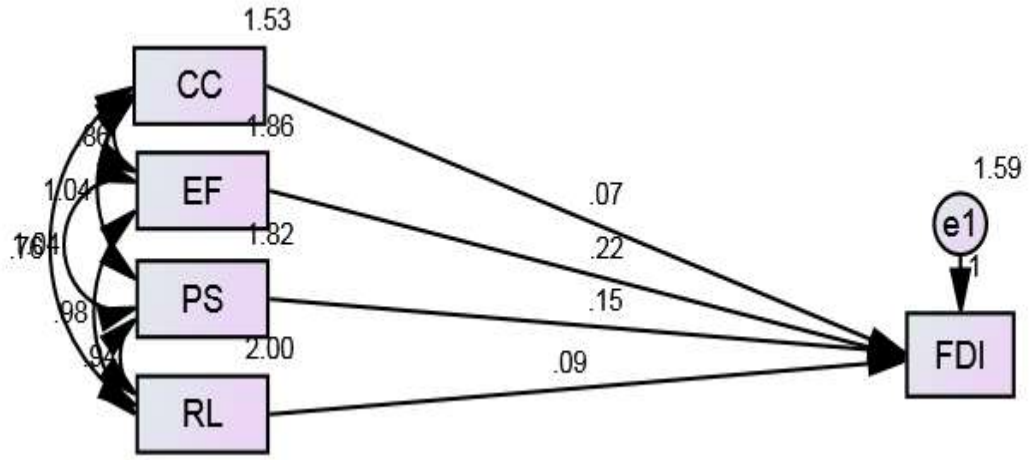
Discriminant Validity

	FDI	EF	PS	RL	CC
FDI	**0.803**				
EF	0.410	**0.839**			
PS	0.380	0.619	**0.832**		
RL	0.321	0.544	0.542	**0.830**	
CC	0.327	0.573	0.694	0.469	**0.744**

Fit indices values of structural model

	χ2(df)	**χ2/df**	**CFI**	**GFI**	**RMSEA**
Model results	9.310(6)	1.551	0.886	0.812	0.068

STRUCTURAL ANLYSIS MODEL



10.CONCLUSION

The study suggested that policymakers should ensure that funding is used optimally and that projects are implemented in a timely manner. To attract more FDI inflows to India, the government needs to retain investor confidence through strict controls on inefficient bureaucracy, red-tapism, and rampant corruption. Finally, the government must ensure quality FDI inflows rather than its magnitude. Policymakers must ensure transparency and consistency in policy making, as well as an integrated long-term development strategy. The study also suggested that the government should take faster action to improve the country's infrastructure to further diversify its businesses. 3. In short, it should stabilize the economy and provide a source, leading to deeper economic ties, improving the financial position, facilitating exports, stabilizing exchange rates, complementing national savings and foreign reserves, stimulating R&D activities and lowering interest rates and inflation, etc.

11. REFERENCES

1. *Mazumdar (2020): - Political Economy of Federalism in India. Oxford: Oxford University Press, Pg 15, VOL 99.*
2. *Bhaumik (2020): - "Understanding Regional Economic Growth in India" (paper presented at the Asian Economic Panel Meeting, October 25-26, 2005 Vol 99, pg 155, issue 11*
3. *Nagesh Kumar (2019): - Does states Have an Enabling Environment for Industrial Growth? Some Evidence from Karnataka", Economic and Political Weekly, October 28,2005, Vol no 15, Pp.3861-3869.*
4. *Peng Hu (2019): - Peng Hu (2006) " India's Suitability for Florien Direct Investment, " working paper No 553, India Business with special reference to India. University of Arizona.*
5. *Elissa Braum (2018): - " Foreign Direct Investment, Development and Gender equity: A Review of Research and Policy" Occasional Vol no 80, Pg.no No. 12-18.*
6. *Prof. Subramanya and prof. Bhuma (2018): " Out ward Foreign Direct Investment by India-A New Dimension", social science Research network. No. 929054 (economic paper collection)*
7. *Rajesh Narula and S. La1(2017): - "Understanding Foreign Direct Investment Assisted Economic Development", Routledge London and New York. Vol no: - 15, Pg. no 89-96*
8. *Karunagaran (2017): - "Manufacturing Productivity in Indian States: Does Investment Climate Matter" Economic and political Weekly, June I I , 2005,pp. 2413-2420.*

9. *Vasudevan (20016: - State – level Reforms in India: Towards More Effective Government, Macmillan India Ltd, New Delhi, Vol no 81, Issue 16, Pg.no 145-147.*
10. *Figueira (2016): - "Does states Have an Enabling Environment for Industrial Growth? Some Evidence from Karnataka", Economic and Political Weekly, October 28,2000, pp.3861-3869*