

# SUMMARY SHEET



*Service Sector in  
India*





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## Contents

1	Introduction.....	3
2	Services Sector: Concept & Meaning .....	3
2.1	Composition of GDP .....	4
2.2	Composition of Services Sector in India.....	4
3	Performance of Service Sector in India .....	4
3.1	Sectoral Composition of GDP Growth.....	4
3.2	Employment Contribution of the Service Sector .....	5
3.3	Causes of Rapid Increase in Tertiary Sector.....	5
3.4	Prospects & Opportunities.....	6
3.4.1	Domestic Factors .....	6
3.4.2	International Factors .....	6
4	The Need for Reforms .....	7
5	Outlining Future .....	7

## 1 Introduction

We have come a long way from the days of physiocrats and mercantilists when agriculture and trade in goods respectively were the engines of growth of economies. **Production and trade in services** have come to the **forefront**. In modern economies, **service sector** performs many **important roles**.

- First, it **represents a major share of the developed economies** and is increasingly **integrated in the overall production system**.
- Second, it plays an **active role in market integration** and **globalisation**.
- Third, the **creation of employment, value added, income and exports** are increasingly related to the **good performance of the services**.

In India, the service sector has **evolved continually** over the past thirty years, **modifying the structure of employment and the composition of value added**. It constitutes a **large part of the Indian economy** both in terms of **employment potential** and its **contribution to national income**. The sector covers a **wide range of activities** from the most sophisticated in the field of **Information and Communication Technology** to simple services pursued by the **informal sector workers**, for example, vegetable sellers, hawkers, rickshaw pullers, etc. Currently, this sector **accounts for over 50 per cent of the value added**. However, despite its growing weight, the share of the working-age population employed in services remains low.

## 2 Services Sector: Concept & Meaning

The **economy has basically three sectors** viz, the **primary sector** comprising of agriculture, fishing, and extraction such as mining, the **secondary sector** comprising of manufacturing and the **tertiary sector** also referred to as service sector.

The **basic characteristic** of service sector is the **production of services** rather than end-products. Services are **intangible goods** which include **attention, advice, experience, and discussion**. These are used to **enhance productivity, performance, potential and sustainability**. The **production of information** is also



regarded as a service. However, some economists like to classify services relating to the information service in a fourth sector, now known as the **quaternary sector** i.e., the sector that comes after the third and just before the fifth in position.

The **tertiary sector** involves the **provision of services to other businesses**. Services may involve the **transport, distribution and sale of goods** from producer to a consumer, pest control, entertainment or hotel industry. The goods are transformed in the process of providing the service. However, the focus is on **people interacting with people and serving the customer** rather than transforming physical goods.

The **composition of GDP** of an economy **explains the relative significance of the different producing sectors**. When a country is in a state of **underdevelopment**, **primary sector makes the largest contribution** to the national income. As the country grows and gets **developed**, the contribution of the **industrial and service sectors gradually increases**.

## 2.1 Composition of GDP

For the past few decades, there has been a **considerable shift from the primary and secondary sectors to the tertiary sector in the Indian Economy**. The **tertiary sector is now the largest sector** of the economy and is also the **fastest-growing sector**. Examples of service sector employment include: Government, hospitals, public health, waste disposal, education, banking, insurance, financial services, legal services, consulting, news media, hospitality industry (e.g., restaurants, hotels, casinos), tourism, retail sales, franchising, real estate, and sales.

## 2.2 Composition of Services Sector in India

In the National Income Accounting in India, service sector includes the **Trade, Hotels and Restaurants, Transport, Storage and Communication, Financing, Insurance, Real Estate and Business Services, Community, Social and Personal Services**.

# 3 Performance of Service Sector in India

## 3.1 Sectoral Composition of GDP Growth

It would be seen that over the period, the **primary sector's share has fallen by 40 per cent**, while those of the **secondary and tertiary sectors have increased**. This trend is **projected to go further** in wake of liberalization of the economy. This may happen primarily because of the following factors:

- **reduced restrictions on private sector involvement** in areas like software development and information services
- **technological advances**
- **lower fixed capital requirements**.

Presently, about **two-thirds of the incremental growth in the Indian economy can be attributed to the tertiary sector**.

This **pattern of structural change in Indian economy has deviated from the development pattern of Western and South East Asian economies**. Those economies experienced first a **shift from primary to secondary sector** and only in their advanced stage did they experience a **significant shift in favour of tertiary sector**. That pattern of development enabled them to **transfer growing labour force from primary to secondary sector**.

In India, this has not been possible because **secondary sector has not expanded fast enough to absorb growing labour force**. The **unskilled and uneducated rural masses have continued to struggle** in the primary sector and those who have been forced out by economic, social and political factors have joined the urban slum sector. Moreover, the **sharp increase in the share of tertiary sector in GDP in India has occurred at a much lower level of per capita income** than that in the developed countries when they

experienced a similar expansion. This pattern of growth underlines the **link between the growing poverty and unemployment** and the inadequate growth of manufacturing and building activity in the country

### 3.2 Employment Contribution of the Service Sector

The sectoral distribution of workforce in India during the period 1983 to 2009-10 reveals that the **structural changes in terms of employment have been slow** in India as the **primary sector** continued to **absorb 54.9 per cent of the total workforce even in 2009-10**, followed by **tertiary and industrial sectors (25.5 per cent and 19.6 per cent) respectively**.

There has been **disproportionate growth of tertiary sector**, as its **share in employment has been far less when compared to its contribution to GDP**. It is important to understand that, within the services sector employment growth rate is highest in finance, insurance, and business services, followed by trade, hotels and restaurants, and transport etc. The community, social and personal services occupy the last rank in growth rates of employment. Further, there was a **sharp drop in labour absorptive capacity of growth in the economy** (employment elasticity of growth) **from 0.40 to 0.15** during post-reform period (1993-94 to 1999-2000) initially, reflecting the **phenomenon of jobless growth**. However, during 1999-2000 to 2009-10 period the employment elasticity of growth registered an increase from 0.15 to 0.51. With the exception of one subsector of tertiary sector i.e., transport, storage, communication all other sub-sectors of services sector exhibited an increasing trend in employment elasticities and thereby overall elasticity of employment increased from 0.15 to 0.51. **Services sector contributes over 25% of total employment in the economy by 2022.**

### 3.3 Causes of Rapid Increase in Tertiary Sector

The **tertiary, i.e., the non-commodity sector**, has been growing at a much faster rate than the **commodity sector**. This in essence means that **income generated in the process of circulation** grew at a much **faster pace** than that in the **directly productive process**, and thereby resulting in an increase in the share of the non-commodity sector. This trend can be **attributed to a number of factors**, among which, the more important are as follows:

- A very important factor has been the **advent of information technology and the knowledge economy**. This has **enhanced the growth of the high productivity segment** of the services sector as well as a variety of service activities involving low productivity activities catering to a large mass of people.
- A large part of the service sector consists of **infrastructure** such as **banking, insurance, finance, transport and communication** and **social and community** services such as **educational and medical** facilities. An urgent requirement of development is the **proper expansion of infrastructure** to cater to the needs of other sectors of the economy and the **expansion of the social and community services** for the well-being of the people.
- **Public services grow more rapidly** where **national Governments have significant role** in planning and production in the economy as a whole. In fact, the 'visible hands' of the modern governments as reflected in the government policies and in the expansion patterns of the national and international authorities during the last few decades are directed towards the creation of fast economic and social infrastructures.
- Operation of the demonstration effect as a consequence of the growing mobility due to **expanding foreign trade, tourism and cultural and educational tours** is another important factor.
- **Increasing urbanisation** may be regarded as **another cause of expansion of the service sector** in the economy. In fact, urbanisation is closely associated with a rise in demands for infrastructure services such as **communications, public utilities and distribution services**. A substantial change in the private consumption pattern of the economy is observed with increasing urbanisation. Many new goods and services enter into the consumption basket.

- **Tourism** is becoming more and more **international** as knowledge is being spread through television and Internet, and **modern technology** has made **air transport** and **hotel accommodations** quite comfortable. Tourism, in turn, has promoted all types of services.
- With the **increasing complexities of modern industrial organisation**, **manufacturing industries have become service oriented**. This has been reflected in the increasing functions of **accounting, finance, legal services, advertisement, marketing, public relations** etc. Because of the prevalent labour laws, these services are being increasingly outsourced, so that growth in industry is actually being counted as growth in services.

### 3.4 Prospects & Opportunities

Both domestic and international factors augur well for the growth of services sector in India.

#### 3.4.1 Domestic Factors

Some of the important factors can be briefly stated as follows:

- As **real per capita GDP grows**, **demand for services increases** more than proportionately and this, in turn, reinforces GDP growth itself.
- Within the services sector, **demand for producer and government services**, which constitute mainly intermediate consumption, have **strong multipliers effects on real GDP**.
- The growth of such **dynamic service activities**, which are intensive users of **communication and information technology**, will generate **employment opportunities on a rising scale**.
- The **process of economic growth** has itself led to the emergence and expansion of new series such as **advertising, publicity, marketing**, etc. These sub-sectors provide **essential service inputs to other sectors** in the economy, thereby developing **strong linkages** with the rest of the economy.
- **Efficient delivery of services increases the productivity of both labour and capital** in the economy as a whole. In general, services sector appears to be highly growth inducing with positive externalities for other services making service a catalytic agent of growth.

#### 3.4.2 International Factors

Some of the recent global developments which provide opportunities for substantial growth are as follows:

- The fastest growing segment of services is the **rapid expansion of knowledge-based services**, such as, **professional and technical services**. India has a tremendous advantage in the supply of such services because of a **developed structure of technological and educational institutions and lower labour costs**.
- **Progress in IT** is making it increasingly possible to **unbundle** the production and consumption of **information-intensive service activities**. These activities – **research and development, computing, inventory management, quality control, accounting, personnel administration, secretarial, marketing, advertising distribution and legal services** — are performed in all economic sectors.
- Unlike most other prices, **world prices of transport and communication services have fallen dramatically**. The cost of communication is becoming independent of distance. **India's geographical distance from several important industrial markets is no longer an important element** in the cost-structure of skill-based activities.
- India does not necessarily have a low-cost producer of certain types of goods (e.g., computers or discs) before it can become an efficient supplier of services embodied in them (e.g., software or music). It is **possible now to provide value added services without waiting to 'catch up' in technology for production of sophisticated equipment or products**.
- The decline in the share of manufacturing in the output of rich countries implies a relative decline in their demand for industrial raw materials and fuels. It means that **growth in exports of developing countries in the future will depend less on natural resources endowments and more on efficiency in providing services and service-intensive goods**.

- The **aging of population in the developed world implies that the demand for services will continue to grow.**

As a result of the above developments, the **sources of comparative advantage** of nations are **vastly different** now from what they were 50 or even 20 years ago. And, there are **very few developing countries which are as well placed as India to take advantage of the phenomenal changes that have occurred in production technologies, international trade, capital movement and deployment of skilled manpower.** It is now possible for India to take advantage of a **virtuous circle of higher growth, higher capital inflows and higher domestic incomes and savings**, which in sum can lead to further growth.

## 4 The Need for Reforms

Indian services sector has the potential to garner higher economic benefits to the country. But there are many issues both general and sector specific including domestic regulations hinder the growth prospects of the services sector. If these issues are addressed deftly the sector could lead to exponential gains for the economy. There are some general issues related to the policy framework which hamper the healthy growth and expansion of the services sector in the country. They are broadly related to the following areas:

- **Nodal agency and marketing:** Despite having strong growth potential in various services sub-sectors, there is no single nodal department or agency for services. An inter-ministerial committee for services has been set up to look into this. But services activities cover issues beyond trade and a more proactive approach and proper institutional mechanism is needed to weed out unwanted regulations and tap the opportunities in the services sector in a coordinated way. There is also need for promotional activities for service exports like, (i) setting up a portal for services, (ii) showcasing India's competence also in non-software services in trade exhibitions, (iii) engaging dedicated brand ambassadors and experts.
- **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.
- **Credit related:** The issues here include 'collateral free' soft loans to support the sector's cash needs and possibility of considering even export or business orders as collateral for credit-worthy service firms.
- **Tax and Trade Policy related:** These include use of 'net' instead of 'gross' foreign exchange criteria for export benefit schemes, the issue of retrospective amendments of tax laws like, (i) amendment to the definition of royalty to include payment of any rights via any medium for use of computer software, (ii) tax administrative measures to tackle delay in refunds, (iii) introducing VAT (value added tax) refund for foreign tourists, and (iv) addressing the issue of bank guarantees based on past performance to avail of export promotion benefits in services.

## 5 Outlining Future

With plenty of opportunities, the services sector is like an uncharted sea. As yet, its potential has not been tapped fully by India. A targeted policy of removing bottlenecks in major and potential services can result in large dividends in the form of higher services growth and services exports, which in turn can help in pulling up the economy to higher growth levels. The future actions in the sector can be outlined as given below:

- India's services sector, which showed resilient growth after the recovery of the global economy following the global financial crisis, has been showing subdued performance in recent times. Despite the slowdown, the prospects continue to be bright for many segments of the sector.
- In future, government's focus on the following is expected to provide impetus to logistics services—



- infrastructure development
- favourable regulatory policies like liberalisation of FDI norms,
- increasing number of multimodal logistics service providers,
- growing trend of outsourcing logistics to third party service providers, and
- entry of global players.
- Though shipping services are at a low key at present, with increased imports of POL (petroleum, oil and lubricants) for stocks build up to take advantage of low crude oil prices, containerisation of export and import cargo and modernisation of ports with private sector participation, recovery of the shipping and port services sector can be expected.
- The prospects for Indian aviation services have improved following—
  - the fall in prices of aviation fuel, which accounts for nearly 40 per cent of the operating expenses of airlines in India;
  - liberalisation of FDI policies in civil aviation; and
  - strong growth in passenger traffic – expected to continue in the near future.
- The outlook for the retail industry remains positive as India continues to remain an attractive long-term retail destination despite the various challenges faced by the sector. Following initiatives are expected to give a fillip to the sector—
  - allocation of ₹1000 crore to technology and start-up sectors,
  - promotion of cashless transactions via RuPay debit cards, and
  - growth of e-commerce.
- Government's focus on the tourism sector including easing visas and building tourism infrastructure could help in the recovery of the tourism sector.
- Despite challenges in the global market, the Indian IT industry is expected to maintain double or near-double- digit growth as India offers depth and breadth across different segments of this industry, such as, IT services, BPM, ER&D, internet and mobility and software products.
- In the telecom sector, the introduction of 4G which could be a game changer and inclusion of fibre optic connectivity which will tremendously increase the reach and bandwidth along with greater use of mobiles in government's social sector programmes could give a further boost to this fast-growing sector.

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