

# THE IT-BPM SECTOR IN INDIA

Strategic Review 2013

## IT Services



# Executive Summary

**“The old order changeth, yielding place to new, and God fulfils himself in many ways, lest one good custom should corrupt the world” – Lord Alfred Tennyson**

History has proved that no social, political or technological order, however powerful and stable it might be for a time, has been permanent. The continuous advancement of men, invention, and science has ensured a succession of changes that come over societies and nations. Even good practices when mechanically followed over long periods lose their true meaning. Change is after all, the law of life, and even so in a year where the global economy has taken two steps forward followed by one or two steps back.

Uncertainty and moderation of economic activity across the world was the highlight of the year. While there have been policy responses in some markets, changing direction of interest rates and currencies, there has been a higher degree of uncertainty than at almost any time in recent memory, and this has left an indelible impact on the IT-BPM industry. Budgetary tightening has led to smaller IT budgets translating to smaller deal sizes, and reduction in certain existing business lines and market segments. However, there is a clear delinking of overall IT-BPM spending with respect to economic turmoil in the past few years, and this has been fuelled by rising consumerisation of the enterprise segment, which has in turn, meant a lot for clients – it has led to increased competition, with players leveraging new forms of services to create a differentiating factor. It has also led to change management issues, and both these areas have been effective sources of new business for existing and new IT-BPM organisations. New areas such as mobile, social, cloud and analytics is increasingly driving technology spending, and will emerge as mainstays as this decade progresses further.

The Indian IT-BPM industry has exhibited rapid evolution – in terms of expanding their vertical and geographic markets, attracted new customer segments, transformed from technology partners to strategic business partners imbibing a shared vision, offering considerably wider spectrum of services over the years. Growth has been both organic and inorganic, resulting in the emergence of the first Indian MNCs – over 580 global centres in over 75 countries delivering IT-BPM services. At the same time there has been no let down in focus on operational efficiencies. Global in-house centres continue to evolve to higher value added roles further cementing India's premier position in the global sourcing landscape, accounting for 52 per cent of the market in 2012, up from 50 per cent in 2011.

The industry today though is at a crossroad – behind lies a scintillating era of exponential growth and global recognition, the future though looks markedly different. The first USD 100 billion was largely a labour arbitrage play; the next USD 100 billion will be a combination of higher value services and increasingly non linear play, in addition to a further extension of the cost proposition. Today, the Indian IT-BPM industry has already begun moving from enterprise services to providing 'enterprising solutions'. These are not standard lift and shift solutions – key to this world is a high degree of proactivism, maturity, business understanding and entrepreneurship. Our clients today expect the industry to tell them what is best, suggest changes, improve and replace existing workflows. Today, the service provider has to be a lot more enterprising, display entrepreneurship to ensure a service delivery that is IP driven and productised,

involves global delivery and talent, served over multiple platforms, has the customer at the centre of every module, and is transformative in nature. Customers want solutions that do not have capex involved, and today players have to design these as a pay as you go model and recover their costs on a gain-share basis. The Indian IT-BPM industry is leading the drive to design solutions incorporating SMAC (Social, Mobile, Analytics Cloud,) to offer innovative, enterprising answers. These enterprising solutions are able to create client impact on not only cost, but also revenues, profit margins and cash flows.

## Global Sourcing Trends

In the face of a volatile economic environment, 2012 recorded a steady growth for technology and related services sector, with worldwide spending of USD 1.9 trillion, a growth rate of 4.8 per cent over 2011. BPM services with 4.9 per cent (slightly above industry average) contributed majorly to the growth; followed by IT services and packaged software each with 3.3 per cent growth. IT, BPM services and software products continued to lead, accounting for over USD 1 trillion – 58 per cent of the total IT spend. IT hardware with growth rate of ~7 per cent, touched USD 797 billion and accounted for the remaining 42 per cent of the worldwide technology spend in 2012.

In line with growth in global IT spend, global sourcing market also grew to USD 124-130 billion, growth of 9 per cent over 2011 – nearly twice the growth of global IT spend. APAC spend grew 6 per cent, nearly 1.6X faster than mature geographies. IT spend of Americas remained steady at 5 per cent and EMEA recorded a minimal growth of 1 per cent over 2011. The impact was also visible on the vertical spending with emerging verticals driving incremental growth in 2012. While BFSI and manufacturing segment remained the two largest verticals in terms of total share in IT spending with more than ~40 per cent share, emerging verticals like healthcare, retail, government and utilities contributed ~30 per cent of total IT spend in 2012.

Lingering concerns about the global economy also impacted contracts; volume fell ~13 per cent, however Average Contract Value (ACV) remained fairly steady at USD 21 billion largely due to a number of mega-deals in BPM. In terms of regional contracts, APAC was the sole market to have registered significant growth over 2011, ~55 per cent (value terms) and increased its share in total contract value to 15 per cent; EMEA contracts declined 13 per cent and the Americas by about 2.5 per cent.

## Indian IT-BPM Performance

FY2013 has been a year of transition and transformation for the Indian IT-BPM industry as it toiled hard to continue its growth trajectory albeit at a slower pace despite global economic uncertainty.

The industry is estimated to aggregate revenues of USD 108 billion in FY2013, with the IT software and services sector (excluding hardware) accounting for USD 95 billion of revenues. During this period, direct employment is expected to reach nearly three million, an addition of 188,300 employees, while indirect job creation is estimated at 9.5 million. As a proportion of national GDP, the sector revenues have grown from 1.2 per cent in FY1998 to nearly 8 per cent in FY2013. Its share of total Indian exports (merchandise plus services) increased from less than 4 per cent in FY1998 to about 23-25 per cent in FY2013.

- **Exports market:** Export revenues (excluding hardware) are estimated to gross USD 75.8 billion in FY2013, growing by 10.2 per cent over FY2012, and contributing nearly 80 per cent of the total IT-BPM revenues (excluding hardware), employing over 2.3 million employees
- **Servicelines:** The IT services segment aggregated export revenues of USD 43.9 billion, accounting for nearly 58 per cent of total exports and a growth of 9.9 per cent over FY2012. Indian IT service offerings have evolved from application development and maintenance, to emerge as full service players providing testing services, infrastructure services, consulting and system integration. Within that, IT outsourcing exhibited strong growth, in line with global trends, driven by increased spend in the remote infrastructure management, application management, testing and SOA segments. Cloud computing, mobile computing gained credence this year as it offered clients access to best-in-class process management at reduced capital expenditure levels

The BPM segment that has been reinventing itself in the past few years is expected to be the fastest growing at 12.2 per cent and estimated to gross USD 17.8 billion in FY2013. Increased acceptance of platform BPM solutions was the key highlight, as providers increasingly focused on transforming client businesses through a mix of re-engineering skills, technology enablement, and new service delivery methods.

ER&D, OSPD and software products segments are estimated to generate exports of USD 14.1 billion, a growth of nearly 9 per cent over FY2012. ER&D firms are increasingly developing capabilities that are enabling them to participate across all stages of development, thereby delivering high-end services to customers. Disruptive technologies – cloud, mobility, social media and big data/analytics, are playing a significant role in driving growth of OSPD and software products.

- **Geographic focus:** The year was characterised by healthy growth in Europe (including UK) and APAC. US, the biggest market for IT-BPM exports also continued its growth momentum albeit at a slower pace. As the European market is becoming more amenable to offshoring, growth in this region is expected to firm up further
- **Vertical markets:** The industry's vertical market mix is well balanced across several mature and emerging sectors. Growth this year was driven by emerging verticals of healthcare, retail and utilities growing at a consolidated 12 per cent, even as the traditional verticals BFSI and manufacturing recorded above industry average growth
- **Domestic market:** Domestic IT-BPM revenue (excluding hardware) is expected to grow at 14.1 per cent to gross ₹ 1,047 billion in FY2013. Strong economic growth, rapid advancement in technology infrastructure, increasingly competitive Indian organisations, enhanced focus by the government and emergence of business models that help provide IT to new customer segments are key drivers for increased technology adoption in India
- IT services is the fastest growing segment in the Indian domestic market, growing by 14.5 per cent to reach ₹ 674 billion, driven by IS outsourcing, cloud services and increasing adoption from all customer segments – government, enterprise, consumers and SMBs
- Domestic BPM segment is expected to grow by 12.7 per cent in FY2013, to reach ₹ 167 billion, driven by demand for hosted services and higher uptake by traditional and emerging verticals, including the government

- The domestic software products segment is set to grow to ₹ 205 billion in FY2013, a growth of 14 per cent over FY2012. This segment is being driven by the need to replace legacy systems and technology advancements around cloud, mobility, etc. and to streamline existing operations (large firms and SMBs)

India's customer base – government, large enterprises, micro, small and medium enterprises and household consumers, represent a unique set of requirements which has opened up new opportunities for the domestic IT-BPM sector. Rising Indian corporations facing competitive global market conditions, increasing spend by the government in several eGovernance initiatives, enhanced connectivity and increased levels of IT spending are key factors, which make the domestic market lucrative today. Coupled with the fact that organisations are looking to improve competitiveness by adopting global best practices, leverage customised service offerings and new delivery models such as SaaS, which ensures greater cost savings. Additionally, a new wave of start-ups is driving innovative, India specific solutions further spicing up the market

## Indian IT-BPM Value Proposition

Indian IT- BPM Industry is demonstrating its existence and establishment on the five core pillars that it has nurtured and evolved over the past couple of years. With customers increasingly engaging with Indian service providers as a 'strategic partner', rather than just a pure 'technology service provider', key players in the Indian sourcing industry have re-aligned and capitalised on the following five areas –

- **Continued focus on optimal cost-efficiency:** Leading players in the Indian market continued to maintain optimum levels of cost-efficiency through various internal processes and productivity improvement initiatives. Service providers are mitigating cost escalations by adopting various strategic imperatives including agile delivery models, automation and standardisation of business processes, delivery excellence, tapping alternative delivery locations as well as providing faster career transition/ growth for high performing employees
- **Unparalleled human capital:** One of the most critical factor that is contributing to India's position as the most favoured destination in the global sourcing market is its unparalleled human capital. India has the world's largest employable talent pool and every year it churns out a huge number of technical and non-technical pool of graduates and post graduates. India's uniquely diverse workforce, large-scale talent re-engineering initiatives, as well as employee engagement activities is ensuring a future-ready workforce, which in turn, is enabling the industry to grow up the value chain in providing both end-to-end and value added services across sectors
- **Unique customer centricity:** The unique customer centric approach of Indian service providers is best demonstrated by re-engineering businesses/organisational structures, strategic advisory relationships, focus on product/service delivery innovation as well as scale up the value chain by managing high-end complex IT-BPM engagements. Indian service providers are focussing on three main imperatives: business outcome solutions + non-linearity + transforming customer businesses

- **Scalable and secure environment:** The sheer size of the Indian market provides a high level of stability in terms of managing concentricity risk as compared to other sourcing markets. With political/economic stability, India has been able to further de-risk its delivery approach by expanding its global delivery network to other locations so as to leverage their niche capabilities, in addition to adopting robust security practices/business continuity models
- **Supportive ecosystem:** India's infrastructure development landscape is expected to transform to the next level in the coming years. This will be driven by the government's massive thrust of over USD 1 trillion in investments on infrastructure development during the twelfth plan period (2013-2017). Besides, with large-scale investments in eGovernance projects and focus on establishing the national cyber security policy, the IT-BPM industry is very much well poised to maintain its growth trajectory in the domestic market

## Future Outlook

The global economy is set to improve 2013 onwards, with global GDP expected to increase by 3.5 per cent in 2013 and further by 4.1 per cent in 2014. Simultaneously, the growing importance of the BRIC economies in world trade means that these markets are maturing from just being sources of cheap labour to sources of innovation. Five major technology changes are expected to open new opportunities for service providers – smart computing (expected to drive industry-specific solutions), Software-as-a-Service (SaaS to play a dominant role), social technologies (empower all elements of an industry's value chain including suppliers, employees, customers, and business partners), mobility (access to anytime, anywhere information) and analytics (real-time intelligence). Another mega trend is around buyers of technology: the expanding role of IT means that the stakeholder has expanded beyond CIOs; employees now are influencing corporate tech adoption and IT's role is also shifting from a reactive back-end support operation to a proactive enabler of innovation.

These factors are expected to drive growth in overall technology spend by 6 per cent in 2013, with hardware emerging as the highest growth segment at 7.5 per cent driven by an expected surge in demand for infrastructure upgrades and improvements. Worldwide packaged software revenue expected to grow by over 6.5 per cent in 2013, led by growth in infrastructure software, in part because of the growth in operating systems and security software. Business process management spending in 2013 is expected to be increasingly driven by F&A and procurement segments, followed by HR outsourcing and customer care. IT services is expected to grow by 4.2 per cent in 2013 as firms work at ways to reduce costs and increase profitability, realising the inimitable need for information technology to create competitive advantage. Global IT-BPM spend is expected to grow between 5-6 per cent over the next two years and global sourcing is set to grow faster – at about 7-8 per cent during 2013.

India continues to be the global sourcing leader, but the total global sourcing (IT+ BPM) market of USD 124-130 billion accounts for only a little over 10 per cent of global IT-BPM spend – highlighting the still large, untapped market opportunity. Indian IT-BPM firms are well set to take advantage of this opportunity by working towards enhancing their existing capabilities, developing new capabilities and expanding their focus to new services, technologies, verticals and geographies.

FY2014 total revenues (domestic+exports; excludes hardware) is expected to grow by about 13-15 per cent to reach USD 106-111 billion; of this, exports are likely to be about USD 84-87 billion, a growth of about 12-14 per cent. For the industry to continue on the growth path and to counter the challenges of emerging alternative outsourcing destinations, it will have to mitigate various challenges it faces at the macro, operational and ecosystem level.

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**Macro level challenges:** The ongoing global recession is having a fairly big impact on business sentiments and customer confidence, particularly in the main markets of US and Europe. With challenging labour market conditions in these geographies, governments are increasingly resorting to protectionism to boost their economies. Changes in their policies are impacting availability of work permits and visas; the threat of taxation on outsourcing firms is another challenge. Within India market, the upcoming elections of 2014, the continuously rising wage inflation and currency volatility continue to be areas of concern. The industry is also facing certain challenges thrown up by newer technologies that are disrupting the traditional services and traditional forms of delivery. For e.g., cloud-based technologies have the potential to cannibalise business through automation and platform based delivery.

**Operational challenges:** The industry will need to explore new avenues of growth – shift from services to IP-led growth, adapt and take advantage of the changing technology landscape to offer differentiated products/services to customers and showcase value beyond cost. These efforts will go a long way in transforming India's image from a low cost destination to an innovation hub.

**Ecosystem:** India's competitiveness as the foremost outsourcing destination is being threatened by wage inflation, the rise of other locations, particularly the Philippines and China as alternative sourcing destinations and also the customers' desire to de-risk geographic concentration. India is also likely to face a talent shortage (in terms of the quality of people available rather than the quantity) in the medium terms. Cyber espionage is a serious, emerging threat that could lead to security compromise and data breaches, compromise of personal information, risks of insider threats due to liberal access to client networks, and access sensitive IPR information.

Keeping these challenges and variations in mind, the Indian IT-BPM firms will need to keep continuing the transformation of its business models and strategies for future growth. The need for expansion to new markets, further enhancing customer centricity, flexible delivery models, and continue to make strategic investments.

In order to achieve the next level of growth, it is imperative for industry stakeholders to work together on five core agendas that will enable India to retain and enhance its status as the world's most favoured outsourcing destination. On the one hand, efforts must be made to improve the industry ecosystem: in terms of establishing world-class infrastructure, enhancing India's corporate governance and risk/security framework, thus, enhancing confidence in India as a business destination. The government should make it a top-most priority to significantly improving the quality of education. Another important

factor in establishing India as an innovation hub is the need to foster entrepreneurship – having a very strong and robust funding system to finance various start-ups, setting up of a plethora of innovation clusters, Centres of Excellence (CoEs) and research labs to drive primary research and correspondingly, a very strong IP protection and implementation framework.

As technology is rapidly emerging as a platform to deliver social change, it is also necessary for the government to ensure that the technology infrastructure is well established for the delivery of technology-enabled services in healthcare, education, financial and public services. Finally, both the industry and NASSCOM must look to expand beyond core markets – explore opportunities in new, emerging geographies, underpenetrated verticals that have long-term potential and meet and expand customer base – SMBs, India's domestic market and other developing nations.

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