

Analysis: Offshoring getting more costly in India

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Not many global IT majors have started recoiling yet, but the recent decision of Apple Computers to shut down its new Bangalore center and local news about Intel planning to lay off a number of people from its Indian operations have sparked fears that rising cost may have started threatening India's attraction as an IT offshoring destination.

And although the Indian IT sector has shrugged off these two developments as just "internal corporate decisions," many are worried that rising cost pressures -- which are showing signs of lasting for a while -- may end up in some lost opportunities and may even blunt the competitive edge of offshoring IT in India.

"As the Apple story points out, India's first-mover advantage is gone -- at least in established city centers like Bangalore," said Michael Corbett, executive director of The International Association of Outsourcing Professionals, the global organization for the outsourcing profession. "The marketplace dynamic of supply and demand is resulting in rapid salary inflation, high turnover, and other forms of cost escalation, which may end up in some lost opportunities for the Indian IT."

He added that other competing countries like Philippines, China, Russia and Eastern Europe "will exploit India's growing pains to improve their competitive posture," and could even give India a run for the money.

In a startling announcement last week, Apple, which opened its software division in Bangalore with much fanfare in April, announced without

citing reasons that it is closing down its Indian operations and "has decided to put its support center growth in other countries."

Consequently it served layoff notices to about 600 newly appointed employees, who, according to reports, said "India isn't as inexpensive as it used to be," and that was impacting the financial feasibility of the Indian operations.

"Apple hired professionals at salary levels much higher than the industry standards and soon realized that the business generated from the additional expenditure did not justify the costs," said an industry insider requesting anonymity.

But if the Apple decision perplexed the Indian IT offshoring industry, what came as a jolt were local reports that said that Intel, as a part of the company's global cost-cutting and layoff exercise designed to cut \$1 billion out of its forecasted expenses, is seeking to downsize its Indian operations as well.

"Intel is conducting an in-depth review of its focus and structure," said reports quoting Intel officials that would lead to "fewer employees in India as a result of attrition, redeployment and changes to Intel's business."

Indeed, even as global IT behemoths like IBM, GE, IBM, Microsoft and Google, as well as their Indian counterparts, keep announcing grandiose expansion plans almost every other day, the explosive demand for IT professionals is beginning to drive up pay rates in India, raising questions about the long-term benefits of outsourcing work to that country.

According to the "NASSCOM-Hewitt Total Rewards Study 2005" released in early March, the Indian IT-services sector witnessed an average salary increase between 16 percent and 18 percent in 2005, although the salary rise was less dramatic at the entry level.

The report added that attraction and retention of employees remain a key issue for the Indian IT industry, and the pursuit to grab as many staff as possible by IT companies is not only increasing the talent war but is also resulting in soaring salary levels that is impacting margins.

The survey said that at the junior level the average attrition rate is as high as 30 percent in the IT-services sector and 40 percent in the back-office-services sector.

In fact, according to an older report by DiamondCluster International, a U.S.-based consulting firm, although India's salaries are still significantly lower than U.S. levels, the narrowing gap is even forcing a few U.S. companies to reassess the cost savings they can hope to achieve by sending work offshore.

But rising wages are not the only rising cost component. According to Ernst & Young, other elements of cost of operations like higher interest rates and infrastructural hurdles are also adding to the cost inflation.

For instance, Ernst & Young says that the working capital interest at 14 percent in India is at least 6 percent higher compared to other countries and that along with other costs makes the cost of running IT operations in Indian about 3 percent higher than in its Southeast Asian neighbors.

This is why many fear that while no single nation poses a direct threat to India yet, quite a few countries have emerged as a viable alternative.

"Out of the top 30 offshore outsourcing providers identified by IAOP, 23 are based in India," said an official. "While this signifies that India still dominates, it also identifies companies that are based in the Philippines, China, Russia and Eastern Europe and are giving India a run for the money."

Gartner too says that India's current 80-percent ownership of the IT-outsourcing market share could dwindle to about 45 percent by 2007 if costs continue to rise at the current rate.

However, according to Nick Mayes, analyst at the London-based research firm Computerwire, India is not just about getting work done cheap. "India could be the only country where one can find high-quality IT talent in huge numbers."

Mayes adds that global IT companies would continue to expand their India operations to compete both there and globally.

"India is still needed to tap talent and to aid in innovation," he said.

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