

# FDI: An Instrument of Economic Growth & Development in Tourism Industry

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

While talking about Indian scenario, the hotel and tourism industries have been growing rapidly in recent years, bringing in huge revenues through overseas as well as domestic tourists in many parts of India. There was a key rush to inbound tourism in India in 2006 and a double-digit increase in the coming of overseas tourists to India in the same year. Tourism is one of the third largest revenue generators of foreign exchange for India and also employs one of the highest numbers of manpower. *Conde Nast Traveler*, one of the most decorated travel magazines, rated India as one of the hottest destination in the world. According to the World Tourism Organization, India will be the leader in the tourism industry in South Asia with 8.9 million arrivals by 2020. India is gradually emerging as the second most rapidly increasing (8.8 percent) tourism economy in the world over 2005-14 according to the World Travel & Tourism.

Hence, understanding the determinants of FDI is very important for any emerging economy as FDI exerts a larger impact on the economy of country in the short run and a real impact in the long run. The present study examines the foreign direct investment in Indian Tourism Industry, its flow in Indian Tourism Industry and its impact on economy of India.

**Index Terms-** Tourism Industry, FDI Flow, GDP, Tourism Economy.

## I. INTRODUCTION

**A** Brief Note on Tourism and Hospitality Industry  
Hospitality, as an industry segment in itself, is a **US\$ 3.5 trillion service sector within the global economy.**

In India, the tourism and hospitality industries are witnessing a period of exponential growth; the world's leading travel and tourism journal, "*Conde Nast Traveller*", ranked **India as the numero uno travel destination** in the world for 2007, as against fourth position in 2006.

The year 2007 also marked the fifth consecutive year during which India has witnessed **double digit growth in foreign tourist arrivals.**

Along with the rise in foreign tourist arrivals, **foreign exchange earnings** have shown a **robust growth of 25.6%** during January-October 2007 to touch US\$ 6.32 billion as against US\$ 5.03 billion during January-October 2006.

Tourism has now become a significant industry in India, contributing around 5.9 per cent of the Gross Domestic Product (GDP) and providing employment to about 41.8 million people.

As per the World Travel & Tourism Council, the tourism industry in India is likely to generate **US\$ 121.4 billion of economic activity by 2015** and Hospitality sector has the potential to earn US\$ 24 billion in foreign exchange by 2015.

Additionally, India is also likely to become a major hub for **medical tourism**, with revenues from the industry estimated to grow from US\$ 333 million in 2007 to **US\$ 2.2 billion by 2012**, says a study by the Confederation of Indian Industry (CII) and McKinsey.

The booming tourism industry has had a cascading effect on the hospitality sector with an increase in the occupancy ratios and average room rates.

While **occupancy ratio is around 80-85 per cent** – up nearly 10 percent from three years back, the average **increase in room rates** over the last one year has hovered around **22-25%**, *Dewan P.N. Chopra Consultants Private Limited.*

It is pertinent to mention in this context, that according to recent estimates, there are a **total of 110,000 rooms in India, as against a total requirement of approximately 250,000** – demonstrating the untapped potential that continues to exist in this industry.

With a view to **stimulating domestic and international investments** in this sector, the government has implemented the following initiatives:

- **100% FDI** under the automatic route is now permitted in all **construction development projects** including construction of hotels and resorts, recreational facilities and city and regional level infrastructure.
- **100% FDI** is now permitted in all **airport development projects** subject to the condition that FDI for up gradation of existing airports requires FIPB approval beyond 74%.
- A **five year tax holiday** has been extended to Companies that set up hotels, resorts and convention centers at specified destinations, subject to compliance with the prescribed conditions.

- Plans for **substantial up gradation of 28 regional airports** in smaller towns and the privatization and expansion of Delhi and Mumbai airports

The abovementioned initiatives have resulted in **increasing FDI inflows** being witnessed by this industry. For the period April 2000 to November 2007, a total of **US\$ 636 million** in foreign direct investments was channelized towards development of hotels and tourism.

**The hospitality industry has also been receiving increasing interest from the Private Equity Sector – investments have tripled from US\$ 60 million in 2004-05 to over US\$ 180 million in 2006-07.**

It is estimated that the hospitality sector is likely to see a further **US\$ 11.41 billion in inbound investments** over the next two years.

Several global hospitality majors such as Hilton, Accor, Marriott International, Berggruen Hotels, Cabana Hotels, Premier Travel Inn (PTI) and InterContinental Hotels group have already announced major investment plans in India in recent years.

## II. FDI IN TOURISM

With a view to stimulate domestic and international investments in this sector, the government has permitted 100 percent FDI in the automatic route –allowing full FDI into all construction development projects including construction of hotels and resorts, recreational facilities, and city and regional level infrastructure. 100 percent FDI is now allowed in all airport expansion projects subject to the condition that FDI for up gradation of existing airports requires Foreign Investment Promotion Board (FIPB) approval beyond 74 percent. A five year tax holiday has been given to organizations that set up hotels, resorts and convention centers at specific destinations, subject to fulfillment with the agreed conditions. Some international hospitality majors such as Hilton, Accor, Marriott International, Berggruen Hotels, Cabana Hotels, Premier Travel Inn (PTI) and InterContinental Hotels group have already announced major venture plans in India in recent years. It is expected that the hospitality division is expected to see an additional US\$11.41 billion in inbound investments over the next two years.

**Table 1: FDI Inflows into India, 1990-2007 (US\$ millions)**

YEAR	AMOUNT
1990-91	0
1991-92	0
1995-96	2500
1996-97	3000
2000-01	4000
2001-02	6000
2005-06	7500
2006-07	19000

Source: Reserve Bank of India (RBI)

Note: Data includes acquisition of shares of Indian companies by non-residents.

## III. TOURISM INDUSTRY IN INDIA

Tourism sector holds immense potential for Indian economy. It can provide impetus to other industries through backward and forward linkages and can generate huge revenue earnings for the country. In the recent 2007-08 budget, the provision for building tourist infrastructure has been increased from US\$ 95.6 million in 2006-07 to US\$ 117.5 million in 2007-08 (Min. of Tourism, GOI). Tourism is no longer looking at it as a leisure activity, but as a major source of employment. The labor capital ratio per million rupee of investment at 1985-86 prices in the tourism sector is 47.5 jobs as against 44.7 jobs in agriculture and 12.6 jobs in case of manufacturing industries (Market plus Report, Min. of Tourism). Tourism is one of the third largest net earners of foreign exchange for the country and also one of the sectors, which employs the largest number of manpower.

India is rated among the top five travel destinations in the world according to Lonely Planet. ABTA magazine rates India as the most preferred destination on earth. Indian tourism is one of the most diverse products on the global scene. India has 26 world heritage sites. It is divided into 25 bio-geographic zones and has wide ranging eco tourism products. Apart from this it has a 6,000 km coastline and dozens of beaches (WTO 1997). India's great ethnic diversity translates into a wide variety of cuisine and culture. It also has a large number of villages, plantations and adventure locations.

Foreign tourist arrivals are expected to grow to 10 million by 2010-12 and the domestic tourism is expected to increase by 15% to 20% over the next five years as per the Ministry of Tourism expectations basing on the growth in the last one decade. There is a rapid growth in average room rates and is expected to continue until sufficient new supply come on stream (average increase is 21% since 2004-06 in 4& 5 star segment).

Government of India is allowing 100% FDI in Hotels and Tourism, through the automatic route and also identified the investment opportunity of about \$8-10 billion in the next 5 years in tourism sector. India has significant potential for becoming a major global tourist destination. It is estimated that tourism in India could contribute Rs.8,50,000 crores to the GDP by 2020 ( approx. 1800 million USD) if you properly plan to develop and invest on Connectivity Infrastructure, Tourism Infrastructure, Tourism Products, Capacity Building and Promotion & Marketing (WTTC report). It is estimated there is a need of around 10 Billion

US \$ required for development of tourism as per the different state tourism estimates for the next five years. When you think about the long term capital requirement of all states, it is estimated around 56 billion US \$ for the next 20 years.

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

upgrade its airports, roads and other infrastructure to global standards. Also tourism development needs to be pursued with a focus on sustainability.

Though the Government of India is allowing 100% FDI in automatic route to India in tourism sector and there is a wide gap between the demand and supply of hotel rooms and other tourism infrastructure projects, we have attracted the FDI for a volume of 660.87 million US \$ which is 1.46 percent of the total FDI inflow into our country from April 2000 to December 2007.

#### IV. INVESTMENT REGULATIONS

In the Hotel Industry Sector, Foreign Direct Investment (FDI) has been permitted up to 100% under the automatic route. For foreign technology agreements, automatic approval is granted if:

1. Up to 3 % of the capital cost of the project is proposed to be paid for technical consultancy Services.
2. Up to 3 % of the net turnover is payable for franchising and marketing/publicity fees.
3. Up to 10 % of gross operating profit is payable for management fees, including incentives fees.

#### V. NEED OF FDI IN TOURISM

##### REASONS TO INVEST IN INDIAN TOURISM

- Economic liberalization has given a new force to the hospitality industry.
- The Indian hospitality industry is increasing at a rate of 15 percent yearly.
- The current gap between supply and demand is predicted to grow as the economy opens and grows.
- The government predicted an additional requirement of 200,000 rooms in the next five years.
- Due to stable political and social conditions in India, there will be an increase in the number of tourist arrivals. India is ranked fourth among the world's must see countries
- The present government in its process has taken a few projects like opening of the partial sky policy. This allows private domestic airline operators to fly on the Indian skies
- An increasingly growing middle class group, the arrival of corporate incentive travel and the multinational companies into India has bright prospects for tourism. India's easy visa rules, public freedoms and its many attractions as an ancient civilization makes tourism development easier than in many other countries
- The 5 star hotel sector has increased the fastest during the last five years at a CAGR of 12 percent. In the coming years, this sector can be divided into three sub-segments Luxury, Business and Leisure. The growth in this segment shows that segment of travelers coming into India. In the last few years India has seen a large inflow of business travelers in the country courtesy to relaxation of the government's stand on FDI for most of the sectors in the country.

- It costs an average of US\$50-80 million to set up 5 star hotels with three hundred rentable rooms in India. The gestation period is generally between 3-5 years.

**Table 2: STATISTICAL DATA – Indian Hotel Industry**

Size of the Hotel Industry	USD 3.8 Billion
Share of premium segment in the overall hotel market (2008)	USD 2.3 Billion
Expected growth rate from 2008 to 2009	12 percent
Key Players	Indian Hotels, Leela Ventures, ITC Hotels, Oberoi Hotels, Bharat Hotels, ITDC, Kamat Hotels.
Rooms	
Current Supply	About 110,000 hotels rooms
Current Demand	About 150,000 hotels rooms

- According to Economic Survey of 2010-11 the average annual growth rate of hotel and restaurant sector has been 8.8% for the period 2005-06 to 2009-10. However, last two years have not been quite pleasant for the sector as growth faltered badly.
- Till five years ago, the sector was registering a growth of around 15% but slowdown in the economy has affected the growth prospects of the sector badly and the growth rate has dropped to single digit level.
- The sector registered negative growth (-3.41%) in 2008-09 over the year 2007-08, which was due to adverse global economic conditions in this year. But the sector is back in the positive growth territory and clocked a growth of 2.2% in 2009-10.

**Table 3: Indian Hotel Industry: Annual growth rate (%)**

YEAR	SEGMENT	ANNUAL GROWTH RATE(%)
2005-06	Hotels & Restaurants	17.5
2006-07	Hotels & Restaurants	14.4
2007-08	Hotels & Restaurants	13.1
2008-09	Hotels & Restaurants	-3.4
2009-10	Hotels & Restaurants	2.2

Source : Economic Survey 2010-11

According to the statistics by World Travel and Tourism Council, India ranks 18th in business travel and will be among the top 5 in this decade. With such growth, sources estimate, demand is going to exceed supply by at least 100% in coming years.

**Table 4: Number of Hotels — 2010**

Hotel categories	No. of Hotels	No. of Rooms
5 star deluxe/5 star	165	43,965
4 Star	770	13,420
3 Star	505	30,100
2 Star	495	22,950
1 Star	260	10,900
Heritage	70	4,200
Uncategorized	7,078	Not available
<b>Total</b>	<b>8,707(Aprox)</b>	<b>1,32,885</b>

Source: FHRAI

## VI. INFLUENCE OF FDI IN TOURISM INDUSTRY HOTELS, SUSTAINABLE DEVELOPMENT & FDI

### Tourism and Sustainable Development

Tourism is often promoted as a job machine (Cukier, 2002; ILO, 2001; Görg, 2000). According to the ILO, the direct employment in (primarily) hotels and restaurants accounted for around three per cent of total employment worldwide. This share is higher in rural areas with little alternative employment opportunities (e.g. in remote wildlife areas), or in small island economies, such as Mauritius and Barbados, where direct employment in the hospitality sector accounts for approximately 10 per cent of total employment (ILO, 2001, p. 48). At the same time, the quality of jobs and their contribution to economic development is often disputed because of their seasonality, and their servile and low-skilled nature. Also the wages that are paid to especially the lower-ranked employees are sometimes questioned. For example, the ILO established that wages at hotel chains are on average 20 percent below those in other economic sectors (ILO, 2001, p. 121).

Yet advocates of “pro-poor tourism” emphasize that in the context of poverty alleviation, tourism is more relevant than other economic sectors, because it can be labour-intensive, inclusive to marginalized people (e.g. women) and suitable for rural areas with few alternative options for economic development. Even when the numbers of people employed in the sector are relatively low and involve primarily the more skilled persons, the collective income and other livelihood benefits throughout communities can make tourism significant to local poverty reduction (Ashley and Roe, 2002). Other jobs (agriculture, fishing) often pay worse and are physically more demanding, while seasonal or part-time jobs are also attractive in economies where multiple employments prevails (Cukier, 2002). This would explain why almost all employment opportunities associated with tourism in developing countries are highly prized by local residents (Sinclair, 1998, p. 31).

### FDI in the Tourism Sector

FDI in the hotel sector towards developing countries has increased substantially in the past decades, reflecting the rising importance of services in total international investments (see e.g. Dunning and Kundu, 1995; UNCTAD, 2007). But despite its substantial international growth, the major hotel chains remain relatively modest in size and their degree of internationalization is also low compared to other industry sectors (Endo, 2006). For example, none of the major hotel multinationals is included in the top 100 of non-financial MNEs, and most employment in the hotel sector is still created at domestically-owned accommodations: foreign-owned firms account for only 10 per cent of worldwide employment in the hotel and restaurants sector in the 1990s – a low proportion compared to most other industry sectors (UNCTAD, 2007).

However, the limited proportion of hotel FDI is slightly misleading since hotels primarily internationalize through non-equity modes, particularly in developing countries (Endo, 2006). The most popular non-equity mode is the management service agreement, under which the business is controlled and managed by a foreign firm, who is not the owner. Management contracts offer a hotel MNE *de facto* control and supervision over day-to-day operations, and secure reasonable proceeds, while avoiding the financial and political risks associated with the sunk costs of ownership. The alternative non-equity mode is the franchising agreement, which awards a local firm the right to do business in a prescribed manner under an existing brand name. This is a less common mode in least developed countries, because of the limited skills and experiences available in these countries (UNCTAD, 2007: pp. 38-39).

### Developmental Growth through FDI in Tourism Sector (Opportunity)

In the Financial Year 2008-2009, India’s GDP recorded a growth rate of 6.7 % according to the Central Statistical Organization. The GDP growth in the 2008-2009 can be attributed to a strong service sector, steady foreign direct investment, as well as the government policies that helped to sustained growth rate.

The market size of Hotel industry has more than doubled from about USD 1 billion in 2004 to USD 2.3 billion in 2008. It is estimated that India is likely to have around 40 international hotels brands by 2011.

The growth of the Hotel Industry is largely due to the rising business opportunities, strong economic performance and cross border investments. India has currently base of 110,000 hotels rooms and still face the shortage of 150,000 rooms. There is a mismatch between demand and supply, leading to higher occupancies and average room rates.

Occupancy rates across India have improved from 52 percent in 1999 to 67 percent in 2007-2008. Average Room Rates across cities have improved from USD 51.6 to USD 76.4 in the same period.

Despite the global economic recession, foreign tourist arrival increased to 5.37 million in 2008 from 4.98 million in 2007.

Sports events like IPL and the Commonwealth games have a potential to create demand for both Tourism and Hospitality industry in India.

According to the Indian Tourism ministry, the Indian tourism industry would be the third largest foreign exchange earner in the country in the next three year. Till the end of 2012, foreign tourists will grow at the fastest pace in comparison with the last decade and it is estimated that tourism in India could contribute US\$1.8 billion to India's GDP. These statistics show the seriousness of the Indian government towards tourism. Andhra Pradesh, Uttar Pradesh, Tamil Nadu, Karnataka and Rajasthan are the leading tourism destinations in India in terms of total tourist arrivals. In the next few years, some new states should come into the picture such as Uttaranchal, Madhya Pradesh and a few others. According to the ministry, it is predicted that around US\$10 billion is required for the development of Indian tourism in the next five years. When we think of long term capital requirements for all the states, it would be nearly US\$56 billion in the next 20 years.

## VII. INFLUENCE OF FDI IN ECONOMIC GROWTH

Initially, the central government acted as the only source of investment funding for local industries. Foreign investors were not allowed to take part in local economic development. During that time, India's economy suffered from a low development pace and a low growth rate. However, India's national government has opened the economy to investment from outside the country since 1991. Thus, the investment system has been transformed and a series of supportive policies have been proposed to encourage diversification of investment and competition (Economic Analysis, 2007). One of the key elements used to push India's economic reforms is the encouragement of FDI. Since 1991, India's policies toward FDI have undergone various changes in policy priorities. In the late 1991 and early 2000, India's economic policies were characterized by passing new regulations to authorize joint ventures and, setting up Special Economic Zones (SEZs) and "Open Cities"<sup>2</sup>. On Joint Ventures using Chinese and Foreign Investment was adopted, granting foreign investment a legal status in India.

The State Council also awarded rights of autonomy in foreign trade to Guangdong and Fujian Provinces and, in 1980, set up four Special Economic Zones (SEZs) in three cities in Guangdong Province (Shenzhen, Zhuhai, Shantou), and one city in Fujian Province (Xiamen). Since 1984, China also has moved to further openness to FDI. In 1984, the concept of SEZs was extended to another fourteen coastal regions. Later, in 1986, in addition to joint ventures, wholly foreign-owned enterprises were also allowed to enter China. In "22 Article Provisions"<sup>3</sup>, foreign ventures were granted preferential tax treatment, the freedom to import inputs such as materials and equipment, the right to retain and swap foreign exchange with each other, and simpler licensing procedures.

India's supportive policies toward FDI increased the inflow of FDI in the late 1980s and it became even more frequent in the early 1990s. Since 1992, when India's central authority decided to expand the scale and geographical scope of foreign investment, an increase in the foreign direct investment in India emerged. In the years between 1991 and 2002 the average

foreign direct investment in India was US\$ 2.5 billion. This average increased by seven times to become US\$ 37.5 billion during 2005 ("Low Income Countries in Global FDI Race", n.d.). Subsequently, after India's entry to the WTO, India's investment system entered an expanded internationalization stage and the country has now become one of the top recipients of FDI among developing countries (World Investment Report, 2006).

## VIII. CONCLUSION

As we pointed out in the introduction, FDI plays a significant role in expanding the tourism sector in India. This shows that appropriate policy to explore tourism resources and plans to develop new tourist venues and facilities may need to be considered in order to meet the increasing demand of tourism in India expected as a result of continued strong foreign direct investment.

The Travel & Tourism industry provides tremendous opportunity to India in terms of contribution to its GDP and employment generation. According to CII estimates, an additional 1 million visitors can help generate revenues of Rs.4, 300 crore annually. Thus, Government policies, which would focus at increasing tourist arrivals in the country and facilitate investments in tourism infrastructure, would lead to significantly higher multiplier effect on the key economic parameters of the Indian economy.

From the above study following conclusion is recommended as the measures to attract more and more FDI:

- There was need to rationalize the taxation on the hotel industry and adopt a single luxury tax across the country. For provision of single-window clearances at the local, State and Central Government levels to reduce procedural delays.
- Tax holiday would encourage FDI in this sector and more players to set up hotels, to bridge the shortage of rooms which according to Government estimates stood at one lakh rooms.
- Section 72 (A) of the Income Tax Act should be amended such that it is made applicable to the Hospitality sector also by using the word 'undertaking' in lieu of 'industrial undertaking'.
- It is recommended to increase the depreciation rate to 100% in order to incentives hotels to install pollution control equipment and energy generating devices to protect the environment.
- For the calculation of Book profit for the MAT provisions under Sec. 115 JB, Sec 80HHD profits should be allowed as a deduction on par with the deduction available to Sec 80HHC/E/F profits, as under these relevant sections all the assesses deal with foreign Exchange.
- Service Tax should be computed based on the value of service provided, in the nature of VAT; rather than on the gross amount.
- Concessions under Section 10(5) (B) of IT Act should be restored and spa consultants should also be included.
- Inland Air Travel Tax should be applied at the rate of 5% of the basic ticket price.

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