ROLE OF FOREIGN DIRECT INVESTMENT (FDI) IN SERVICES SECTOR IN INDIA

Shivani Chopra*
Sunita Sikri*

ABSTRACT

Services are crucial for the economies of both the developed & developing countries. In recent years there has been a rapid and sustained growth of the Services sector in the Indian economy. The Indian economy has turned around after 2002-03, clocking a growth rate of 8.7 per cent per annum making it the world's seclond largest growing economy after China. FDI plays an important role in the development process of a country. It has potential for making a contribution to the development through the transfer of financial resources, technology and innovative and improved management techniques along with raising productivity. FDI can act as a catalyst for domestic industrial development. Further, it helps in speeding up economic activity and brings with it other scarce productive factors such as technical knowledge and managerial experience, which are equally essential for economic development. Developing countries like India needs substantial foreign investment inflows to achieve the required investment to further accelerate the economic growth and development. Presently India has been a major recipient of FDI inflow in majority of sectors. It has attracted a quantum amount of FDI post liberalization in the services sector which includes (a) trade, hotels & restaurants; (b) transport, storage & communication; (c) banking & insurance (d) real estate, ownership of dwellings & business services; (e) public administration & defense and (f) other services – including education, medical & health, religious & other community services, legal services, recreational & entertainment etc. Under each of these categories there are very many sub-categories. Again, amongst each of these categories / sub-categories there are units operating in all the three institutional sectors: public and private corporate sectors (together constituting the organized sector) and the private unorganized sector. But recognizably, a large part of the economic activities in the services sector is carried out in the unorganized segment of the economy.

Keywords: *FDI (Foreign Direct Investment), Service Led Economic Growth, Services Sector.*

*Asstt. Professor (Commerce Deptt.), MLN College, Yamuna Nagar.

FDI plays an important role in the development process of a country. It has potential for making a contribution to the development through the transfer of financial resources, technology and innovative and improved management techniques alongwith raising productivity. Developing countries like India need substantial foreign inflows to achieve the required investment to accelerate economic growth and development. It can act as catalyst for domestic industrial development. Further, it helps in speeding up economic activity and brings with it other scarce productivity factors such as technical knowhow and managerial experience which are equally essential for economic development.

India has been a major recipient of FDI Inflows in the majority of sectors. There has been an unnerving upsurge in the economic development of the country. In the liberalization era, India is known to have attracted a quantum amount of Foreign Direct Investment, especially after the liberalization. The huge market for computer hardware in India, coupled with the availability of skilled workforce in this sector has boosted the inflow of FDI. High growth prospects, in terms of increased consumption in the India as well as increasing demand for exports are expected to lead to more Foreign Direct Investments in this sector.

FDI opportunities in the telecommunication sector in India exist in the areas of Ecommerce, Manufacturing of equipments and components, Tele-education, Telebanking, Exports of telecom equipment and services, Tele-medicine, Setting up a national long distance bandwidth capacity in the country. Construction projects which have received the maximum FDI include, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure. FDI Inflows in the construction industry in India are permissible under automatic route to ensure flexibility in construction activities which will boost the Indian economy. In the real estate sector, the foreign investors are not allowed to sell undeveloped land, such as, lands which do not have proper facilities of roads, water, electricity, drainage and all other basic requirements for inhabitation.

The huge size of the market in the power sector in India and high returns on investment are important factors in boosting FDI inflows to power. There are huge opportunities of FDI in power sector in India. Opportunities of Foreign Direct Investment (FDI) in the Power Sector in India exist in Hydro Projects, Captive Power, Ultra Mega Power Projects, Nuclear Power, National Grid Program, Rural Electrification, Trading, Renewable etc.

Important factors which are conductive to FDI Inflows to Electronics are the availability of low-cost, efficient, and technically skilled workforce, opportunities for the manufacturing of consumer electronic goods and mobile handsets are high given the growing demand in the domestic electronics market, electronics hardware is growing leaps and bounds globally, large-scale manufacturing units of electronics hardware will be set up in the special economic zones with a total exemption of duties and taxes, India has high chances to acquire a size USD 11 billion in terms of contract manufacturing out of USD 500 billion by 2010, Designing of electronics will touch USD 7 billion by 2010, component exports will touch USD 5 billion by 2010, Nokia and Elcoteq Network are planning to set up manufacturing operations in India.

LITERATURE REVIEW

Cheng, (1993) noted the growing importance of cross-border R & D activities and suggested that additional research on FDI should be done on why firms internationalize their R & D.

Dijkstra (2000), Tybout (2000) and Vachani (1997) found that investment policy liberalisations have major impacts on firms in less developed countries (LDCs) where the pre-liberalisation level of protection was high. Not all firms are affected equally; some will be losers while others will be winners, depending on their characteristics.

Nagesh Kumar (2001) analyses the role of infrastructure availability in determining the attractiveness of countries for FDI inflows for export orientation of MNC production.

Anand Virmani and Susan Collins (2007) studied empirically India’s economic growth experience during 1960-2004 focussing on the post 1973 acceleration. The analysis focuses on the unusual dimensions of India’s experience. They find that India will need to broaden its current expansion to provide manufactured goods to the world market and jobs for its large pool of low skilled workers.

Kulwinder Singh (2005) has analyzed FDI flows from 1991-2005. A sectoral analysis in his study reveals that while FDI shows a gradual increase has become a staple of success in India, the progress is hollow. The telecommunication and power sector are the reasons for the success of infrastructure. He finds that in the comparative studies the notion of infrastructure has gone a definitional change.FDI in sectors is held up primarily by telecommunication and power is not evenly distributed.

In their study on FDI and its economic effects in India, Chandand Chakroborty and Peter Munnen Kamp (2006) assess the growth implications of FDI in India by subjecting industry specific FDI and output to causality tests.

Jaya Gupta (2007) in his paper made an attempt to review the change in sectoral trends in India due to FDI Inflows since liberalization. This paper also examines the changed policy implications on sectoral growth and economic development of India as a whole.

Jayashree Bose (2008) in his book studied the sectoral experiences faced by India and China in connection with FDI inflows. This book provides information on FDI in India and China, emerging issues, globalization, foreign factors, trends and issues in FDI inflows, FDI inflows in selected sectors. A comparative study has also been conducted on FDI outflows from India and China. This book also revealed the potential and opportunities in various sectors in India that would surpass FDI inflows in India as compared to China.

Tanay Kumar Nandi and Ritankar Saher (2008) in their work made an attempt to study the Foreign Direct Investment in India with a special focus on Retail Trade. This paper stresses the need of FDI in India in retail sector and uses the augment that FDI is allowed in multiple sectors and the effects have been quite good without harming the domestic economy. The study also suggests that FDI in retail sector must be allowed.

OBJECTIVES

The main objective of the study is to analyze the FDI inflows in India with special reference to Sector –wise inflows. The other objectives are:

- To explore the Sector wise distribution of FDI inflows in order to point out the dominating sector, which has attracted the major share.
- To rank the sectors based upon highest FDI inflows.

NATURE AND SOURCE OF DATA

The present study is of analytical nature and makes use of secondary data. The relevant secondary data has been collected from reports of the Ministry of Commerce and Industry, Department of Industrial Promotion and Policy, Government of India, Centre for Monitoring Indian Economy, Reserve Bank of India, World Investment Report and World Investment Report.

ANALYSIS

Analysis of Country-wise Inflows of FDI

It is proposed to analyze the country-wise share of foreign direct investment in India from 2008-2011.The data relevant to the analysis is presented in the following Table.

Country–wise FDI Inflows - Top 10 Countries (From 2008-2011) (Amount Rupees in Crores)

Rank	Country	2008-09	2009-10	2010-11	(for April '11)	Cumulative Inflows (April '08 to April '11)	%age to Total Inflows
1	Mauritius	44483	50794	49633	2528	213434	43
2	Singapore	12319	15727	11295	1933	47080	9
3	USA	4377	8002	9230	404	37593	7
4	UK	4690	3840	3094	265	26263	5
5	Netherlands	2780	3922	4283	312	20438	4
6	Japan	3336	1889	5670	1455	18350	4
7	Cyprus	3385	5983	7728	123	17900	4
8	Germany	2075	2750	2980	102	12571	3
9	France	583	2098	1437	184	7102	1
10	UAE	1039	1133	3017	31	7054	1
	Total FDI Inflows	98664	123025	123378	9854	526357	83%

Source Government of India (GOI) (2011). FDI Statistics, Ministry of Commerce & Industry, Department of Industrial Policy and Promotion

India's 83% of cumulative FDI is contributed by nine countries while remaining 17 per cent by rest of the world. The analysis of country wise inflows of FDI in India indicates that during 2008-2011, the total amount of Rs 526537 of FDI was received from 113 countries including NRI investments.

India's perception abroad has been changing steadily over the years. This is reflected in the ever growing list of countries that are showing interest to invest in India. Mauritius emerged as the most dominant source of FDI contributing 44 % of the total investment in the country. Singapore was the second dominant source of FDI inflows with 9% of the total inflows. However, USA slipped to third position by contributing 7% of the total inflows. They maintained continuous increasing trend under the period of study. UK occupied fourth position with 5%followed by Netherlands with 4%, Japan with 4%, Cyprus with 4%, Germany with 3%, France with 1%, UAE with 1%.

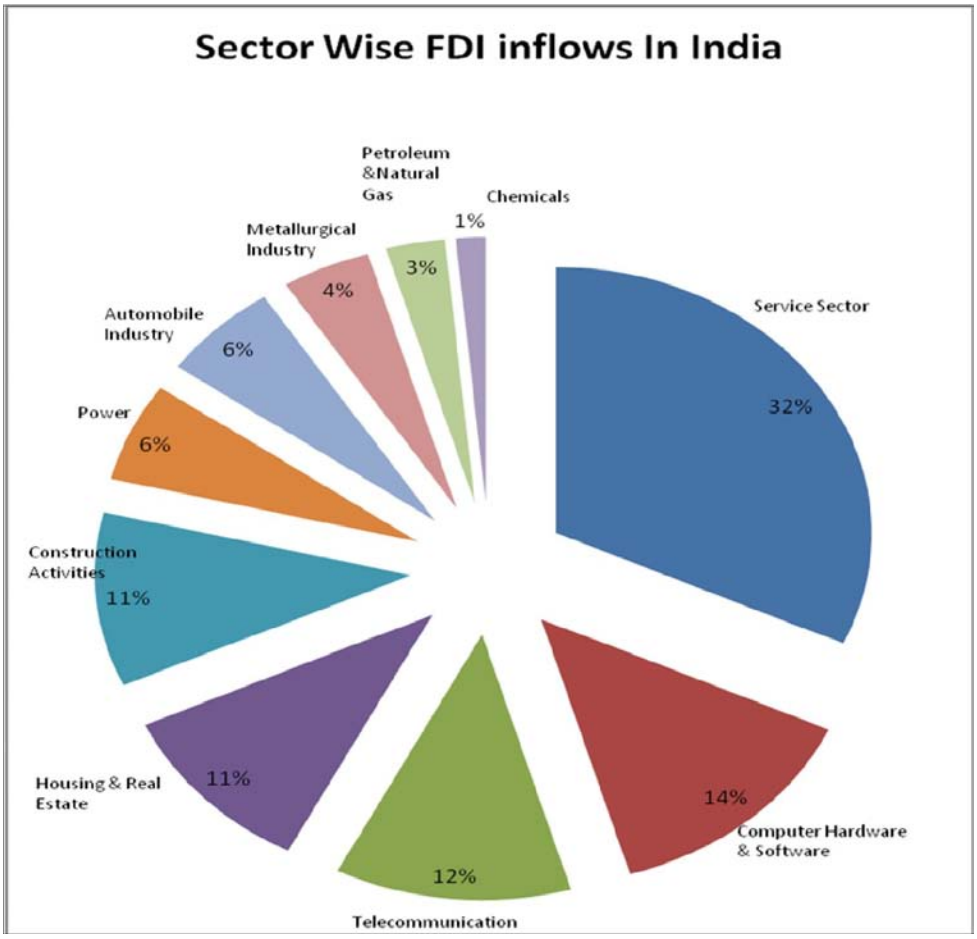
It has been observed that some of the countries like Israel, Thailand, Hong Kong, South Africa and Oman increased their share gradually during the period under study. It is also interesting to note that some of the new countries such as Hungary, Nepal, Virgin Islands, and Yemen are making significant investments in India.

FDI Inflows in India - Sectoral Analysis of Top 10 Sectors

Sector-wise FDI Inflows in India from April 2008-April - 2011

Sector–wise FDI Inflows (Rupees in Crores)

Sector	2008-09 (April-March)	2009-10 (April-March)	2010-11 (April-March)	2011-12 (for April '11)	Cumulative Inflows (April '08 - April '11)	% age to Total Inflows (In terms of US$)
Services Sector (financial & non-financial)	26,589	28,411	20,958	1,581	106,992	32 %
Computer Software & Hardware	5,623	7,329	4,350	765	44,611	14 %
Telecommunications (radio paging, cellular mobile, basic telephone services)	5,103	11,727	12,338	1,914	42,620	12 %
Housing & Real Estate	8,749	12,621	13,586	246	37,615	11 %
Construction Activities (including roads & highways)	6,989	8,792	13,544	345	36,066	11 %
Power	3,875	4,382	6,908	547	21,466	6 %
Automobile Industry	2,697	5,212	5,609	187	20,864	6 %
Metallurgical Industries	4,686	4,157	1,935	404	13,845	4 %
Petroleum & Natural Gas	5,729	1,931	1,328	522	12,026	3%
Chemicals (other than fertilizers)	920	3,427	1,707	115	11,390	1 %



Graph Showing Top Ten Sectors attracting FDI Inflows in India since April 2008- April 2011

☐ Ranking of Sector wise FDI inflows in India since April 2008- April 2011

Rank of Sector–wise FDI Inflows

Industrial Sector	Rank
Service Sector	1
Computer Hardware & Software	2
Telecommunication	3
Housing and Real Estate	4
Construction Activities	5
Power	6
Automobile Industry	7
Metallurgical Industry	8
Petroleum and Natural Gas	9
Chemicals	10

Source Fact Sheets on FDI, DIPP

FINDINGS

The Sector wise Analysis of FDI Inflow in India reveals that maximum FDI has taken place in the service sector including the telecommunication, information technology, travel and many others. The service sector is followed by the computer hardware and software in terms of FDI. High volumes of FDI take place in telecommunication, real estate, construction, power, automobiles, etc.

The rapid development of the telecommunication sector was due to the FDI inflows in form of international players entering the market and transfer of advanced technologies. The telecom industry is one of the fastest growing industries in India. With a growth rate of 45%, Indian telecom industry has the highest growth rate in the world.

FDI inflows to real estate sector in India have developed the sector. The increased flow of foreign direct investment in the real estate sector in India has helped in the growth, development, and expansion of the sector.

FDI Inflows to Construction Activities has led to a phenomenal growth in the economic life of the country. India has become one of the most prime destinations in terms of construction activities as well as real estate investment.

The FDI in Automobile Industry has experienced huge growth in the past few years. The increase in the demand for cars and other vehicles is powered by the increase in the levels of disposable income in India. The options have increased with quality products from foreign car manufacturers. The introduction of tailor made finance schemes, easy repayment schemes has also helped the growth of the automobile sector. The basic advantages provided by India in the automobile sector include, advanced technology, cost-effectiveness, and efficient manpower. Besides, India has a well-developed and competent Auto Ancillary Industry along with automobile testing and R&D centres. The automobile sector in India ranks third in manufacturing three wheelers and second in manufacturing of two wheelers. Opportunities of FDI in the Automobile Sector in India exist in establishing Engineering Centres, Two Wheeler Segment, Exports, Establishing Research and Development Centres, Heavy truck Segment, Passenger Car Segment.

The increased FDI Inflows to Metallurgical Industries in India has helped to bring in the latest technology to the industries. Further the increased FDI Inflows to Metallurgical Industries in India has led to the development, expansion, and growth of the industries. All this has helped in improving the quality of the products of the metallurgical industries in India.

The increased FDI Inflows to Chemicals industry in India has helped in the growth and development of the sector. The increased flow of foreign direct investment in the chemicals industry in India has helped in the development, expansion, and growth of the industry. This in its turn has led to the improvement of the quality of the products from the industry.

Based upon the data given by department of Industrial Policy and Promotion, in India there are sixty two (62) sectors in which FDI inflows are seen but it is found that top ten sectors attract almost seventy percent (70%) of FDI inflows. The cumulative FDI inflows from the above results reveals that service sector in India attracts the maximum FDI inflows amounting to Rs. 106992 crores, followed by Computer Software and Hardware amounting to Rs. 44611 crores. These two sectors collectively attract more than thirty percent (30%) of the total FDI inflows in India. The housing and real estate sector and the construction industry are among the new sectors attracting huge FDI inflows that come under top ten sectors attracting maximum FDI inflows.

Thus the sector wise inflows of FDI in India shows a varying trend but acts as a catalyst for growth, quality maintenance and development of Indian Industries to a greater and larger extend. The technology transfer is also seen as one of the major change apart from increase in operational efficiency, managerial efficiency, employment opportunities and infrastructure development.

FDI AND ECONOMIC DEVELOPMENT

FDI is considered to be the life blood and an important vehicle of for economic development as far as the developing nations are concerned. The important effect of FDI is its contribution to the growth of the economy. FDI has an important impact on country’s trade balance, increasing labour standards and skills, transfer of technology and innovative ideas, skills and the general business climate. FDI also provides opportunity for technological transfer and up gradation, access to global managerial skills and practices ,optimal utilization of human capabilities and natural resources, making industry internationally competiteve,opening up export markets,aceess to international quality goods and services and augmenting employment opportunities.

FDI ISSUES AND POLICY RECOMMENDATION

FDI can be instrumental in developing rural economy. There is abundant opportunity in Greenfield Projects. But the issue of land acquisition and steps taken to protect local interests by the various state governments are not encouraging. MOU Arecelor-Mittal controversy is one of the best examples of such disputes.

India has a huge pool of working population. However, due to poor quality primary education and higher there is still an acute shortage of talent. This factor has negative repercussion on domestic and foreign business. FDI in Education Sector is less than 1%. Given the status of primary and higher education in the country, FDI in this sector must be encouraged. However, appropriate measure must be taken to ensure quality. The issues of commercialization of education, regional gap and structural gap have to be addressed on priority.

Indian economy is largely agriculture based. There is plenty of scope in food processing, agriculture services and agriculture machinery. FDI in this sector should be encouraged. The issue of food security, interest of small farmers and marginal farmers need cannot be ignored for the sake of mobilization of foreign funds for development.

India has a well developed equity market but does not have a well developed debt market. Steps should be taken to improve the depth and liquidity of debt market as many companies may prefer leveraged investment rather than investing their own cash. Looking for debt funds in their own country invites exchange rate risk.

In order to improve technological competitiveness of India, FDI into R&D should be promoted. Various issues pending relating to Intellectual Property Rights, Copy Rights and Patents need to be addressed on priority. Special package can be also instrumental in mobilizing FDI in R&D.

Though service sector is one of the major sources of mobilizing FDI to India, plenty of scope exists. Still we find the financial inclusion is missing. Large part of population still doesn't have bank accounts, insurance of any kind, underinsurance etc. These problems could be addressed by making service sector more competitive. Removal of sectoral cap in insurance is still awaited.

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