Executive Summary

2008 was a transformational year for the Indian Information Technology-Business Process Outsourcing (IT-BPO) sector, as it began to re-engineer itself to face the challenges presented by a macro-economic environment which witnessed substantial volatility in commodity prices, inflation, and decline in GDP rates, cross-currency movement, finally culminating in the economic downturn.

In an increasingly globalised world, significant complexity and uncertainty is getting attached to this unprecedented economic crisis. The Indian economy has also been impacted by the recessionary trends, with a slowdown in GDP growth to seven per cent. The focus and exponential growth in the domestic market has partially offset this fall and insulated the country, resulting in net overall momentum.

TheIT-BPO industry in India has today become a growth engine for the economy, contributing substantially to increases in the GDP, urban employment and exports, to achieve the vision of a "young and resilient" India.

During the year, the sector maintained its double digit growth rate and was a net hirer. This growth has been fueled by increasing diversification in the geographic base and industry verticals, and adaptation in the service offerings portfolio. While the effects of the economic crisis are expected to linger in the near term future, the Indian IT-BPO industry has displayed resilience and tenacity in countering the unpredictable conditions and reiterating the viability of India's fundamental value proposition. Consequently, India has retained its leadership position in the global sourcing market.

While the current mood is that of "cautious optimism," the industry is expected to witness sustainable growth over a two-year horizon, going past its USD 60 billion export target in FY2011. While the industry has significant headroom for growth, competition is increasing, with a number of countries creating enabling business environments aimed at replicating India's success in the IT-BPO industry. Hence, concerted efforts are required by all stakeholders to address the current challenges, to ensure that India realises its potential, and maintains its leadership position.

Global sourcing trends in 2008

Worldwide technology products and related services spend is estimated to cross USD 1.6 trillion in 2008, a growth of 5.6 per cent over 2007. IT-BPO services (including software products) touched USD 967 billion, an above average growth of 6.3 per cent in 2008, underscoring its increasing importance. Worldwide BPO spending in 2008 grew by 12 per cent, which was the highest among all the segments. BPO today is an integral part of the global delivery chain and is increasingly involved in mission critical applications. Within IT-BPO, outsourcing emerged as a key driver, accentuated by shifts in regional spending as emerging markets such as CEMA (Central and Eastern Europe, Middle East and Africa), Latin America, and Asia Pacific (excluding Japan) increased their share.

Steady growth in outsourcing spend was driven by increased adoption of global sourcing. While the global sourcing market size has increased threefold in the period 2004-2008, the addressable market is more than five times the current market size, signifying the immense opportunity at hand.

Offshore IT-BPO service providers continued to build their global delivery footprint, expanding service lines and also growing inorganically by acquiring firms in the US and Europe to build skills and "nearshore" delivery capabilities. Therefore, though the established players dominated the market, Indian heritage service providers gained ground and market share.

The performance of the Indian IT-BPO industry

The Indian IT-BPO industry is estimated to achieve revenues of USD 71.7 billion in FY2009, with the IT software and services industry accounting for USD 60 billion of revenues. During this period, direct employment is expected to reach nearly 2.23 million, an addition of 226,000 employees, while indirect job creation is estimated to touch 8 million. As a proportion of national GDP, the sector revenues have grown from 1.2 per cent in FY1998 to an estimated 5.8 per cent in FY2009. Net value-added by this sector, to the economy, is estimated at 3.5-4.1 per cent for FY2009. The sector's share of total Indian exports (merchandise plus services) has increased from less than 4 per cent in 1998 to almost 16 per cent in 2008.

Exports market: The Export revenues are estimated to gross USD 47.3 billion in FY2009, accounting for 66 per cent of the total IT-BPO industry revenues. Cross currency movement during the year, led by the strengthening (and high volatility) of the US dollar versus some of the major invoicing currencies (Euro, Pound), suppressed volume growth in the European market by about 2.2 per cent at an industry level. Software and services exports (including BPO) are expected to account for over 99 per cent of total exports, employing over 1.76 million employees.

- **Geographic focus:** While the US with a 60 per cent share remains the largest export market for Indian IT-BPO services, incremental growth is being driven by the European market, with UK and Continental Europe growing by a CAGR of 41.4 per cent and 51.4 per cent in the period FY2004-FY2008.
- **Vertical Markets:** The industry's vertical market mix is well balanced across several mature and emerging sectors. While the Banking, Financial Services and Insurance segment (BFSI) remains the biggest sector with over 41 per cent of total revenues, verticals like Hi-tech / Telecom, Manufacturing and Retail are increasingly gaining share.
- **Service Lines:** The IT Services segment aggregated export revenues of USD 26.9 billion, accounting for 57 per cent of total exports. Indian IT service providers have evolved from application development and maintenance companies, to full service players providing testing services, infrastructure services, consulting and system integration. Within these segments, it was IT outsourcing that exhibited strong growth, in line with global trends. Remote infrastructure management, expected to deliver almost 30 per cent net savings to customers, continued its robust performance, with an above average growth of 25 per cent expected in FY2009. BPO is the fastest growing segment of the industry and is estimated to reach USD 12.8 billion in FY2009, growing at 17.5 per cent. Additionally, the engineering, R&D, and software products segment is also expected to grow by 14.4 per cent in the current fiscal, to touch USD 7.3 billion, which highlights the strong impetus and renewed focus on improving IP driven service capabilities in India.

Industry Structure: The industry is dominated by large integrated players consisting of both Indian and international service providers. During the year, the share of Indian providers went up to 65-70 per cent due to the emerging trend of monetisation of captives. MNCs however, continued to make deeper inroads into the industry and strengthened their Indian delivery centres during 2008.

Domestic market: The domestic market presents a significant opportunity as IT spending in India is growing at a pace faster than any other country in the Asia Pacific region. The demand for offshoring is driven by specialised skill sets and not just labor arbitrage. Domestic IT-BPO revenues are expected to grow at almost 20 per cent to reach INR 1,113 billion in FY2009, driven by increased IT-BPO adoption. While growth in the hardware spend (the largest segment) has moderated, the domestic BPO segment remained the stellar performer, with a growth of 40 per cent during FY2008, and revenues of INR 88.7 million. Domestic IT services are expected to grow by 20 per cent in FY2009, driven by increased acceptance of IT as a growth enabler, and a competitive tool for Indian corporations looking to compete in an increasingly globalised environment. Increased IT adoption in not only the large/mid-sized companies, but also the 35 million strong small and medium business (SMB) segment is expected to drive growth in the future.

India’s IT-BPO value proposition

Strong fundamentals, a robust enabling environment, and enhanced value delivery capability are the hallmarks of the Indian IT-BPO industry.

Strong fundamentals: India’s fundamental advantages—abundant talent and cost—are sustainable over the long term. With a young demographic profile, where over 3.5 million graduates and postgraduates are added annually to the talent base, no other country offers a similar mix and scale of human resources. While some gaps in talent suitability exist, they are being addressed through strong provider-level initiatives and industry-led programmes. India enjoys a cost advantage of around 60-70 per cent as compared to source markets. Additional productivity improvements and the development of tier 2/3 cities as future delivery centres, is expected to enhance India’s cost competitiveness.

To develop India as a trusted sourcing destination, Indian IT-BPO companies have put in place world-class security standards, to ensure high levels of quality and service delivery. Adherence and compliance to standards such as ISO 270001, EU directives, SOX, PCI, HIPAA and GLBA, and various other data protection regulations ensures the establishment of a proper risk management framework which is followed through with proper monitoring, testing and authorisation. Further, the Data Security Council of India (DSCI) initiatives are aimed at defining industry standards for data security and privacy.

Robust enabling environment: Timely government policies and increased public-private participation have played a key role in developing an enabling business environment for the Indian IT-BPO industry. The Government’s focus on education has helped create the large talent base from where the industry draws its workforce. Establishment of Software Technology Parks of India (STPI) stands out as a seminal policy action, specifically targeted towards encouraging, promoting and boosting the export of software and services from India. Public and private enterprises have contributed by building the required capacities of key business infrastructure, helping this sector enjoy world-class facilities and services. The private sector is now, in partnership with the Government, also beginning to play an increasing role in the overall infrastructure development in the country. The Government’s proactive approach towards the IT-BPO industry was further highlighted in 2008 through actions such as the IT Act Amendment, extension of tax incentives by a year, removal of the SEZ Act anomalies and the introduction of progressive telecom policies that focus on work from home.

Enhanced value delivery capability: The Indian IT-BPO industry clients are now seeking more than just cost savings. They are looking at the country's service providers as transformation partners, innovating and developing customised solutions to address their needs. As a result, Indian companies are now trying to adopt a culture that encourages innovation, embrace new trends such as Green IT, and deliver solutions that are focused on re-engineering and transformation. Proactive capability building through focused investments across domains, processes, and technology expertise, coupled with added flexibility and scalability, deliver on this enhanced value proposition.

Benefits to source economy: In a globally integrated economy, outsourcing is leading to overall benefits for the source economies, providing significant monetary and employment benefits.

The silver lining of the economic downturn is the opportunity for the industry to enhance its overall efficiency. Companies are increasingly looking inwards and focusing on process benchmarking, enhanced utilisation of infrastructure and talent, increasing productivity and greater customer engagement. Coupled with wage moderation and lower attrition, these measures will help industry sustain its margins and invest in future growth.

Future outlook

Key global sourcing drivers will continue to be cost, access to talent, business improvements, increasing speed-to-market and access to emerging markets. The future outlook for all these drivers is positive, leading to increased momentum for global sourcing. The focus on cost reduction is expected to increase, keeping in mind the current recessionary environment. Environmental considerations such as climate change, global warming, social responsibilities, and compliance issues are all adding up to increase pressure on margins, which can be offset by increasing global sourcing to keep tabs on spiraling costs. Access to talent is likely to become more decisive as workforce demographics indicate a shortfall in the long term, in all major developed countries such as USA, UK, France and Germany, Japan and some developing countries as well.

While the 2009 outlook for global technology related spending is affected by the recessionary environment, a rebound is expected from 2010 onwards. Worldwide adoption of outsourcing is also expected to rise significantly in the coming years.

Sustained demand, robust fundamentals and a supportive business environment will help realise the significant potential the IT-BPO industry offers, both for exports and the domestic market. The industry can achieve an export target of USD 60-62 billion by FY 2011, employing 2.5-3 million professionals directly and contributing substantially to the socio-economic development of the country.

The size of the opportunity in hand can be gauged from the fact that India currently accounts for just over 4 per cent of worldwide technology related spend. Additionally, growth in global sourcing is estimated to be almost four times that of technology related spend. India currently generates the bulk of its IT-BPO revenues from the US, and the BFSI sector, while accounting for a miniscule part of technology spend in other geographies and verticals.

India, with its fundamental advantages can capture a large share of the opportunities available. However, in order to achieve this goal, the key stakeholders need to work in tandem.

Firms: The Indian IT-BPO industry must work with clients to enhance the cost value proposition. This would involve additional investments in building capability across employees, domain knowledge, functional and technical skills, and an increase in their global delivery footprint. While Indian IT-BPO firms are adept in driving efficiencies through automation and process improvements, the companies need to understand the fact that in the medium to long term, they would need to deliver a more significant impact on client businesses, through solutions that are innovative and transformative in nature. These enhanced, innovative solutions will also enable companies to access new market segments, delivering new service lines, and leading to the creation of in-house IP in emerging technology areas. Leading players within the Indian IT-BPO industry have already started to make investments in increasing their innovation portfolio, and these efforts need to be replicated by the entire industry to reap further benefits. Additionally, firms need to focus on increasing their levels of customer intimacy, as well as developing the brand value of their organisations through product and service differentiation.

Government: The supportive policy environment created by the Government of India has played a key role in the rapid development of this sector. While policies have effected infrastructural development of leading cities as IT-BPO destinations in India, additional work needs to be done in developing tier 2/3 cities as viable IT-BPO service delivery locations. Efficiencies and the provision of public services—power, local transportation, security, etc., are also critical for the development of this sector. The Government's efforts on increasing the quality of talent from India needs to be stepped up by laying special emphasis on the talent needs of knowledge intensive industries, technology and innovation. The focus should be on improving the quality of graduate and post graduate out-turn, enhancing capacity across the country, policy de-regulation and nurturing clusters of research institutes.

With enhanced competition from other low cost countries and the current recessive scenario, support is needed from the Government to extend the tax incentives under the Software Technology Parks Scheme (STPI). This would enable small and medium companies to reinvest their profits back into the business and invest for future growth. It would also make India competitive vis-à-vis other destinations that are offering tax incentives and subsidies on training and infrastructure costs. Removal of procedural obstacles—service tax refunds, taxation of software products, and clarity around transfer pricing norms that are applicable to foreign companies is needed.

Academia: The success of the IT-BPO industry is determined by the availability of skilled and employable talent. Efforts to enhance talent availability and quality need concerted action from all the stakeholders—the government, academia and the industry. The role of academia in fact is critical. Specific initiatives like Faculty Development Programmes, upgrading the curriculum, setting up research labs, launching internship programme and industry-academia collaboration can help to bridge the employable talent gap.

Industry and NASSCOM: The industry and NASSCOM need to step up their engagement with all stakeholders—the government, customers, employees, academia and society to realise the full potential of the sector. Efforts towards enhancing information and data security; participation in public private initiatives in technology led development; proactively working with academia to address quality of education and building an integrated delivery model in leading cities alongside tier 2/3 locations are some of the critical imperatives for the industry and NASSCOM. Expansion of new markets will require different strategies and focus from the industry players. NASSCOM in partnership with the industry should look to build institutional relationships with appropriate stakeholders in these markets. In the developed regions, the industry will need to take a broader leadership role and drive global sourcing to the next level of customers.

Additionally NASSCOM and the industry need to build a communications campaign that will highlight India's changing value proposition—from cost and labor arbitrage, to a secure destination that excels in delivery quality and flexibility, and innovative solutions.

The growth of the IT-BPO sector has been synonymous with India's rise to prominence on the global map. The industry gainfully employs over 2.23 million people, leading to increased tax collections, enhanced consumer spending and more inclusive growth. Additionally, the industry has made substantial contributions to GDP, generating foreign exchange, and leading to the establishment of a host of supporting industries. Every IT job has led to the creation of 3.6 additional jobs in related sectors.

The Indian IT-BPO industry is now at a critical point in its evolution. Behind it stands a decade of stellar performance which has left a deep imprint on the Indian economic and social landscape. Moving forward, it faces a transforming macro-economic environment, rapidly changing customers and needs, evolving services and business models, and rising stakeholder (employees, investors) aspirations. These forces are expected to redefine the nature of demand and supply for the industry, and also redefine the strategic imperatives for businesses in 2009.