Journal of Advances and Scholarly Researches in Allied Education
Vol. 16, Issue No. 2, February-2019, ISSN 2230-7540

Sector-Wise Analysis of FDI Inflows in India

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Abstract – As global capital flows expanded manifold and into different sectors, India's approach towards FDI too changed ever since independence, the initial approach overwhelmingly reflecting hostility following the experience with the colonial rule. From being assigned the role of supplementing and strengthening the domestic private sector, FDI was given greater freedom and a role of its own to contribute to India's development process along with gradual liberalization of India's economic policies which started in the 1980s.130 The New Industrial Policy, 1991, accelerated the process of liberalization, while Government would continue to follow the policy of self-reliance, there would be greater emphasis placed on building up our ability to pay for imports through own foreign exchange earnings. The government was welcome foreign investment which was in the interest of the country's industrial development

Keywords: Services Sector, FDI Inflows

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INTRODUCTION

Factors Determining Sector- Wise FDI Inflows in India

The following are the determining factors of sector wise FDI inflows in India.

Size of the Sector

Large sectors have bigger markets for their final products in the host country along with established input suppliers and skilled labour. This creates several external economies of scale (or industry size). These industries also belong to sectors in which the host country enjoys a comparative advantage. Among various industry–level characteristics, the size of the industry is a crucial factor for FDI inflow.

Growth of the Sector

Investment is made to receive future returns, and thus it is always expected that investors will invest into a sector where the possibility of doing business is much better than in other sectors. A growing sector can provide better scope and hence can attract investors. FDI will be more inclined to a growing sector.

Labour Intensity (Wage Share)

Intrinsic features of FDI indicate that FDI inflows are expected to be directed towards relatively capital-intensive industries for better exploitation of the specific ownership attributes (e.g., money capital, advanced know-how, managerial expertise and marketing skills.).

Export Orientation

Developing countries identify manufacturing exports as significant and positive determinants of FDI.

Import intensity & Import Technology

Industries with higher import-intensities indicate greater dependence on inputs like raw materials, stores, capital goods and know-how. More import-intensive industries attract more FDI because foreign firms have better access to imports through global production and marketing networks. In many LDCs, industries using advanced production techniques rely heavily on technological imports due to non-availability of quality indigenous import substitutes. FDI is expected to respond favourably to these industries due to the oligopolistic advantages enjoyed by foreign firms who possess advanced technology.

Profitability

Industries earning higher profits retain larger surpluses for future investment, these industries are to offer scope to foreign firms for higher remittances to home countries. FDI would flow into more profitable industries.

Advertisement Intensity

Advertisement intensity is a common feature for industries, where development of brand loyalties through market promotion assumes considerable significance. Product differentiations through innovations and their successful applications are typical attributes of multinational firms. To acquire meaningful ownership advantages of FDI, advertisement plays a significant role. FDI in India has a greater concentration in advertising-intensive industries.

MAJOR SECTOR-WISE ANALYSIS OF FDI INFLOWS IN INDIA

Before the introduction of economic reforms in the 1990's, FDI inflows were concentrated in the manufacturing activities in India, which was due to the import substituting industrialization programs that encouraged the tariff-jumping investments to capture the protected domestic market. However, the trends clearly changed towards an increase in FDI in the territory sector that encompassed mainly the services' activities.

Services Sector

The services sector is one of the largest and fastest-growing sectors in the global market. Over the past two decades, the services sector has expanded rapidly and has come to play an increasingly important role in national economy and in the international economy. Services accounts for large shares of production and employment in most economies around the world. The share of services in world trade and investment too has been increasing. The structure of FDI worldwide has also shifted towards services. In the early 1970s, services sector accounted for only one quarter of the world FDI inflows. In the year 1990 the share was less than one half and by 2013, it has risen to about 70 per cent. Its contribution to the Indian economy is particularly significant, with regard to employment potential and impact on national income. Services sector in India contributes to about 60 per cent of the country's Gross Domestic Product (GDP), 35 per cent of employment, a quarter of the total trade. Keeping in mind the rising services sector, India opens doors to foreign companies in the export-oriented services which could increase the demand of unskilled workers and low skilled services and also increase the wage level in these services. As many services are neither tradable nor storable, but must be produced where they are consumed FDI is the dominant means of delivering them to foreign markets. There is potential for positive spillovers to the host 189 economy, there by stimulating improvements in competing service firms as well as for customers and suppliers.

FDI Regulation in Service sector

India has opened up 100 per cent FDI under automatic route in the insurance sector subject to obtaining licence from Insurance Regulatory and Development Authority (IRDA). Foreign companies have been able to grab a 22 per cent market share in the life insurance segment and about 20 per cent in the general insurance segment. Economic liberalization has given a new impetus to the hospitality industry. 100 per cent FDI is permissible in this sector in the automatic route. Many foreign companies have already tied up with prominent Indian companies for setting up new hotels, and holiday resorts. Trading is permitted under automatic route with FDI up to 51 per cent provided it was primarily export activities. FDI up to 100 per cent is permitted in the trading sector for specified activities, like exports bulk imports with export/ex-bonded warehouse sales, cash and carry wholesales trading, other import of goods or services provide at least 75 per cent for procurement and sale of goods and services among the companies of the same group and not for third party use or onward transfer/ distribution /sales.

FDI Inflows in Services Sector

FDI inflows to service sector have been phenomenal in the past few years. Since the onset of the liberalization of the Indian economy in the year 1991, the country has experienced a huge increase in the inflow of FDI. The service sector in India has tremendous growth potential and as such it has attracted huge FDI inflows. It is important to analyses the Annual Growth Rate of FDI inflows in Service sector, Annual Share to the total FDI inflows in Service sector, trend values and the share of service sector in GDP to know the contribution of service sector to the Indian economy.

Sub-Sectors of Services Sectors

The FDI inflow to service sector has helped the development of several industries in the service sector of the Indian economy, such as Financial and Non financial services, Research & Development and Hotel & Tourism and the like. The following were the sub sectors of service sector:

Financial services

The services provided by the financial institutions in a financial system are known as financial services. The following are some of the examples of financial services.

- Leasing, credit card services and factoring,
- Portfolio management and financial consultancy services.
- Underwriting, discounting and rediscounting of bills.
- Acceptances, brokerage and stock holding.
- Depository services, housing finance and book building.
- Mutual fund management and Deposit insurance.
- Financial and performance guarantees.
- E-commerce and securitization of debts.
- Loan syndicating and credit rating.

Non-Financial services

Services provided by a company that do not include brokering, banking or anything related to investment industry which does not deal with financial or investment related goods or services are known as non-financial services. The following are the some of the examples of non-financial services.

- Wholesale trade, retail trade and Human health
- Repair of motor vehicles and motorcycles
- Accommodation, Transportation, social work activities and storage
- Information, communication, and food service activities
- Education, Real estate activities, Public administration and defence
- Professional, scientific and technical activities
- Administrative and support service activities
- Arts, entertainment and recreation
- Activities of households as employers
- Activities of extraterritorial organizations and bodies
- Other service activities

The sector wise shift of FDI in last two decade has shown a dramatic change. During the first decade of reforms started from August 1991 to December 1999, services sector in Indian economy was unable to attract the attentions of foreign investor and held third place after the transportation and electrical equipment, but second decade starting from January 2001 to March 2013, the emergence of the service sector has changed the composition of FDI in India. In the second decade of economic reforms this sector accounts 18 per cent of total FDI and holds first rank in attractive sector for foreign investor. This is due to the growth of sub sectors like IT, Financial Services and Insurance sector.

CONSTRUCTION SECTOR

India is on the verge of witnessing a sustained growth in infrastructure build up. The construction industry has been witness to a strong growth wave powered by large spending on housing, commercial premises, resorts, educational institutions, recreational facilities, city and regional level infrastructure, township, road, port, water supply, rail transport and airport development. The share of Construction sector as a percentage of the total GDP of the country has increased from 5.7 per cent in the year 2001 to around 8 per cent in the year 2013. The Planning Commission of India has proposed an investment of around US $ 1 trillion in the Twelfth five-year plan (2012-2017), which is double of that in the Eleventh five –year plan.

FDI Regulation in Construction Sector

FDI is permitted upto 100 per cent under automatic route for development of Townships, Infrastructure & Construction Development project like Housing, Commercial Premises, Hotels, Hospitals, Educational Institutions, and Recreational facilities. FDI is prohibited in Real Estate Business, Construction of Farm Houses, Trading in Transferable Development Rights (TDRs). However, the prohibition is not applicable to construction of a Farm House by an NRI for his personal use or for purchase of TDR to be used in construction for personal use.

Prerequisites for FDI inflows in Construction Activities in India

A minimum land area of 10 hectare for the development of services housing plots.

- A minimum built-up area of 50,000 square meters for construction development projects.
- Both the land requirements are applicable for combination of projects.

- The wholly owned subsidiaries would have a minimum capitalization of US $10 million.
- The Joint Venture companies which have Indian collaborations are entitled to US $5 million.
- The funds should be acquired within six months of commencement of the business of the company.
- A minimum of three years is given for repatriation of original investment amount.

FDI Inflows in Construction Sector

In the post-liberalization era, India attracts a quantum amount of FDI, especially after the liberalization of the construction sector. Construction sector is one of the major sectors and also it is one of the most booming sectors that have contributed leaps and bounds to the Indian industry. FDI inflows to construction activities have 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. FDI inflows will improve the quality of construction activities in India. It is important to analyses the Annual Growth Rate of FDI inflows in Services sector, Annual Share to the total FDI inflows in Construction sector, trend values and the share of Construction sector in GDP to know the contribution of Construction sector to the Indian economy.

Telecommunication Sector

The Indian telecommunication sector is one of the fastest growing sectors in the world. The sector is growing at a speed of 45 per cent during the recent years. Government policies and regulatory framework implemented by Telecom Regulatory Authority of India (TRAI) have provided comfortable environment for service providers.140 India has the second largest number of telephone subscribers in the world (among 222 countries), accounting to 12 per cent of the world's total telephone subscribers. The share of telecom services as a percentage of the total GDP of the country has increased from 0.96 in 2000-01 to 3.78 in 2009-10. Telecommunication sector has got the third rank for attracting FDI inflows in India. The telecom services have been recognized the world-over as an important tool for socio-economic development for a nation. It is one of the prime support services needed for rapid growth and modernization of various sectors of the economy. Indian telecommunication sector has undergone a major process of transformation through significant policy reforms, particularly beginning with the announcement of National Telecom Policy (NTP) 1994 and is subsequently re-emphasized and carried forward under NTP 1999. Driven by various policy initiatives, the Indian telecom sector has witnessed a complete transformation in the last decade. It has achieved a phenomenal growth during the last few years and is poised to take a big leap in the future also. The Indian Telecommunications network has with 1120 million connections as on 31 March 2013. Total wireless subscriber in March 2013 is 1019.17 million. Total broadband subscribers are 14.79 million at the end of March 2013. From 2000 to 2013, the total number of telephone subscribers had grown at a compound annual growth rate (CAGR) of 35 per cent. The comparable rates in the 1980s and 1990s were 9 per cent and 22 per cent, respectively. Overall tele-density has reached 76.86 per cent in December 2013. The sector was growing at a speed of 45 per cent during the recent years. This rapid growth is possible due to various proactive and positive decisions of the Government and contribution of both by the public and the private sectors. The rapid strides in the telecom sector have been facilitated by liberal policies of the Government that provides easy market access for telecom equipment and a fair regulatory framework for offering telecom services to the Indian consumers in affordable prices. Presently, all the telecom services have been opened for private participation. The Government of India has taken measures to ensure pro-active and positive policies to boost the FDI to telecommunications sector in India. Tremendous growth has taken place in this sector in recent years. A number of telecom service providers are working in both the private and public sectors. The two most crucial causes behind the huge success of the telecom sector are the growing demand for mobile phone services and private sector participation in the telecommunication industry. The private sector participation in the telecommunication sector in India increases at a rapid pace.

CONCLUSION

India ranks second most favoured destination for Foreign Investment after China. Factors determining FDI inflows in various sectors are size of the sector, growth of the sector, labour intensity, import intensity & import technology, profitability and the advertisement intensity. More than 135 countries are investing their investments in India in various sectors situated in various places. The top ten sectors that attracted FDI inflows are Services sector, Construction sector, Telecommunication sector, Computer Software and Hardware sector, Drugs and Pharmaceutical sector, Chemicals sector, Automobile sector, Power sector, Metallurgical sector and Petroleum and Natural Gas sector. The top ten sectors attracted high amount of FDI inflows from Mauritius, Singapore, UK, USA, Switzerland, Russia, Japan, Cyprus, the Bermudas, Netherlands, UAE, Italy and South Korea. Most favoured destination for FDI inflows are Mumbai, New Delhi, Bangalore, Ahmedabad, Hyderabad, Chennai, Kolkata, and Panaji.

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