Services industry: The prime mover of the economy makes a strong investment case

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"It's not India's decade, it's India's century," McKinsey & Co's CEO Bob Sternfels had remarked recently in a media interview. He went on to add that India's large workforce, multinational corporations and massive digital scale in the financial system were the key components of the success story.

We know that the country is among the fastest growing in the world. But it is critical to understand that much of this change in India's economic growth story is led by a key component of the country's GDP – Services.

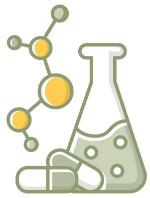
When we speak of India's demographic dividend – median age of 29, per capita more than $2300, financially aspirational and upwardly mobile Gen Z and millennials – it actually takes off from the younger population's propensity to spend on services, or on experiences as they are called.

Just this recent holiday season, we had airports packed, hotels fully occupied, airline tickets sold, tourist destinations overcrowded and ecommerce sites reporting record sales, indicating how services are all-pervasive.

Then there is India's world-class software services industry that pays its young workforce well, and yet operates at among the lowest costs compared to global standards. Finally, the whole financial services part that has taken off from the JAM (Jan Dhan, Aadhaar and Mobility) trinity.

As an investor, this is perhaps the best time to gain from the prime mover of the Indian economy by investing in the services segment that has a large number of attractive sectors with immense potential over the next decade at least.

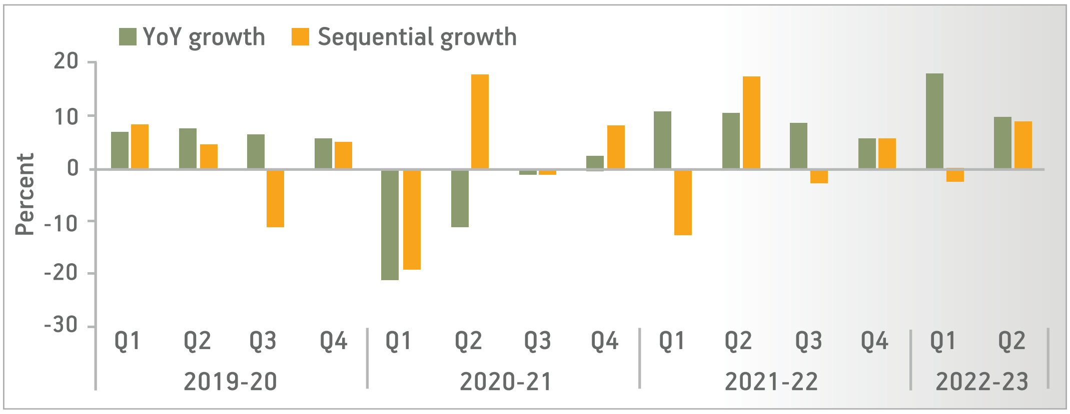
The Might of Services Sector



Services contributed as much as 53% of India's GVA (Gross Value Added) in FY22 and have been growing steadily over the past couple of decades. In fact, post-COVID, the bounce-back has been sharp. Now, services span several sectors - hospitality, tourism, healthcare, software and financial services, ecommerce, telecom and logistics among others.

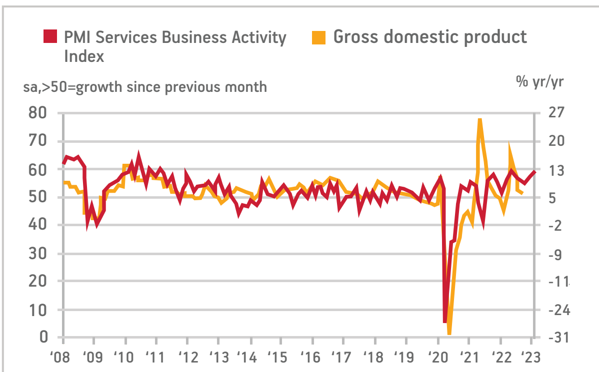
Source: National Statistical Office (NSO), Ministry of Statistics Planning and Implementation (MOSPI), Economic Survey

And in recent years, services have grown at least at 1.5 times the overall GDP growth rate.



Source: NSO, MOSPI, Economic Survey

After contracting 7.8% in FY21 due to COVID's onset, the segment grew 8.4% YoY in FY22 and is all set to rise by 9.1% (Gross Value Added) in FY23, according to the economic survey. The key measure of services activity is S&P Global's PMI. In February 2023, the reading was 59.4, which is a 12-year high for India. A reading above 50 signals expansion. What's more, most of the service companies did not pass on any cost increases to clients. That shows the segment's cost competitiveness and ability to work on tight margins when required.



Source: S&P Global, Central Statistical Office (CSO)

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Unlocking Value in Key Sectors

A host of industries within the services realm has been on the mend over the past couple of years and resumed its larger multi-decade growth story post-COVID.

- The hotel and tourism industries topped the list. Occupancy levels are nudging 70% to pre-COVID levels. Average daily rate and revenue per available room are up sharply from 2019 levels, indicating the return to normalcy and the potential growth trajectory ahead.

Hotels Sector

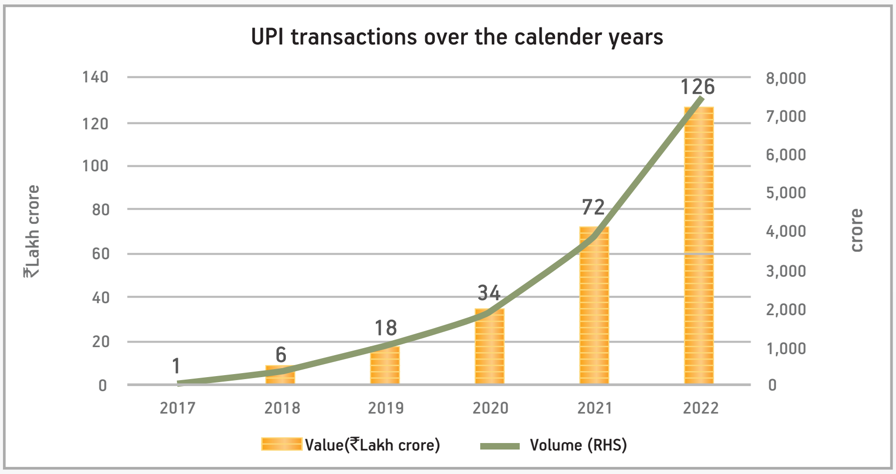
Key Stats (India Average)

	Dec 2022	Change over (Pre-COVID) Dec 2019	Change over (Post COVID-19) Dec 2021	Nov 2022
ADR	₹ 7,600-₹ 7,800	↑ 14-16%	↑ 31-33%	↑ 5-7%
Occupancy	68%-70%	↓ -1-3 pp	↑ 9-11 pp	↑ <- Stable ->
RevPAR	₹ 5,168-₹ 5,460	↑ 12-14%	↑ 53-55%	↑ 5-7%

Source: Anarock; ADR-Average daily rate; RevPAR-Revenue per available room; pp-percentage points

- The country's famed IT and business process management (BPM) industry has delivered exceptionally on the digitisation front for global clients. The work-from-home transition was smooth for the industry even during the pandemic. The industry grew 15.5% in FY22. At over $178 billion, IT-BPM accounts for 51% of services exports. The IT sector is set to hit $300-350 billion by 2025-26, according to industry body NASSCOM.

- India's telecom and digital payment journeys have been nothing short of spectacular. In 2009, we had only 17% adults with bank accounts. Only 15% used digital payments, mainly net banking then and just 4% had a unique ID document. About 37% had mobile phones. In 2022, tele-density was 93%, over 100 crore people have a digital ID document, more than 80% have bank accounts. UPI has become the ubiquitous payment platform. Other innovations such as account aggregators (AA) and open network for digital commerce (ONDC) are still in the nascent stages. India has 11 crore plus demat accounts, more than Rs 40 lakh crore in mutual fund assets and over ₹13.4 lakh crore in AIF and PMS investments.



Source: NPCI, Economic Survey

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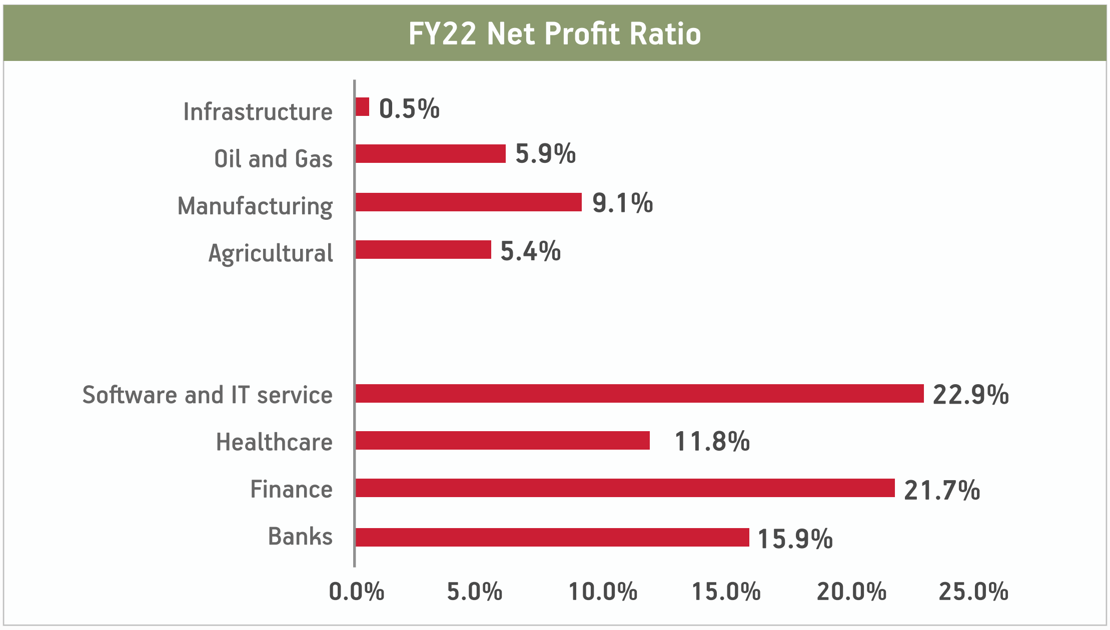
- Ecommerce shipments are set to quadruple between 2020 and 2025 to about INR 10.5 billion according to Spark Capital Research. This will benefit third-party logistics players significantly.

On the profitability front, too, when looked at from a net margin point of view, services firms tend to beat other industrial and manufacturing companies comfortably (10-12 percentage points higher).



Source: Moneycontrol, MOFSL, ABSLAMC

Given that services – via all the factors discussed above – would be one of the key drivers of economic growth in India, it would pay for investors to consider this segment for the enormous potential that it holds.

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