

FDI IN INDIA'S SERVICE SECTOR: PROBLEMS AND PROSPECTS

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Abstract

Foreign Direct Investment (FDI) has become an asset for developing countries including India. FDI flows to developing economies reached a new high of \$778 billion, accounting for 54% of global inflows in 2013 (World Investment Report, UNTAD 2014). And in this Service sector continues to account for largest FDI share. The present study mainly focuses upon the FDI scenario in Service sector of India. The impact of one over the other and degree of association between FDI and GDP growth in services has been measured through applying statistical tools. Also the present challenges with regard to investment in service sector of India and their complementary remedial measures have been discussed in this study.

Key Words: FDI, Service Sector, globalization, India

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Introduction

In today's globalized world competition among countries and regions to attract Foreign Direct Investment (FDI) from multinational enterprises has increased significantly. An increasing number of governments want to attract FDI rise because the characteristics associated with FDI increasingly fit the government's development objectives (growth, poverty reduction, etc.). This is based on a perception that the potential positive effects of FDI (growth, technology, skill upgrading and capital) generally outweigh its negative effects (income inequality, environmental degradation, profit repatriation) (Te Velde, 2001).

Foreign Direct Investment (FDI) has extensively been regarded by policy makers as a stable development engine. According to International Monetary Fund (IMF), "FDI refers to the investment that is made to acquire lasting interest in an enterprise operating in an economy other than that of investor. The investor's purpose is being to have an effective voice in the management of enterprise". There is long standing evidence from around the world that FDI is more conducive to long run growth and development than other forms of capital inflows.

Currently and prospectively the service sector has been the major growth accelerator of Indian economy with the highest sectoral contribution (57%) in GDP. India's trade in services has increased overtime and services account for the largest share in India's foreign direct investment (FDI) inflows and outflows. The sectoral disaggregation of India's national income shows that the service sector has been growing relatively faster as compared with the primary and secondary sector. Since liberalization it has been seen as a tool to boost economic growth of the country with a share of 17.19% of total FDI inflows.

Literature Review

FDI is expected to accelerate the economic growth of all countries. The link between FDI and economic growth, development has been a subject of great discussion for several past years.

Some of those literatures have been discussed here:

Banerjee, A. (2014) examines the impact of FDI in Indian scenario with special focus on service sector. He applied correlation and simple regression model to achieve his objectives. In this study he found out that FDI in service sector is positively influencing the cumulative FDI in Indian economy. Accordingly he also suggests that significant measures in terms of liberalizing

FDI processes and robust infrastructure should be taken by the government, so as to make India an investment hub.

Mukherjee, A. (2013) concluded that there is a need for inclusive growth in service sector of India as it has not been able to generate employment in terms of numbers and quality. And to achieve this as per the author there is need for private investment and FDI in services like transport, energy and telecommunications. Also stable government, non-discriminatory policy and competitive environment are the need of the time.

Saleena, N.J. (2013) analyses the impact of FDI on services export in India through Augmented Dicky- Fuller (ADF) test, the ordinary least square method and granger causality test. The author found significant relationship between FDI and services export variables, which indicates that FDI has positively influenced the growth of services export in Indian economy. The author also suggests that FDI should be pursued as long term policy objective in an economy.

Aggarwal, A. (2012) highlights various problems with the service sector as the gateway to development of Indian economy. Decrease in the share of employment with an increase in GDP share, creating poverty leading to worsening of inequality, concentrated growth, mismatch between the level of output and the level of employment are some of the problematic issues with the growth of service sector highlighted by the author. He also suggests that the mindset regarding the role of service sector should be set in the light of these problems.

Prasad, H.A.C. and Sathish, R. (2010) focus towards the major policy issues in service sector of India. They classified major policy issues under three main headings. First one is domestic policy issues like FDI, disinvestment, tariff, trade etc. Second one is regarding domestic regulations in terms of tariffs. Third one is related to market access issues like domestic regulations, subsidies and other barriers for India's service exports. The study also suggests that to attain targeted GDP growth rates and overall growth in the economy there is a need for immediate and time bound reforms.

Chakravarty, D. (2006) explains about the determinants of service sector growth in India through inter-sectoral analysis of state domestic product data. The author finds that the industrial sector is one of the most important determinants of service sector growth in different states of the country. Also the commodity producing sector of the country outside the state plays an important role in determining the performance of service sector in India.

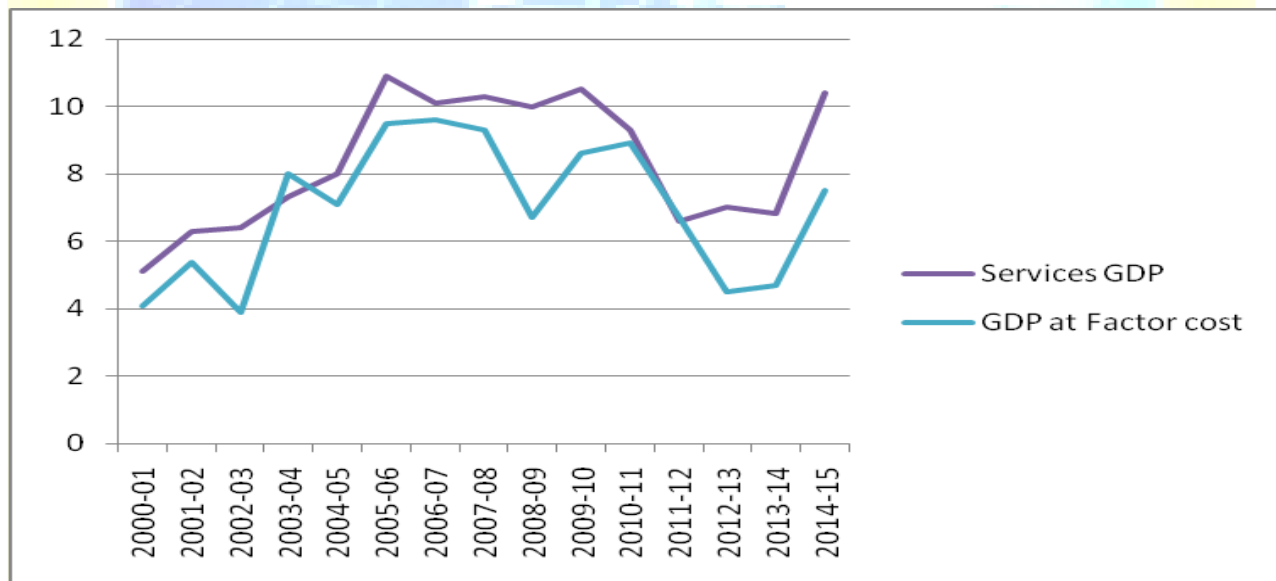


Service Sector: Indian Outlook

Service sector has emerged as the leading and top growing sector in the global economy, providing more than 60 percent of global output. As per World Investment Report 2015 (UNTAD), “Services continued to account for the largest shares of announced Greenfield projects and M&A deals. In 2013, it was the fastest growing sector in terms of total value of announced greenfield projects, with a significant increase of 20 per cent, while the value of M&A deals decreased moderately”.

In the same way service sector in India has also grown rapidly with a major contribution to country’s GDP. Share of financial services has been on top with an increase from 3.5 in 2000-01 to 13.7 in 2014-15. Figure 1 shows that service sector GDP is always high as compared to overall GDP except in the year 2003-04 in case of Indian economy. In the year 2014-15 overall GDP is 7.5 whereas service sector GDP is 10.4 showing higher level of contribution.

Fig.1: Comparison of Services GDP to Overall GDP at Factor Cost



(Source: Prepared through data collected from Economic Survey 2014-15)

The Services Sector of the Indian economy can be broadly grouped into three broad segments namely, the public sector, private corporate sector and the household sector. In India classification for services has been provided by National Industrial Classification, Central Statistical Organization and Ministry of Statistics and Programme Implementation (MOSPI). India’s service sector covers a broad variety of activities that have different features and



dimensions. Its range covers services like IT, telecommunications, financial, non-financial, insurance, education, health, art, entertainment etc.

FDI in Services

Since 1990s onwards there has been a large inflow of FDI into India. Flow of FDI in India also followed the global trend i.e. shift from manufacturing to services. The growing importance of services sector in India can also be seen through its policy regime in the form of liberalization of various services.

Table 1: Top 5 sectors attracting the highest FDI inflows in Indian Economy

(Amount in Rs. crores (US\$ in million))

SECTOR	2011-12 (April- March)	2012-2013 (April- March)	2013-14 (April – March)	Cumulative Inflows (April '00 – March '14)	% age to total Inflows (In terms of US\$)
SERVICES SECTOR**	24,656 (5,216)	26,306 (4,833)	13,294 (2,225)	185,570 (39,460)	18%
CONSTRUCTION DEVELOPMENT: TOWNSHIPS, HOUSING, BUILT-UP INFRASTRUCTURE	15,236 (3,141)	7,248 (1,332)	7,508 (1,226)	108,558 (23,306)	11%
TELECOMMUNICATIONS (radio paging, cellular mobile, basic telephone services)	9,012 (1,997)	1,654 (304)	7,987 (1,307)	66,720 (14,163)	7%
COMPUTER SOFTWARE & HARDWARE	3,804 (796)	2,656 (486)	6,896 (1,126)	59,671 (12,817)	6%
DRUGS & PHARMACEUTICALS	14,605 (3,232)	6,011 (1,123)	7,191 (1,279)	56,070 (11,598)	5%

(Source: Department of Industrial policy & promotion, GOI, SIA Newsletter)

Notes: ** Services sector includes Financial, Banking, Insurance, Non-Financial / Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis

Table 1 shows the top 5 sectors of the Indian economy leading to highest FDI inflows. FDI in services sector is 18% followed by construction development, telecommunications, computer software and hardware and drugs and pharmaceuticals from 2000 to 2014. Table 2 on the other hand deals with top 5 services in terms of highest FDI inflows. The top 5 services alone lead to 45% share with respect to total FDI in India from 2000 to 2014. This clears the prominent position of service sector among different sectors in Indian economy.

Table 2: Top 5 Services attracting highest FDI inflows in India (April 2000- March 2014)

(Value in US \$ million)

Sector	2011-12	2012-13	2013-14	Cumulative Inflows (April 2000- March 2014)	Percentage to total
Services Sector (Financial & Non-Financial)	5216	4833	2225	39460	18
Construction development #	3141	1332	1226	23306	11
Telecommunications*	1997	304	1307	14163	7
Computer Software & hardware	796	486	1126	12817	6
Hotels & Tourism	993	3259	486	7118	3
Total top 5 services	12143	10214	6370	96864	45
Total FDI inflows	46556	34298	36396	217581	100

(Source: Based on Department of Industrial Policy and Promotion (DIPP) data.)

Notes: # indicates township, housing, built-up infrastructure and * indicates radio paging, cellular mobile, basic telephone services.

Table 3 basically shows the FDI equity inflows in sub sectors of services sector with financial services (6.54%) at the top, followed by non-financial services (4.81%) and others. This shows that financial, non-financial and other services lead to 17.19% of total contribution of FDI from 2000 to 2015.

Table 3: FDI equity inflows in sub sectors of Services Sector (April 2000- March 2015)

Sub Sectors	Amount of FDI equity inflows		%age with total FDI inflows
	Rs crore	US\$ million	
Financial	77,284.21	16,257.21	6.54
Banking Services	17,162.89	3,725.51	1.50
Insurance	18,802.17	3,814.79	1.53
Non-Financial Services/Business Services	59,002.19	11,947.45	4.81
Outsourcing	6,570.09	1,390.50	0.56
Research & Development (R&D)	2,512.74	507.91	0.21
Courier	2,287.06	485.10	0.20
Technical Testing And Analysis	1,180.54	219.30	0.09
Commodity Exchange	1,855.44	451.79	0.18
Other Services	18,874.88	3,912.51	1.57
Total of above	205,532.20	42,712.67	17.19

(Source: Department of Industrial policy & promotion)

Table 4 investigates the share of top five countries in FDI equity inflows for services sector in India. Mauritius holds the top most position with a percentage share of 40.30 followed by Singapore (15.53%), UK (7.11%), USA (6.88%) and Netherlands (5.73%). The share of these countries in total is 75.55% of total FDI inflows for services sector in Indian economy from 2000 to 2013.

Table 4: Share of top 5 countries in FDI equity inflows for Services Sector (January 2000- December 2013)

Ranks	Country	Amount of FDI equity inflows		%age with total FDI inflows for Services Sector
		Rs crore	US\$ million	
1.	Mauritius	73,160.69	15,656.18	40.30
2.	Singapore	28,577.03	6,033.81	15.53
3.	United Kingdom	12,293.61	2,763.39	7.11
4.	U.S.A	12,581.28	2,672.30	6.88
5.	Netherlands	10,913.65	2,227.49	5.73
Total of above		137,526.26	29,353.17	75.55

(Source: Department of Industrial policy & promotion, GOI, SIA Newsletter)

To study the impact and level of association between FDI inflows and growth of GDP in service sector Correlation Analysis and Linear regression analysis with the help of SPSS has been calculated and the data for the same is given in Table 5.

Table 5: Financial year wise growth of GDP in Service Sector through FDI

Financial Year	FDI inflows(US \$ million)	Growth of GDP in Service Sector (%)
2000-01	4029	51.83
2001-02	6130	53.02
2002-03	5035	53.18
2003-04	4322	53.04
2004-05	6051	53.06
2005-06	8961	53.87
2006-07	22826	52.71
2007-08	34843	53.93
2008-09	41873	54.72
2009-10	37745	55.14
2010-11	34847	56.37
2011-12	46553	54.90
2012-13	34298	56.30
2013-14	36396	57.00

(Source: Department of Industrial policy and promotion, Economic Survey 2012-13, 2013-14)

As the Correlation analysis helps to measure the strength and direction of a linear association between two variables here in this study the result of the same is given in Table 6. The estimated result of Correlation analysis tells us that the level of association is 0.758 between FDI inflows and growth of GDP in service sector which is positive and significant at 0.01 level.

Table: 6 Correlations

		FDI Inflows	GDP growth in Services Sector
FDI Inflows	Pearson Correlation	1	.758**
	Sig. (2-tailed)		.002
	N	14	14
GDP growth in Services Sector	Pearson Correlation	.758**	1
	Sig. (2-tailed)	.002	
	N	14	14

** . Correlation is significant at the 0.01 level (2-tailed).

Table 7 shows the result of Regression Analysis. Here R square is 0.574 and adjusted R square is 0.539 which means that FDI inflow leads to 53.9% variations in the GDP growth of service sector.

Table: 7 Regression Analysis Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.758	.574	.539	1.061

Therefore the result here shows that FDI inflow and Growth in GDP of service sector has been positively correlated and also there is positive impact of FDI inflow over GDP growth in service sector.

Service Sector Investment:

In India the inflow of FDI in to the services sector has been biased towards few of the services sector. It shows the lopsided growth of the services sector. The following section deals with some of the major issues and their prospective remedies with regard to investment scenario in service sector of India.



Problems

Problems with the service sector investment inflow come basically from the internal structure of the country. First and the foremost is restrictive FDI policy leading to low level of investment. In India FDI in some sectors is not allowed at all such as legal services, postal services whereas in others like teleports, retail and insurance it is highly restrictive. Another issue is related to single nodal agency for services. As the governance structure in India is quasi-federal leading to approval requirement at various levels. Also there are multiple nodal agencies in case of services like transport with conflicting interests among them whereas in services like retail no such agency exists. Quality of infrastructure is also a major bottleneck leading to increasing costs and delay in projects. Taxation structure of India also works as a constraint. As India has a high corporate tax rate i.e. 30% to 40% compared to its counterparts like China (25%) and Singapore (17%). Deteriorating education quality in India is also a major concern as it leads to lower quality and quantity of employability.

Prospects

To maintain India's service sector led growth story among developing countries, there is need for immediate steps to be taken in this prospect. Inflow in terms of FDI can be improved through further reforms in policy measures such as removal of restrictive conditions. Further there should be a single nodal agency for services sector consisting of different departments covering various services. Issue related to infrastructure should also be taken care of through allowing private sector participation. It can also be in the form of public-private partnership. The need of stable government working as a facilitator in various issues like proper infrastructure planning in terms of both existing and new, reforms in terms of policy issues and tax structure, quality of education through setting standards is the need of the country to achieve its goal in both quantitative as well as qualitative form.

Conclusion

In this paper it has been examined that Service Sector is the major contributor to Indian GDP as services GDP is always at a high level than overall GDP of the country. Also service sector is at the top in attracting FDI. The relationship between FDI inflows and GDP growth in service sector has been measured through correlation and regression analysis. The result shows that there is a positive relationship between them and FDI inflows positively impact GDP growth in service

sector. The study also talks about the hurdles faced by the country in attracting the desired level of FDI and the prospective measures in that regard.

The study finally concludes that the Service sector FDI inflows in India have witnessed astounding growth over the period leading to a positive impact over the GDP growth of the country. The service sector is the fastest growing sector in India and to maintain its sustainable impact over the GDP there is need for remedial measures to be taken in the light of problems coming in its way of desired FDI. As the FDI inflow in Indian economy is maximum for service sector, there is need for strategic FDI policy in this regard. The policy should be framed keeping in view the concept of inclusive growth so that productivity and efficiency in both qualitative and quantitative terms can be achieved.

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