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BRIEF REPORT

ON

IT & ITES INDUSTRY IN INDIA

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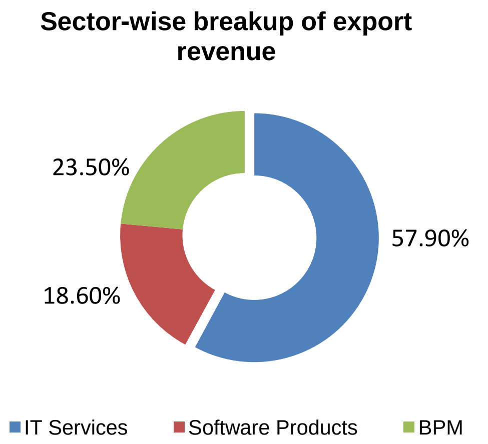
1. OVERVIEW OF INDIA'S IT & ITES INDUSTRY

1.1 Background

India is the world's largest sourcing destination for the information technology (IT) industry, accounting for approximately 52 per cent of the US$ 124-130 billion market. The industry employs about 10 million Indians and continues to contribute significantly to the social and economic transformation in the country.

The IT industry has not only transformed India's image on the global platform, but has also fuelled economic growth by energising the higher education sector especially in engineering and computer science. India's cost competitiveness in providing IT services, which is approximately 3-4 times cheaper than the US, continues to be its unique selling proposition (USP) in the global sourcing market.

The Indian IT and ITeS industry is divided into four major segments – IT services, business process management (BPM), software products and engineering services, and hardware.



The IT-BPM sector in India grew at a compound annual growth rate (CAGR) of 25 per cent over 2000-2013, which is 3-4 times higher than the global IT-BPM spend, and is estimated to expand at a CAGR of 9.5 per cent to US$ 300 billion by 2020.
India has emerged as the fastest growing market for Dell globally and the third largest market in terms of revenue after the US and China..

Global IT spending, which picked up in CY13, is expected to maintain a decent growth in CY14 as the economic situation in the US and Europe continues to improve. Discretionary spending on IT budgets by large global corporations has ticked up compared to last year but is limited to the new digital technologies. In terms of industry verticals, Banking, Financial Services and Insurance (BFSI) and Energy are the growth drivers.

Export of IT services has been the major contributor, accounting for 57.9 per cent of total IT exports (excluding hardware).

- Indian IT companies had a good year in terms of financial performance, driven by factors like such as the improvement in the quality of service offerings, stable pricing environment and the depreciation of the Indian rupee. Indian IT firms continue to move up the value chain by providing more end-to-end solutions and engaging more closely with clients. They are also increasingly relying on internal cost optimisation measures to improve profitability.
- India's IT industry can be divided into five main components, viz. Software Products, IT services, Engineering and R&D services, ITES/BPO (IT-enabled services/Business Process

Outsourcing) and Hardware. Export revenues, primarily on project based IT Services continue to drive growth with IT Services. This accounts for 54.2% of total revenues followed by BPO and Engineering services at 19.5%, Software Products at 15.3% and hardware at 11%. Multi-year annuity based outsourcing agreements continue to increase at a steady rate. In terms of total export and domestic revenues, Application Development and Maintenance (ADM) still continue to be the bread and butter for Indian IT companies; however traditional services have become increasingly commoditised.

- Labour arbitrage has been the competitive edge of the Indian software sector over the last few years. However, the focus has now shifted to providing value to clients beyond cost savings. Software services are being increasingly demanded by global MNCs which can boost sales as well as improve internal efficiency.
- Increasing competition, pressure on billing rates of traditional services and increasing commoditization of lower-end services are among the key reasons forcing the Indian software industry to make a fast move up in the software value chain. The companies are now providing higher value-added services like consulting, product development, R&D as well as new digital technologies like social media, mobility, analytics, and cloud computing (SMAC).
- The new Indian government is emphasizing on better technology enabled delivery mechanisms for a multitude of government projects. Further, with the new digital India initiative being launched, the domestic market for software services looks forward to a bright future.

2 GOVERNMENT INITIATIVE AND FDI IN POWER INDUSTRY

2.1 Government Initiatives

The adoption of key technologies across sectors spurred by the 'Digital India Initiative' could help boost India's gross domestic product (GDP) by US$ 550 billion to US$ 1 trillion by 2025.

Some of the major initiatives taken by the government to promote IT and ITeS sector in India are as follows:

- India and the United States (US) have agreed to jointly explore opportunities for collaboration on implementing India's ambitious Rs 1.13 trillion (US$ 18.22 billion) 'Digital India Initiative'. The two sides also agreed to hold the US-India Information and Communication Technology (ICT) Working Group in India later this year.
- India and Japan held a Joint Working Group conference for Comprehensive Cooperation Framework for ICT. India also offered Japan to manufacture ICT equipment in India.
- The Government of Telangana began construction of a technology incubator in Hyderabad—dubbed T-Hub—to reposition the city as a technology destination. The state government is initially investing Rs 35 crore (US$ 5.64 million) to set up a 60,000 sq ft space, labelled the largest start-up incubator in the county, at the campus of International Institute of Information Technology-Hyderabad (IIIT-H). Once completed, the project is proposed to be the world's biggest start-up incubator housing 1,000 start-ups.
- Bengaluru has received US$ 2.6 billion in venture capital (VC) investments in 2014, making it the fifth largest recipient globally during the year, an indication of the growing vibrancy of its startup ecosystem. Among countries, India received the third highest VC funding worth US$ 4.6 billion.

2.2 Policy and Promotion

IT and ITeS has played a major role in the overall growth and development of India. In the electronics and IT sector, 100% FDI is permitted under the automatic route. The major fiscal incentives provided by the Government of India in this sector have been for export-oriented units (EOU), software technology parks (STP) and special economic zones (SEZ). These are detailed below:

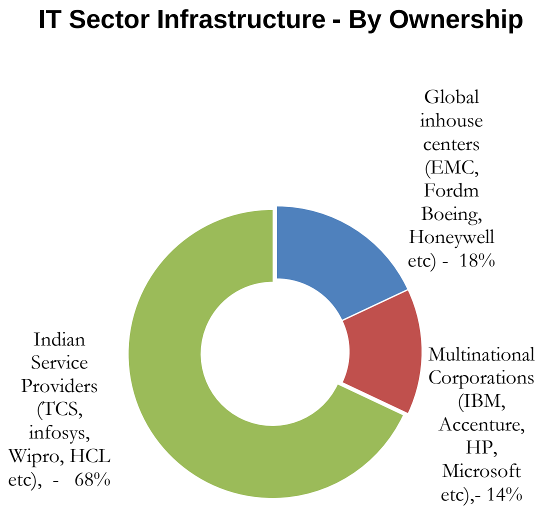
- Software Technology Parks (STPs) were set up as autonomous societies under the Department of Electronics and Information Technology in 1991 to promote software exports from the country. There are about 51 STP centers that have been set up since the start of the programme. STPs enjoy a number of benefits that include exemptions from service tax, excise duty and rebate for payment of Central sales tax. The most important incentive available is 100% exemption from income tax of export profits; the STPs have been instrumental in boosting India's IT and ITeS exports.
- As per MoC&IT, exports by STP units crossed Rs. 2,044.40 billion in 2010–11. The state with the largest export contribution was Karnataka followed by Maharashtra, Andhra Pradesh and Tamil Nadu. STPs have a pan-India presence, including in the cities of Bangalore, Bhubaneswar, Chennai, Coimbatore, Hyderabad, Gurgaon, Pune, Guwahati,

Noida, Mumbai, Kochi, Kolkata, Kanpur, Lucknow, Dehradun, Patna, Rourkela, Ranchi, Gandhinagar, Imphal, Shillong and Nashik, among others.

- The Special Economic Zones (SEZ) scheme was enacted by the Government of India in 2005 with an objective of providing an internationally competitive and hassle-free environment for exports. It provides drastic simplification of procedures and a single-window clearance policy on matters relating to Central and state governments. Under the scheme, the exemption from income tax is tapered down over 15 years from the date of commencement of manufacture. There is 100% exemption of export profits from income tax for the first five years, 50% for the next five years and 50% for next five years subject to transfer of profits to special reserves.
- According to the SEZ Approval Board of India, the maximum number of SEZs has been approved for the IT-ITeS sector. Overall for the IT, ITeS, electronic hardware and semiconductor sectors, the government has given formal approval to 354 SEZs and the number of notified SEZs in these sectors was 236 until 2010.
- Information Technology Investment Regions (ITIRs) were notified in 2008 in order to address the sector's infrastructure needs. As per plans, these regions will be endowed with excellent infrastructure that will allow companies to reap the benefits of co-siting, networking and greater efficiency through use of common infrastructure and support services.
- R&D promotion is also being encouraged by the government; major highlights include promoting start-ups that are focused on technology and innovation, and a weighted deduction of 150% of expenditure incurred on in-house R&D under the Income Tax Act. In addition to the existing scheme for funding R&D projects, the Department has put in place the two key schemes — Support International Patent Protection in Electronics & IT (SIP-EIT) and Multiplier Grants Scheme (MGS).

3 MAJOR PLAYERS

Global companies such as Accenture, HP Enterprise Services, IBM and Capgemini have a strong presence in India. These companies already have a large number of India-based employees — Accenture (40,000+), IBM (130,000+), HP Enterprise Services (15,000+) and Cap Gemini (26,000+); global players are aiming to develop onshore service providers who can deliver seamless hybrid onshore-offshore services at low costs.



Some of the top IT firms in India are TCS, Tech Mahindra Limited, Infosys Technologies Limited, Patni Computer Systems Limited, Wipro Technologies Limited, Oracle Financial (I-Flex Solutions Ltd), Mahindra Satyam Computer Services Limited, Mphasis, HCL Technologies Limited and Larsen & Toubro Infotech Limited.

Indian IT companies have, in recent years, started expanding their global footprint through the global delivery model to seamlessly service their clients' needs worldwide. Industry analysts expect the top IT firms to grow between 23% and 27% in 2012 on the basis of an increased number of discretionary projects, improved pricing and robust business volumes.

4 FUTURE PROSPECTS

Indian information technology (IT) spending is forecast to reach $73.3 billion in 2015, up 9.4% from $67.1 billion in 2014. The pace of IT spending in India may make it the third-largest IT market in the Asia-Pacific by 2016 and second-largest by 2018. IT services segment is forecast to grow 15.7% while software sector may grow 14% in 2015.

Online retailing, cloud computing and e-commerce are leading to rapid growth in the IT industry. Online shopping is fast gaining popularity with the emergence of internet retailing. Increasing internet penetration and affordability for personal computers has led to increase the industry further expected to grow triple by 2015.

The Indian IT/ITES industry is expected to maintain a growth of 13-15% in FY2015 and to achieve a revenue target of USD 225 bn by 2020 for which the industry needs to grow by about 13% on a Year on year basis in the next six years.

Emerging protectionist policies in the developed world are expected to affect the Indian IT companies. Due to US restrictions on visas as well as rising visa costs, most Indian IT companies are increasingly subcontracting onsite jobs to local employees in the US. Additionally, the new immigration bill is still under consideration in the US which, if implemented, will significantly raise employee costs for onsite workers. This would adversely affect margins of Indian IT companies.

Indian IT companies are increasingly adopting the global delivery model. They are setting up development centers in Latin America, South East Asia and Eastern European countries to take advantage of low cost and also cater to the local market. In the US, such centers will help mitigate the risks of the new immigration bill and increase the probability of winning projects in highly regulated sectors such as healthcare, government services, utilities etc.

ADM services, which used to provide major chunk of revenues to the domestic IT players, are getting affected due to the falling billing rates. Hence, the companies are now venturing into new high value services such as IT Consulting, Product Development, and the new digital SMAC services.

The integration of IT-BPO contracts is expected to become more common, as companies look out for end-to-end service providers. Large Indian companies like Infosys, TCS, Wipro, Tech Mahindra and HCL Technologies, will benefit from this trend.

1. Strong Buyer Confidence: 78% of decisions makers feel confident of planning for investment and growth in 2014
2. Global IT spending projected to grow faster in 2014- IT by 3.9 per cent, BPM by 5.9 per cent;
3. Increased contract volume for global sourcing
4. Industry revenues expected to reach USD 130 billion
5. Disruptive technologies, digitization and entrepreneurship to fuel growth
6. Future of industry- Collaborate, Connect, Co-Create specifically tailored business models