

The Impact Of Foreign Direct Investment On Indian Economy Specific To Service Sector: A Systematic Literature Review

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Abstract

Purpose: This study aims to provide a systematic review of the existing literature on the impact of FDI on India's service sector. By synthesizing insights from prior studies, it identifies key trends, gaps, and implications of FDI in this crucial segment of the economy.

Methodology, design, and approach: The study uses the PRISMA 2020 which is a revised edition of the initial PRISMA statement, which was published in 2009. The studies were searched from the Scopus and Google Scholar directories using the appropriate keywords in the relevant subject areas. Initially, a total of 821 research articles were selected. Furthermore, after applying different exclusion criteria, for the study, a total of 28 research articles were finally considered.

Findings: Most of the studies indicate that foreign direct investment in the service sector positively affects the growth of the Indian economy.

Implications: The findings offer valuable perspectives for policymakers, investors, and academics in understanding the dynamic interplay between FDI and the Indian service sector.

Keywords: foreign direct investment, GDP, Indian economy, service sector, systematic literature review.

Introduction

For emerging nations like India, foreign direct investment (FDI) is often seen as a key factor in economic progress. Large FDI capital inflows enable infrastructure strengthening, productivity growth, and the creation of new job opportunities in India. Foreign investment helps to supplement domestic savings and overcome domestic constraints. It also contributes to creating a competitive business environment that leads to success through higher economic efficiency and superior product and service quality (Chandran, 2010).

India stands out among rapidly rising nations due to the importance of the service sector. In contrast to several countries which expanded their economy by exporting labor-intensive manufactured items, India has relied more on services. India stands out for the vibrancy of its service sector, even if there are other growing nations where services account for a larger portion of GDP than manufacturing (Panagariya 2008). The Indian service industry is recognized as one of the important sectors in the country's Gross Domestic Product (GDP) since it has drawn a substantial amount of foreign investment, played a critical role in driving employment levels, and contributed to the bulk of India's exports. Foreign direct investment has aided in the stimulation of domestic investment, the development of human capital, and the transfer

of technology in the service sector (Bhushan and Mittal, 2015).

This paper seeks to provide a systematic review of the existing literature on the impact of FDI on India's service sector. By synthesizing insights from prior studies, it aims to identify key trends, gaps, and implications of FDI in this crucial segment of the economy. The findings are expected to offer valuable perspectives for policymakers, investors, and academics in understanding the dynamic interplay between FDI and the Indian service sector.

The following three research questions will be investigated during the analysis.

- Research Question 1: What are the major trends regarding the studies on FDI inflows into India's service sector over the past few decades?
- Research Question 2: How has FDI impacted the economic growth and performance of specific industries within the service sector in India?
- Research Question 3: What are the potential areas that could be addressed in future investigations?
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Methodology

The study aims to retrieve and review the papers that address the impact of FDI on the Indian economy in the service sector. The study uses the PRISMA 2020 which is a revised edition of the initial PRISMA statement, which was published in 2009. the standardized framework of Systematic reviews and meta-analyses seeks to improve research reporting's accuracy, completeness, and transparency. The rigorously established and evidence-based PRISMA (Preferred Publishing Items for Systematic Reviews and Meta-Analyses) guideline describes the crucial components that must be present when publishing systematic reviews and meta-analyses.

We have searched in Scopus and Google Scholar for pertinent research publications in the fields of economics, econometrics, finance, business, management, and accounting that were published between January 2000 and April 2024 for the study. The keywords used for the search were Foreign Direct Investment, GDP, Indian economy AND service sector, foreign investment, FDI, AND Indian service sector. The eligible articles were analyzed in detail regarding the impact of FDI on the Indian economy, specific to the service sector. (as shown in fig. 1)

Figure: 1

| Search filters Description | Data |
|----------------------------|---|
| Search date | May 07, 2024 |
| Keywords | FDI or Foreign Direct Investment, GDP, Indian Economy, and Service sector |
| Language | English |
| Material type | Article and review |
| Concentration areas | Economics or business or business finance or management. |
| Search period | From January 2000 to April 2024 |
| Initial sample | 821 |

| Year | No.of Publication Published |
|------|-----------------------------|
| 2000 | 0 |
| 2001 | 0 |
| 2002 | 0 |
| 2003 | 2 |
| 2004 | 0 |
| 2005 | 2 |
| 2006 | 2 |
| 2007 | 3 |
| 2008 | 1 |
| 2009 | 1 |
| 2010 | 0 |
| 2011 | 1 |
| 2012 | 1 |
| 2013 | 0 |
| 2014 | 2 |
| 2015 | 3 |
| 2016 | 1 |
| 2017 | 1 |
| 2018 | 1 |
| 2019 | 4 |
| 2020 | 1 |
| 2021 | 1 |
| 2022 | 1 |
| 2023 | 0 |
| 2024 | 0 |

Table 2: Year-wise publications

As shown in Table 2, a total of 28 research papers were selected for the study from the years 2000 to 2024. The years 2007 and 2019 had the highest number of publications, with four research papers released each year. The most recent study chosen for analysis was conducted in 2022 by Faniband et al.

| Title | year | Citation |
|--|------|----------|
| Government policies and foreign direct investment inflows: Evidence from infrastructure sector in India | 2022 | 2 |
| The role of FDI's in the service sector in India | 2021 | 0 |
| Multinational enterprise's motivational factors in capitalizing emerging market opportunities and preparedness of India | 2020 | 5 |
| The Influence of FDI with GDP its impact of FDI in the civil aviation sector in India | 2019 | 0 |
| Foreign direct investment (FDI) and its impact on hotel and tourism services in India | 2019 | 0 |
| Sectoral contribution of FDI in India (With special reference to automobile, telecommunication, services, and computer software sectors) | 2019 | 0 |
| The progress and achievement of the top five services sectors through foreign direct investments in India | 2019 | 0 |
| India's services: sector, trade and employment | 2018 | 12 |
| An empirical investigation of causal linkage between sectoral reforms, FDI and growth: Evidence from India | 2017 | 1 |
| Foreign direct investments, global competitiveness, and tourism in India | 2016 | 1 |
| Foreign direct investment and economic growth: Empirical evidence from India | 2015 | 3 |
| Determinants of Exports of Information Technology in India: An Empirical Analysis | 2015 | 21 |
| The global recession and its impact on the telecommunication industry: An empirical dissection | 2015 | 1 |
| A macroeconomic approach to foreign investment flows in India | 2014 | 7 |
| Growth of the Service Sector in India | 2014 | 4 |
| A review of performance and contributions of Indian service sectors towards sustainable economic development | 2012 | 0 |
| FDI in the Service Sector–Propagator of Growth for India? | 2011 | 36 |
| FDI in India and its economic effects on service industry | 2009 | 9 |
| Attracting Foreign Direct Investment (FDI) to India | 2008 | 37 |
| Foreign direct investment in India with a special focus on retail trade | 2007 | 14 |
| FDI in Retail | 2007 | 0 |
| India's economic growth and the role of foreign direct investment | 2007 | 9 |
| Services-led industrialization in India: Assessment and lessons | 2006 | 110 |
| Services reform and manufacturing performance: Evidence from India | 2006 | 673 |
| Critical issues in India's service-led growth | 2005 | 246 |
| FDI in the retail sector, in India | 2005 | 164 |
| Rise of service sector outward foreign direct investment from Indian economy: trends, patterns, and determinants | 2003 | 28 |
| Foreign direct investment and growth: Does the sector matter | 2003 | 1237 |

Table 3: Citations

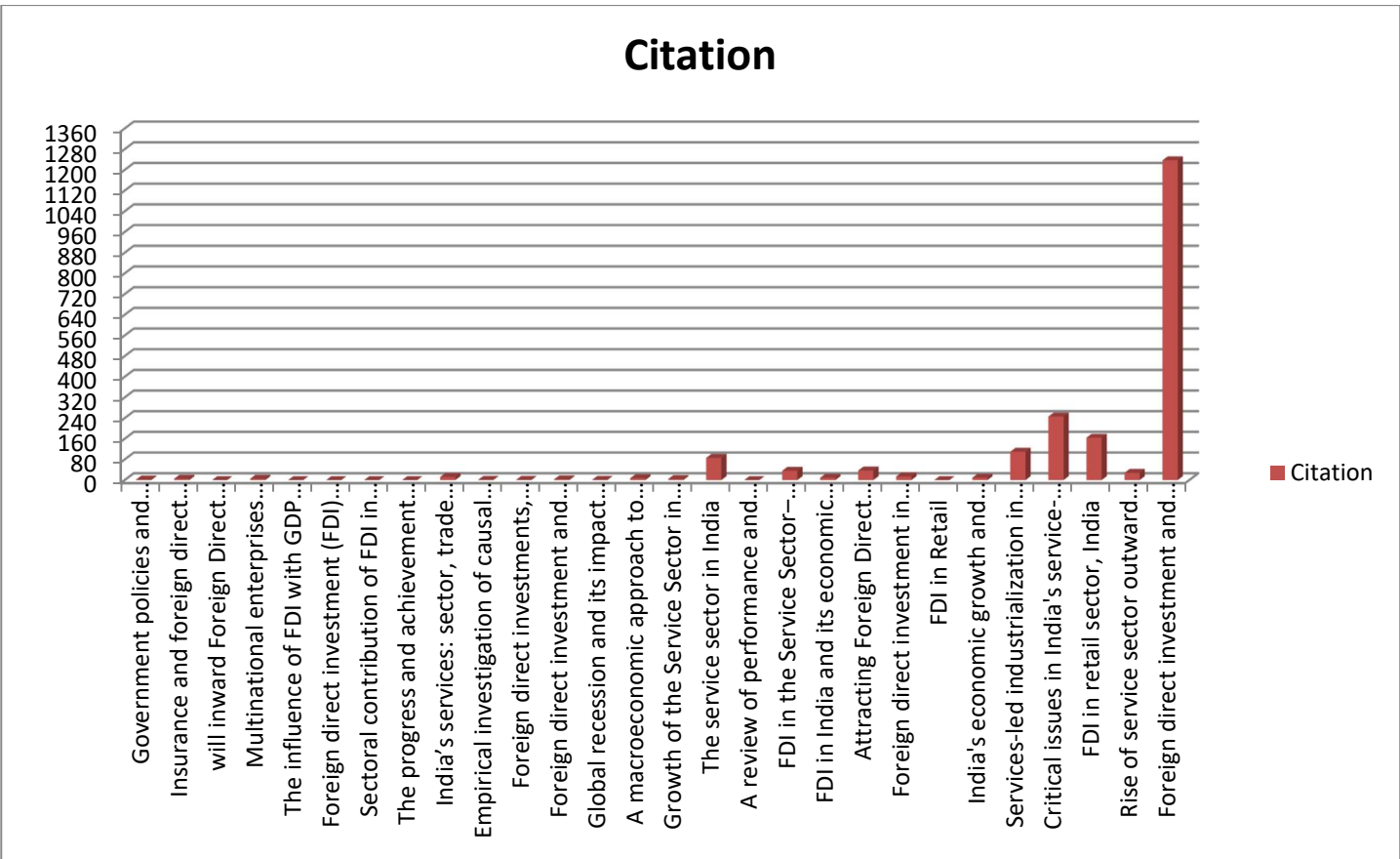


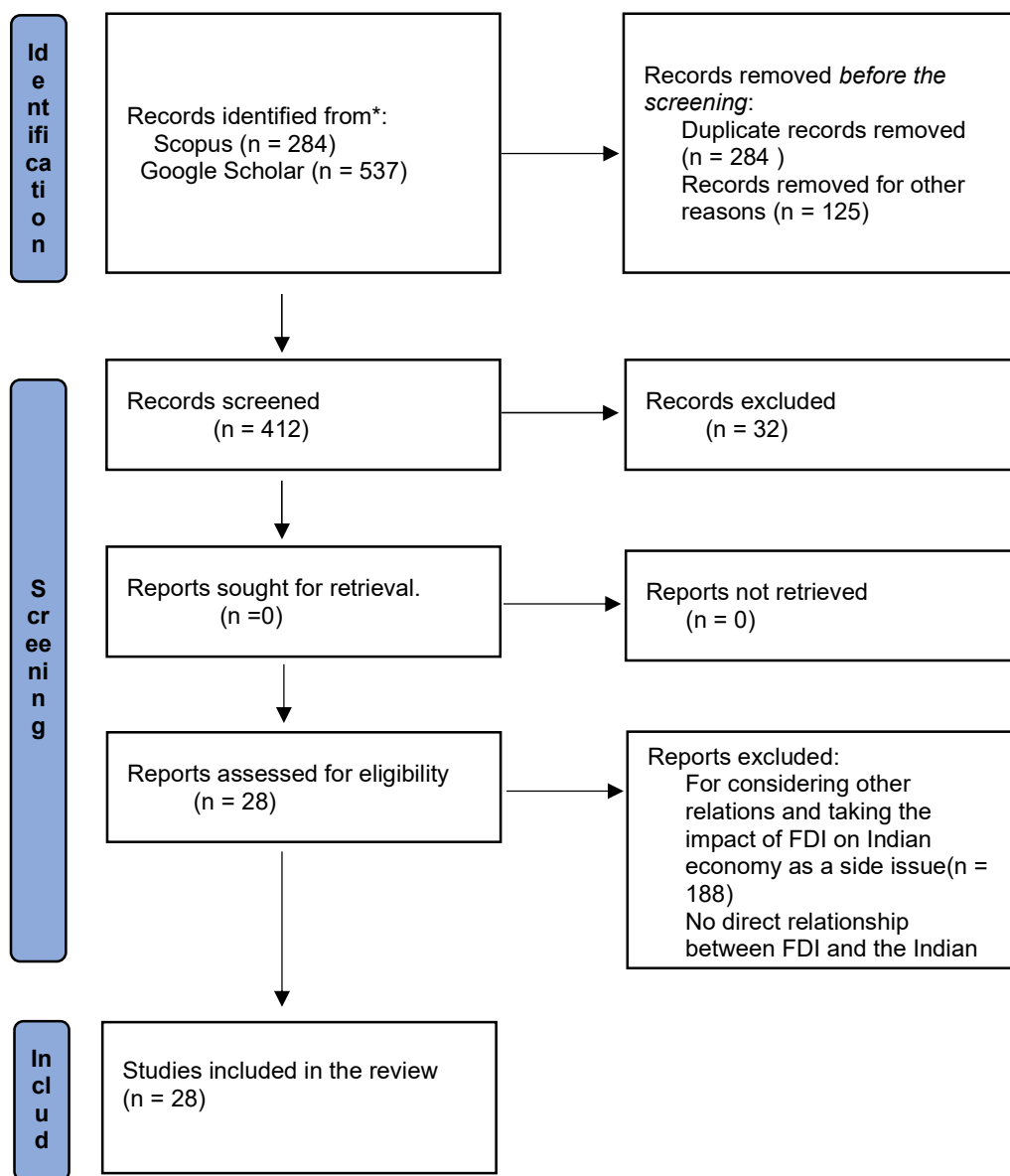
Fig.2 Citations

As shown in Table 3 the paper titled "Foreign direct investment and growth: Does the sector matter" authored by Alfaro,(2003)has the maximum number of citations followed by "Critical issues in India's service-led growth" authored by Banga,(2005) being the second most cited publication chosen for study.

Inclusion and Exclusion Criteria

The literature was searched from the Scopus and Google Scholar directories using the keywords foreign direct investment, GDP, Indian economy AND service sector, foreign investment, FDI, AND Indian service sector, the literature published from January 2000 to April 2024 in the subject areas of Economics, Econometrics, Finance, Business, Management, and Accounting, a total of 821 research articles were selected. Furthermore, the studies that were repeated or duplicated (98studies); the research articles that didn't include India as the primary study (248); and the studies that indirectly presented the FDI and Indian economy and Indian service sector relationships (241), were excluded from the study. For the study, a total of 28 research articles were considered.

Identification of studies via databases and registers



Discussion

For the discussion, the research papers have been classified based on sector-specific data. Most of the articles focus on various subsectors within the service industry, while others examine the industry as a whole or specific parts of it. Moreover, the research paper's findings were also taken into consideration.

Role of FDI in Hotel & Tourism Industry

Singh and Singh (2016) in their paper stated that India has emerged as the third-largest economy in the world based on purchasing power parity. However, it is currently experiencing fluctuations in its global competitiveness rankings. Following the implementation of new economic policies in 1991, the government is increasingly attracting Foreign Direct Investment (FDI) flows to enhance its economic growth. Within the several sectors of the Indian economy, the Services sector stands out as the dominant one, with tourism playing an increasingly important role in contributing to the national GDP. The government is also attracting a significant portion of Foreign Direct Investment (FDI) for the tourism sector. According to Aravindaraj & Muthusamy (2019) when a nation's domestic capital is insufficient to spur

economic growth, foreign direct investment, or FDI, is required. For India to achieve economic growth and development, large inflows of foreign capital are necessary.

Role of FDI in the Indian Banking Sector

According to Arnold et al. (2016) foreign direct investment plays a vital role in the development of the Indian economy because it not only provides possibilities to improve financial health but also optimizes the country's earnings by utilizing all resources effectively and efficiently. The country's financial sector is always regarded as critical to total economic growth and development, with the banking industry being the most significant of all. Since the country's economic reforms in 1991, India's banking sector has come a long way. Foreign direct investment has a substantial impact on the development and growth of the Indian banking sector since it delivers benefits such as increased risk management, employment, new products, financial stability, and technology transfer.

Role of FDI in the Indian Retail Sector

Fatima & Jafri (2007) compared the retail industry of India with other developing and developed economies, it is extremely fragmented. The majority of retail in India is done by hawkers, vendors, owner-manned general stores, small local shops, and so on. Furthermore, they found that by outsourcing supplies domestically, foreign direct investment (FDI) in the retail trade has improved food processors and wholesalers, increased exports, and spurred growth. Nandi & Sahu (2007) highlighted how important FDI is to India. In an attempt to emphasize that FDI in the retail sector must be permitted, it makes the case that FDI is permitted in several sectors and that the impacts have been positive without negatively impacting the local economy. A 100 percent FDI is needed to boost the Indian GDP with a more lenient economy policy for FDI entry into the Indian retail sector.

Role of FDI in the Indian Aviation Sector

Muthusamy & Kalpana (2019) stated that foreign direct investment (FDI) is crucial for fostering collaboration among all stakeholders and partners to optimize the advantages of air transport and promote the sustainable expansion of aviation by facilitating increased connectivity between individuals and destinations. The aviation industry has experienced ongoing growth and expansion. Despite facing various crises, it has demonstrated long-term durability and has become an essential mode of transportation. In the past, the aviation sector has grown at a faster rate than most other industries, doubling in size every 15 years. Regression, descriptive analysis, and trend analysis were among the statistical tools used by the researcher.

Role of FDI in Indian IT sector

Gupta et al. (2015) in their paper stated that the IT sector has made a substantial contribution to India's economic growth and is one of the rapidly expanding sectors focused on exporting goods and services. The study evaluates the factors that influence the export performance of Indian IT companies between 2000 and 2012, utilizing data at the company level. The research paper utilizes conventional panel data regression to determine the impact of world demand and real effective exchange rate on business exports. The results indicate that these variables have the expected indications. Foreign capital, despite its significant role in the development of the IT sector in India, has a negative coefficient. This indicates a substitution relationship between exports and domestic wants. The dynamic panel data regression demonstrates the presence of export persistence, which serves as a moderating effect on demand variations and has a significant influence. Moreover, the dynamic panel estimations unequivocally demonstrate that past exports have a significant impact on the growth of India's gross domestic product (GDP). This implies that the level of world demand, when adjusted relative to India's GDP, has no significant effect on its future exports.

Overall Impact of FDI on the Indian Service Sector

The majority of India's GDP comes from the services sector, which has increased exports, created a large number of jobs, and attracted substantial international investment. Trade, lodging and dining establishments, construction, commercial, social, and personal services, as well as storage, communication, finance, insurance, and real estate, are all included in India's services sector.

Feng, (2009) investigated the connection between the Indian service sector and FDI inflows. Applying time series data on foreign direct investment (FDI) inflows, exports, and outputs in the service sector based on aggregated data available for 1991–2007, co-integration, Vector Auto-Regression (VAR), and causality analyses are conducted. Even if the performance of service exports and outputs does not appear to be considerably impacted by FDI input, the empirical data demonstrate that FDI and service exports and outputs in India have long-term co-integrating links. There is also no proof that FDI intake and service exports and outputs in the service sector are causally related over the long run, and the association between FDI and service output is also weak.

According to Sen, (2011) over the past twenty years, the Indian service industry has experienced an unparalleled expansion. The study examines the mechanics of growth and determines whether the increase in foreign direct investment (FDI) has a substantial effect on the expansion of the service sector. Additionally, it examines the correlation between the expansion of this industry and the increase in GDP. The study findings indicate that foreign direct investment (FDI) has had a substantial and beneficial influence on the services sector. Furthermore, this increase in the services sector has had a notable impact on the gross domestic product (GDP). The study also looks at the dynamics of several subsectors and concludes that the subsectors that have the biggest effects on the growth of the Indian service sector are trade, lodging and dining, transportation, storage, and communications. Therefore, by favorably influencing the growth of the services sector, foreign direct investment (FDI) can successfully operate as a stimulant for economic growth.

Chandrakumarmangalam and Govindasamy (2012) stated, that India is notable for the large-scale and vibrant nature of its services sector. The services sector has made significant contributions to the Indian economy in various ways. It accounts for 55.2% of the gross domestic product (GDP) and has been growing at a rate of 10% per year. Additionally, it employs approximately 25% of the workforce and attracts a large share of foreign direct investment (FDI). Furthermore, the services sector contributes to over one-third of total exports.

Chawla and Sharma (2014) claimed that the Indian economy, which is a growing economy and a desirable place for global investment, has seen growth swings since it was liberalized in 1991. India has seen a steady increase in foreign investment between 1990–1991 and 2010–2011. According to research, the services sector in India has benefited most from foreign direct investment (FDI). The flow of FDI and FLLs in India is influenced by several macroeconomic factors, including GDP, inflation, money supply, IIP, WPI, exchange rate, balance of trade, and others. To determine a relationship between macroeconomic parameters and the amount of foreign investment in India, the study carefully examines previous studies.

Sutradhar, (2014) stated that the service industry has a higher global proportion of FDI. The service sector is where India, a significant player in this circle, draws the majority of its foreign direct investment. After liberalization is put into effect. FDI is becoming more significant in emerging nations. FDI flows have multiplied sixfold, especially in emerging nations, according to World Bank data. A comparatively steady GDP growth rate in recent years has contributed significantly to India's justified high level of domestic investment, which in turn has increased foreign direct investment inflows.

SubbaReddy, (2021) in her paper, stated that the FDI plays an important role in a country's economic development for the sample she took fourteen years of data on FDI inflows in the Indian market from 2006 to 2020 and found out that Gross Domestic Product (GDP) is positively and significantly impacted by Foreign Direct Investment. Moreover, she found out that the Foreign Direct Investment (FDI) inflows into the service sector are exhibiting a consistent upward

trend, which indicates that FDI inflows are increasing. However, it has also been demonstrated that the ratio of investments in the service sector is displaying a downward trend when compared to the years 2006-2008.

Role of FDI in multiple sectors of Service Industry

Alfaro, (2003) the study looks at how foreign direct investment (FDI) affects growth in the manufacturing, services, and primary sectors. Based on cross-country data from 1981 to 1999, the analysis shows that there are wide variations in how FDI affects growth. Although the overall effect of foreign direct investment (FDI) on growth is ambiguous, manufacturing investments often have a positive impact whereas primary sector investments typically have a negative one. There is conflicting evidence about the service industry.

Sutradhar, (2014) claimed that in the current globalized economy, the service sector receives the majority of foreign direct investment (FDI), with India being a participant in this phenomenon. Furthermore, the service sector attracts the majority of its foreign direct investment (FDI). The study focuses on the global and Indian patterns of foreign direct investment (FDI) flow. It also looks at India's foreign direct investment (FDI) policy throughout the post-liberalization era. The rise in foreign direct investment (FDI) in the services sector can be attributed to both India's liberalization and globalization policies as well as changing worldwide FDI trends. Many industries, including financial and non-financial services, telecommunications, computer software and hardware, hotels and tourism, construction, and real estate, have expanded as a result of the notable increase in foreign direct investment (FDI) since 2000.

Bhushan et al. (2015) explain that the Indian service sector is one of the main drivers of the country's GDP, has been drawing large inflows of foreign investment, has been instrumental in raising employment levels, and has been responsible for the majority of India's exports. In the service industry, foreign direct investment has significantly boosted technology transfer, enhanced human capital formation, and stimulated local investment. In addition, the Indian service industry has expanded quickly in recent years, and its components include telecommunications, financial services, IT-based services, and community services.

As per Gupta & Pillai (2017) It has been frequently observed that FDI affects a nation's economic growth. Several Indian sectors have had an uneven inflow of foreign direct investment (FDI). The study makes an effort to evaluate the effects of foreign direct investment (FDI) on the economic expansion of various industries.

Maiti, (2018) provided a comprehensive analysis of India's service sector, including many areas of services and the associated opportunities or problems. In its first phase, the study looks at several different aspects of India's services sector, such as GDP, the contributions of individual states and union territories, FDI, exports, employment, inflation, and the overall performance of the service industry. The performance of India's services sector is then contrasted with the GDP of the top 15 nations worldwide.

As per Gautamet. al. (2015) the recession has had a detrimental impact on India's exports of software, IT services, and service industries. To combat this crisis, the Government of India responded by implementing public expenditure and investment strategies to address the economic downturn. The Indian government is injecting liquidity into the system through the implementation of monetary policy and the utilization of effective fiscal policy. India has experienced a resurgence in strong economic growth. However, this growth should not be driven by a new speculative bubble, but rather by increased government spending that directly enhances the quality of life for the population.

As per Prasad & Williams(2019) "The Indian government is prioritizing the attraction of Foreign Direct Investment (FDI) over Foreign Institutional Investment (FII)." Foreign Direct Investment (FDI) has been a major contributor to the Indian economy since the liberalization, bringing with it technological advancements, best practices in firm management, and increased efficiency in addition to wealth to the host nation.

Faniband et al. (2022) concentrate on how government policies affect foreign direct investment in India's infrastructure industry. The impact of foreign direct investment policies on various sub-industries was determined by using data on yearly foreign direct investment inflows from a variety of infrastructure-related sectors, including telecommunications,

railroads, land transportation, construction, ports, and natural gas.

FDI and the Indian Economy

Foreign direct investment (FDI) is the most efficient means of transferring technology and cash from other economies, particularly industrialized ones, to developing nations like India. In exchange, these economies think that India has a lot of space to expand. In their article analyzing the Impact of FDI on the Economic Growth of Postcommunist Transition Economies, Thomas, (2016) concluded that FDI has a large and positive impact on the economic growth of host countries. According to the study, foreign direct investment has a positive correlation with a region's growth rate. The findings demonstrate that robust financial and institutional sectors play a major role in both GDP growth and inflows of foreign direct investment.

Nonetheless, divergent theoretical viewpoints and empirical results have surfaced regarding the relationship between foreign direct investment (FDI) and economic growth. The modernization theory posits that FDI fosters economic growth through increases in capital accumulation, job opportunities, total factor productivity, domestic competition, and resource allocation (Arisoy, 2012; Ali & Asgher, 2016).

Mohanasundaram & Karthikeyan (2015) in their paper stated that foreign direct investment (FDI) inflows are widely recognized as a crucial determinant of economic growth. India, being a rapidly growing economy, has garnered significant foreign direct investment (FDI) in recent times. Countries that experience stronger economic growth are more likely to attract larger foreign direct investment (FDI) due to their capacity to provide higher returns on foreign investments. The study examines the correlation between foreign direct investment (FDI) inflows into the country and economic development from January 2000 to December 2014.

Pagavathi & Prabhakar (2019) stated that Foreign Direct Investment (FDI) is crucial for national growth. It is crucial in the context of poor and developing nations. A common attribute of developing and undeveloped economies is their insufficient savings and revenue to support the necessary investment for sustaining economic growth. Foreign direct investment is crucial in filling the disparity between the existing and necessary resources or finances in these situations. Foreign direct investment (FDI) is crucial for a country's long-term growth, serving as both a capital source and a means to improve the competitiveness of the domestic economy. FDI achieves this by facilitating the transfer of technology, bolstering infrastructure, increasing productivity, and creating new job possibilities. FDI is regarded as a means of development in India, aiding in the attainment of self-sufficiency across different sectors and contributing to the overall growth of the economy.

Bhattacharya, (2020) emphasizes India's implementation of a reform-oriented foreign direct investment policy to attract foreign capital. The study uses a descriptive analysis that relies on secondary data obtained from various reports published by the Indian Government and the Central Bank of India. It was observed that the Indian economy has experienced significant and extensive liberalization, implementing comprehensive changes in various sectors, while also embracing internationalization policies to support the expansion of domestic enterprises into the global market. Nevertheless, India must revise its current labor and land regulations, in addition to ensuring the availability of a skilled and capable workforce. India requires a transition towards a cashless economy, which will eventually lead to the establishment of a digitized credit system. This will enhance India's appeal to global investors.

Conclusion

With a focus on the service sector, the current study aims to examine, condense, and synthesize the body of research on the direct relationship between FDI and the Indian economy. The study examines the effects of foreign direct investment

(FDI) on the Indian economy specifically in the service sector. We included 28 publications in the study after using a methodical approach to choose pertinent literature. Except for one study that showed a negative impact, all indicators suggest that FDI inflows into India's service sector are having a positive impact. The service industry in India has grown significantly and is currently one of the main drivers of employment and GDP in the country.

The theoretical intuitions were mostly validated by the empirical data. The papers selected for the current study demonstrate the most important and favorable links. In particular, a collection of research found that the Indian economy is significantly impacted by foreign direct investment. These studies indicate that countries with an open market and skilled workers are more attractive to overseas investors. Foreign investments are more likely to go to nations with weak institutions, immature financial systems, and a history of original sin, according to a small number of research that established a negative link in this connection.

However, a different set of research correctly determined how FDI inflows affect a nation's economic growth. Others found causal relationships between growth and FDI that were either one-way or two-way.

In summary, the Indian economy is significantly impacted by FDI. Once the Indian market, especially the service sector, has sufficiently matured, more foreign direct investment (FDI) is anticipated to join the Indian service market. Additionally, FDIs will support the growth of the Indian service industry. Therefore, FDI can increase the dominance of the Indian service sector, which can significantly boost the economic development rate of the Indian market.

Therefore, we advise policymakers to modify and create policies that increase the nation's attractiveness to foreign investors, like enhancing institutional quality and changing taxation laws. Additionally, India's banking and financial industries, as well as the information technology sector, have been the primary focus of the majority of research articles in the service sector. To completely grasp their potential and assess them in light of governmental regulations, it is crucial to also study the other service industry sectors. Future research has a lot of promise in the areas of trade, lodging and dining, transit, storage, communication, business services, community, social and personal services, and construction services.

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