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CEO Spotlight

**THOLONS**

Advisory • Investments • Research



Avinash Vashista,
CEO Tholons

A Year in Perspective and the Year Ahead

Service providers are experiencing impact of sluggish growth, decreased margins and employee downsizing. Service buyers are reducing IT budget allocations but still under tremendous pressure to reduce cost and survive.



The ripple of the global economic downturn continues to impact the foundation of the outsourcing industry, both near and long-term.

Despite this lingering cloud of uncertainty, Tholons maintains that the long term demand for Outsourcing remains intact. Decreasing margins will push providers to better utilize existing resources, leverage operational levers, implement new technologies efficiently to differentiate themselves and improve service delivery processes. Clients, with reduced IT budgets will be more selective – demanding stringent SLAs, greater contractual flexibility and output/result based payments.

“Service buyers will need to re-assess their outsourcing strategies and implement a better mix of multi-sourcing, nearshore and offshore models, while service providers will look to tap growing domestic markets (such as China, India, Argentina, Brazil and even US) as a means to hedge against the volatility of existing offshore contracts.”

These shifts will significantly induce a high degree of consolidation - smaller and less efficient providers may face difficulties in tapping new revenue streams and will be prone to acquisition or outright dissolution.

It's an opportune time for the larger players to continue their string of strategic, niche acquisitions. In an increasingly competitive market, and improbable economic state, the mantra of only the strong will survive has never been more relevant.

The year round has seen dramatic events turning the tables around. Early 2008 began with the dollar (USD) depreciating by nearly 10% against most typical “offshore” destinations. The British Pound (GBP) and the Euro (EUR) also had similar impact,

Little did the service providers expect that by the time they did well in combating the forex crisis, global recession would hit them. And this time it was harder than ever before. Practically, 90% of their client markets including USA, Europe, and Japan had declared to be under recession, forcing them to revise their growth plans. Offshore IT majors have reduced their revenue guidance by nearly 10% for CY’09 and frozen their hiring plans.

Coupled with the recession was the downfall of global financial giants such as Bear Sterns, Lehman Brothers, AIG etc, which affected the large service providers of the world, who had significant exposure to these firms and the financial services sector as a whole.

The global slowdown has brought about attractive valuations, for firms to expand and enhance their portfolios. 2008 provided the IT/BPO Industry the stage to initiate and complete investments in strategic areas which helped to enhance their service capabilities or improve global presence/footprint. Coupled with this, the increased demand for value-added services from IT service providers, which require high-level domain knowledge and global footprint – service providers have recognized this and are now concentrating on M&A. This trend of geographical and portfolio expansion is expected to continue in 2009.

TCS's acquisition of Citi BPO, WNS acquisition of Aviva's captive units and HCL's acquisition of Axon Consulting were clear indicators of firms trying to fill gaps, either in their portfolios or their geographic mix (both revenue and physical presence).

In dollar terms, the value of cross border M&A in IT/BPO firms had increased from 51% in 2007 to 64% in 2008.

Recent event regarding Satyam Corporation in India are unfortunate, we believe that the incident was more an anomaly than a trend. We also hope that organizations/associations like NASSCOM, SEBI and the Government will come together to manage the situation in a matter of days and not weeks. This also calls for a more stringent due diligence to be performed on service providers as we work sourcing contracts with clients.

Undeniably, 2008 was a tumultuous year for outsourcing, and though we continue to advise clients to remain cautious in the year ahead, we do not discount the opportunities and potential still very much evident in the market. We consider the current struggles of the industry as a driver for positive change and expect the outsourcing industry to develop in the coming years – more mature, efficient, dynamic, and ultimately more resilient. With prudence, heightened focus, and a more adaptive approach towards outsourcing – 2009 can in fact be a watershed moment for the global outsourcing industry.

A copy of Tholons Top Ten Trends in Services Globalization - 2009 is available at: http://www.tholons.com/Trends_2009.pdf
