

## THE SIGNIFICANCE OF SERVICE SECTOR IN INDIAN ECONOMY

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### **ABSTRACT**

*Service sector is the fastest growing sector around the world. Services sector has become more important in recent years as modern technology has permitted new means of providing services across the borders. It has become the lifeline for the social economic growth of a country as it is contributing significantly to GDP, GDP growth, employment, trade and investment. On the way of its economic growth and development, India has reached a level where there is a predominance of service sector. But without the growth of agricultural and industrial sector, service sector alone cannot sustain its growth for the longer period due to the high backward and forward linkages of agricultural and industrial sector. This paper provides an overview of the Indian services sector with major issues in service sector of India and also provides some suggestions to solve these issues.*

**KEYWORDS:** *Service sector, India, Growth, Development.*

### **INTRODUCTION**

India is a fast growing developing country and from the last decade, India has concentrated on service sector. Service sector includes all other economic activities which are not covered by the agricultural or manufacturing sectors are broadly defined as services and hence belong to the service sector

Services include services provided for the agricultural sector, activities associated with the supply of water, electricity and gas, transport and communications, wholesale and retail trade, finance and insurance, business and personal services, and community and social services.

The real reason for the growth of the service sector is due to the increase in urbanization, privatization and more demand for intermediate and final consumer services. The growth in services has also been accompanied by the rising share of services in the world transactions.

Its growth has in fact been higher than the growth in agriculture and manufacturing sector. An efficient service sector is crucial for the growth and competitiveness of an economy.

## **LITERATURE REVIEW**

The growth in the service sector in India has been linked to the reforms of the 1990s. In the first 3 decades after independence in 1947, India was largely an agrarian economy. The service sector started to grow in the mid-1980s, but growth accelerated in the 1990s when India initiated a series of economic reforms after the country faced a severe balance of payments crisis. Reforms in the service sector were a part of the overall reform program which led to privatization, the removal of FDI restrictions, and streamlining of approval procedures among others. After the 1990s, the service sector grew. In this respect, India has been considered as an outlier among South Asia and other emerging countries (Ansari 1995).

Existing literature shows that liberalization and reforms have contributed to the growth of the sector (Chanda 2002, Gordan and Gupta 2003).

Some studies have pointed out lack of an integrated service sector policy (Banga 2005), and a strong focus on skill-intensive services and higher education while a majority of the population remains unskilled and poorly educated (Kochhar, Kalpana, Ioannis 2006), barriers to growth in services including lack of decent employment (Basu and Maertens 2007), a poor business environment (Joshi 2008),

Bosworth, Collins and Virmani (2007), examine the role of services as part of a detailed, up-to-date growth accounting for India.

G. Ramakrishna (2010), investigates that apart from service sector growth, industry, agriculture and the open policies of 1990s also had positive impact on India's economic growth though, the service sector appears to contribute more.

A working paper on policy for India's service sector by Prasad and Satish (2010), focused on the major policy issues for India's service sector. This paper analysed the contribution of

service sector in terms of GDP growth, service export growth and openness of the economy. The paper concludes that immediate and time bound reforms in the service sector of India could not only help in attaining India's targeted GDP growth rate but also give fillip to grow the exports of the service sector.

Mukherjee Arpita, (2012), study on service sector in India, trends, issues and way forward identifies a number of barriers faced by the service sector and suggested policy measures which if implemented will lead to inclusive growth, increased productivity, employment generation, trade investment and it enhances India's global competitiveness in services.

Another working paper on the service sector as India's road to economic growth by Barry and Gupta (2012), explores the growth, structural changes and Indian employment in service sector. This paper using national accounts statistics and cross country data shows that the growth of services has been broad based. This study observes that for sustaining economic growth and rising living standards require shifting of labour out of agriculture into both manufacturing and services and not just into one or the other.

### **OBJECTIVES OF THE STUDY**

1. The objective of this research paper is to explore the significance of service sector and
2. To study the Impact of service sector on Indian economy.

### **RESERACH METHODOLOGY**

This research paper is based on the secondary sources of data. The secondary data were collected from various published sources like journals, books, websites, reports, etc.

### **CLASSIFICATION OF THE SERVICE SECTOR**

India has a quasi-federal governance structure and according to the Constitution of India some services are under the jurisdiction of the central government (Union List), some are under the state governments (State List) and the remaining are under the joint administration of central and state governments (Concurrent List).

- Union List
  - Telecommunications, postal, broadcasting, financial services (including insurance and banking), national highways, mining services
- State List
  - Healthcare and related services, real estate services, retail, services incidental to agriculture, hunting, and forestry
- Concurrent List
  - Professional services, education, printing and publishing, electricity

Source: Author's compilation from the Constitution of India, 1950.

## SIGNIFICANCE OF THE SERVICE SECTOR IN INDIA

The importance of the services sector can be gauged by looking at its contributions to different aspects of the economy.

**CONTRIBUTION TO GDP:** India's services sector has the largest share in the GDP, accounting for 57% in 2013-14 at factor cost (at current prices) up from 15% in 1950. It is the 12th largest in the world by nominal GDP. The growth rate of the financing, insurance, real estate, and business services grew robustly at 12.9 percent.

### Share and Growth of India's Services Sector (at factor cost)

	2000-01	2011-12 <sup>@</sup>	2012-13 <sup>*</sup>	2013-14 <sup>**</sup>
<b>Trade, hotels, &amp; restaurants</b>	14.5 (5.2)	17.4 (1.2)	17.2 (4.5)	24.0 (3.0) <sup>*</sup>
Trade	13.2 (5.0)	15.9 (1.0)	15.8 (4.8)	—
Hotels & restaurants	1.3 (7.0)	1.5 (3.8)	1.4 (0.5)	—
<b>Transport, storage, &amp; communication</b>	7.6 (9.2)	7.3 (9.4)	7.5 (6.0)	—
Railways	1.1 (4.1)	0.7 (7.5)	0.8 (0.3)	—
Transport by other means	5.0 (7.7)	5.4 (8.6)	5.6 (6.6)	—
Storage	0.1 (6.1)	0.1 (2.9)	0.1 (8.6)	—
Communication	1.5 (25.0)	1.1 (11.2)	1.1 (6.5)	—
<b>Financing, insurance, real estate, &amp; business services</b>	14.1 (3.5)	16.5 (11.3)	17.2 (10.9)	18.5 (12.9)
Banking & insurance	5.4 (-2.4)	5.7 (12.9)	5.9 (11.8)	—
Real estate, ownership of dwellings, & business services	8.7 (7.5)	10.7 (9.9)	11.4 (10.0)	—
<b>Community, social, &amp; personal services</b>	14.7 (4.6)	13.8 (4.9)	14.3 (5.3)	14.5 (5.6)
Public administration & defence	6.5 (1.9)	5.9 (4.2)	6.0 (3.4)	—
Other services	8.2 (7.0)	7.8 (5.4)	8.2 (6.8)	—
<b>Construction</b>	6.0 (6.1)	8.2 (10.8)	8.1 (1.1)	7.8 (1.6)
<b>Total services</b>	51.0 (5.1)	54.9 (6.6)	56.3 (7.0)	57.0 (6.8)
<b>Total services (including construction)</b>	57.0 (5.2)	63.1 (7.1)	64.4 (6.2)	64.8 (6.2)
<b>Total GDP</b>	100.0 (4.1)	100.0 (6.7)	100.0 (4.5)	100.0 (4.7)

Source: Central Statistics Office (CSO).

Notes : Shares are in current prices and growth in constant prices; Figures in parentheses indicate growth rate; \* first revised estimates, @ second revised estimates, \*\* provisional estimate; # includes the combined share and growth of trade, hotels, & restaurants and transport, storage, & communication for 2013-14.

**Average by Decade of the Share of Sectors in India's Gross Domestic Product**

(in %)

Sector	1950s	1960s	1970s	1980s	1990s	2000s
Agriculture	55.3	47.6	42.8	37.3	30.9	21.8
Industry	14.8	19.6	21.3	22.3	23.3	24.5
Services	29.8	32.8	35.9	40.3	45.7	53.7

Source: Author's calculations from National Income Accounts

**EMPLOYMENT IN SERVICE SECTOR:** Although the primary sector (agriculture mainly) is the dominant employer followed by the services sector, the share of services has been increasing over the years while that of primary sector has been decreasing. The pattern of the sectoral share of employment has changed over the last two decades with the share of agriculture falling from 64.8 per cent in 1993-4 to 48.9 per cent in 2011-12 and of industry rising from 15.6 per cent to 24.3 per cent.

The share of the services sector in employment has gone up in the same period from 19.7 per cent to 26.8 per cent.

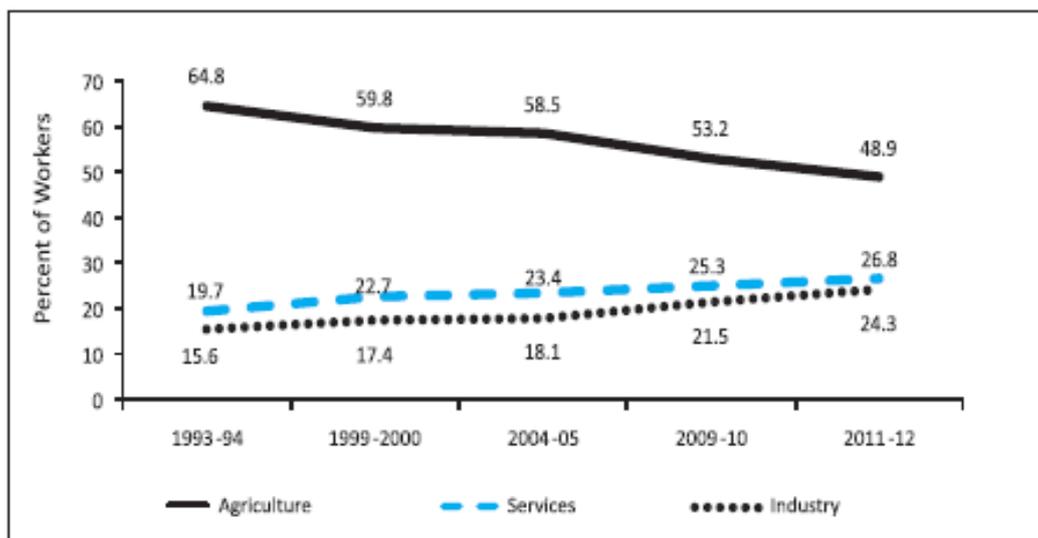
It is expected that the e-commerce sector will generate close to 150,000 jobs within the next 2-3 years.

**SECTORAL SHARE OF EMPLOYMENT**

YEARS	AGRICULTURE	INDUSTRY	SERVICES
1993-94	64.8	15.6	19.7
1999-2000	59.8	17.4	22.7
2000-05	58.5	18.1	23.4
2009-10	53.2	21.5	25.3
2011-12	48.9	24.3	26.8

(Percent of Workers)

Source: National Sample Survey of India



Source: Based on Inputs of Ministry of Labour and Employment which uses National Sample Survey Office (NSSO) data from different rounds.

**FDI IN SERVICE SECTOR:** The growth of the services sector is closely linked to FDI inflows into the service sector and the role of transnational firms.

The Indian services sector has attracted the highest amount of FDI equity inflows in the period April 2000-September 2014, amounting to about US\$ 40,684.98 million which is about 18 per cent of the total foreign inflows, according to the Department of Industrial Policy and Promotion (DIPP).

### Services Attracting Highest FDI Inflows

Ranks	Sector	Value (in US \$ million)			Cumulative inflows (Apr. 2000-Mar. 2014)	Percent age to total	Growth rate	
		2011-12	2012-13	2013-14			2012-13	2013-14
1	Services sector(financial & non-financial)	5216	4833	2225	39460	18	-7.3	-4.0
2	Construction development #	3141	1332	1226	23306	11	-57.6	-8.0
3	Telecommunications *	1997	304	1307	14163	7	-84.8	29.9
4	Computer software & hardware	796	486	1126	12817	6	-38.9	31.7
5	Hotels & tourism	993	3259	486	7118	3	228.2	-85.1
	<b>Total top five services</b>	<b>12143</b>	<b>10214</b>	<b>6370</b>	<b>96864</b>	<b>45</b>	<b>-15.9</b>	<b>-37.6</b>
	<b>Total FDI inflows</b>	<b>46556</b>	<b>34298</b>	<b>36396</b>	<b>217581</b>	<b>100</b>	<b>-26.3</b>	<b>6.1</b>

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.

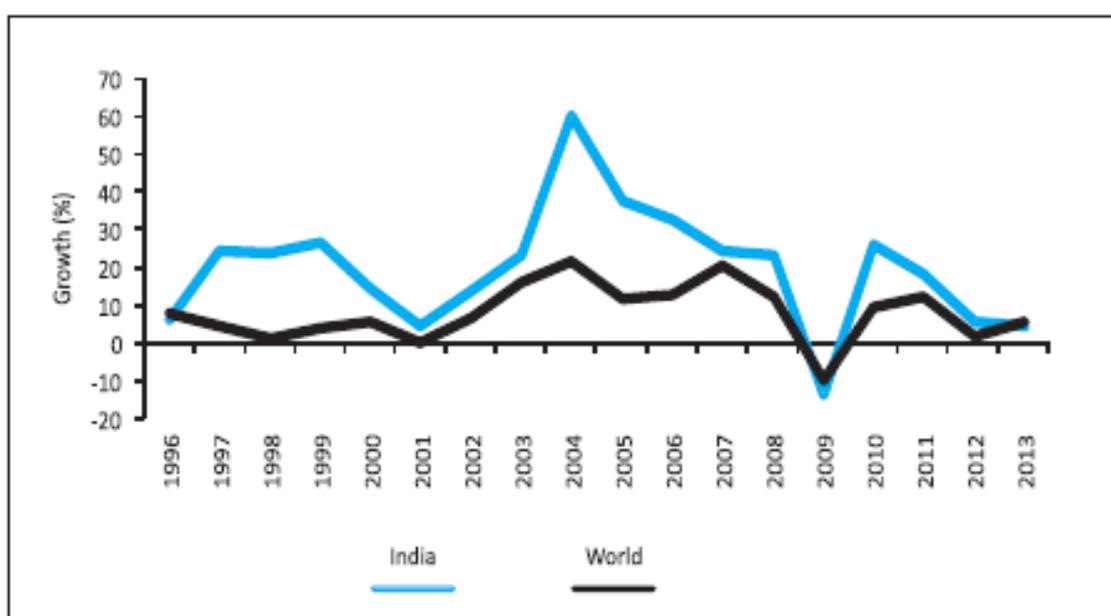
**SERVICE EXPORTS:** The share of India in world services exports, which increased from 0.6 per cent in 1990 to 1.1 per cent in 2000 and further to 3.3 percent in 2013, has been increasing faster than its share in world merchandise exports.

The share of exports of software services is 46 percent of India's total services exports.

India's exports of financial services registered a high growth of 34.4 per cent in 2013-14.

World services export growth was at 0.1 per cent in 2001, reached a high of 21.5 per cent in 2004, and it was 5.5 per cent in 2013.

### Export Growth of Commercial Services: India and World



Source: Computed from WTO database accessed on 1 June 2014.

### MAJOR ISSUES IN SERVICE SECTOR

- 1. Port Services:** India does not have world class ports. As a result, third-generation ships are not able to enter the harbour and goods have to be offloaded outside in smaller ships, adding to costs. There are also issues like the many port charges in India and the port charges in India being considerably higher than in many developed countries.

2. **Inadequate Infrastructure:** The infrastructure is inadequate not only in rural areas but also in urban sector, such as, power shortage, poor connectivity of roads and railways, traffic congestions in metro cities, etc. These affect the quality of services.
3. **Competition:** Indian service providers like BPOs and IT firms are facing hard competition from other countries as well as facing some unfair competition within the national boundaries.
4. **High Cost:** The cost of services in India is very high. There are many reasons such as poor infrastructure, more wastage of resources, training to employees, high tax rates, etc.
5. **Less Talented Workforce:** In our country, literacy rate is not very high. The number of technical education institutions are also very less. So, it is very difficult to find out suitable, talented, able and skilled employees in India.
6. **Use of Out-dated Technology:** In the modern world, Indian service providers are still using old and out-dated technology. It leads to high costs and high wastages and less profits.
7. **Dependency on Other Sectors:** Service sector is dependent on primary and secondary sectors for getting raw materials, semi-finished goods, etc. If both the sectors (primary and secondary) would not perform well then it will automatically hamper the performance and quality of service sector.
8. **FDI Restrictions:** India is one of the few countries, which have FDI restrictions on a number of services sectors. According to the Organisation for Economic Co-operation and Development (OECD) FDI Restrictive Index, 2010, India is considered more restrictive than Korea such as equity restrictions on foreigners, screening of foreign applicants, hiring of key personnel and operational conditions imposed on foreigners.

## SUGGESTIONS

- 1. Set up a Nodal agency and regulations:** There is no single nodal department or agency for services in our country. It is the need of the hour that government should set up a nodal agency or department for the smooth functioning of service sector as services activities cover issues beyond trade and also work on regulatory reforms for service sector.
- 2. Promotion and marketing:** There is also need for promotional and marketing activities for service exports like setting up a portal for services, showcasing India's competence also in non-software services in trade exhibitions, and engaging dedicated brand ambassadors and experts at the international level.
- 3. Credit facilities:** Government and Reserve Bank of India should provide more credit facilities at reasonable interest rates and collateral free soft loans to support the sector's cash needs.
- 4. Proper infrastructure:** Government should make efforts to improve the infrastructure in the country such as construct more roads in rural and backward areas, as well as railways and air connectivity to all the cities of the country and also improve the condition of its ports.
- 5. Improve the condition of tourist places:** Government should work to improve the poor condition of historic buildings in the country. These places are the main attraction for tourists. It helps in generating more income.
- 6. Control costs and wastage:** Service providers should focus on controlling the costs and wastage of resources with the use of modern technology.
- 7. Disinvestment:** There is plenty of scope for disinvestment in services PSUs under both central and state governments. Speeding up disinvestment in some services-

sector PSUs could not only provide revenue for the government but also speed up the growth of these services.

- 8. Modern technology:** Service providers in India should use modern and latest technology while providing services to its clients. It provides maximum satisfaction to the customers and also helps in reducing costs.
- 9. Subsidies and tax benefits:** India has a high corporate tax i.e. 30-40% compared to around 17% in Singapore and up to 25% in China. Government should provide some tax benefits and subsidies for service sector for the all-round development of service sector in the country.
- 10. Co-ordination with other sectors:** Service sector should co-ordinate with the primary sector and secondary sector for better performance and it also helps to predict the uncertainty and risk in the near future.

## **GOVERNMENT INITIATIVES**

India plans to double India's exports of goods and services by the end of the 12th Five-Year Plan period, over the level achieved at the end of the 11th Five-Year Plan period. The long-term objective is to double India's share in global trade by the end of 2020 through adoption of appropriate strategies.

The government of India has adopted a few initiatives in the recent past. Some of these are as follows:

- The Reserve Bank of India (RBI) has eased the guidelines for issue of shares or convertible debentures under the automatic route which will allow companies to issue equity shares to a resident outside India against any type of fund. The norms allow issuance of shares subject to conditions such as entry route, sectoral cap, pricing guidelines, and compliance with the applicable tax laws.

- As part of Government's 'Look East Policy', Shipping Corporation of India (SCI) has started a fortnightly service to Myanmar. The service will cater to Mizoram and other north-eastern states using the Sittwe port in Myanmar located on the mouth of the Kaladan river.
- The Government of India has signed the Free Trade Agreement (FTA) with the 10-member Association of Southeast Asian Nations (ASEAN). The move is expected to pave the way for free movement of professionals and further open up opportunities for investments.

## **CONCLUSION**

India's services sector has emerged as the most dynamic sector of the Indian economy, particularly since last one and half decade and this sector is contributing significantly to GDP, employment, trade and FDI inflows. India is among the top 10 WTO member countries in services exports and imports. There are disparities in access of services and a major proportion of the poor in India do not have access to basic services such as health and education. India's export competitiveness is in a few services sector and there are wide variations in growth across different sub-sectors of services. The paper found that the services sector faces a number of problems such as infrastructure facilities are poor, cost of service deliveries is high, unskilled workforce and FDI restrictions, which makes it very difficult for the service sector to reach its full potential and contribute to inclusive growth. This paper also provides some suggestions that will help the services sector to not only to grow at a fast pace but also create quality employment, attract investment and customer satisfaction.

If the barriers will be removed and new reforms and regulations are implemented it will enhance the productivity and efficiency of the services sector and also enhance India's global competitiveness and trade in services at the international level. It will help in achieving the country's main objective of overall growth of the economy in the future.

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