BUSINESS SERVICES AND THEIR CONTRIBUTION TO ECONOMIC GROWTH WITHIN EUROPEAN UNION

Jaroslava Hečková – Emília Huttmanová – Alexandra Chapčáková

ABSTRACT

The sector business services contributes directly and indirectly to aggregate economic growth in Europe. The direct contribution comes from the sector’s own dynamism. Though the business services industry appears to be characterised by strong cyclical volatility, there was also a strong structural growth. Business services actually generated more than half of total net employment growth in the European Union since the second half of the 1990s. Apart from this direct growth contribution, the sector also contributed in an indirect way to economic growth by generating knowledge and productivity spill-overs for other industries. The knowledge role of business services is reflected in its employment characteristics. The business-services industry created spill-overs in three ways: original innovations, knowledge diffusion, and the reduction of human capital indivisibilities at firm level. The share of knowledge-intensive business services in the intermediate inputs of the total economy has risen sharply in the last decade. Firm-level scale diseconomies with regard to knowledge and skill inputs are reduced by external deliveries of such inputs, thereby exploiting positive external scale economies. The process goes along with an increasingly complex social division of labour between economic sectors.

KEY WORDS


INTRODUCTION

The European economy is in a process of structural change. Two major trends characterised the period of the past two decades. One is that the share of manufacturing in the economy is shrinking (Hečková, 2005). The other trend is that services, and particularly business services, account for a monotonically increasing share of the European economy (Bobáková, Hečková, 2005). Both structural shifts are linked to each other in several ways. The fabric of inter-industry relations is being weaved in a new way due to the growing specialisation in knowledge services, the exploitation of scale economies for human capital, lowered costs of outsourcing in-house services, and the growing tertiarisation of all production processes, including that of manufacturing industry
(Bobáková, Hečková, 2007). The business services industry plays a key role in many of these processes. Many links between the development of the business services industry, and its role in economic growth remain under-explored in the literature (Katsoulacos, Tsounis, 2000, ECORYS-NEI, 2004). In the present paper we argue that business services contributed heavily to European economic growth, in terms of employment, productivity and innovation.

The paper analyses two aspects of the position of business services in the European economy, at first what has caused the fast growth of the European business-services industry, and second how has the business-services industry contributed to the growth of economy within European union.

**METHODOLOGY**

This paper is divided in two parts. The first one deals with conceptual issues, presenting concept of business services. The second section covers the explanations for the very strong growth of business services industry in recent decades. The growth of business services represents a qualitatively new stage in the social structure of production. A major characteristic of this structural change is that firm-level scale economies with regard to knowledge and skill inputs are reduced by external deliveries of such inputs, thereby exploiting external scale economies. It goes along with an increasingly complex social division of labour between economic sectors. The end of the second section covers the contribution by the business services industry to overall economic growth through level of value added and employment (direct contribution) and then through spillovers in the form of knowledge dissemination, innovation and productivity (indirect contribution) in other parts of the economy.

**RESULTS AND DISCUSSION**

The concept of business services covers a broad spectrum of services that are mainly traded in business-to-business (B2B) transactions. These intermediary services range from software development to temporary-labour agencies, from equipment rental to legal consultancy, and from translation services to the management of complex engineering projects. Business services form a most dynamic group of activities that over the last two decades accounted for more than half of the European employment growth. In some EU countries, this sector is by now in terms of employment equal-sized or larger than the total manufacturing industry.

Service activities were initially part of more vertically integrated production activities. Agriculture and manufacturing already included service functions like planning, management, administration, assessment of quantity and quality of products and inputs, product improvement, labour recruitment, learning and education, marketing, transport, storage and distribution. Service
professions gradually took over part of these business functions, running them as specialised and commercially independent activities. This went along with process and product innovations that further developed these service functions.

Business services are predominantly delivered to companies, other production organisations and government agencies. Hence, viewed from the angle of their destination, business services are primarily intermediate inputs, even though some business services – such as notary or architectural services – supply part of their production to individual consumers. Often the business service is co-produced interactively with the client. Building on this concept we define business services as a set of service activities that - through their use as intermediary inputs - affect the quality and efficiency of the production activities, by complementing or substituting the in-house service functions. This definition implies that business-services firms supply activities that in many cases could also have been produced in-house by the client. Service elements are pervasive in any production process, indeed functional services lie at the very heart of any production process. Such functional services can be provided by employees on a firm’s own payroll, or they can be bought from outside providers. In the latter case, we speak of business services as an independent industry. In Figure 1 we present an operational taxonomy of business services based on the aforementioned definition.
The most direct contribution of the business-services sector to economic growth comes from its own dynamism and expansion. The business services sector has experienced a remarkably strong growth process in the past two decades, in terms of both employment and value added. Business services nowadays count as one of the largest economic sectors in the European economy, larger than such sectors as transport, communication, hotels and restaurants taken together. More than 19 million workers in business services generate more than 1000 billion euro, and the sector’s employment and value added account for some 11 per cent of the total EU economy.
Interestingly, the EU countries and the USA had similar employment growth rates in business services over this long period, but the average value-added growth in the USA was higher. This differences implies that productivity growth in the EU business services sector was weaker than in the USA.

![Figure 2: The growth of business services within European union](image)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Value added</th>
<th>Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business services</td>
<td>1 067</td>
<td>11,2%</td>
</tr>
<tr>
<td>Renting of equipment</td>
<td>90</td>
<td>0,9%</td>
</tr>
<tr>
<td>Computer and related activities</td>
<td>183</td>
<td>1,9%</td>
</tr>
<tr>
<td>Research and development</td>
<td>37</td>
<td>0,4%</td>
</tr>
<tr>
<td>Legal, technical, advertising</td>
<td>472</td>
<td>4,9%</td>
</tr>
<tr>
<td>Other BS</td>
<td>286</td>
<td>3,0%</td>
</tr>
<tr>
<td><strong>For comparison</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>All sectors</strong></td>
<td>9 540</td>
<td>100%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>2 516</td>
<td>26,4%</td>
</tr>
<tr>
<td>Distributive trades</td>
<td>937</td>
<td>9,8%</td>
</tr>
<tr>
<td>Transport</td>
<td>455</td>
<td>4,8%</td>
</tr>
<tr>
<td>Financial services</td>
<td>576</td>
<td>6,0%</td>
</tr>
</tbody>
</table>

*Source: OECD National Accounts data, 2008*

Employment in business services grew over the past decades faster than in the total European economy and also faster than in the rest of the European services sector. The countries of northern and central Europe display stronger employment growth in business services than those in southern Europe. Job creation in the business services sector within European union represented a major shift in market-sector employment. The growth difference between business services and the rest of the economy was smaller for value added than for employment.

The business-services industry is intimately tied-up with the economic performance of other industries. This would suggest that the sector is much more sensitive to cyclical aspects than consumer services. On the other hand, the business services sector has some characteristics that could support its stability (Greenhalgh, Gregory, 2000), as well for example:

- **Job market characteristics** (the on average high qualification of workers in business services may produce a high degree of labour hoarding during the downswing of the business cycle),
Sharp cyclical fluctuations (these are often found in sectors whose products can easily be stocked. As with other service sectors, this does not apply, thus contributing to limited business cycle sensitivity),

- Some 25% of the intermediate outputs of the business services industry go to sectors (public sector, trade, utilities) that are relatively stable over the business cycle,
- The fact that some professions and activities are still relatively heavily regulated could dampen the effect of business fluctuations.

The business services sector has a higher exposure to cyclical effects than most service sectors.

Moreover, the business-cycle volatility may be different in various parts of the business services industry. The behaviour, for instance, of advanced and personalised services, where labour hoarding can be important, may be very different from that of operational and standardised services, where labour can be hired and fired more easily.

**Graph 1: Cyclical growth as percentage of deviation from long-term value-added growth within European union**

![Graph 1](image_url)

Source: OECD National Accounts data, 2006

Graph 1 shows the development over the business cycle of value added for business services (and separately computer services), manufacturing and the total economy. The business services

The development of business services as an industry forms a step in the process of labour division (Bobáková, 2007). The output increase in (business) services has to more to do with overall changes in the productive system than with just a redistribution of activities between manufacturing sector and the services sector. Specialised knowledge-intensive business functions that in the past were regarded as core competences of firms - and therefore not subject to outsourcing – are increasingly outsourced to specialised outside firms, or are continued in close co-operation with the latter.

Graph 2: Correlation between GDP per capita and the share of business services in total employment in Europe, 2006

Source: Eurostat national account data for GDP, PPS, 2008
There is a positive relation between size of economy and the role of the business services sector in the inter-industry division of labour, so that we could expect to find a relatively larger business services sector in the larger and more developed countries. In Graph 2 we plot a correlation between GDP per capita and the employment share of the business services sector. The average values for the EU are used as the basis for comparison (index = 100). We indeed find the expected pattern, even within the Europe. EU member states with a low income per capita all have a less developed business services sector, while in none of the richer countries we find a low share of business services jobs. Countries like Slovakia or Portugal, Lithuania and Latvia are below 60 percent of the EU average. Luxemburg is an outlier. For a consideration of the results of correlation we may infer that the development of the business services sector is associated with a process of structural change in the economy as average income goes up.

The growth of business services represents a qualitatively new stage in the social structure of production. The business services and communication sectors are in the focal point of the structural change. The direct contribution of business-services industry to economic growth arises from its own employment and value-added growth.

Figure 3: The direct contribution of business services to value-added growth and employment growth within European union

<table>
<thead>
<tr>
<th>Sector</th>
<th>Level of Value added</th>
<th>Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Billion euro 1980</td>
<td>Billion euro 2006</td>
</tr>
<tr>
<td>Business services</td>
<td>122,9</td>
<td>1 067,4</td>
</tr>
<tr>
<td>Renting of equipment</td>
<td>10,8</td>
<td>90,3</td>
</tr>
<tr>
<td>Computer and related activities</td>
<td>12,4</td>
<td>182,7</td>
</tr>
<tr>
<td>Research and development</td>
<td>7,0</td>
<td>36,7</td>
</tr>
<tr>
<td>Legal, technical, advertising</td>
<td>59,7</td>
<td>472,0</td>
</tr>
<tr>
<td>Ohter BS</td>
<td>33,0</td>
<td>285,7</td>
</tr>
<tr>
<td>For comparison</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All sectors</td>
<td>2 1240,0</td>
<td>9 540,1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>804,1</td>
<td>2 515,9</td>
</tr>
<tr>
<td>Distributive trades</td>
<td>218,5</td>
<td>936,6</td>
</tr>
<tr>
<td>Financial services</td>
<td>103,7</td>
<td>576,4</td>
</tr>
</tbody>
</table>

Source: OECD National Accounts Data, 2008

The value-added growth between 1980 and 2006 was stronger in business services than in any other economic sector of the European economy. Within business services, computer services
registered the strongest growth performance, while the weakest growth occurred in Research&Development.

The business services industry accounted for more than half the EU’s net employment growth between 1980 and 2006. This was more than the joint employment contribution of all other commercial services taken together and it was even larger than employment growth in public services. Business services more than compensated the shrinking employment in manufacturing.

The indirect contribution to economic growth stems from the positive spillovers that business services create for other industries. The spillovers relate to the sector’s role in knowledge and technology dissemination to client industries, and to its role in removing scale indivisibilities with regard to knowledge inputs. Knowledge-intensive business services firms have an important role in national innovation systems (Hečková, 2006). They contribute in three ways to modern knowledge infrastructure, through original innovations, through knowledge diffusion, and through their role in surpassing human capital indivisibilities. We assume that the poor productivity performance of business services industry will at least to some extent be compensated by the indirect growth contributions originating from this industry. Of particular importance are three forms of spill-over effects – in the form of original innovations, knowledge diffusion, and the reduction of human capital indivisibilities at firm level – that have a positive impact on productivity in other industries.

**CONCLUSION**

The business services sector has experienced a remarkably strong growth process in the past two decades, in terms of both employment and value added. Business services nowadays count as one of the largest economic sectors in the European economy, larger than such sectors as transport, communication, hotels and restaurants taken together. There is a significant and strong positive correlation between the average income per capita and the share of business services in total employment for European countries. The growth of business services represents a qualitatively new stage in the social structure of production. A major characteristic of this structural change is that firm-level scale economies with regard to knowledge and skill inputs are reduced by external deliveries of such inputs.

**LITERATURE**


vzdelanostnej úrovne regiónov. In: Znalostné determinanty regionálneho rozvoja. Súbor
vedeckých štúdií projektu VEGA c. 1/4638/07 a Centra excelentnosti výskumu kognícii -


z integrácie SR do EÚ, In: MEKON 2006 : sborník příspevků VIII. ročníku mezinárodní
konference EKF VŠB - TU Ostrava 2006: výsledky vědecké práce studentů doktorského
studia. - Ostrava : Vysoká škola báňská - Technická univerzita Ostrava, 2006. - ISBN 80-
248-1013-1

**KONTAKTNÁ ADRESA**

Ing. Jaroslava Hečková, PhD., Fakulta Manažmentu PU, ul. 17. novembra č.1, 080 01 Prešov,
email: heckova@unipo.sk

Ing. Emília Huttmanová, PhD., Fakulta Manažmentu PU, ul. 17. novembra č.1, 080 01
Prešov, email: huttmanova@unipo.sk

Ing. Alexandra Chapčáková, PhD., Fakulta Manažmentu PU, ul. 17. novembra č.1, 080 01
Prešov, email: chapcakova@unipo.sk