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SEGMENT ANALYSIS | IT SERVICES

DON'T RUN FOR THE CHERRY, WALK UP THROUGH THE CAKE

Indian IT Services players are facing new heat in the form of ripples of some global turbulence, delays in multi-year deals and margin pressures. But they are also betting on exotic fruits like quantum computing, AI and complex IT modernization projects. Will they make some new dough?

It was a year marked with fears and speculations emerging from many front-burners. Like the SVB-meltdown and the ensuing banking crisis. Like geo-political friction. Like protracted deals.

At the same time, there are client wins happening in all brackets – from US$1 million+ to US$100 million+. There is continued traction in cloud, digital transformation and modernization projects—as enterprises across verticals try to squeeze in cost savings and get ready for the digital world – in every way they can.

So, what did we learn this year about the big global pie of IT service market?

SUN-DRIED FRUITS

The sentiment is gloomy, and some latest quarterly results corroborate the ripples of the banking crisis in the US,

the global economic turmoil and inflation issues. For the short-term horizon – like the next few quarters or a year or two—this scenario will stay, captures Arun Jethmalani, Founder and Managing Director of ValueNotes. If we look at predictions from JP Morgan too, the demand environment for IT services has, likely, weakened further in June—as its report says. What complicates this further is the enhanced competition for a smaller slice that can lead to falling win-rates, pricing and not-so-great deal terms. The report also augurs that deferred project starts, project halts and cancellations could persist.

Devroop Dhar, Co-Founder and Board Member at Primus Partners also reckons that, overall, the IT industry is going through a transition. "There are strong headwinds fuelled by macroeconomic factors with the war in Ukraine and inflation pressure and higher interest rates.

> **INDIAN IT PLAYERS SHOULD NOT SHY AWAY FROM THEIR CORE COMPETENCE—WHICH IS ABOUT DEVELOPING FOUNDATIONAL WORK IN TECHNOLOGY. THEY HAVE DONE THAT QUITE WELL IN THE OUTSOURCING INDUSTRY, IN APPLICATION DEVELOPMENT ETC. SO WHY RUN FOR THE CHERRY IN AI RIGHT AWAY? LET'S BUILD THE CAKE.**

North America and Europe remain the biggest and most important markets for the Indian IT industry, and both may see recessionary pressures."

It is expected (As per JP Morgan's report) that recovery for the industry isn't likely over the next six to nine months and it's probable that the sector will not deliver expected revenue figures or growth expectations for around a year.

Dhar, however, anticipates that the industry would continue to grow at higher single digit or lower double-digit rates and is expected to come out of this phase in 12-18 months. "We would see areas such as Digital transformation, Cloud and AI being some of the in-things. As clients look at consolidation of vendors to optimize cost, the larger IT firms would see an upside as multiple consolidation deals would be there in the market. Clients would also look at significant automation in regular and routine areas such as maintenance and support, and the same would open up opportunities."

Jethmalani echoes that prognosis. "The Indian IT services industry is very resilient. And tech spends, as percentage of GDP, are not going to go down. New segments like Cloud, analytics, AI – which are not traditionally classified as IT services—will get big. But in an era where not just big companies, but small companies too, are moving towards digitalization—tech spends will only expand. Especially with AI and 5G (accompanied with IoT, M2M, Industrial 4.0 etc.) kicking in—companies will either want to build their own capabilities or want someone to build it for them. That's where Indian IT players will be highly relevant."

The scenario could get upbeat in a quick way if we see more multi-billion and multi-year deals happening in the next 2-3 years. And that is not impossible.

As Dhar affirms, "While the global economy is seeing certain headwinds which may impact the IT industry, the IT industry is still expected to see various multi-billion and multi-year deals happening over a period of time, fuelled by large clients looking at vendor consolidation and cost savings."

But he also points out that while large deals would be there, the IT firms would continue to face margin pressures and the slowdown in North America (the largest market for most of the Indian IT firms) would have an impact as well.

GOING FOR THE CHERRIES – WITH AI

Whether it is HCL or LTIMindtree or TCS or Wipro, players seem to be whipping up new ingredients in the mix already – with both efforts and investments going in sprucing up areas like AI, Quantum Computing and Machine Learning. From developing own frameworks and accelerators, to CoE-launches to collaborating with specialists—IT players are making a dash at full tilt towards this new world.

It is a good strategy from an internal lens, avers Indranil Bandyopadhyay, Principal Analyst, Financial Services, insurance, Data Science, AI at Forrester. "AI is quickly moving from testing to code generation tools in a SDLC cycle. Use of AI and new-age tools can help companies improve efficiencies, margins and quality of delivery—thus, leading to a tangible monetary impact."

From an external facet too, AI can mean a lot of potential, he reasons. Especially as the demand and supply equation is tilted towards demand-side presently. And this space is changing and exploding fast – we had not heard of ChatGPT some months back, and now it's in every conversation. But. There is a big 'but', as he underlines well. "Indian IT players should not shy away from their core competence—which is about developing foundational work in technology. They have done that quite well in the outsourcing industry, in application development etc. so why run for the cherry in AI right away? Let's build the cake."

He weighs in that there are not many who are doing that. "We need players who can bring the dough, the eggs, the cream, the right ingredients; and who know how to mix it all well before putting the cherry on the cake." As he rightly hints at, it's not too bad to be experts at grunt work – especially since we have done it so well before.

> INDIAN IT SERVICE PLAYERS HAVE PROVEN 'ADAPTABILITY' AS THEIR STRONG SUIT SINCE THE INCEPTION OF THIS INDUSTRY. FROM COBOL TO BODY-SHOPPING TO HIGH-END OUTSOURCING TO Y2K TO APM TO CLOUD—WE HAVE ALWAYS PIVOTED WELL TO NEW REALITIES AND OPPORTUNITIES.

Areas of focus

- With stable job outlook and lesser attrition, companies would be able to focus on margin consolidation, which would be important in the long run

- Companies need to further fine-tune the Onsite-offshore mix to optimize the margin and cost pressure

- Utilisation had become a challenge for companies, which companies would need to work on and improve

- For AI – work on the spade-work instead of shiny product launches – as this would be a big gap in the market and Indian players have a core expertise here

- Generative AI is becoming an area of interest and application across industries, and companies which are focusing on product and innovation centred around it would gain a lot

Source: As shared by various experts

"This tailwind of AI, combined with core Indian culture and expertise, would lead to a strong future for the IT Service players."

Jethmalani seconds that argument and adds that companies will need players to do all the AI work for them. "Sure, it's a big force but if any company wants to tap AI, it will need experts who can build it and run it. In other words, another opportunity for IT service players."

HOW LONG – IN THE OVEN?
What marked this year particularly was the jolt felt in specific segments like banking and regions like the USA. Would the spill-over continue ahead?

While the turbulence brought in by the SVB-aftermath has stabilised to a great degree, segments like technology clients might show a dull phase. "VC funding and valuations have plummeted in this area." Jethmalani dissects. But he believes that in the long-term there is a huge demand lying ahead.

Overall, companies need to focus on a mix of product and solution-oriented approach driven by innovation to be relevant in the market, Dhar stresses. "This would also be the right time for some of the cash-rich Indian IT firms to look at M&A if they find the right fit. Globally, as clients are looking at deeper sectors and domain-specific knowledge and solutions, some of the Indian IT firms may look at M&A to shore up their capabilities in niche segments."

With the scope of global recession looming large over the next one or two years, fueled by global macroeconomic factors such as the war in Ukraine, inflation pressure and higher interest rates; clients would look at digital transformation as a way to reduce cost, Dhar reminds. "Also, with the pandemic behind us, clients may also look at change of vendors and vendor consolidation to optimize cost. The larger players are expected to benefit from this, as clients would look at consolidating projects and engagements and working with fewer vendors."

If we look at the next five or ten years, there will be no fundamental change in the momentum of Indian IT service industry. "There is a huge opportunity ahead." augurs Jethmalani. Especially when the future will mean a computer in everything—from cars to household appliances to factory machines. And the Indian IT service players have proven 'adaptability' as their strong suit since the inception of this industry. From COBOL to body-shopping to high-end outsourcing to Y2K to APM to Cloud—we have always pivoted well to new realities and opportunities."

The next year can smell much better – if we stick to the recipe that works—with some new twists, as needed. 🔴