

# Foreign Investment in Service Sector During Post Reform Period

## Abstract

FDI is a tool for economic growth through its strengthening of domestic capital, productivity and employment. FDI also plays a vital role in the up gradation of technology, skills and managerial capabilities in various sectors of the economy. The present paper attempts to analyze significance of the FDI Inflows in Indian service sector since 1991 and relating the growth of service sector FDI in generation of employment in terms of skilled and unskilled.

**Keywords:** FDI, Service Sector, Employment

## Introduction

Foreign direct investment has a major role to play in the economic development of the host country. Over the years, foreign direct investment has helped the economies of the host countries to obtain a launching pad from where they can make further improvements. This trend has manifested itself in the last twenty years. Any form of foreign direct investment pumps in a lot of capital knowledge and technological resources into the economy of a country. It has been observed that the economically developing as well as underdeveloped countries depends upon economically developed countries for financial assistance that would help them to achieve some amount of economic stability.

The entire world economy has been experiencing dramatic and momentous change during the decade of last eighties and nineties. In the recent past, never the less economic reforms have been a widespread as today. Various countries of the world are now favoring economic reforms because it promises more rapid and more sustained economic growth. Economic growth is possible with the policy of globalization, privatization and liberalization.

## Defination of Foreign Direct Investment

Foreign direct investment, in its classical definition, is defined as a company from one country making a physical investment into building a factory in another country. The direct investment in building, machinery and equipment is in contrast with making a portfolio investment, which is considered as indirect investment. In recent years, given rapid growth and change in global investment patterns, the definition has broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investing firm's home country. As such, it may take any form, such as a direct acquisition of a foreign firm construction of a faculty, or investment in a joint venture or strategic alliance with a local firm with attendant input of technology. So in the last decade, FDI has come to play a major role in the inter-nationalization of business.

## Need for Foreign Capital for Developing Country Like India

1. Domestic capital is in adequate for purpose of economic growth, so it is necessary to invite foreign capital.
2. The underdeveloped countries like India have a very low level of technology as compared to advanced countries. But they posses a strong urge for industrialization to develop their economies. This raises the necessity for importing technology.
3. Foreign capital brings with them other scarce factors such as technology know-how, business experience etc. which are equally essential for economic development.
4. Underdeveloped countries are not able to take risk due to scarcity of resources. The foreign investors will take the risk of investment in the host countries are provided the much needed process of industrialization.
5. In underdeveloped economics like India, there is potential of savings but this will not take place at the initial stage. So in initial stage foreign capital helps in the spreading up of economic development.

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**Importance of the Study**

Foreign direct investment provide a major source of capital which brings with it up-to-date technology. It would be difficult to generate this capital through domestic savings and even if it were not, it would still be difficult to import the necessary technology from abroad, since the transfer of technology to firms with no previous experience of using it is difficult, risky and expensive. Over a long period of time FDI creates many externalities in the form of benefits available to the whole economy. These include transfers of general knowledge and of specific technologies in production and distribution, industrial upgrading, work experience for the labour force, the introduction of modern management, establishment of financial and trading networks and the upgrading of telecommunication services. So we can study in detail that how foreign direct investment helps in the development of a host country.

**Methodology**

To analyze the trend, growth and impact of foreign capital in Service sector, we have collected the data for the post liberalization period i.e. from 1991 to 2007 from various publication of Reserve Bank of India, Handbook of Industrial Statistics, Government of India, Economic Survey, various published and unpublished research work.

The percentage share in total investment exponential trend and growth rates has been calculated for the entire period.

The equation of the exponential trend is

$$Y=ab^x$$

Where a is Y- intercept and b slope of the curve at the origin of x.

In the logarithm form, the above equation is written as under:

$$\text{Log } Y = \text{Log } a + x \text{ Log } b$$

The annual rate of growth in case of exponential trend is obtained as:

$$R = \text{Antilog } (\text{log } b - 1) \times 100$$

**Foreign Direct Investment in Service Sector**

Over the past two decades, the service sector has expanded rapidly and has come to play an important role in national economics and in the international economy. Services account for large shares of production and employment in most economies around the world. The share of services in the world trade and investment has been increasing. The structure of FDI would wide have also shifted towards services. In the early 1970's service sector accounted for only one quarter of the world FDI stock. In 1990 this shares was less than one half and by 2003, it has risen to about 67 percent.

Now, service sector like telecommunication, IT enabled services, electricity, insurance, air transport is becoming prominent. The rise of services in the world trade and investment is due to growing preserve of transnational corporation, the technology progress especially in telecommunication and information technology and liberalization of many services sector activities (telecom, transport, finance etc). Advances in Information and Communication Technologies (ICTs) facilitate trade in service as they make it unnecessary for providers and users to be close to one another.

**Trend and Patterns of FDI Inflow in Indian Service Sector**

Table 1

FDI inflows in service sector (from 1991-2005) (Amount in Rs. Million)

Year	Tele-Communication	Consultancy Services	Financial & Non- financial	Hotel & Tourism	Trading	Total services
1991	0.0	0.0	0.3	0.0	0.0	0.3
1992	0.0	0.0	48.3	7.4	1.9	57.7
1993	16.6	0.0	1214.9	2.9	55.0	1289.4
1994	140.2	0.0	943.1	533.0	240.9	1857.1
1995	1274.5	0.0	11014.9	219.1	3320.1	15828.5
1996	7529.8	0.0	10106.9	444.3	650.7	18731.7
1997	11850.0	0.0	5411.4	1031.9	945.1	19238.4
1998	17410.2	5.8	7679.8	399.5	520.0	26015.3
1999	2155.6	214.2	4023.8	405.4	980.6	7779.5
2000	6855.4	209.0	1861.5	524.0	1239.8	10689.7
2001	42671.0	2922.9	8202.2	471.5	2204.4	56472.1
2002	9090.7	1003.0	15431.4	2237.9	1824.2	29587.2
2003	7272.6	2480.3	13904.0	2594.2	831.5	27082.6
2004	6087.84	11843.5	11455.83	1527.23	682.16	31596.56
2005	9639.13	1627.16	31445.14	2799.59	1257.67	46768.69
Total	121993.57	20305.86	122783.47	13197.92	14754.03	292994.85

Source: Dipp, Department of Industrial Policy and Promotion.

In this table foreign direct investment in the service sector during the period of 1991 to 2005 is shown. Service account for large of production and employment in most economies around the world. The services which are including in this sector are Tele- Communication, Consultancy Services, Financial and Non- Financial, Hotel and tourism and Trading.

The total foreign direct investment inflow into services sector is Rs. 292994.75 million. The inflow of FDI was maximum in financial and non-financial services, accounting for 9.71 percent share out of total FDI inflows. This includes the services of banking and insurance companies. Telecommunication sector receives 9.53 percent share out of total FDI inflows. Tele density in India has increased from low of 4 per 1000 person in 1986 to 45 per 1000 person in 2002.

Consultancy services also receive a huge amount of FDI capital after 1997. In Hospitality industry 100 percent FDI is permissible on the automatic route. Out of total FDI inflow into services sector Hotel and Tourism industry receives 4.50 percent share which is least out of the five services studied. Trading Service receive FDI inflow upto 5.04 percent of the total inflow into services sector.

**Exponential Trend of Foreign Direct Investment in Service Sector**

**Table 2**  
**Exponential Trend of FDI inflow in Service Sector**  
**(From 1991- 2005)**  
**(Amount in Rs. Million)**

Year	Foreign Direct Investment	Exponential Growth
1991	0.3	163.8
1992	57.7	270.5
1993	1289.4	446.9
1994	1857.1	738.2
1995	15828.5	1220
1996	18731.7	2015
1997	19238.4	3329
1998	26015.3	5498
1999	7779.5	9082
2000	10689.7	15010
2001	56472.1	24780
2002	29587.2	40950
2003	27082.6	67640
2004	31596.56	111800
2005	46768.69	184600

Source: Dipp, Department of Industrial Policy and Promotion.

**Note:** Exponential Growth:  $\log Y = 3.74022 + 0.218x$   
Annual Growth rate:  $r = (\text{Antilog } b - 1) \times 100$   
For Services sector = 16.52%

Exponential trend and annual growth rate for the services sector is calculated. In the initial stage of economic reform the FDI inflow was very low i.e. 0.3 million. The exponential trend during the whole period was upward sloping. The annual growth rate for the services sector is 16.52 percent which is more than the growth rate of foreign direct investment.

**Conclusion**

In short, we conclude from our study that the FDI helps Indian economy to reach in the orbit of high rate of economic growth. After liberalization, the inflow of FDI is continuously increasing which helps a lot in the development of economy. The inflow of FDI was at the rate of 13.18 percent per annum respectively. FDI in the form of technological know-how, skilled man power promote development of the economy.

The question which will always remain in mind is that whether FDI is good for the third world countries like India? What is the purpose of investment made by the Donor country towards recipient country? Whether FDI should be welcomed or not? If it should be welcomed than in which sector.

**Suggestions**

1. FDI has come mainly to the capital- intensive sector, so the employment opportunities have been created only for skilled laborers, but the desired employment opportunities could not be created for manual and semi skilled labour.

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2. FDI is shying away from the important sectors and regions where it is directly needed. So policy makers make efforts to encourage investors to invest in these sectors and regions.
3. The inflow of FDI into agriculture sector was very low, so government should make efforts to encourage investors to invest in this sector.

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