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EMERGING MARKETS SERIES

Opportunities for Indian IT-BPO Industry in the Germanic Region

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Executive Summary

The German speaking countries of Austria, Germany and Switzerland have traditionally been the economic vanguard for rest of Europe. They continue to retain this claim as they strongly recover from the economic downturn while the other European economies continue to struggle or face another round of economic turbulence with unsustainable public debt. In this context, it is important to mention that though the Indian economy, has been impacted by the global slowdown, it has been largely resilient.

The Germanic region – comprising Austria, Germany and Switzerland – is one of India's most important trading partners with a total annual business of more than $32 Bn. Germany and Switzerland figure among India's top 10 trading countries with machinery, energy, textiles, and chemicals being the largest traded commodities. Beyond the trade partnership, the Indo-Germanic relationship has been based on economic and political co-operation, shared values and agreement on international affairs.

There exists an opportunity for the Germanic region and India to leverage the past economic relations and their individual strengths for common interests. This will require both India and the Germanic countries to strategically align themselves – by being conscious of the markets, regulations and the preferences on both the sides.

The focus of this study is to identify partnership opportunities for both India and the Germanic countries in the area of IT services, business process outsourcing (BPO) and engineering services.

Market Overview

The changing macroeconomic scenario and opportunities for mutual cooperation

The Germanic countries are not exceptions to the changing world economic order in which the market hot spots are shifting to newer geographies. These countries, which have traditionally been economic leaders, are already facing prospects of a reducing dominance in the global output.

Simultaneously, saturation in its traditional markets is inducing Germanic companies to approach new markets with lower costs and the continued commitment to quality. In the long-term, competitiveness is further under threat considering the aging population and the decreasing availability of science and technology skills critical to deliver innovative and cost-effective products to the new markets.

In contrast, India has gradually increased its share in the world GDP and has emerged as a lucrative market. This, combined with its favourable demographic position, the large technically qualified workforce and lower cost credentials, offer opportunities for both India and the Germanic countries to take their economic relations to the next level of co-operation.

Germanic IT and BPO Market Landscape

IT Services market: The Germanic countries are the largest IT and BPO markets in Europe. These economies spend over USD 100 Bn on IT services, of which over USD 46 Bn is purchased. Germany is the largest consumer with over USD 36 Bn worth of IT services purchase followed by Switzerland (USD 7 Bn) and Austria (USD 3 Bn). The Germanic clients are mature users of IT outsourcing and are used to handling large-scale multi-vendor engagements. The Germanic clients are discerningly quality- conscious and expect superior project management skills in addition to high domain and technology expertise. Among the critical soft factors influencing decisions on prospective partners are the degree of local presence, proficiency in German language and security.

Outsourcing: The Germanic countries have been one of the first proponents of outsourcing and therefore, have an established ecosystem of local and regional service providers exists. The supplier side is heavily fragmented with the top five players holding a cumulative market share of less than 40%. Among the larger players are the global IT companies like IBM, HP and Accenture and the regional dominant players like T-systems and Siemens. More than 40% of the market is still characterised by many small- and medium-sized players that operate in niche or local markets. Indian companies earn close to USD 1.4 Bn from these countries with a market share of about 3%.

Offshoring: The propensity to offshore among the Germanic companies has been limited and only USD 5.6 Bn worth of IT services have been offshored. India is the single-largest destination for the offshored IT work and constitutes close to 25% of the offshoring pie. However, close to 70% of this pie is served by the Eastern European and CIS countries.

BPO Services: Germanic companies, owing to the large exposure to exports, have significant multi-national operations. Considering this, the companies have been early adopters of the captive shared centre model as a means to improve efficiency and also save costs. As a result, many Germanic companies have dedicated shared service centres either locally or in offshore locations. The market for BPO is estimated to be around USD 4 Bn with a growth rate of 11% CAGR. Human resources and finance are the highest offshored business services. As in the case of IT services, German language skills, cultural fit and data security capabilities are critically evaluated while deciding on a potential destination for BPO services.

Engineering Services Offshoring: The market for engineering services in the Germanic countries is estimated to be around USD 100 Bn. While services worth only USD 3.5 Bn is offshored currently, the trend is increasing and the expected market for offshore engineering services is expected to grow to over USD 20 Bn by 2020. India is the destination of choice for engineering services with export revenues of over USD 900 Mn to these countries in 2009. Among other competitors to India are Eastern Europe, China and CIS countries.

Strategies to succeed for Indian IT-BPO companies

Indian companies currently earn less than USD 2.6 Bn from this region across the IT, BPO and engineering services space. Business from the region has the potential to grow to USD 10 Bn by 2020, provided Indian companies take the strategic and tactical steps required to succeed in this market.

Strategic long-term intent: Indian companies need to strategically develop their presence in this region with adequate German language skills, high domain expertise, flexibility to offer nearshoring as well as offshoring options and all of this combined with an evident long-term commitment to the region. The market rewards long-term players who are willing to invest time and capital in the region, while short-term players are rarely considered.

In this context, it is critical that Indian companies establish a local presence either independently or in partnership and develop German language skills among its sales and delivery teams. It is a general perception that the only proposition Indian companies bring to the table is offshoring and low cost. Changing this perception is critical for success in the region and Indian companies should focus on establishing relationships and comfort with the clients by accepting onshore engagements.

German language skills: The Germanic economies have traditionally been export-dependent and are mature in operating in a complex multi-geography environment. In spite of these factors, communication and poor project management have been highlighted as the most important factors, which hinder realising the envisaged benefits of engaging with Indian companies.

Indian companies should be mindful of the fundamental need to develop German language expertise among its front end as well as the delivery teams. Indian companies have the advantage of having access to a pool of technically skilled workforce, which is quick in learning foreign languages and deploying those skills on client engagements. These companies should capitalise on this latent expertise and the existing German language training capacity in India to endow itself with the basic requirement in these markets. Small and mid-sized companies should seek partnerships with similar-sized Germanic companies for front-end capabilities.

Nearshore capabilities: To target the huge Germanic market, Indian companies should consider setting up delivery centres in the nearshore regions of Eastern Europe and the CIS countries. This will also help them reach out to the large Germanic companies and the reserved middle market customer segment. This strategy will also help Indian companies to circumvent the constraints placed by the EU directives on data protection.

High domain expertise, quality and project management: These are the top three expectations that Indian companies should meet to succeed in this market. The Germanic companies, while synchronised with their global counterparts, have operating methods which are unique to the region. Germanic companies will expect their partners to appreciate these unique industry-specific domain peculiarities and showcase resources who either understand or are capable of quickly grasping these technicalities.

Further, Indian companies will need to ensure that their sales as well the delivery are adequately supported by professional project management, which stresses on the need to meet timelines, without compromising on quality and ensuring a continuous stakeholder management.

M&A as the opportunity: The Germanic IT services market is fragmented and is in the consolidation phase. Though Indian companies have also been active in this scenario, the transaction size has been small. Indian companies should look at large-ticket acquisitions as a viable strategy to establish themselves in this market to gain the necessary scale and have access to specific customer accounts.

Sectors to target: Manufacturing, BFSI, automobile and the logistics sectors are the most attractive targets for Indian companies. These four sectors mutually consume IT services worth more than USD 30 Bn.

Customer segments to target: Over 75% German companies and over 99% Swiss and Austrian companies belong to the SME segment. Indian companies have so far only engaged with large companies leaving the demand from the SME segment untapped.

The SME segment, on account of its large exposure to international markets, has equally complex operations like the larger companies. Currently, the SME segment is largely served by the local SME IT-BPO companies. Indian companies will need to customise their approach to the SME segment by adopting a more partnership based relationship.

Services to target

IT Services: Indian companies should target package product maintenance and implementation services as a quick win service offering. Besides this, Application Development and Maintenance and Remote Infrastructure Management (RIM) are the services that will find a large market in these countries.

BPO: Indian companies should as a first step target the non-voice based transaction services in the Germanic region. Amongst the non-voice services, financial services back office, F&A and HR are the services to take to this market.

Considering the Germanic sensitivity to the language, voice based contact centre services should only be taken to this market after obtaining relevant experience of working with these companies in the non-voice scenario and being equipped with the requisite German language skills. To obtain adequate skill sets in German voice contact centre services, Indian companies should consider partnering or acquiring companies in the Germanic region or Eastern Europe in addition to developing the language capability inventory internally.

Engineering Services: Owing to its language independent nature and obvious cost benefits because of easy offshore ability, engineering services is a low hanging opportunity for the technically equipped Indian companies. Companies with technology expertise in Automobile, Energy, Telecom and Industrial Design and Research have a huge potential to succeed in this market.

Action points for Germanic Countries

Germanic countries are currently facing challenges on the demographic and the talent front. It is essential that Germany, Austria and Switzerland re-look at their policies which may be impeding talent development, acquisition and deployment and make suitable amendments. These measures are also critical to ensure the realisation of benefits of partnering with India.

Some of the areas that require immediate attention are:

Controlled migration: Germanic countries need a highly qualified and motivated workforce across industries and, more so, in the knowledge-based sectors. The strategy should, therefore, be to attract the best brains from the world over. The current policies on work permits and permanent residency need to be made more industry friendly and flexible.

Education reforms: Many of the talent shortage issues that these countries face are also because the education system is not in keeping with the changing nature of the economy and the demographic profile. As a result, in spite of the higher unemployment rate, these countries continue to face talent shortages in specific sectors. The policy makers need to take steps to reform the education system to ensure that education is relevant and meets the economic and social requirements. Encouraging adaptation of science and technology courses has a direct bearing on the innovation capacity for the future.

Popularise region for international studies: Only 8-10% of the total international student base chooses the Germanic region as a destination. This inhibits the inflow of talented manpower with high skill sets getting assimilated in the Germanic countries

We would like to thank **German Trade & Invest** for their support.

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