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ADVANCED BUSINESS SERVICES IN EMERGING ASIAN ECONOMIES¹

ZAAWANSOWANE USŁUGI BIZNESOWE WE WSCHODZĄCYCH GOSPODARKACH AZJI

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Summary: The goal of this paper is to present the results of the empirical analysis of the role of emerging Asian economies in the global market for business services. The focus is on India, as the leader in advanced business services in the region. The method applied in this paper is the quantitative analysis of data related to trade and foreign direct investment in services. The novelty of the paper lays in focusing on business services through their international exchange and activities of multinational corporations. This papers aims to focus on broader economic perspective rather than usual offshoring. The main conclusion of the paper is the rising role of services in economies that were previously focused on manufacturing and merchandise trade. Both due to the structural changes in foreign markets and home governments' policies the process of tertiarisation is taking place. Special focus is on advanced business services which require and create vast amount of knowledge.

Keywords: Asia, India, advanced business services, exports, foreign direct investment.

Streszczenie: Celem niniejszego artykułu jest przedstawienie roli wschodzących gospodarek azjatyckich na globalnym rynku usług biznesowych. Nacisk położony jest na Indie, jako lidera zaawansowanych usług biznesowych w regionie. Metodą badawczą zastosowaną w niniejszym artykule jest ilościowa analiza danych dotyczących handlu i bezpośrednich inwestycji zagranicznych w usługach. Nowością tego artykułu jest koncentracja na usługach biznesowych poprzez ich międzynarodową wymianę i działalność korporacji transnarodowych. Niniejsze opracowanie skupia się na szerszej perspektywie gospodarczej niż, jak to ma miejsce najczęściej, tylko na offshoringu. Głównym wnioskiem tego artykułu jest rosnąca rola usług w gospodarkach, które poprzednio koncentrowały się na produkcji i handlu towarami. Zarówno ze względu na zmiany strukturalne na rynkach zagranicznych, jak i politykę władz, proces tertiaryzacji nabiera tempa. Szczególnie podkreślono zaawansowane usługi biznesowe, które wymagają dużej ilości wiedzy, a także ją tworzą.

Słowa kluczowe: Azja, Indie, zaawansowane usługi biznesowe, eksport, bezpośrednie inwestycje zagraniczne.

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1. Introduction

Asia became the centre of global manufacturing in recent decades. This fact is frequently pronounced and implications of this situation have been deeply analysed. Less attention has been paid to the role of Asian as the global hub for services, especially those of knowledge intensive type. Nevertheless, the structural change in Asian economies is taking place. In 2013 the share of services in Asian GDP exceeded 50% for the first time. This is due to the changing rising level of development of emerging Asian economies, policies aimed at rebalancing economies, and policies towards exports of services.

The rise in services, especially those related to professional knowledge, and information and communication technology (ICT), was also a part of strategic national plans. These plans also focus on attracting foreign direct investment (FDI) to their shores. Both big Asian economies, like India and China, and smaller ones, like Malaysia or Thailand, gather pace to boost services sector. So called tertiarisation of economies became one of the fundamental change in recent decades. However, the issue is how to identify the proper areas of services and how to exploit the growth of the sector for the development purposes.

The policies of Asian countries are also aimed at increasing their positions in international market for services. Therefore they focus on advanced services, called also knowledge-intensive business services (KIBS), that are easy to transfer across borders. However, KIBS require vast number of highly educated employees and investment in communication infrastructure. It also explains why the first Indian city connected by satellite communication was Bangalore – the hub of Indian advanced services (described as IT-BPM – information technology and business process management).

Taking it all into consideration it is not surprising that Asian economies occupy top positions when it comes to the quality of environment for investment in business services. According to the consultancy A.T. Kearney the best conditions for such operations were provided by India, China and Malaysia [A.T. Kearney 2016]. The most important factors taken into consideration were costs of compensation and infrastructure, the availability of labour force with the right skills and languages proficiency, and quality of macro business environment.

The goal of this paper is to present the results of the empirical analysis of the role of emerging Asian economies in the global market for business services. The focus is on selected Asian economies, with special attention on India, as the leader in advanced business services in the region. The method applied in this paper is the quantitative analysis of data related to trade and FDI in services. The novelty of the paper lays in focusing on business services through their international exchange and activities of multinational corporations (MNCs). This paper aims to focus on broader economic perspective than usual offshoring. Moreover, the frequent approach to investigating services in Asia is focusing only one economy – India. In the present work, the Indian service sector will be analysed in the context of competing peers.

The rest of the paper is organised as follows: Section 2 provides an overview of theoretical background and recent contributions on business services; Section 3 contains results of the analysis of global and regional trends in services with respect to trade and FDI; Section 4 contains detailed analysis of advanced business service sector in India.

2. Theoretical background and literature review

This part has been devoted to the outlining the theoretical background of the role of services in an economy and international flows. First, the conceptual framework of services, business services and advanced business services will be provided.

The feature of traditional services is that they should be consumed in the place of their providing. For example, touristic service is consumed when a tourist arrives and spends time at his destination. It was also important that the service provider and user had to meet in order to exchange the service. It all influenced the general non-tradability of many traditional services. However, the situation has changed due to the development of communication tools, changing nature of production process and codifying knowledge related to services. Thanks to those changes the tradability of services increased significantly. Moreover, the non-physical form of services made them prone to delivering over large distance and still the costs of transportation is close to zero.

The mainstream of trade in services may be associated to the trade in tasks instead of trading in goods or components [Grossman, Rossi-Hansberg 2008]. The services have been incorporated in tasks at different stages of global value chains. Actually the services become the link between different operations in the value chain.

More specific focus on trade and FDI in business services was delivered by Markusen and Strand [2009]. They prepared a theoretical model in which an earlier explanation of international production by MNCs has been enhanced with service activities. The advantage of the model is also comprehending the effects of service activities for production factors' markets in a host economy.

Business services play important role in rising the productivity of manufacturing sector [Wirzt et al. 2015]. Special attention has been put on the KIBS, which require vast amount of expertise. It is also underlined that KIBS are combination of codified (formal) knowledge created by scientific institutions and tacit (informal) knowledge embedded within firms [Ciarli et al. 2012].

The issue regarding business services is their correct identification and measurement. Only recently, the international institutions (World Trade Organisation, International Monetary Fund and United Nations) delivered the comprehensive methodology of services' statistics. The example of practical problems with measuring business services in United Kingdom were presented by Herbert and Paraskevas [2012].

3. Empirical analysis business services

The problem indicated in the previous section is the limited availability of data on trade and FDI in business services. It requires the use of the aggregated data and making additional assumptions in the analysis.

In order to present the role of business services in the flows of FDI, the dynamics in the value of greenfield projects in three categories of economic activities were taken into consideration (Fig. 1). First, the manufacturing sector was compared to the services sector. Such action was necessary as for many years FDI in manufacturing dominated the global flows of investment. However, recently more FDI flows into services than into manufacturing. Indeed, the value of greenfield FDI in manufacturing has not recovered to the pre-crisis level. In the case of services it was 34% more in 2016 than in 2006.

The main focus of the analysis, however, was the investigation of the dynamics of business services. FDI in this category was much more dynamic than in overall services (57% growth over the period 2006–2016). This confirms the rising role of business services within the services in the broad meaning. It is important to note that business services according to international statistics do not encompass computer and information services. This is crucial to understand performance of Asian economies.

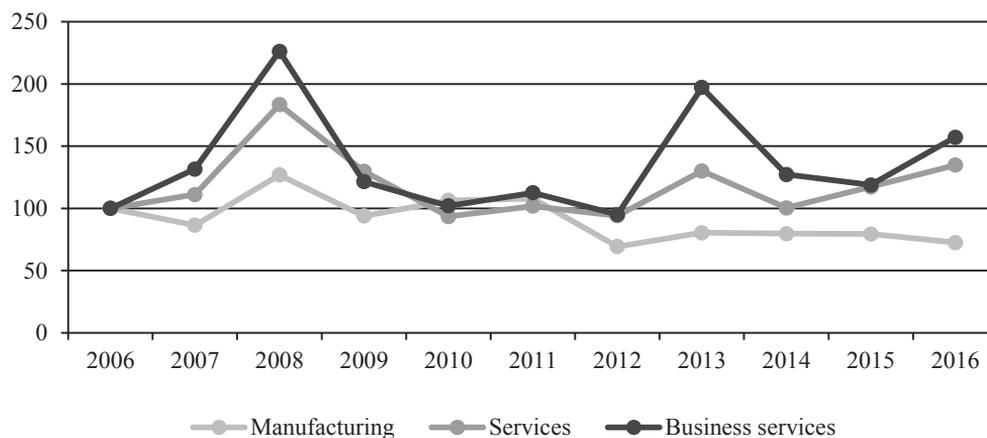


Fig. 1. Global value of greenfield projects in selected sectors (billions of dollars)

Source: own elaboration based on UNCTAD data.

The next part of the analysis was aimed at presenting the role of Asian economies in FDI flows in services. To be more specific, the category of developing Asia was considered. According to the data for 2014–2016 Asian emerging economies attracted much more capital to business services than invested abroad (Fig. 2). However, there

was a fourfold increase in the value of outward FDI in 2016 as compared to 2015. This can be interpreted as the changing role of Asia from being recipient of FDI in services to becoming an important source of this type of capital. Similar trend have been observed in the case of manufacturing FDI since a few years.

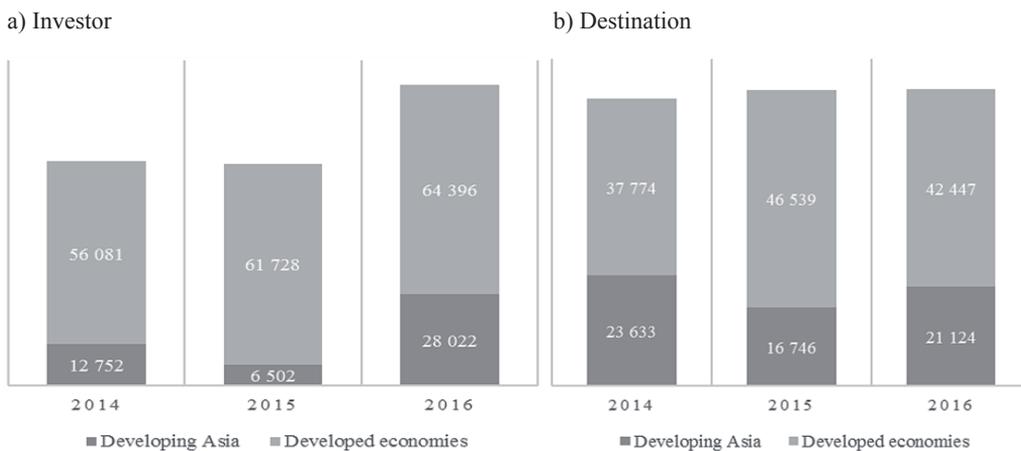


Fig. 2. Foreign direct investment in business services (millions of dollars)

Source: own elaboration based on UNCTAD data.

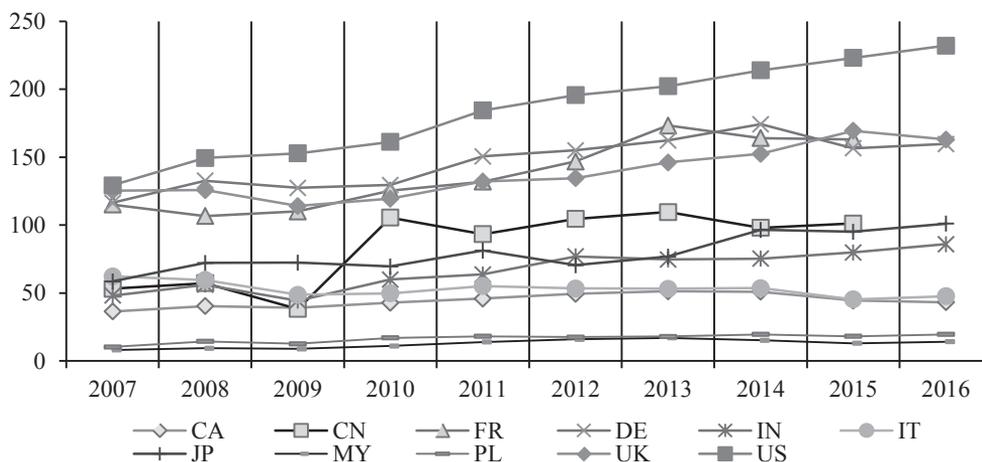


Fig. 3. Trade volume in business services (billions of dollars)

Source: own elaboration based on WTO data, country codes according to ISO 3166.

Second measure of the importance of services was their international trade. Both volume of trade and the balance of trade were analysed. To better illustrate the role of leading developing Asia economies the comparison to main developed economies

(known as G7) was applied. Additionally, Poland was included as an important localisation for business services in Central and Eastern Europe. The analysis of the absolute value of trade in business services reveals that developed economies still execute much larger volume of such trade (Fig. 3). Anyway, recently large Asian economies – India and China – have become important exporters and importers.

The positive situation of developed economies is changing when we analyse the balance of trade in business services. India and China are among the countries with the highest positive ratio of trade balance to trade volume (Fig. 4).

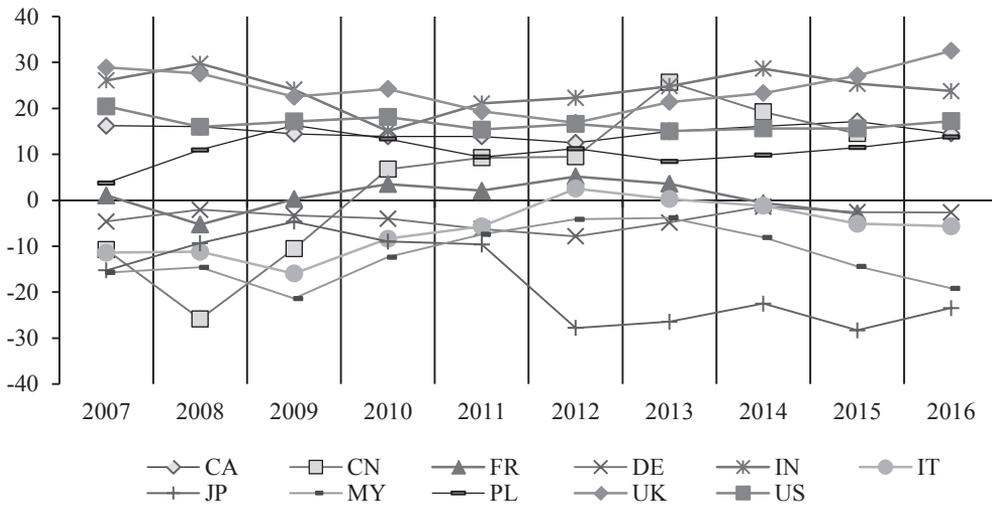


Fig. 4. Ratio of trade balance to trade volume in business services (%)

Source: own elaboration based on WTO data, country codes according to ISO 3166.

The balance of trade in business services is positive in the case of China. This is opposite situation to what can be observed in the trade of services in general. China having a large surplus in merchandise trade lagged significantly when it comes to services [Chen, Whalley 2014].

Robust results for trade and FDI should be considered as the consequence of liberalization of Asian economies. However, the economies are quite restrictive towards the opening their domestic markets for competitors originated in the same region. The analysis of international exchange of services between India and Thailand revealed that there is more competition between the countries than cooperation in spite of many commonalities [Mukherjee, Goyal 2016].

4. Indian advanced business services sector

The leading country in Asia when it comes to services, especially their knowledge-intensive type, became India. As the starting point of the rise of service sector may be described a liberalization of many areas of Indian economy at the beginning of the 1990s. However, the origins of the industry can be dated for 1980s, when the liberalization of trade in hardware and software took place. The idea of the regime of Rajiv Gandhi was to introduce and diffuse the computer technology [Sharma 2015, p. 5].

Services in India cannot be separated from the manufacturing activities. First, the focus of authorities to expand service sector was to compensate for insufficient development and international presence of India's manufacturing sector. Second, the growth in services positively influenced the development of manufacturing firms [Arnold et al. 2012].

The focus on services in India was also the result of poor physical infrastructure. Modern manufacturing requires the network of transport or reliable sources of energy. Building them takes time and induces large costs. Indian authorities, instead, promoted activities requiring abundant Indian resources: large population of young workers trained at higher education institutions. The colonial past also brought another advantage – many people speak English. Taking it together creates favourable conditions for developing advanced business services.

KIBS in India should be analysed in the wider context of the entire services sector. In spite of its low level of development, measured by *per capita* income, services in India contributed to GDP much more than in countries of comparable level of development [Shingal 2014]. However, much of India's exports constitute advanced business services with minor role of traditional services [Sahoo, Dash 2017].

Important role was also ascribed to clustering of the advanced business service providers. According to Rao and Balasubrahmanya [2017] seven clusters play the key role in international trade (descending): Bangalore (by a large margin), Chennai, Hyderabad, Mumbai-Pune, National Capital Region, Kolkata.

Exports of software and services rose from 30 billion in 1981 to 100 billion in 2013 [Sharma 2015, p. 2]. However, the big issue in the exports of services in India is its diversity (Fig. 5). Computer services dominate the exports, while research and development services have marginal role in the trade. Due to large focus on computer services India falls into the category of non-diversified countries exporting exclusive services [Anand et al. 2015]. This may lead to structural problems, when the conditions for IT change. An example of such impediment may be a new policy of the United States which try to limit imports of goods and services. India may be particularly hit because of the visa scheme, which may reduce possibility of Indian firms to send workers to the US to provide services. Indian exports of business services levelled off in 2013 after several years of robust growth. The Indian providers

of computer services represented by National Association of Software and Services Companies expect in the financial year 2017/2018 slower growth of exports of services than in previous period and also slower than the growth of domestic market [NASSCOM 2017].

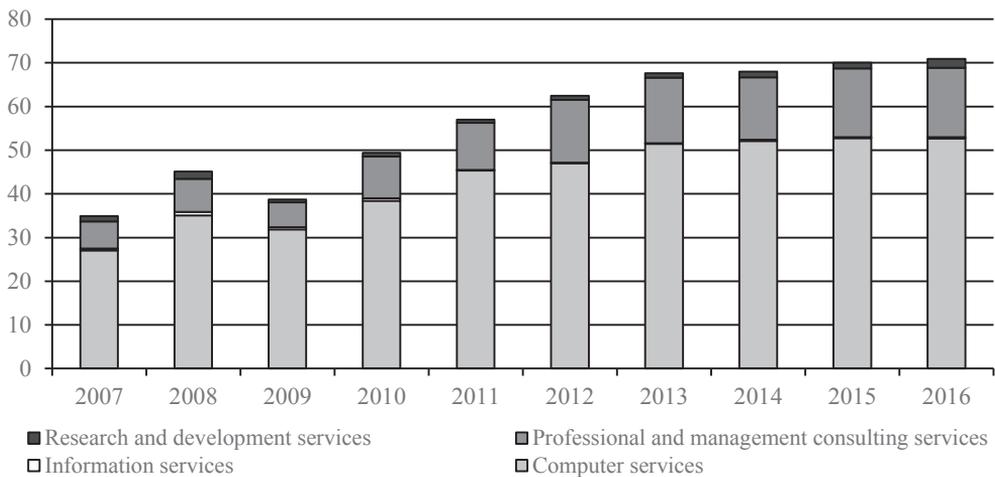


Fig. 5. Indian exports of selected services (billions of dollars)

Source: own elaboration based on WTO data.

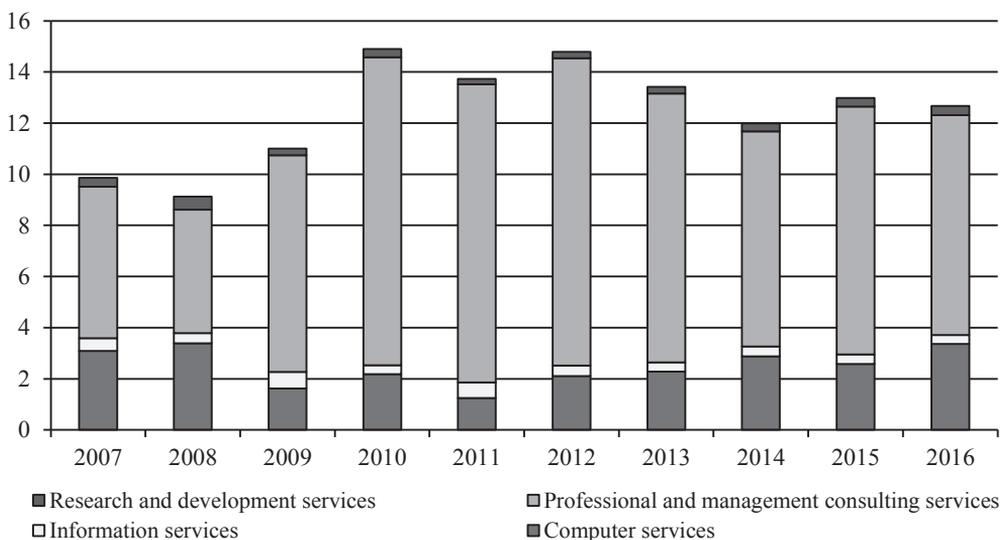


Fig. 5. Indian imports of selected services (billions of dollars)

Source: own elaboration based on WTO data.

When we analyse the imports of services the situation is much different from the exports (Fig. 6). The professional and management consulting services dominate the Indian purchases of services abroad. Important category among the services are international transfers of holding companies. Many of the operations are rather designed to optimize taxation, not to undertake real operations abroad.

In the case of trade in services there are not direct linkages between the volume of imports and exports. In the case of manufacturing goods in most cases if a country is an exporter of a certain product it is also an importer of the same category of products. This is explained by the necessity of exchanging components for the production (i.e. vertical intra-industry trade). Such relationship is almost not existent in the trade of services.

5. Conclusions

The objective of the study was to investigate the role of advanced business services in emerging Asia. The focus was on the analysis of international exchange of business services and related foreign direct investment.

The main conclusion of the paper is the rising role of services in developing Asian economies that were previously focused on manufacturing and merchandise trade. Both due to the structural changes in foreign markets and home governments' policies, the process of tertiarisation is taking place. Special focus is on advanced business services which require and create vast amount of knowledge. The countries of emerging Asia are well equipped with resources to be competitive in services sector: relatively young and well educated cohort of workers and comprehension of the recent information and communication technologies.

The policies of Asian governments are also aimed at increasing the trade in advanced business services. However, it is very difficult to achieve taking into consideration tense competition between firms from economies across the emerging Asia region. Additionally, the recent protectionist moves of some advanced economies are hindering the foreign presence of service firms. This can be particularly harmful to countries dependent on foreign markets, like India. In such difficult global environment there should be also rebalancing between foreign markets and domestic ones. Indian IT-BPM firms are already envisioning weaker growth of export sales and the need to focus more on domestic market. It will require reshuffling the business models, that were originally designed to serve as low-cost partner to companies from industrialized economies. All in all, the development of advanced business services in Asian economies is the result of policies of boosting international competitiveness of service sector and the entire economies. The official policies were built on the abundance of essential resources and structural changes in the global economy allowing for trade in services.

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