



ECONOMIC PERSPECTIVES

IT-services as locomotive

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The role of software and IT-enabled services in India's economy is substantial. But, with a sizable section of the population outside its ambit, an excessive dependence on this sector may be inequalising.

THE refrain was tiresomely extraordinary. In its recently released results on the performance of India's software and IT-enabled services sector during 2004-05, the National Association of Software and Services Companies (NASSCOM) declared that the sector had once again notched up a record of sorts. Its revenues had grown by 32 per cent over the previous year, the highest rate since the slowdown of 2001, surpassing the agency's own 25 per cent projection. Once again, exports were principally responsible for this dynamism, having grown by 34 per cent. And domestic revenues of the industry, though lagging behind, also grew at an impressive 23 per cent.

In absolute terms too the size of the software and IT-enabled services sector is now impressive. NASSCOM estimates the size of the industry at \$22 billion, comprising \$4.8 billion of domestic revenues, \$12 billion of software and services export revenues and \$5.2 billion of revenues from exports of IT-enabled services and business process outsourcing (BPO). Thus, even when the hardware segment of the IT industry is excluded, gross revenues from IT services have come to account for as much as 3.3 per cent of gross domestic product. Needless to say, gross revenues tend to be higher than the value added (or the excess of revenue over purchases of raw materials, intermediates and power and fuel) in an industry, which determines its contribution to GDP. However, based on a sample of 209 software companies included in the Centre for Monitoring Indian Economy's (CMIE) Prowess database, it has been estimated that value added in 2002-03 amounted to as much as 92 per cent in this industry, making gross revenues a close approximation of value added in the services sector.

By way of comparison, the gross revenues from IT services was in 2004-05 about 20 per cent higher than the GDP generated in India's construction sector and almost three times as much as the GDP in mining and in electricity, gas and water supply. What is more, gross revenues from IT services exceeded 12 per cent of GDP generated in India's services sector as a whole, which accounts for more than 50 per cent of the nation's GDP. Thus, even though the software and IT-enabled services sector started from a small or negligible base a decade back, its rapid expansion at an annual compound rate of more than 30 per cent per annum between 1998-99 and 2004-05 has ensured that it is today an important presence in the economy.

THERE are two aspects to the rise to maturity of this sector that are well recognised now. First, it has been driven predominantly by external demand.

Exports of software and IT-enabled services have risen at a compound annual rate of 38 per cent a year since 1997-98, and overwhelmingly explain the rapid rise of the sector. Second, within exports, in recent years IT-enabled services have emerged the dynamic segment, growing at an amazingly high annual compound rate of 56 per cent per annum when IT software and services exports were growing at less than half that rate.

Given the importance of exports in explaining the sector's growth rate, it is not surprising that its rise to dominance has substantially increased its contribution to India's foreign exchange earnings. According to Reserve Bank of India estimates, net invisible earnings from exports of software (and IT-enabled) services rose from \$5.8 billion in 2000-01 to \$11.8 billion in 2003-04 and \$12.2 billion during the first nine months of 2004-05 (April-December). If that trend had persisted during the rest of last year, net earnings from software services exports would have amounted to \$17.1 billion in 2004-05, which is a number that tallies with NASSCOM's software and IT services exports figure.

This has made IT services exports an important component of India's total (merchandise and non-merchandise) exports. The ratio of IT services to merchandise exports has risen from 13 per cent in 2000-01 to an estimated 20 per cent in 2004-05. Further, the ratio of net IT services export earnings to total net invisible earnings rose from 53 to 59 per cent between those two years.

It is well known that private transfers or remittances from Indian residents abroad together with revenues from IT have helped India notch up a current account surplus during the three years 2001-02 to 2003-04. While remittances are the result of the short-term migration of natural persons, IT services earnings are the result of a process of digital migration facilitated by the technology that allows for the cross-border supply from remote locations of a range of services, often in real time. Thus the provision of labour services through actual or digital migration have substantially strengthened India's balance of payments. Even during 2004-05, despite the sharp increases in oil prices and India's non-oil import bill, the deficit on the current account has been held down because of flows on account of these forms of migration.

Initially remittances were far more important than software services earnings. But partly because of a slowing of remittance inflows in 2004-05, it is estimated that the ratio of software services earnings to remittance inflows has risen from 45 per cent in 2000-01 to 60 per cent in 2002-03 and 83 per cent in 2004-05. This makes the role of the IT sector in shoring up the current account of India's balance of payments quite crucial.

Finally, the software and IT-enabled services sector is becoming a major source of employment at the margin. The only available estimates here are those from NASSCOM, which indicate that employment rose from around 285,000 in 1999-2000 to just above one million in 2004-05, or at a compound rate of about 28.5 per cent per annum. This is indeed remarkable given the fact that the rate of growth of employment during the second half of the 1990s (1993-94 to 1999-2000) as per National Sample Survey statistics amounted to just 0.67 per cent in rural areas and 1.34 per cent in urban areas. Further, since aggregate revenues from software and IT-enabled services grew at the same pace over that period, it appears that for every one percentage point growth in output, employment in the sector also rose by a percentage point. Thus the phenomenon of jobless growth does not appear to be true of this sector at all.

In sum, the current and evolving role of software and IT-enabled services in India's economy is indeed substantial. The sector is proving to be a major growth pole within the services sector, which in turn drives GDP growth in the country. Not surprisingly, there is much concern as to whether the sector can

sustain a high, even if not the dramatic, growth rate; whether that growth would continue to support India's balance of payments; and whether the benefits of this growth would spill over onto the rest of the economy.

THE answers to all these questions would depend on how we interpret the structural characteristics of growth in the IT sector. There are a number of such characteristics that need to be flagged. The first is that while the external market is the prime driver of growth in this sector, that market is dominated by one country: the United States. This makes the industry vulnerable. Any slowdown in the U.S. can have a dramatic impact on the fortunes of the industry.

Second, India today dominates the global market for outsourced software and IT-enabled services. NASSCOM quotes an estimate according to which India today accounts for 44 per cent of the global outsourcing market. This ratio goes up to 55 per cent if only the ITeS-BPO segment is considered. If current growth rates are to persist either the global market would have to grow at that rate with a stable Indian share or the industry would have to increase its share of the global market over time. That is indeed a tough difficult.

Third, since the ITeS-BPO sector accounts for a rising share of total revenues, India's dependence on the less skill-intensive segments of the software and IT-services sector is rising. This makes it even more difficult to maintain market shares, especially without a substantial drop in revenues per employee, since competitors are more easily generated.

Even if India's share of outsourcing revenues remains high, the net benefits of this are still unclear because of the dominance of a few firms and a substantial share for captive offshore outsourcing by international firms in the ITeS-BPO sector. According to NASSCOM figures, in 2003-04 the top 20 software and IT services exporters accounted for as much as 61 per cent of total export revenues. And captive ITeS-BPO providers accounted for as much as 65 per cent of the value of ITeS contracts outsourced to India. This kind of concentration not only makes the linkage effects of the growth of the industry less significant, it also has adverse implication for the net foreign exchange earning of the sector after taking into account repatriation of profits and other payments abroad.

Finally, the absolute employment contribution of the software and IT services sector makes its position within the Indian economy that of an enclave. Even at just over a million, the number of worker in software and IT services amount to just one quarter of one per cent of all workers in India as per the 2001 Census, or one-third of one per cent of all main workers in 2001 or two-thirds of one per cent of all workers outside agriculture and household industry. This suggests that a sector whose presence in terms of its contribution to GDP and its contribution to India's currently comfortable balance of payments position is indeed substantial, cannot make much of a direct difference to a substantial section of India's population. Hence an excessive dependence on this sector for growth at the margin may be inequalising, unless players in the industry make a substantial contribution to the state's tax revenues that can sustain expenditures on employment generation and social provision.

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