Rising salary may blunt India's BPO edge

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Despite the fact that with an expected growth of nearly 28 percent in the financial year 2005-06, scorching growth continues to be the trend this year too, India's money spinning IT-ITeS industry that earns about $36 billion in annual revenues will face rising people costs as its single biggest challenge going forward.

This the conclusion a joint study of salary trend in 2005 conducted by India's software lobby NASSCOM, and the human resource consultants, Hewitt Associates arrived at in its report released early this week.

"As per the Phase - 1 results of the Hewitt Salary Increase Survey 2005, the average increase in the IT sector across levels was between 16 and 18 percent," the study said adding, "outsourcing companies are now falling prey to increasing wage costs for specialized skills and the need to constantly align reward practices to the market continues."

Forty eight percent of the survey partners, the report said, had paid premiums for specialized skills at the hiring stage and the quantum payout was often left upon the recruitment manager's discretion. Nearly the same number reported that they had to design innovative pay packages for hot skills.

"One of the startling revelation of the study was that most organizations in the IT and ITeS industry have now chosen to bear the tax burden themselves rather than pass it on completely to the employees," the report said.

"Over the years this industry has witnessed double digit salary increases," it added, "however the actual compensation median data across levels has not moved in the same proportion due to companies ramping up operations and augmented hiring. As per the results, the average year on year movement in compensation across levels has been 10 percent on Total Cost to Company (TCC)."

But according to the industry experts, even as the total cost increase is "a manageable 10 percent," the fact that it has been rising every year is significant, considering the fact that people costs are most critical for India since its trump card in the global outsourcing game has been mainly abundant low-cost skills.

They add that some of that advantage is in danger of getting eroded in the face of emerging challenges from places such as Eastern Europe and neighboring Asian countries.

"If we look back 10-12 years, we see that India emerged as an (IT services) outsourcing destination for global companies, purely because cheap labor was available here," says Kapil Singh, the country manager of IDC India. "But today, when we look into the future and re-evaluate our competitive advantage, we can see that there are challenges for us. This is in terms of other locations, like China, Philippines, Russia and Central European countries ramping up fast and providing the same advantage of being a low cost base or a more appropriate quality base."

"On the other hand," he added, "Cost of operations in our country is only going up, primarily because of rising salary levels of employees. Though we boast of a large pool of manpower available, only a handful is employable and is wooed by many."

According to the study, attrition rates in the IT sector has gone up from 20 percent in 2004 to 30 percent in 2005, and in ITES or back office

outsourcing sector that rate was as high as 32 percent in 2004 and 45 percent in 2005.

Indeed the NASSCOM-Hewitt survey could very well be a wake up call for the industry. For, rising employee cost costs is not only diluting India's competitive advantage but is also impacting the industry's margins. For instance IT services sector has been witnessing a steady decline in profit margins from around 41 percent in 2001 to 30 percent now, most of which says the industry has been caused by the rapidly-escalating employee costs that constitute up to half of the sector's revenues. Recent research studies reveal that while the revenue of the top 20 companies have just about doubled in the past five years, employees costs have quadrupled.

NASSCOM however, believes that wage inflation is a temporary phenomenon caused by a short-term mismatch between the demand and supply of human resources and the industry is learning to cope with it as it matures.

"Our research shows that Indian IT sector will remain cost competitive on the basis of total cost at least until 2015," said Sunil Mehta, the vice president research of NASSCOM. "And the salary increases are being offset by declines in other cost like telecom costs, improvement in productivity, and the sheer economies of scale."

"Still," says Vikram Talwar, the CEO of EXL Services, one of India's prominent IT services companies, "to remain on course, the IT industry has to keep moving up the value chain."

"For instance the sooner India can get out of its low-value added back office services like the call center (or help desk) businesses the better it is for the industry."

Moreover, says Kapil Singh of IDC, this sector needs to spread out as well instead of remaining concentrated in just a few Indian cities like Bangalore, Hyderabad, Mumbai, and Noida (near Delhi).

"There is saturation in the top metros and the sector needs to move to smaller cities for their development base," he said.

And that according to the study, is already happening. "Movement to tier II and tier III cities has expanded the talent base," said Nishchae Suri, Asia Pacific business consulting leader with Hewitt Associates. "But on the other hand the shift from low-end business processes to higher value knowledge based processes has amplified the challenge of hiring specialized manpower."

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