

# The Service Sector as India's Road to Economic Growth : An Analysis

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## Abstract

Services are tasks or functions, which are performed by a group or an individual, for which price is decided on the basis of demand if that particular service is available in the related market. Services are sometimes referred to as intangible goods. The consumption is done only at the point of production. Services are typically non-transferable that means they cannot be resold or purchased at a different price. In an economy the service sector perform a vital role in the resource allocation process. The service industry is not only the World's largest industry, but also contributes major portion in GDP. It generates three times more employment in comparison to the manufacturing sector. The contribution of the service industry to the GDP of countries like India is over 56.1% in 2015-16.

The service sector is not only the star performer in terms of employment generation, but has also attracted significant export growth, foreign direct investment flow, employment generation and portrayed itself for sustainable economic development. As per the report of Department of Industrial Policy and Promotion (DIPP) India's service sector has shown a remarkable presence to attract the maximum amount of FDI equity inflow during the period of April 2000 -December 2016, amounting to about US\$ 58.34 billion, which is about 18% of the total foreign inflow. In addition to this more than 50% of total export of services comes from export of software services in India. On the basis of this rapid growth in service sector growth rate will going to be more than 60 percent in the next fifteen years in India. After China, India has got the second position as the fastest growing service providing country in the world.

The present study is all about the analysis of the potential and capability of the service sector in the economic growth of the country over the last couple of decades. The main objective of this study is to see the correlation between the growth in the Indian service sector along with growth in the economy in terms of growth in GDP, per capita income and foreign investment.

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## Introduction

"Services are any tasks or functions, which is performed by a group or an individual, for which price is decided on the basis of demand if that particular service is available in the related market. Services are sometimes referred to as intangible goods. The consumption is done only at the point of production, services are typically non-transferable that means it cannot be resold or purchased on a different price. Service sector has a huge potential in a country like India.

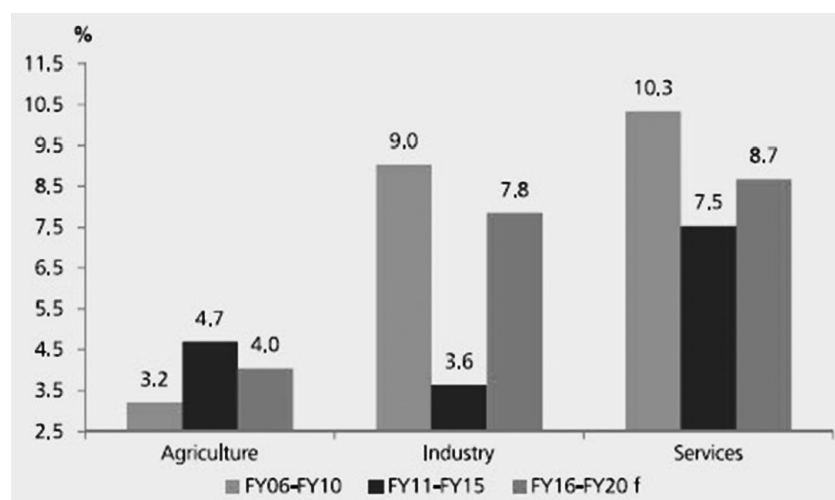
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According to Reserve Bank of India (RBI) along with World Trade Organization (WTO) there are 'N' number of service exist in the service sector and some of the major contributors are restaurant and hotel, communication, trade, transport, , storage, real estate, insurance, financing and business services along with construction services.

In utmost developed countries of the world, the services sector is contributing the major portion of its GDP and generates 3 times more employment than the manufacturing sector. In recent years, services sector experienced a rapid shift in generating both income and employment. Thus it has been observed that the service sector has become a major player in almost all the countries of the world.



**Growth in Industry and Service sector to resurge**

## Overview of Service sector in India

### Contribution of Gross Domestic Product:

The contribution of total services sector excluding construction in India's Gross Domestic Product (at constant prices), increased from 28.5 % in FY 1950-51 to 51.3 % in the FY 2013-14. But the share of total services sector, apart from construction, to India's GDP at factor cost at current prices increased rapidly from 30.5 % in the FY 1950- 51 to 50.8 % in the FY 2010-11 and 54.40 % in the FY 2018-19 which contributes Rs. 169.61 lakh crore in Indian economy.

If we can include construction, then the same share of services sector improved from 56.8 % in FY 2000-01 to 59.6 % in FY 2013-14. Among the major components of services sector, the share of transport, Communication and trade in India's GDP (at constant prices) increased from 11.0 % in FY 1950-51 to 18.6 % in FY 2013-14.

The Contribution of community and personal services to GDP (at constant prices) improved from 8.5 % in FY 1950-51 to 13 % in FY 2017-18. The stake of real estate, business services & finance

insurance increased from 9.0 % in FY 1950-51 to 20.96 % in FY 2018-19. Service sector made a rapid stride in last one and half decade and has appeared as largest & fastest growing sector of Indian economy which has reached at 7<sup>th</sup> position in world's GDP ranking in 2015-16 with a GDP size of almost \$2.25Tn. With a decadal average contribution of less than 30% over the period 1950-60 the contribution of service sector has now reached over 53%.

### **Higher CAGR and Rapid Growth of Services Sector:**

The significance of services sector towards Indian economy can be traced from its attainment of higher compound annual growth rate (CAGR). The CAGR of the services sector attained at 10.0 % during FY 2004-05 to 2011-12 has been found to be more than the 8.6% of CAGR of Gross Domestic Product (GDP) of India, which indicates that the services sector's growth rate is more as compare to industry and agriculture sectors. Services sector GVA (at current basic prices) has grown up at a CAGR of 6.25 per cent between FY12-FY19 to touch US\$ 1,294.41 billion. Moreover, the growth has been specifically marked in the public services, information technology & financial services.

The overall growth rate (CAGR) of service sector in 1990 was 7.5% and it increases up to 10.3% during 2004-05 to 2009-10 and it create a positive impact on the Indian economy and the result was in 1990 the CAGR was 5.7% and it increases up to 8.6% in the period of 2004-05 to 2009-10. The services sector's growth was pointedly faster as compare to agriculture & industry sectors. During the year 2015-16 agriculture and manufacturing sectors have grown by 1.1% and 7.3% respectively, whereas service sector has shown a significant growth of 9.2% during the same period of time. It is expected that The Indian service market is grow at 17% CAGR during 2015 - 2020 and exceed the US\$19 billion mark reinforced by growing hospitality, retail, and real estate sectors.

### **Employment Generation of Services Sector:**

The contribution of service sector in terms of employment generation is now increases as compare to agriculture sector which was our primary sector. Up till 2018, 35% of India's labour force was employed in the services sector. During 1993-94 to 2009-10, there has been a huge drop in the stake of primary sector in employment from 64.75 % in 1993-94 to 53.2 % in 2009-10 and further less than 50% in 2015-16.

Although there was down fall in the agriculture in terms of employment generation but still, agriculture sector remains to be the biggest employment giving sector in India as compare to service sector which comes just after agriculture sector.

For this same period, the contribution of services and construction sectors in employment increased from 19.70 % to 25.30 % and 3.12 % to 9.60 % respectively.

There are certain state which remain top in the list in terms of employment generation in rural area like Sikkim, Tripura and Manipur and There are certain state which remain top in the list in terms of employment generation in urban area with very high share of employment in service like 879 and 826 out of 1000 employed persons.

Kerala stands on first position in terms of high share of employment generation in the rural services sector at 511 persons out of 1000 persons among the major states. Some major employment providing service sectors are public administration, education and community, Construction; trade, hotels and restaurant.

In urban areas of India the ratio of employment with services in most of the states varied like 877 in Meghalaya, 653 in Uttar Pradesh, 787 in Jharkhand, 833 in Assam, 732 in Bihar, 712 in Kerala, 717 in Maharashtra, 744 in Rajasthan, 641 in Gujarat, 683 in West Bengal and 587 in Tamil Nadu out of 1000 working people. The share of service sector in employment generation in India need to improve as on global aspect service sector contributes 45% in total employment.

### **Contribution to India's Services Trade:**

In recent years India is grow as an export oriented country. According to Balance of Payment (BoP) data, merchandise & services exports increased by 23% and 26% respectively during 2004-05 to 2018-19 and it contributes US\$ 16.87 billion in Indian economy.

In the world export of services, share of India's services exports increases from 0.6 % to 3.47 % during 1990 to 2017, and it has been growing quicker than the share of commodities exports in world exports which stood at 1.9% in 2015-16. In 2009-10 growth of service remains slow as a result there was global recession, but the drop in the development of service sector was less noticeable than the go-slow in commodities export growth and has recovered quickly in 2010-11.

India's services sector GVA raised at a CAGR of 6.93 % to US\$ 1,267.1 billion in FY 2018 from US\$ 846.8 billion in FY 2012, during the same period CAGR of merchandise exports grew at 19.7 per cent. If we enter into the details of services sector, CAGRs of software at 21 per cent was at lower level and financial services (29.2 per cent) were at higher level.

Major services export category is software in terms of size, and the contribution was US\$ 167.5 billion in FY 2018 from US\$ 154.6 billion in FY 17. The Compound Annual Growth rate of merchandise imports, at 21.4 % as compared to CAGR for import of services was 20.21 %. Among the various items of services imports, transportation (20.5%) and non-software services (22.6%) had high Compound Annual Growth rate.

Moreover, the liberalization in the Indian economy replicated by total trade counting services as a percentage of Gross Domestic Product showed a higher degree of openness at 59.0 % in the financial year 2016-17 as compared to 25.4 per cent in FY 1997-98 and 38.1 per cent in 2004-05.

India ranked at 8<sup>th</sup> position globally in terms of export of services and contributes 3.3% of world's total export of services. While India's merchandise trade balance has always remained in negative during last 15 years, the trade balance of services has shown a positive trend during the same time. Merchandise trade balance in year 2014-15 stood at \$137.7bn while the service trade balance for the same year was \$75.6bn.

### **Services Sector Growth and FDI Inflows:**

Some years ago many transnational companies, were give their focus only on their domestic markets, but now they shift their interest from domestic to internationalization which involve ambitious investments in other country. Now a days Asia is the most attractive destination for the big multinational business houses.

The FDI share of services includes real estate, computer software as well as hardware along with financial and non- financial services. Such FDI share of services was 40.5 % of accumulative Foreign Direct Investment equity in flows during the tenure of 2000 to 2012. Including the construction sector (6.5 %), the contribution of services in FDI inflows increases to 47.0 %.

In terms of cumulative FDI equity inflows during 2000 to 2011, the financial and non-financial services are found to be the largest recipients with 20.1 per cent, (\$ 31.7 billion), which is again followed by telecommunications with 7.9 per cent (\$ 12.5 billion), computer hardware and software with 6.9 per cent (\$ 10.9 billion), housing and real estates with 6.9 per cent (\$ 10.9 billion), and construction activities 6.5 per cent (\$ 10.2 billion) share.

The contribution of financial as well non-financial services in total Foreign Direct Investment inflows from these sourcing countries are Singapore 30.6 %, U.K 29.5 %, Japan 11.9 %, USA 21.9 % and Mauritius 20.1 %.

During the period April 2000-December 2018 these sector has engrossed the highest amount of FDI equity inflows, which is near about 20% of the total foreign inflows amounting to about US\$ 70.91 billion.

### **Contribution towards Development of Communication & Infrastructure Services:**

Services sector has also been playing an important role in the management and development of infrastructure with a special emphasis on expansion of transportation as well as communication services. Government expenditure on telecommunications & infrastructure services increase by six times in the country – from US\$ 1.41 billion (Rs 9,900 crores) during 2009-14 to US\$ 8.55 billion (Rs 60,000 crores) (actual plus planned) during 2014-19. The contribution of storage, transport, and communication services to the Gross Domestic Product at factor cost (at current prices) in India ranges from 8.2 % in FY 2006-07 to 6.8 % in FY 2018-19.

### **Contribution towards Growth of IT and ITeS:**

The services sector has also cemented the way for a continuous growth of its IT & IT enabled services (ITeS) sector and thereby helping the economy of the country to attain higher growth. The IT and ITeS sector of the country has developed an image of a new and strong global knowledge power and has earned a brand identity in this sector.

Research and development (R&D), Engineering services, software products and Business process outsourcing (BPO) are four major sub-components of IT and IT industry.

According to NASSCOM estimates, India's Business process management sector and IT revenues were to the tune of US \$ 98 billion in FY 2015-16 and has been able to generate indirect employment of around 89 lakh and direct employment for around 28 lakh persons in the country.

The contribution of IT sector to GDP have grown considerably from 1.2 % in FY 1997-98 to 9.5 % in 2015-16 which was a significant part or proportion of national GDP.

Software exports from India from US \$ 99 billion in 2014-15 which was almost 12 % more as compare to last year. IT and ITeS industry dominate the exports and it contribute about 78.40% of total industry income.

The revenue comes from domestic sector of IT-ITeS and exports sector in 2010-11 were \$ 68.8 billion and \$ 19.0 billion respectively as compared to that of \$ 190 billion and \$ 39.45 billion attained respectively in 2018-19. Consistent and growing demand from US is largely responsible for increasing its part in total exports of India's Information technology and ITeS services.

#### **Contribution towards Development of Some Social Services:**

Services sector is also contribute a substantial role in the development and expansion of some social, sports and cultural services etc it contributes 13.9% of GVA (Rs. 1,924,339 crore) at current prices for the FY 2016-17. Moreover, cultural activities, or services include TV broadcasting, radio, and entertainment and besides other related cultural services. In addition to the objective of Government of India is to preserve and promote all forms of art and culture. During the Eleventh Plan the total allocation of Rs 3,555 crore was made to this sector..

Throughout the world they have been identified as a vital element of job creation, growth as well as a transporter of cultural distinctiveness. India is the nation who deliver US \$ 4 billion worth of creative services in 2010 only at a CAGR of 26% so it create a positive impact in the growth of Indian economy.

As per the report of Ernst and young, "the Indian entertainment and media industry is worth at US \$ 26 billion in 2014 and is estimated to grow at a CAGR of 14.3% in the next six years (2014-20) to touch the figure of US \$33.9 billion".

However, the outlook and status of the services sector which had once fallen due to the global economic slow-down and financial crisis faced by US, but the same sector has turned its heads towards its revival and growth once again. The growing opportunities in this sector has been generating employment to many across the nation and are also attracting FDIs for attaining success in future.

The challenge faced by this sector will be to hold India's competitiveness in those areas where the country has made a spot viz. telecommunications, IT and ITeS etc. Besides, India has to face another challenge to penetrate into some outmoded areas such as shipping and tourism where other countries have already a stronghold. India's potential for success in the sector is very high. Thus

these challenges faced by India need to be addressed if the country wants to realize its pipe dream of attaining double digit growth and generating large number of employment opportunities for its growing population in the days to come.

Finally, in a country like India, having a large size of population and presently enjoying the merit of population dividend in the form of increasing proportion of working age population, the potential& prospect of the services sector in producing income and employment for its people is quite optimistic.

## Literature review

**Cahal (2015)**analyze the importance of service sector for the growth of Indian economy. His study shows that in the last two decadesservice sector has appeared as the leading and fastest-growing sector in the worldwide economy. This sector continues to play a role of star performer as well asunremittingly contributing significantly part in the GDP growth, employment generation and enhance the trade and investment in the country.

**Singh (2015)**said that on the way of its development and economic growth, India has touched a point where there is a prevalence of service sector. But without the growth of industrial sector and agricultural, service sector single-handedly cannot continue its growth for the longer period due to the high forward and backward linkages of industrial and agricultural sector.His paper give a significantimpression on Indian services sector with major challenges for service sector of India and also provides some remedial step to overcomefrom these issues.

**Eichengreen and Gupta (2010)** in there research they analyze the causes of development in the services sector and measure the employment generating ability of services in India. They discovery that there are both type of labor skill as well as unskilled exist in the service and manufacturing sector in India. They find out that “whether India should continue exploiting its comparative advantage in services instead of following the usual route to economic growth in the process of economic development- which consists in building-up labor intensive manufacturing, or if these two approaches are in fact complementary strategies for enhancing economic growth and raising living standards in the country”.

## Objectives of the study

1. To examine the role of service sector in growth of India's GDP.
2. To examine the role of service sector in per capita income in India.
3. To examine the role of service sector in growth of FDI in India.

## Research methodology

Type of data:

The present study is quantitative in nature and secondary data will be used for the purpose of analysis.

**Source of data:**

The present study is built on secondary data. The sources of data include the evidences released by World Bank, World Trade Organization(WTO), Export& Import Bank of India(EXIM), Reserve Bank of India(RBI), Ministry of Commerce and Industry, Government of India etc.

**Analysis and Interpretation**

i). Correlation between Service Sector and GDP:

<b>Year</b>	<b>Size of Service Sector(US \$ bn)</b>	<b>Size of GDP(US \$ bn)</b>
2000-01	241	477
2001-02	252	494
2002-03	275	524
2003-04	324	618
2004-05	383	722
2005-06	448	834
2006-07	512	949
2007-08	675	1239
2008-09	687	1224
2009-10	778	1365
2010-11	974	1708
2011-12	893	1823
2012-13	920	1829
2013-14	951	1864
2014-15	1072	2042
2015-16	1220	2250
2016-17	1430	2274
2017-18	1500	2597



ii). Correlation between Service Sector and Per Capita Income:

<b>Year</b>	<b>Size of Service Sector(US \$ bn)</b>	<b>Per Capita Income(US \$)</b>
2000-01	241	463
2001-02	252	471
2002-03	275	492
2003-04	324	572
2004-05	383	658
2005-06	448	749
2006-07	512	840
2007-08	675	1081
2008-09	687	1053
2009-10	778	1159
2010-11	974	1430
2011-12	893	1522
2012-13	920	1496
2013-14	951	1508
2014-15	1072	1627
2015-16	1220	1751
2016-17	1430	1862
2017-18	1500	1963

ii). Correlation between Service Sector and Foreign Direct Investment:

Year	Size of Service Sector(US \$ bn)	FDI(US \$ bn)
2000-01	241	4
2001-02	252	6.1
2002-03	275	5
2003-04	324	4.3
2004-05	383	6
2005-06	448	9
2006-07	512	23
2007-08	675	35
2008-09	687	42
2009-10	778	38
2010-11	974	36
2011-12	893	47
2012-13	920	34
2013-14	951	36
2014-15	1072	44
2015-16	1220	46.4
2016-17	1430	55.56
2017-18	1500	60.22

**Results and findings:**

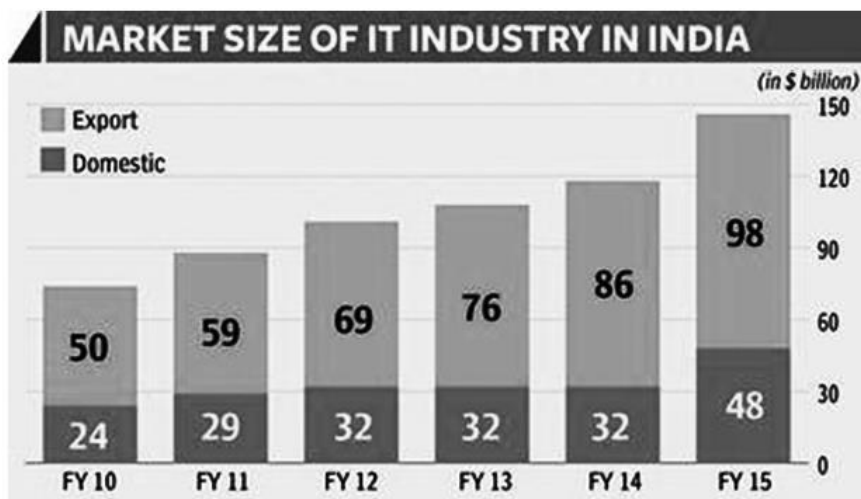
1. Correlation between Size of Service Sector and Size of GDP is found to be **0.987**
2. Correlation between Size of Service Sector and Per Capita Income is found to be **0.986**
3. Correlation between Size of Service Sector and FDI is found to be **0.939**

## Summary of Findings:

1. A very high degree of positive correlation is found between Size of Service sector in India and Size of GDP for the period under study. This proves that the growth of service sector has contributed to the financial growth of India. Since 2000-01 the service sector has seen a fourfold jump and the same has been seen in the overall GDP size.
2. A very high degree of positive correlation is found between Size of Service sector in India and Per Capita Income for the period under study. This proves that service sector has contributed in raising the earning level of people in India.
3. A very high degree of positive correlation is found between Size of Service sector in India and FDI flow for the period under study. This proves the growth of service sector has resulted in more inflow of foreign investment in the country.

## Conclusion

The present study has shown the significance of service sector in sustainable economic development in India. For the period 2000-2018 service sector in India has attracted highest amount of foreign investment about US\$ 60.22 billion in 2017-18 which is about 17% of the total external inflows. India has arose as one of the leading country in providing IT services to the rest of the world. The size of Indian IT industry has crossed the mark of \$167bn. It also contributes almost 55% of total service export from India. Improvement in global and domestic factors will further drive the service sector to grow at a fast pace. Performance of other sub-sectors of service industry like hotels and restaurants, transportation, storage, communication, real estate, retail, hospitality, financing and insurance sectors will also improve in FY19. The growth in GDP will surely be driven by the performance of service sector.



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