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India – the leading destination for outsourcing IT services

Source: **IT outsourcing in Central and Eastern Europe 2009**
Countries' attractiveness and development forecasts

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Introduction

The IT industry has played a stellar role in building the 'brand India' image in international markets, especially in the US and Europe. Together with the liberalization of the domestic economy, the IT industry's success has paved the way for the global community's greater participation across a wide range of Indian industries, particularly the sunshine sectors of banking, financial services and insurance (BFSI), automotive, textiles, infrastructure, real estate, cement and metals (ferrous and non-ferrous). According to the National Association of Software and Service Companies (NASSCOM), the IT industry's overall contribution to the country's GDP increased from a mere 1.2% in 1997 to 5.5% in 2007.

The industry essentially comprises software, hardware and IT enabled services (ITeS) segments. In terms of revenue contribution, software accounts for about 62% of industry turnover, followed by ITeS and hardware with shares of nearly 20% and 19%, respectively.

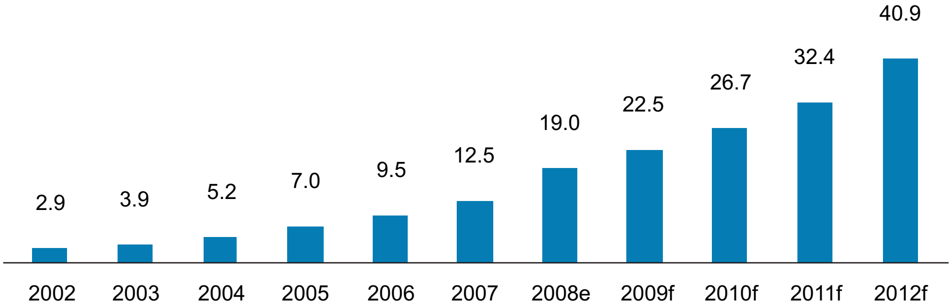
However, it is the ITeS segment – comprising transaction intensive processes and knowledge driven research across a very wide range of verticals – which has single-handedly catapulted India into the global outsourcing arena. Since its humble beginnings in 1998, India has emerged as the leading destination for all forms of ITeS related outsourcing (i.e. BPO and KPO), due primarily to the following factors:

- the world's second largest English speaking population
- a large pool of highly experienced IT professionals with extensive project management experience
- a greatly improving infrastructure
- 24*7 client servicing support compatibility
- extensive government support to the IT industry
- comparatively lower manpower and operation costs vis-à-vis other ITeS outsourcing destinations.

Overview

The size of the ITeS outsourcing market in India increased from $2.9bn in 2002 to $12.5bn in 2007, reflecting a CAGR of 33.9%, and is further predicted to grow to $40.9bn by 2012, at a CAGR of 21.2%.

Size of IT outsourcing services market in India ($ bn), 2002-2012



e – estimate
f – forecast
Source: National Association of Software and Service Companies (NASSCOM), 2008; PMR Publications, 2009

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Key market features include:

- transaction intensive business process outsourcing (BPO) services account for nearly 78% of the revenue mix, and knowledge driven process outsourcing (KPO) garners the remaining 22% market share. Industry experts estimate that after 2012 revenue contributed by these segments will change substantially, with the BPOs contributing nearly two thirds of total turnover, followed by the KPOs with the remaining one third share
- revenue mix is essentially driven by exports to the US and Europe. Presently, exports account for nearly 85% of the total ITeS market in India – a trend that is also predicted to continue in future
- India currently accounts for a near 45.0% share of the global ITeS outsourcing market. According to key players this is predicted to grow to nearly 55.0% by 2012 – largely due to the accelerated growth of KPO, as well as in the growth of BPO services. In addition, outsourcing is set to increase from continental Europe and the Middle East, on top of the traditional markets i.e. the US and the UK.

A segmental analysis of the ITeS outsourcing market in India is as follows:

BPO segment

- this segment largely comprises outsourced processes pertaining to customer interaction driven call centers / helpdesks and telemarketing services, finance & accounting (especially BFSI), recruitment processing, translation and transcription of medical documents etc
- the size of the BPO segment in India increased from $2.6bn in 2002 to $9.7bn in 2007, reflecting a CAGR of 30.2%, and is further predicted to grow to $30.1bn by 2012, at a CAGR of 20.5%

KPO segment

- the segment essentially comprises outsourced services for investment research, business research, market research and competitive intelligence, data management, information management, content management, legal research, intellectual property research, IT technology research, engineering and design research etc.
- the size of the KPO segment in India increased from $0.3bn in 2002 to $2.8bn in 2007, reflecting a CAGR of 56.1%, and is further predicted to grow to $10.8bn by 2012, at a CAGR of 23.3%.

Competition in the ITeS outsourcing market in India essentially comprises a mix of:

- BPOs: Genpact, WNS, TransWorks, IBM Daksh, Progeon, Aegis, EXL, 24/7 Customer, MphasiS, Intelenet.
- KPOs: Evalueserve, McKinsey, RocSearch, Pangea3, OfficeTiger, Copal Partners, Gevity, Pipal Research, Grail Research, Accenture, Aptara.
- IT companies with BPO operations: Tata Consultancy Services (TCS), Infosys Technologies, Wipro Technologies, Satyam Computers, HCL Technologies, Tech Mahindra, Cognizant.

In terms of geographic concentration, the ITes market in India is largely confined to the metros (the nation's capital Delhi and the regional centres of Chennai, Mumbai and Kolkata) and satellite towns such as Bangalore, Hyderabad and Pune. However, the recent emergence of Tier 2 & 3 cities, together with other satellite towns, offering low cost arbitrage vis-a-vis the established centers has forced many leading players to opt for a multi-location presence. This augurs extremely well from India's point of view, as it positions it well in countering the:

- slowdown in the US economy
- rise in wages and overall operations costs
- augmented demand for additional professionals
- stiff competition from other low cost emerging ITeS destinations such as Philippines, Ireland, Israel and Russia.

Impact of the global crisis

In the wake of the current turmoil in the world economy, the key developments shaping the future of the ITeS market in India include:

- a delay in outsourcing deal awards by most of the companies across different industries. This is largely due to the liquidity crunch impeding the market in the wake of the economic crisis gripping the Western world following the fall of Lehmann Brothers and other major investment banks in the US
- industry players focusing extensively on other verticals such as healthcare, retail, media, telecom, manufacturing, pharma, engineering etc, in an effort to offset the loss in revenue from the downturn in BFSI services
- introduction of newer delivery models entailing coverage of the entire process including technology and infrastructure support under a single service level agreement. This is reflected already in the deals recently finalized by Indian IT majors

- a direct fallout of the above is the introduction of newer pricing models with a higher risk-reward quotient. This is purely to provide greater value to the end clients, so as to negate the impact of the slowdown. In the process revenue loss incurred by a majority of Indian firms due to the appreciating Indian currency is also arrested (in H2 2008 the rupee rose by more than 10% against the US dollar)
- rationalisation of processes, applications and vendor base, in an effort to reduce costs, improve operating margins and maintain bottom lines
- higher incidence of M&A amongst the leading IT companies in India – a few of the major deals struck since September 2008 include:
    - TCS takeover of Citi's captive BPO unit for a price tag of $505m
    - HCL acquiring Axon (a UK based consultancy firm) for $658m
    - Wipro takeover of Citi's Technology Services for $127m
    - 3i Infotech buyout of the US based Regulus Group for $80m.

Industry experts predict a further continuation of the consolidation trend in the near future arising from concerns regarding vendor rationalization (i.e. a single source supplier) and price reduction amongst the international clientele.

Future outlook

The ongoing slowdown in the world economy has also impacted upon India, though the effect is less pronounced. In light of this, the outlook for the Indian ITeS market will be positive, due to the following factors:

- renewal of ongoing contracts by the majority of international companies. Additionally, new contracts bagged by leading companies augur extremely well for the domestic market – a few of the recently struck deals include:
    - TCS inked a $1.2bn deal with AC Nielsen for providing IT and operations support for a 10-year period. The company also concluded a $100.0m contract with the UK based telecom major 4U Group for ensuring IT and business support. Additionally TCS bagged a multi-year contract from the Italian bike major Ducati for implementing an ERP solution
    - Infosys added thirty new clients during Q3 2008. The company further secured a service agreement for a variety of corporate services with the global pharma major AstraZeneca
    - Wipro has been awarded a $500m master services agreement by Citigroup for providing infrastructure support and application development. The company has been roped by Credit Suisse for setting up its captive unit
    - Genpact has been awarded a financial and accounting transaction deal by the world's leading hotelier Global Hyatt Corporation
    - Cognizant announced a $21.0m deal with the Netherlands based Rabo Bank.
- several other deals under various stages of finalization, such as the $250m contract by Australian telecom major, coupled with other contracts valued between $50-$100m from global BFSI and telecom majors such as Citi, BT, GE etc.

- an expected increase in discretionary spending amongst US companies from H2 2009 onwards, following the stimulus package being rolled out by the Government, presently in the final stages of approval by the Senate
- leading players to focus aggressively on moving up the value chain. Outsourcing of high end work processes pertaining to innovation and R&D therefore augur extremely well for the domestic market – this would in fact be a key differentiator
- domestic BPO market is growing at a rapid pace, undeterred by events in the global arena, thus also signaling a huge local potential, especially in the banking and telecom verticals
- the emergence of Tier 2 & 3 cities to help Indian companies maintain their competitive edge vis-à-vis other outsourcing hotspots.

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