

INDIAN IT INDUSTRY: NASSCOM ANALYSIS

Worldwide spending on IT-ITES witnessed steady growth in 2005, on the back of healthier spending across key markets of the US and Western Europe, and strong growth in emerging markets. Outsourcing continued to be the primary growth engine with global delivery forming an integral part of the strategies adopted by customers as well as service providers.

The year 2005 also witnessed the coming of age of the Indian IT multinationals, with the traditionally India-centric, indigenous players beginning to build noticeable presence in other locations – through crossborder acquisitions, onshore contract wins and organic growth in other low-cost locations. This was complemented by global majors continuing to significantly ramp-up their offshore delivery capabilities – predominantly in India, vindicating the success of the global delivery model and highlighting India's increasingly important role in the new world IT order.

In addition to the growth in scale, the portfolio of services sourced globally continued to expand into higher-value, more complex activities– further reinforcing the growing maturity of the global delivery model.

Key Highlights of the IT-ITES sector performance

IT Industry-Sector-wise break-up

USD billion	FY 2004	FY 2005	FY 2006E
IT Services	10.4	13.5	17.5
-Exports	7.3	10.0	13.2
-Domestic	3.1	3.5	4.3
ITES-BPO	3.4	5.2	7.2
-Exports	3.1	4.6	6.3
-Domestic	0.3	0.6	0.9
Engineering Services and R&D, Software Products	2.9	3.9	4.8
-Exports	2.5	3.1	3.9
-Domestic	0.4	0.7	0.9
Total Software and Services Revenues	16.7	22.6	29.5
<i>Of which, exports are</i>	12.9	17.7	23.4
Hardware	5.0	5.9	6.9
Total IT Industry (including Hardware)	21.6	28.4	36.3

Total may not match due to rounding off

**NASSCOM estimates have been reclassified to provide greater granularity*

- *Revenues from Engineering and R&D services and Software Products reported separately (erstwhile clubbed with IT Services / ITES-BPO)*
- *Historical values for a few segments have changed*
- *For ease of comparison, details for two preceding years have been restated as per the new classification*

Growth in Revenues

- Indian IT-ITES industry continues to chart remarkable double-digit growth for the nth successive year and is expected to exceed USD 36 billion in annual revenue in FY 2005-06, a growth of nearly 28 per cent.
- The Indian IT-ITES industry has grown at a CAGR of over 28 per cent since FY 1999-2000. Over the same period, the industry's contribution to the national GDP has risen from 1.9 per cent in FY 1999-2000 to a projected 4.8 per cent in the current fiscal.
- As in the previous years, IT services continue to account for a lion's share of the Indian IT-ITES industry, contributing over 47 per cent of the total industry revenue in FY 2004-05.
- The hardware, ITES-BPO and engineering and R&D Services segments accounted for 21 per cent, 18 per cent and 14 per cent respectively.
- The segment composition of industry revenues is likely to remain unchanged – weighed towards the services (IT + ITES-BPO) and software segments in FY 2005-06.

Increasing Exports

- Export earnings accounted for 64 per cent of the total IT-ITES aggregate in FY 2004-05. Strong fundamentals including a large base of skilled talent, demonstrated quality and service delivery expertise at a significant cost advantage and an enabling environment have ensured that India attracts a disproportionately larger share of the global IT-ITES demand for offshored services – and continues to drive India's export-led growth.
- IT-ITES exports from India grew from USD 13.3 billion in FY 2003-04 to USD 18.2 billion in FY 2004-05. It is estimated that total IT-ITES exports from India will exceed USD 23.9 billion in the current fiscal (FY 2005-06).
- Software and services exports (excluding hardware) are projected to grow at 32 per cent in the current fiscal.
- India's stock of foreign exchange earnings is amongst the highest in the world, with reserves having risen from USD 5.8 billion in FY1990-91 to USD139 billion in January 2006.

Geographical Breakdown of Exports

- An interesting industry trend that has been noticed in recent years is the expansion of the Indian IT industry's presence from beyond traditional destinations, to newer geographies. The industry's focus is no longer on English-speaking countries alone, and a key strategy for Indian IT majors has been to harness local talent to tap domestic markets and de-risk the revenue model by reducing their dependence on one geographical region.

- Americas and Europe remain the key markets, accounting for over 90 per cent of IT-ITES exports. However, export earnings from markets other than the US and the UK are also witnessing significant double-digit year-on-year growth.
- While Indian service providers have built delivery centers in key source markets (e.g. US), they are expanding their footprints in specialist locations like China for engineering and design; South Africa for insurance, and near-shore locations like Eastern Europe and Mexico. Apart from companies in the US, organizations from Europe, South East Asia, Australia, Japan, Hong Kong, New Zealand, etc. are also reaching out for Indian software expertise, supported by the conducive policy environment and incentives for software exports offered by India.

Location	FY 2004	FY 2005
Americas	69.4%	68.4%
Australasia	22.6%	23.1%
Europe	7.4%	8.0%
Others	0.6%	0.5%

IT Services Exports by Verticals

- Services exports in FY 2004-05 witnessed continued strength in traditional vertical market segments including BFSI, manufacturing and telecommunications.
- Underlying the increasing geographic and vertical market penetration is the continuing supply-side maturity of the Indian industry. This is reflected in
 - the ongoing scale expansion without compromising on quality or productivity and growing deal sizes;
 - demonstrated abilities of India-based firms to broaden their service portfolio, leverage productivity and utilisation levels to sustain competitiveness and enhance their global service delivery capabilities – while maintaining high levels of growth.

Employment trends

- The total direct employment in the Indian IT-ITES sector is estimated to have grown by over a million, from 284,000 in FY 1999-2000 to a projected 1,287,000 in the current fiscal (2005-06)
- In addition to the nearly 1.3 million-strong workforce employed directly in the industry, Indian IT-ITES is estimated to have helped create an additional 3 million job opportunities through indirect and induced employment. Indirect employment includes expenditure on vendors including telecom, power, construction, facility management, IT, transportation, catering and other services. Induced employment is driven by consumption expenditure of employees on food, clothing, utilities, recreation, health and other services.

Key industry highlights:

- The leading publicly- listed players have reported a top line year-on-year growth of nearly 34 per cent, over the first half of the current fiscal.
- MNC-owned captive units have been scaling up their operations steadily with the headcount forecast to grow by at least 30 per cent this year.
- IT-ITES activity in the domestic market is also witnessing steady growth with the services segment coming into its own – reflecting sound optimism for the year-end results.

India-based Service Provider Landscape:

Category	No. of players	Share of India's total IT/BPO export revenues	Performance
Tier I Players	3-4	<ul style="list-style-type: none"> • 45% of IT Services • 4-5% of BPO 	Revenues greater than USD 1 billion
Tier II IT Players	7-10	<ul style="list-style-type: none"> • 25% of IT Services • 4-5% of BPO 	Revenues USD 100 million-USD 1 billion
Offshore operations of Global IT majors	20-30	<ul style="list-style-type: none"> • 10-15% of IT Services • 10-15% of BPO 	Revenues USD 10 million-USD 500 million
Pure play BPO providers	40-50	<ul style="list-style-type: none"> • 20% of BPO 	Revenues USD 10 million-USD 200 million (Excluding top provider with USD 500 million)
Captive BPO units	150	<ul style="list-style-type: none"> • 50% of BPO 	Revenues USD 25 million-USD 150 million (top 10 units)
Emerging players	>3000	<ul style="list-style-type: none"> • 10-15% of IT Services • 5% of BPO 	Revenues less than USD 100 million (IT) Revenues less than USD 10 million (BPO)

* Based on last comparable Annual Report

** Earnings before interest, tax, and depreciation and amortization margins (last reported)

*** Including captive centres for Independent Software Vendors (e.g. Microsoft, Oracle)

Source: NASSCOM McKinsey Report 2005