

Challenges ahead for India outsourcing

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Although the latest Nasscom-McKinsey study on India's information-technology and business-process outsourcing projects a scorching 25-percent growth a year for the next five years, it adds that achieving that growth isn't going to be easy.

A huge shortage of talent, infrastructural deficiencies and external political problems like a backlash from European and North American markets could pose formidable challenges.

"India's economic growth will be greatly accelerated if the India-based IT and BPO industries sustain their global leadership and are able to generate approximately \$60 billion in export revenues by 2010," the report released Monday said.

"But India's offshore industries have to overcome major challenges to continue their heady growth and sustain their share relative to other competing countries," it added.

The first major challenge is that the demand growth may slow down.

According to Noshir Kaka, principal of McKinsey and a co-author of the report, global companies are now at a crossroads point: "Increasingly there is a realization that changing business processes to accommodate large offshore workforces is a difficult, time-consuming task and often produces lower than expected savings."

For instance, he says that it can take a year or two before performance

stabilizes and the volume of work ramps up, which slows the payoff. And, as union and political opposition to offshoring grows, companies in Europe and North America are growing more wary of sending thousands of jobs to India.

Indeed, during the recent referendums on the European Constitution, as well as the 2004 U.S. presidential campaign, job losses from offshoring were a major issue.

"There are also concerns about service quality and security, in the wake of several well-publicized security breaches," said Kaka, "and these put together are making many companies think twice before moving functions offshore."

The BPO sector faces even bigger problems. Urban infrastructure is an even bigger challenge than the demand constraints that its peer -- the IT services sector -- faces. After all, India's offshoring industries are dealing with bottlenecks ranging from power to cafeteria services, the most glaring example of which is Bangalore -- considered to be the "Silicon Valley" of India -- which is almost on the verge of collapse.

The report added that most larger Indian cities have reached saturation in terms of supporting the IT sector, and further growth will have to come from entirely new business districts outside of the Tier I and Tier II cities such as Bangalore, Madras (now called Chennai), Gurgaon (near New Delhi) and Pune (near Bombay).

Equally importantly for the BPO sector, India also confronts a potential shortage of skilled workers in the next decade. The report has estimated that currently only about 25 percent of the country's technical graduates and 10 percent to 15 percent of general college graduates are suitable for employment in the offshore IT and BPO industries respectively.

"India will need a 2.3 million-strong IT and BPO workforce by 2010 to maintain its current market share," it says. "And our supply projections indicate a potential shortfall of nearly 0.5 million qualified employees -- nearly 70 percent of which will be concentrated in the BPO industry."

"As countries from around the world enter the market and competition for offshoring contracts intensify, India must improve the quality and skills of its workforce," the report added.

For instance, India lacks large numbers of workers who are fluent in French, German, Japanese and Spanish, making China and Eastern Europe more attractive offshoring destinations for Japanese and Western European companies, respectively.

The final challenge facing Indian IT service providers, according to the report, is the need to continuously innovate in developing new service lines and improving their operating processes.

"Traditional service lines such as call-centers are under pressure," says Jayant Sinha, a partner at McKinsey.

And given the latest rise in costs -- wages and other costs that are rising by 15 percent per year -- India-based IT and BPO providers will need to keep finding ways to reduce total costs so that "they can continue to offer customers 30 percent to 40 percent cost savings."

Additionally, the model of offshore replication of existing onsite processes limit providers from capturing the full value from offshoring.

Nevertheless, it is also true that the addressable market for global offshoring is huge and offers India an opportunity of dramatic growth if the country can meet these challenges.

"Our research suggests that rapid growth is likely to continue in the global offshore IT and BPO industries," the report said. The Nasscom-McKinsey study, which examined the offshoring potential for each service line in the IT market and for each vertical industry in the BPO market, indicated that the addressable market for global offshoring is above \$300 billion, split almost evenly between IT and BPO. And India has realized "only around 10 percent or so of this addressable market until now leaving ample headroom for future growth."

Small wonder then that S. Ramadorai, CEO of TCS, the country's largest IT services company, believes the country's IT sector could become "one of the biggest examples of export-led growth in the world, rivaling the oil exports from the Gulf."

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