UK INDIA BUSINESS COUNCIL

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Sector Report
Digital Innovation

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Digital Innovation

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Report highlights:

- *Overview of the Indian BPO industry, including growth drivers, current challenges and steps taken by players to overcome them*
- *Growth prospects of the Telecom and Television industries*
- *Acquisition of an Indian technology firm by a UK-based company*

SECTOR:
DIGITAL INNOVATION

SECTOR OVERVIEW: March 2014

Welcome to this quarter's sector report on Digital Innovation. Our main theme this month is the BPO industry in India, the most preferred destination for outsourcing in the world. In this report, we provide an insightful briefing on the sector, including key growth drivers, India's competitive advantage, challenges that the sector currently faces, as well as the steps being taken to overcome these challenges. The increasingly intense competition is also an opportunity for foreign small and medium enterprises (SMEs) to consider outsourcing, as Indian BPOs are now including SMEs in their list of probable clients, instead of focusing only on large corporates as they previously did.

Our Market & Investment Update sections includes an update on growth prospects in the Telecom and TV sectors in India and another on the acquisition of India-based Cyberoam Technologies by Sophos, a UK-based IT security products company.

We hope you find this report useful and look forward to your comments and suggestions.

Economic Indicators

Indicator	Q2	Q3
Real GDP Growth (%)	4.7	5.0 (F)
FDI (GBP bn, Monthly Average)	1.5	1.0
FII (GBP bn, Monthly Average)	-1.3	0.5
CII Business Confidence Index	45.7	54.9
FDI in Telecommunications (GBP billion)	0.2	0.2
FDI in Computer Software & Hardware (GBP billion)	0.4	0.1

Relevant Indices	3 Months	6 Months
S&P BSE TECk Index: TMT – Returns (%)	10.6	20.9

References: Reserve Bank of India, Department of Industrial Policy and Promotion, Bombay Stock Exchange

Note: Data retrieved on Feb 25th 2014

In focus: India's BPO Industry

A part of the GBP 65 billion Indian IT-BPO (or IT & ITeS) industry, India's BPO sector is estimated to be worth GBP 12.5 billion in 2013, accounting for ~36% of global BPO revenue. Structural factors such as demographics have played vital role in the sector's growth. India has a huge talent pool (an English-speaking population) that is available at a fraction of the cost compared with developed markets, providing India a significant cost advantage. Additionally, an increasing trend towards outsourcing of non-core services, and now outsourcing of even core services, by global companies offers the Indian outsourcing industry new horizons for growth.

The outlook for the sector is bright, as industry revenue is expected to cross GBP 30 billion by 2020, according to a report by the Confederation of Indian Industry (CII).

Growth drivers and India's competitive advantage

Tailwinds for the Indian BPO sector are structural in nature, giving India a competitive edge over other contenders.

Talent pool: An estimated 4.7 million graduates are believed to have joined India's talent pool in 2013 as per NASSCOM. Moreover, the talent pool is characterised by an optimal mix of both young and experienced professionals

Cost advantage: As per NASSCOM, outsourcing IT-BPO services to India can yield cost savings of 60-70% over the originating countries. Labor cost arbitrage is the key reason behind the low cost services being provided from Indian shores and this arbitrage is likely to remain over next 20-30 years

High quality & productivity: Apart from available talent pool, quality is managed through well defined quantifiable quality and process metrices. Also BPOs provide efficiencies with faster turnaround time, time zone advantages, 24x7 service and learning curve

Global demand: Global BPO spending is estimated to have expanded at a CAGR of ~7% over 2011-13, which is one of the key driver for Indian BPOs – an opportunity to capture bigger pie

Domestic demand: Initially export-focused, the Indian BPO sector now earns 15% of its revenue from within India, indicating strong and growing local demand. With several public sector projects lined up for IT-BPO sector, Indian government is expected to become a major contributor to domestic demand in coming years

Government support: Apart from tax holidays for STPI and SEZs created for the IT & ITeS sector, procedural ease and single-window clearance for setting up facilities have also buoyed the sector

All these factors have added to India's competitive edge over other emerging outsourcing destinations.

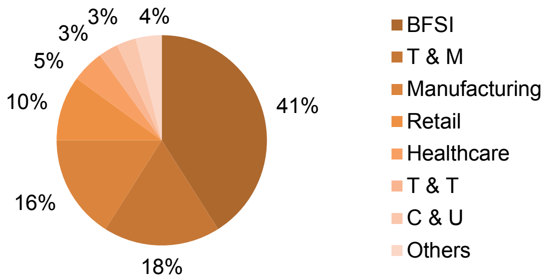
As per Tholons Top 100 Outsourcing Destinations report 2014, 6 of the Top 7 cities are in India, highlighting the country's dominance in the outsourcing space. India's positioning as the preferred outsourcing destination is backed by the fact that it accounts for 52% of the global sourcing industry.

Key client segments and geographical breakdown

The Indian BPO industry has transformed considerably since outsourcing first gained momentum. Factors that helped this development include the expansion of verticals and geographies, bringing in new customers, switching from an outsourcing partner to a strategic partner, all of which have enabled India to become a global outsourcing hub.

BPOs in India now manage end-to-end services and thus demonstrate the sector's increasing range of capabilities. Key offerings in the sector include customer support, technical support, telemarketing, IT help desk, insurance processing, data entry/processing, data conversion, bookkeeping and accounting, forms processing and online research services.

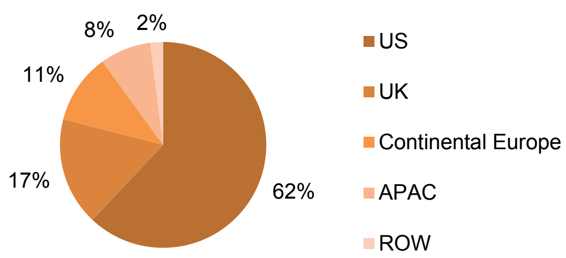
Graph 1: Distribution of IT-BPO export revenue across verticals (2013)



Reference: India Brand Equity Foundation, August 2013
Note: C&U - Construction & Utilities, T&T - Travel and Tourism, T& M - Telecom & Media, BFSI - Banking, Financial Services and Insurance

BFSI, Telecom and Media, Manufacturing and Retail emerged as the key verticals served by the Indian IT-BPO industry, together accounting for 85% of the sector's export revenue in 2013.

Graph 2: Distribution of IT-BPO export revenue across geographies (2013)



Reference: India Brand Equity Foundation, August 2013

Geographically, the US and the UK are the biggest markets for the Indian IT-BPO sector, accounting for ~80% of the sector's export revenue in 2013.

Current challenges facing Indian BPOs

In recent times, India's dominance in the global services outsourcing industry has been challenged by rising costs, anti-outsourcing sentiment, declining growth and the emergence of alternative outsourcing destinations.

Rising costs: The cost of providing BPO services from India has risen significantly over the years to the extent that even countries such as Poland, Ireland and some East European countries now compete with Indian BPOs in terms of cost effectiveness. Rising costs of BPO services in India can be attributed to wage-push inflation and mounting infrastruture costs. Indian BPOs now need to move to Tier 2 cities that can prove to be economically more viable. As per NASSCOM analysis, BPOs can reduce total operating costs by 20-30% by moving to a low-cost cities within India.

Anti-outsourcing sentiment: The "Bangaloring" of jobs (as outsourcing to India is often referred to) has become a key discussion point for mainstream political parties in major outsourcing economies, particularly in the US. The rising unemployment in these countries has seen their legislators discuss regulations to protect domestic jobs. As a result, global firms are under tremendous pressure to project a nationalistic brand image and are thus opting for "near-shoring" instead.

Rise of alternative outsourcing destinations: The Indian BPO industry faces competition from emerging BPO destinations such as the Philippines, Ireland, Vietnam, Latin America and Eastern Europe. In 2013, the Philippines' BPO sector grew 15.6% to GBP 7.8 billion, compared with the sector in India growing 8.9% to GBP 12.5 billion. The Banking and Capital Markets industry is the largest spender on BPO services globally, and Manila in the Philippines has become the sector's most preferred outsourcing destination. India also lost approximately 10% market share in the voice segment to the Rest of the World between 2008 and 2013 but remains at the top of the overall rankings.

Steps taken by the industry to tackle challenges

In order to achieve a sustained growth and to counter competition from other regions, Indian BPO providers have started strategic initiatives such as scaling up the value chain, growing the available skill pool, expanding niche skills to a broader talent pool, establishing rural BPOs and adopting Impact Sourcing. Impact Sourcing is an initiative that encourages mainstream companies to hire from the "excluded population" and from disadvantaged sections of society for internet-based jobs.

The Indian outsourcing industry is moulding itself to the changing demands and the new business scenario by rolling out customised solutions for clients. It has understood that flexible business and pricing models are critical to engaging more clients, resulting in a switch from the initial Full-Time Employee model to fixed price- and subscription-based pricing models and to non-linear models that include hybrid-based, gain-share, transaction-based, outcome-based and pay-per-use pricing. This helps clients control costs and leverage the benefits of resource pooling.

The high level of competition from other outsourcing destinations and shrinking margins resulting from too many small vendors undercutting established players has also persuaded Indian BPO players to look beyond Tier 1 clients and evaluate opportunities from SMEs in the major outsourcing economies. This is also an opportunity for SMEs as they had thus far not been able to use services provided by Indian BPOs due to the former's small size and scale.

Market Update

India's telecom subscriber base to double by 2018

According to the India Telecom Services Market Forecast & Opportunities 2018 report, the market for India's telecom services in terms of subscribers is likely to double by 2018, growing at a five-year CAGR of ~11%. The sector is primarily driven by supportive government policies and regulations.

Already the world's second-largest telecom service market in terms of subscribers in 2012, the Indian market continues to grow on the back of rapid adoption of newer technologies and rising penetration of mobile phones in the country. The sector is further supported by the declining cost of telecom services and the increasing usage of applications.

Cyber Media India, 11th Feb

Indian TV industry valued at GBP 4.8 billion

According to the Ministry of Information and Broadcasting (MIB), India is now the largest TV market in the world –

next only to China and the US – with close to 154 million households having a TV. The number of TV channels grew from 130 in 2004 to 788 in 2014. At the same time, the TV industry itself grew exponentially and was valued at GBP 4.8 billion in 2014 from GBP 1.8 billion in 2006.

Indiantelevision.com, 19th Feb

New M&A rules for telecom may disappoint players, discourage consolidation

New M&A rules for the telecom sector, which are expected to be announced soon, are likely to disappoint phone companies as they will be required to pay market-linked prices for the spectrum they gain from an acquisition. The government has broadened market-share rules to include annual revenue. The new rules are likely to discourage consolidation in the sector, which is already dealing with intense price wars and fierce competition among the 10-12 players.

The Economic Times, 20th Feb

Excise duty of 6% on all mobile handsets

In the Interim Budget 2014-15, Finance Minister P. Chidambaram restructured the excise duty for all categories, fixing it at 6% with CENVAT credit or 1% without CENVAT credit. "To encourage domestic production of mobile handsets, which has declined, and to reduce the dependence on imports, which have increased, I propose to restructure the excise duties for all categories of mobile handsets," Chidambaram told the lower house of parliament.

As part of last year's budget 2013-14, the government had raised the excise duty to 6% on handsets priced above GBP 19.2.

The Times of India, 17th Feb

Ten technologies to transform India

McKinsey Global Institute has identified several disruptive technologies that have the potential to create a global economic impact to the tune of GBP 8.4-19.8 trillion annually by 2025. Over the coming decade, 10 transformational technologies could contribute 3-5 times the current economic impact of the IT & ITeS sector to the Indian economy. McKinsey's list includes the following:

- Ubiquitous connectivity
- The internet of things
- Cloud technology
- Digital payments
- Universal biometric identity
- Automation of knowledge work
- Renewable energy
- Advanced oil & gas
- Advanced energy storage
- Next-generation genomics

These technologies have the ability to transform various sectors, including healthcare, education, financial services, citizen services, energy and agriculture.

Business Standard, 13th Feb

Microsoft ties up with Tata Tele, MBD & Acer to bundle content for schools

Microsoft has tied up with personal computer and notebook maker Acer, publishing house MBD and telecom services provider Tata Teleservices to launch bundled tablets for private schools. The deal represents a first-of-its-kind venture in the education space, where four companies spanning diverse industries have come together to provide digital learning solutions for students of classes 6-12 in Indian schools. The K-12 segment in India is valued at GBP 23 billion, according to Technopak estimates, and expected to reach GBP 57 billion by 2020. It currently has around 230 million students. The success of this venture depends on how the product is made commercially viable in Indian market.

The Economic Times, 5th Feb

Investment Update

Oxford-based Sophos acquires Cyberoam Technologies

Sophos acquired India-based Cyberoam Technologies, a leading global provider of network security products. The acquisition expands and deepens Sophos's already significant product portfolio in network security by combining Cyberoam's Unified Threat Management (UTM), next-generation firewall and network security expertise with Sophos's existing award-winning network security solutions in UTM and wireless security.

IDC Research pegged the network security market at GBP 4.7 billion in 2012; UTM accounted for GBP 1.6 billion of the market and was cited as the fastest growing segment, with 21% growth. In the recent Gartner Magic Quadrant for Unified Threat Management, Sophos was again named a "Leader" and Cyberoam a "Visionary".

Sophos, 10th Feb

Diageo picks TCS as its new IT service provider

UK-based distiller Diageo has selected Tata Consultancy Services (TCS) as its new global IT service provider. The companies did not disclose the contract value and other details. TCS will manage Diageo's global IT infrastructure, data centres and servers and provide service desk support to Diageo employees.

Live Mint, 20th Feb

Vodafone gets CCEA nod for its GBP 973.4 million FDI proposal

Vodafone announced that it has received cabinet approval to acquire minority shareholdings in its Indian arm for GBP 973.4 million; the deal is estimated to be the single largest foreign investment in the country's telecom sector. After the deal is completed, Vodafone India would become the first telecom operator to be fully owned by a foreign firm. The Cabinet Committee on Economic Affairs (CCEA) has approved CGP India Investment Ltd's proposal to increase foreign equity in Vodafone India Ltd from 64.38% to 100%. The government had allowed 100% FDI in the telecom sector last year.

MSN News, 7th Feb

Essar Group's BPO unit Aegis plans to buy two more firms, including one in Britain

Essar Group's Aegis is planning to acquire two more companies in the BPO space, as per CEO Sandip Sen. The move demonstrates the country's third-largest standalone BPO firm's continued appetite for acquisitions. One of the targets is likely to be in the UK; the company did not divulge the location of the other firm, but it is expected to be one in the non-voice category.

The Economic Times, 14th Feb

Wipro bags 10-year contract from Carollion

Carillion, a UK based integrated support services company, selected Wipro, an Indian IT services provider, as its sole preferred global strategic partner to provide integrated IT and BPO services. As part of the ten year engagement, Wipro will deliver operational and cost efficiency to Carillion through its outsourcing and transformation services. The engagement covers Carillion's IT infrastructure and applications, HR (Human Resources) and F&A (Finance and Accounting) BPO services.

Business Standard, 25th Feb

Events Update

UK Business Secretary takes trade delegation to India's growing regional cities

On 9 December 2013, the UK's Business Secretary Vince Cable took a delegation representing 25 British companies for a four-day trade visit to India's growing regional cities. The visit was focused on the planned development of business opportunities and strengthening existing partnerships over the coming years. Dr. Cable signed various agreements related to trade and investments, including plans to form a joint platform that would support business by the UK India Business Council and UK Trade & Investment (UKTI) to help small and medium sized enterprises (SMEs) in Britain gain access to pre-approved service providers.

Gov.uk, 9th Dec

Access to India: An introduction to the Indian Creative Industries with IVCA

On 20th March 2014, UKIBC organised the event with the aim of providing British companies with an understanding of the Indian media and entertainment industry – its current landscape, events and opportunities. The event provided companies with significant networking opportunities and visibility in the UK-India business corridor.

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Please note:

- Conversion rate used across the report is for Feb 28th 2014. 1 GBP = 103.16 INR and 1 GBP = 1.67 USD
- Numbers rounded across the report