CAPITALISING OF THE POTENTIAL OF GLOBAL SERVICES OUTSOURCING : A KNOWLEDGE SECTOR PERSPECTIVE

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Abstract

The contribution of the services sector to the Indian GDP is showing a consistent increase and among the services, it is the IT and ITes services which have layed a prime role in winning global recognition for India's prowess in delivering high quality services to global clients. The IT and BPO industry in India contributes to over 20 per cent of exports, its contribution of GDP is 5.9 per cent, accounts for 10.5 per cent of the revenue share of the service sector. The country today is the prime destination of global sourcing for IT and ITes accounting to 51 per cent of the global sourcing market of $94 billion in 2008-09. India has a 62 per cent share of the global technology services market (IT services, engineering services and R&D) of $58 billion and 32 per cent share of the Global Business Outsourcing market of $37 billion. The share of outsourcing to India has increased because customers derive great value from transformation of processes, access to critical resources, quality trained workforce and reduced reaction time apart from lower costs. India would emerge as the services outsourcing destination of the world just like how China has become the manufacturing destination of the globe. India has ample opportunities to capitalize on the services outsourcing space due to its demographic advantage and the emerging global reality of ageing population across continents. This paper discusses the key trends with regard to markets, employment, strengths and unhapped potential of India in IT and ITes, the emerging potential KPOs, and the real picture with regard to the future growth of India as a key palyer in the outsourcing services sphere.

Key Words : Outsourcing, IT, BPO, KPO

1. INTRODUCTION

The IT and ITes industry is the most notable performer from India in the global platform. Though being a late starter, India has carved its own special space in the IT and ITes arena and Indian expertise and talent drives key sectors of the computers and communications business worldwide. IT and IT services have heralded a revolution, especially during the last decade. Today India's prowess in the IT sector is well recognized globally and many IT companies in India have Fortune 500 companies as their clients. Many Indian have been employed in the Silicon Valley and have been important drivers of innovations and product breakthroughs in the technological sphere. The global footprint in IT and ITes services cover 400 delivery centres across 52 countries and this strategy of geographical diversification has strengthened the competitive and this strategy of geographical diversification has strengthed the competitive edge of the Indian outsourcing industry.

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The IT and BPO industry in India contributes to over 20 per cent of exports and its contributionto GDP is 5.9 per cent. It contributes to 10.5 per cent of the revenue share of the services sector. The sector has accounted for over 10 per cent of the total FDI investments in India in the last decade. The direct employment in the sector is expected to cross 2.3 million and it has created close to 2.4 lakh jobs in the year 2010-11. The Indian government's IT spending which was Rs. 150 billion in 2009 is expected to cross Rs. 250 billion by 2011.

1.1 Need for the Study

The Indian IT and ITes outsourcing industry has been among the favoured vendors for the leading global companies. From the inception, they have battled various restrictions of the licence permit quota raj and have improved their competitiveness by competing with the top global IT companies for business. In this scenario the growing rhetoric towards protectionism in the US, the weak e3conomic recovery and the drop in IT spending of the European markets, the devastation wrought by the tsunami in Japan point to the fact that the sector would be facing tough challenges in the future. Therefore it becomes imperative to understand the structure and potential of the industry to meet those challenges and emerge stronger.

1.2 Research Methodology

The paper is conceptual in nature and descriptive research has been applied.Secondary data has been used in the study and the data was sourced from business journals and magazines, information from the industry promotion body, NASSCOM and internet sources. Key information was also collected from the interaction the authors had with experts associated with the industry.

1.3 Literature Review

Cathay Hayward (2003) opined that however it is labeled, BPO, BTO, contracting out, outsourcing or co-sourcing, the idea of getting an expert to run non-core activities is a fundamentally attractive option that allows companies to focus on their strengths Radhanath Pyne (2003) contended that the power of outsourcing lies not in its capacity to effect a rapid, instant solution to an organization's problems but rather its potential to help the organization rethink its entire way of doing business, even its reason for existence. Balaji CD and Ibohal Meitei (2005) stated that the most commonly outsourced service to the country include professional services like accounting, architecture, customer support, internet research, information processing, marketing, media management, medical transcription and translation services etc. The paper proposed the possible strategies that the Indian BPO companies can adopt to develop a sustainable growth in this business. Diana Farrell (2008) pointed out that organisations'

narrow focus on offshoring is obscuring the bigger picture. Escalating competition, steady trade liberalization and the continual introduction of new technologies will increase the pressure on companies to globalize. Thanks to plummeting telecom costs and the digitization of some paper based business processes, many service jobs and back office functions are performed remotely.

2. COST – NOT THE ONLY CONSIDERATION BEHIND OUTSOURCING

It is a wrong perception that cost was and is the only reason for outsourcing. The fact is though cost remains a important consideration, quality, productivity and skills are increasingly emerging as the prime drivers of outsourcing decisions, especially in high end work. The share of outsourcing to India has increased because customers derive great value from transformation of processes, access to critical resources, quality trained workforce and reduced reaction time apart from lower costs. A *Pwc (Pricewatercoopers)* report points out that apart from savings in manpower, Indian co., offer 20% higher productivity in comparison to other competing countries like Philippines, Canada and Australia.

In terms of quality of services offered, India ranks 30% higher than any other region. For instance in the case of captive units they are transitioning from being cost centres for their parent companies, to 'Centers of Excellence' that provide higher value and efficiency preposition. According to Nasscom, over 750 captives currently operate in India, together employing four lakh professionals.

3. OUTSOURCING TRENDS IN IT SERVICES

IT and IT services have heralded a revolution, especially during the last decade as brought out by the following table:

Table-1 : Software and IT Services Exports

Year	Exports (Rs. In Crores)
2004-05	1,01,920
2005-06	1,33,700
2006-07	1,78,000
2007-08	2,11,410
2008-09	2,75,190
2009-10	3,01,280

Source: Various Economic Surveys

Though cost had been the most important reason for work being offshored to India in the past it is the quality of work, adherence to delivery schedules, and the vast talent pool which have ensured that relationship are built and work which was once a trickle has turned into a flow. Unrelenting focus on quality has been the hallmark of Indian IT companies and most of them have improved their

process efficiencies and made their work adhere to robust global quality standards. Most of the companies operating the sector have adopted ISO 9001 (quality management) and ISO 27000 (for Information Security). India based centres today account for the highest number of quality certifications achieved in any country. The following achievements of the top three Indian IT companies for the year 2010-11, highlight the competitiveness and focus on excellence of the sector:

- TCS has been adjudged the 'Outstanding Company of the year 2011' at the Data News Awards for Excellence held in Brussels.

- TCS has been cited as a leading company in the Forrester Wave Global IT Infrastructure Outsourcing Report 2010.

- TCS is the first organization in the world to be appraised at Level 5 of the CMMI SVC model indicating the maturity of the companies BPO and Infrastructure Services Business.

- Infosys has been ranked 15th among the world's most innovative companies by Forbes.
- Infosys is among the top ten value creators in technology and telecom according to the 2010 Value Creators Report of BCG.

- Cognizant Technology Solutions has been ranked 11th among the world's fast growing technology companies in the annual Forbes ranking for 2010.

- Cognizant Technology has been ranked 3rd among the world's most admired company in information technology services by the Fortune magazine.

- Cognizant has been ranked among the top 13 companies Training Outsourcing companies for providing outstanding learning solutions.

As a result of the above mentioned emphasis on quality, innovation and customer focus, the country today is the prime destination of global sourcing for IT and ITes industry has crossed the $75 billion mark, with exports accounting for $60 billion and the domestic market contributing to $15 billion of revenues. India has a 62 per cent share of the global technology services market (IT services, engineering services and R&D) of $58 billion and 32 per cent share of the Global Business Outsourcing market of $37 billion.

According to Meta figures 1/3rd of new IT development work for big US Co., is done overseas with India being the biggest site. According to a Nasscom Report the IT software and service exports are expected to account for 30% of all foreign

exchange inflows in 2012. The IT and ITes industry has grown at 18.7 per cent in the year 2010-11 inspite of lowered spending in the US and European markets and is expected to grow at over 17 per cent in the next year.

3.1   Market Structure

The US which was accounting for over 90 per cent of software exports in the early days of the industry today accounts for 61 per cent of exports. Though the volume of exports has increased considerably, the Indian IT industry's conscious decision to adopt a derisked model by focusing on exports to other geographies enabled it to reduce its reliance on the US market. The UK accounts for 18 per cent of India's software exports. Indian software companies are also active in tapping the Asia Pacific market which currently contributes to 10 per cent of software exports and this share is expected to considerably increase in the coming years. The domestic IT market is also growing significantly backed by the ICT initiatives of the government as well as the private sector. Revenues from the domestic IT market is expected to cross @14 billion in 2009-10 which is a significant increase from $12.8 billion in 2008-09.

3.2   Employment in the Sector

The total IT Software and Services employment is expected to reach 2.3 million in 2009-10 while the indirect employment would be 8.3 million during the said period. The industry is a role model of both gender diversity and equal employment opportunity. 30 per cent of the employees in the sector are women and over 60 companies operating in the sector employ differently abled people.

3.3   Contribution to GDP and Social Development

The IT and ITes industry's contribution to GDP is expected to increase from 6 per cent in 2008-09 to 6.1 per cent in 2009-10. The industry has contributed to social development by spending $50 million towards CSR activities for 2010-11.

3.4   Future Potential

A Nasscom–Mckinsey study predicts that the turnover of the IT sector could touch $120 billion by 2015 of which $90 billion will come from exports.

4.   BPO'S – STAR PERFORMER IN INDIAN SERVICES SPHERE

India is emerging as a global hub in the BPO market and even during the slow down in software services growth it is the IT enabled services segment that propelled the country's growth engine in the services sphere. The industry is growing at 15-16 per cent, and employ over a million people. It is estimated to

reach revenues of $14.7 billion by the end of the current fiscal. The growth rate of the captive units was 11.6 per cent and they employ 4.4 million people. According to industry estimates, the current voice-to-non-voice business ratio is around 60:40.

According to research findings of Data Quest, the combined export earnings of the top 20 Indian BPO firms grew by 15 per cent to touch $6.1 billion in the year 2009-10. It is significant to note that the export revenue of the top 20 BPO firms grew twice as fast as that of the top 20 IT firms, which witnessed an increase by 7.8 per cent during the same period. IT, BPO and engineering research and development units – located in India touched $11.1 billion during fiscal ended March 2010, reflecting a CAGR of 20 per cent between 2003 and 2010. According to a latest report by Nasscom, the revenue from captive units now account for nearly 22 per cent of total IT-BPO industry export revenues.

4.1   Industry Structure

IT and ITes exports from India are not concentrated in any particular areas. As proof of the industry maturity and wide ranging capabilities to service varied needs of diverse clients, the industry has reported growth across all major industry verticals. Among the verticals, BFSI (Banking, Financial Services and Insurance) is the largest vertical accounting to 40 per cent of exports for 2009-10. The growth in emerging verticals such as health care, retail and utilities are expected to be three times faster when compared to the industry rates and Indian companies have wide ranging expertise in these areas.

4.2   Improved Expertise and Delivery Capabilities – An Encouraging Sign

The Indian ITes industry has tremendously increased its strength both in terms of size as well as in case of scope of service offerings. Due to robust quality standards and strict adherence to delivery schedules and standards the industry has become the preferred partner for a wide range of buyers in multiple industry verticals. Due to the attractive growth opportunities and the strong brand equity already created in the global markets, many IT majors have set up BPO units and are able to offer integrated services to clients thereby becoming a one stop shop for all client requirements. The industry is further expected to move up the value chain to provide complex solutions such as data analytics, business analytics, market analytics etc.

4.3   Future Potential

The ITes and BPO is growing at a faster rate when compared to the IT industry. It is expected to generate exports revenue of $12.4 billion in 2009-10 as against $11.7 billion in 2008-09. The domestic BPO industry is expected to cross $3.2

billion in 2011-12 up from $1.93 billion in 2008-09. The global BPO market is expected to grow at an increasing pace holding tremendous potential for Indian companies is participate and benefit from it as brought out in the following table:

Table-2 : Global BPO Market Growth ($ billion)

Year	Market Size ($ billion)
2001	128
2002	143
2003	172
2010*	703
1015*	1,234

Source : Nasscom   * Estimated

4.4   India's Position

In relation to the world spend of $800 billion on BPO last year; India's market share of $3.6 billion is miniscule. According to IDC estimates the global market is projected to grow at an overall CAGR of 11% and reach $1.2 trillion by 2006. The following table gives the data about the proposed worldwide ITes-BPO spending in select sectors.

**Table-3 : Worldwide ITes-BPO spending in select Sectors
(Figures in US $ Million)**

Vertical	2006 ((Actual)	2012 (Projections) Increase in (%)
HR	25,555	246
Logistics	3,06,651	119
Purchasing	12,185	130
Engg/R&D	1,23,882	77
Legal	1,63,962	47
Fin/Acg	64,872	78

Source: Gartner

If India achieves at least 2% of this market it could achieve revenue of over $20 billion.

4.5   Vast Untapped Potential

According to *Nasscom Mckinsey* Report on ITes, since India's share in the global BPO market across verticals is negligible, there is tremendous potential for future growth as brought out in the following table:

Table–4 : India's Share in the Global BPO Market

Vertical	India's Share
Human Resources (HR)	3.5 – 4%
Customer Relationship Management (CRM)	8 – 8.5%
Payment Services	3 – 3.5%
Content Development	2.5 – 3%
Finance	2.5 – 3%

Source: Nasscom

4.6 Employment Projections

Nasscom estimates that BPO's would generate 1.4 million jobs by 2011 as compared to 5 lakh jobs created by the IT industry in the last 20 years, making it a 20 times bigger opportunity than the latter. *AT Kearney* predicts that IT services and back office work in India will swell five fold to $57 billion annual export industry employing nearly 4 million people. According to *Gartner*, the worldwide HR outsourcing market is projected to grow to $58.5 billion by 2006.

According to a survey conducted by *Merit Trac Services*, the BPO industry would need to recruit 5 lakh employees annually by 2008-09 and by the year 2012 it needs to annually recruit 10 laks employees every year. *With Mr. Raman Ray* stating that every job created in the BPO sector creating 4 jobs in the economy in terms of transport, food and maintenance, the BPO sector wold not be a godsend not just fop the educated unemployed youth but also for the uneducated.

4.7 KPO – The Emerging Opportunity

Due to the strong brand created in the global outsourcing space and the presence of high quality talent at relatively lower cost, the KPO (Knowledge Process Outsourcing) is expected to be the next big growth area for the BPO industry.

Exports from the KPO space is expected to reach $1 billion in 2009-10 up from $0.6 billion in 2007-08 growing at a CAGR of 19 per cent. Securities research, Investment advice, Patent registration, Patent filing, Patent litigation, High end research across industry verticals, creating content for media, education etc are some of the growth areas in the KPO space and the country endowed with high quality human resources is well equipped to capitalized on the growth opportunities offered. The transition to the KPO space is expected to further increase the profit earning capabilities of the Indian players because KPO is a high margin business with long term relationship with clients. The revenue streams would be robust enjoying a high growth trajectory with attractive profit margins.

5.   **THE GROWING TEND TOWARDS PROTECTIONISM – THE REAL PICTURE**

There has been a growing demand for a ban on outsourcing which is gaining momentum every passing day. This is of great concern to the Indian IT and ITes providers because the US is still the key market accounting nearly half of the market. The reason behind the growing trend towards protectionism is because of the huge job losses caused due to the global financial crisis. Though theoretically the US is out of recession, still millions are out of jobs and therefore it is felt that outsourcing should in order to reduce the problem of unemployment. This trend is expected to be a temporary phenomenon and may continue at the most for the next couple of years.

The US industry having realized the cost and value benefits of outsourcing would continue to outsource its work and only the government related outsourcing pie might shrink. Many research reports have suggested that for every one dollar of work that is outsourced, the US economy gets a benefit ranging from 15 to 20 per cent at the minimum. Further the demographic trends in US point out that the economy can grow and sustain in the future only through outsourcing. According to Evalueserve 1 out of 6 persons in the US will be over 65 years by 2008. This would lead to a demand supply gap of 5.6 million jobs in the country's labour market by 201 which would lead to a shortfall of 2.4 million workers leading to a GDP loss of $884 billion. These demographic trends clearly point out that US cannot sustain its economic growth without outsourcing.

CONCLUSION

According to the report, 'Opportunities for Indian IT – BPO industry in Germanic countries', prepared by Pricewaterhouse Coopers for Nasscom, Indian Information Technology (IT) and Business Process Outsourcing (BPO) sectors may get almost $ 10 billion from Germany, Switzerland and Austria by 2020, up from the $2.6 billion they earn from this region across the IT, BPO and engineering services space, against the addressable market size of more than $53 billion. Revenues from the region, has the potential to grow so much because of the decline in workforce due to ageing population, provided Indian companies take the strategiec and tactical steps required to succeed in this market. This report is proof of the fact that India would emerge as the outsourcing destination of the world just like how China has become the manufacturing destination of the globe. Though India has lost the initiative to China in the manufacturing space, it has got ample opportunities to capitalize on the services outsourcing space due to its demographic advantage and the emerging global reality of ageing population across continents. The government needs to reconsider the proposal to levy Minimum Alternate Tax (MAT) on special economic zones considering the fact that the STPI scheme is also set to expire at the end of the current fiscal. The need of the hour is to invest in producing high quality human resources through improving access to education, designing tailor

made and job oriented courses to utilize the potential of the opportunities provided by the outsourcing opportunity.

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