



TALKING POINTS

India - The Global IT
Services Backbone

Dr. Suresh Surana
RSM Astute Consulting

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TALKING Points

India -The Global IT Services Backbone

- India is the global leader in offshored IT (Information Technology) services and a principal player in BPO (Business Process Outsourcing) services
- Indian exports of IT and BPO services are projected to grow by 18-20 percent annually over the next five years
- While the United States and United Kingdom remain the foremost buyers of Indian IT/BPO services, Asia-Pacific and Continental Europe have become important destination markets
- The geographic diversification of the industry's global customer base mitigates the effects of the U.S. economic downturn
- India's offshored services industry is structured along specialized segments: Customized application development, application management, and information systems outsourcing in IT services; customer interaction, finance/accounting, and vertical specific services in BPO
- India's competitive advantage in offshored services emanates from the country's large supply of IT professionals, whose salaries are approximately one-third those of counterparts in the U.S. and Western Europe
- Mounting competition for talent and rising attrition have prompted Indian IT service providers to strengthen their human resource management capabilities
- Some Indian IT service companies are launching operations in other emerging markets (e.g., Wipro in Mexico) to sustain their cost competitiveness in the wake of rupee appreciation
- The forthcoming expiration of India's Software Technology Park tax holiday raises a potential threat to the competitive position of IT/BPO service providers
- Prominent Western multinationals (e.g., Accenture, Citibank, Deloitte) are expanding their IT/BPO operations in India, demonstrating the industry's strong value proposition for global businesses seeking costs efficiencies and operational improvements

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“70% of the business processes must be outsourced...70% of the outsourced work must be off-shored...and 70% of the off-shored processes must be in India”

Jack Welch (70 : 70 : 70 rule)

Background

India has been deemed the IT engine of the world. It has also become a preferred destination for Business Process Outsourcing (BPO) services. This is evident from the fact that exports of Indian IT Services and BPO services grew by 28 percent over the past year to reach \$34 billion. The industry directly employs about 2 million people and is expected to sustain an export growth rate of 18 to 20% annually for the next five years.

Industry Structure

Indian IT services generate \$23.1 billion annual exports. The primary segments of that market are customized application development (43% of IT service exports) application management (15.4%), information systems outsourcing (14.3%), and systems integration and software support. BPO services account for \$10.9 billion of annual exports, including customer interaction and support (43.5% of BPO exports), finance and accounting (22.1%), and verticals-specific BPO services (17.7%). (Source: NASSCOM (National Association of Software and Services Companies))

While the United States and United Kingdom remain the largest export markets (61 per cent and 18 per cent respectively), India's IT services industry is steadily increasing its presence in other geographies. Continental Europe now accounts for 12.3 % and Asia-Pacific 6.4% of industry exports.

India's Competitive Proposition

The foremost competitive advantage of India's IT/BPO services industry is a highly skilled workforce that offers a 3:1 cost differential compared to service providers in the United States and Western Europe. India's higher education system annually produces nearly 2.8 million graduates (of whom 495,000 possess technical degrees) and over 300,000 post-graduates. This large, technically proficient, linguistically capable labor pool enables Indian IT service companies to deliver a compelling economic proposition to clients worldwide.

Business Challenges

In addition to huge growth opportunities, India's IT/BPO industry faces a number of challenges:

- **The U.S Economic Slowdown**

India's IT sector is heavily dependent on the United States and thus vulnerable to the slowdown of the American economy. However, it is expected that U.S. demand for offshored IT services will remain strong as American businesses undertake cost cutting and re-engineering exercises. Furthermore, Indian IT service providers are diversifying their customer bases to other markets such as U.K., Australia and Middle East.

- **Talent Retention, Attrition & Cost of Retention**

The retention of middle and senior management teams is critical success factor and is proving to be a major challenge for Indian IT-BPO service companies. According to McKinsey & Co., the industry leaders that are setting best practices in human resource management actually pay less than the laggards. These high performing companies emphasize effective people management practices rather than financial compensation to keep their teams intact. At the same time, many Indian IT companies are expanding their service delivery infrastructures within India by moving into Tier-II and Tier-III cities to maintain their cost-effectiveness and improve talent retention.

- **Rupee Exchange Rate**

The rupee's appreciation against the U.S. dollar (nearly 12% over the past year) is a major test for Indian IT services companies, whose offshore receivables are mostly dollar-denominated but whose expenses are settled in rupees. As a result, companies are increasingly focusing on high-margin service lines such as finance and accounting, legal process outsourcing, risk management services, analytics, advisory and process re-engineering. The sector is also reducing currency risks by improving productivity and providing greater value to customers.

Some Indian companies are even heading offshore to maintain their cost effectiveness. For example, Wipro has opened a facility in the Mexican city of Monterrey to service American and European clients, while Satyam has launched a software centre in MSC Malaysia, a government-designated high-tech zone.

- **Expiration of Tax Holiday**

Yet another challenge facing India's IT-BPO industry is the expiration of the income tax holiday period for Software Technology Park (STP) Units in 2009. While the 15 year tax break (100% for first 5 years and 50% for next 10 years) would be available to units located in Special Economic Zones (SEZs), the benefit will not be available to STP units. This will reduce India's attractiveness as certain competing countries offer tax breaks.

To meet these challenges, key industry players are seeking ways to convert each customer into a value-adding, revenue-generating resource that promotes continual productivity improvement and technology adaptation. Consequently the Indian IT/BPO industry continues to enjoy significant growth potential.

Opportunities for Global Businesses

The value proposition presented by the Indian IT/BPO services industry represents a huge opportunity for global businesses. This is evident from the fact that Citibank has over 10,000 employees in business process outsourcing operations and Accenture employs over 35,000 people in India's IT/BPO segment. Accenture's Indian operations are currently ranked second to the U.S. in terms of headcount. Deloitte is estimated to employ 5,000 personnel in India, and is expected to increase its Indian workforce to 15,000 employees over the next 5 years.

Another example is the \$ 1.2-billion deal that Tata Consultancy Services (India's largest IT services company) has struck with AC Nielsen for IT and operations support over a ten-year contract. AC Nielsen's finance and HR business processes are also included in the contract, which will be executed on a new business platform designed by TCS. TCS has also taken over the responsibility for a new development centre as part of the deal.

The following segments of India's IT services industry offer the greatest offshoring potential:

- Software application development and support
- Information systems outsourcing and systems integration
- Customer interaction and support
- Finance and accounting services
- Human resources support services
- Vertical-specific BPO services and knowledge based services

By leveraging the capabilities of Indian IT service companies in these segments, global businesses stand to reap substantial improvements in operational performance and shareholder value.

The author is a Chartered Accountant and founder of RSM Astute - the Indian member of RSM International.

Biography

Dr. Suresh Surana

Dr. Suresh Surana is a Chartered Accountant and a graduate in law from the Bombay University. He completed his doctorate in 'Business Policy & Administration' from the Bombay University.

He is the founder chairman of Astute Consulting and affiliates headquartered in Bombay (Astute Group). Astute Group is the Indian member of RSM International, the 7th largest accounting and consulting group worldwide with gross billings of US \$ 3.06 billion and offices in 64 countries. Astute and RSM's Indian operations have 14 offices in 10 cities in India and a team of over 900 employees.

Dr. Surana's experience in IT and ITES-BPO sector includes:

- He is the founder and Vice-chairman of RSM McGladrey FPO India Pvt. Ltd., a financial process outsourcing company having a team of over 400 employees. It provides end to end financial accounting solutions to franchisees of prestigious US corporations operating in the fields of restaurant chains, automobile spare parts and retail grocery.
- Astute Group's IT and IT solutions operations have a team of over 175 personnel.
- Astute Group is advisor to several IT and BPO companies including Mastek and i-flex.

Besides this, he sits on the board of various listed and unlisted companies.

He has authored several articles and is a regular speaker at various professional and business forums.

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