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## NASSCOM®

International Youth Centre, Teen Murti Marg, Chanakyapuri

New Delhi – 110 021, India

Tel – 91 11 2301 0199 Fax – 91 11 2301 5452

Email: research@nasscom.in



**PricewaterhouseCoopers International Limited**

'Muttha Towers' 5th floor, Suite No.8, Airport Road,

Yerwada, Pune – 411 006

Tel – 91 20 4100 4444, Fax – 91 20 4100 6161

Email: puneet.gaharana@in.pwc.com

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# Executive Summary

Today, Japan constitutes less than two per cent of the IT services exports from India. Penetrating the second biggest IT services market in the world continues to be a challenge for the Indian IT companies. Indian companies looking to de-risk themselves from dependence on a single market have long tried to establish themselves in this market, but with nominal success. With its large technically qualified manpower base and IT service delivery expertise, India definitely has a big role to play as the aging Japanese economy makes choices to stay competitive in global markets.

This study strives to bring out the key opportunities for Indian IT companies and the potential strategies to play a major role in the Japanese market.

## Market Overview

**Market size:** Japanese IT services market at USD 108 billion is the world's second largest after the US. Demand is primarily driven by the BFSI and Manufacturing industries, which together consume close to 42 per cent of the IT services. Other large consuming industry sectors are the system integrators (16.3 per cent), public sector (8.6 per cent) and ICT (7.9 per cent).

IT usage in Japanese firms so far has focused on improving the business efficiencies in administrative and intra company transactions. Only small portion of companies have utilised IT for strengthening competitiveness of the firm. This is also underlined by the absence of a fully functional CIO's office and a documented IT strategy. Low strategic importance to IT is also manifested by the fact that IT budget is limited to meager 1-1.5 per cent of the annual sales for most firms. Further, these budgets are largely utilised for ongoing maintenance of the current setup rather than new development.

Another uniqueness of current IT setup is the domination of custom-built softwares versus package products. With changing business requirements and increased need for flexibility, enterprises are now overcoming their deep rooted preference for custom-built application and increasingly adopting a wide range of packaged software applications. ERP, Sales force automation and CRM lead the wish list. However, availability of Japanese versions and language support continues to be a precondition.

**Service providers:** Similar to other Japanese industries, IT service providers are also organised in the Kieretsu business model where Fujitsu, Toshiba, NEC, NTT Data, and IBM form the top layer. The top tier works closely with the in-house IT teams of Japanese companies and assist in identifying investment priorities and the roadmap. All IT development work is first contracted only to these large system integrators, who then break large projects and outsource to secondary and tertiary players forming a hierarchical ecology. Indian and Chinese vendors often serve as tertiary service providers.

**Offshoring:** Less than 10 per cent of the outsourced IT services are offshored. Most offshoring initiatives are by the system integrators and the next levels in the services hierarchy. Estimated revenues from offshoring of Japanese IT services are around USD 8.6 billion. More than 50 per cent of services are offshored to China, while India receives around 13 per cent of the offshoring pie. Philippines and Vietnam are other low cost offshoring destinations.

Shortfall of skilled manpower and cost pressures are driving the Japanese to explore offshore options. However, language and the oligopolistic service provider hierarchy have resulted in few alternatives for the Japanese clients to benefit substantially. Preference to China has emerged out of lack of options to cater to these demands.

Though China has enjoyed preference as a location, it is largely regarded as a low-end service provider with limited capabilities to manage large complex projects requiring high domain expertise. Indian IT vendors are considered high on technology and domain competence, with fast ramp-up capabilities, low on cost and with a better IP protection environment.

## Strategies to Succeed

### Japan – A market for long-term players

Japan calls for a strategic approach and the capability and intent to invest in long-term relationships. The Japanese market is harsh to short-term players and rewards long-term partnerships. Indian IT companies intending to gain an entry into this market need to keep in mind that Japan is a difficult country for opportunists and short-term fruits are rare.

### Localise to succeed

The importance of localisation in the Japanese market context cannot be over-emphasised. IT companies in the market should have Japanese front-end at the senior management levels supported by a Japanese sales force. This has to be backed by moderate to high levels of Japanese language skills for the delivery staff.

### Big opportunity in legacy migration/modernisation

Most Japanese enterprises continue to operate the legacy mainframe. More than 53 per cent of the Japanese IT services constitute of customised software development. These applications, developed primarily using the IBM family architecture, require extensive COBOL skills to maintain and enhance them.

Japanese companies are now beginning to modernise/migrate their legacy application in view of the high maintenance cost, low flexibility and non-availability of legacy skills. Top tier Japanese vendors who developed these systems will get the biggest pie of the migration opportunity. However, Indian vendors with strong domain understanding, experience with global clients and moderate level of language skills should target this market.

### Embedded systems and engineering services are quick win areas

Japan has a very strong industrial and market base for embedded products and with the reducing product lifecycles, increasing functionalities and product complexities, companies are driven to exploring opportunities with offshore vendors. These services can be quick wins for Indian companies owing to their high market requirement, low language dependence and high offshoreability.

Targeted capacity building in the embedded software, engineering and R&D space can be used to position oneself as a niche market player. Similarly, developing and showcasing high standards to work on leading edge technologies through process and quality certifications are essential.

### JV/Alliance with the top and second tier players

Alliance with the first and second tier players is a good entry strategy. These large players are also exploring offshoring options to China and India to leverage cost efficiencies and access skilled human capital.

### Offshore development centre in China

China is currently a preferred location for outsourcing low-end development work by Japanese clients. China's moderate success is on account of its 'closeness' with Japan culturally and geographically. Dalian and Shenyang in China offer a large Japanese speaking workforce, which is being utilised for serving Japanese clients. Setting up an ODC in China can be an option for Indian companies. However, this strategy will first require Indian companies to invest substantially in developing service delivery capabilities amongst the Chinese, before expecting returns. This approach is also subjected to the stability of the Sino-Japanese relationship and the perception of Chinese companies as low-end service providers.

## Initiatives by Japan

### Japanese Government and industries need to make proactive efforts to break the traditional model and reach out to the advantages of Indo-Japanese partnership in IT services.

Japanese Government should proactively encourage industries to look beyond the service provider pyramid and engage with global players. These global players can offer substantial value in terms of their domain expertise and service delivery maturity, which can be leveraged to improve the competitiveness of the Japanese economy.

Given the changes in the demographic pattern and the emerging preference for non-IT professions, the government should also facilitate inflow of foreign skilled workers and their acceptance in the Japanese social as well as business setups.

Industries in Japan, to truly realise the benefits of IT need to re-evaluate their traditional attitude to IT and view it as a strategic enabler rather than a cost centre.

Establishing a CIO/CTO office to manage IT can be a first step, which will also help organisations mature on the global IT project management best practices concerning scope and contract management, governance, documentation and vendor relationship management.