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CEO Spotlight

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Riding through the Sunset

It is only a question of “when”.

Time has come for the outsourcing industry to prepare, re-invent and transform itself and drive into a new dawn of opportunities.

The outsourcing industry has stood the test of time, standing strong on its four pillars of cost arbitrage, talent availability, improved operations and government incentives provided to the sector across global locations. While the various governments have implemented several beneficial measures to aid the industry and assist in its rapid development these past years, one of the fundamental support tools that the government extended to the outsourcing industry – tax breaks – are coming under increased scrutiny and in some countries like India, soon coming to an end.

Moving forward we will witness the expiration of the tax breaks provided to the industry, most possibly starting with India. Anticipating future dynamics, a quick shift in the center of gravity is advised if one of the four pillars is taken out of the equation.

Come March 31, 2011, the Software Technology Parks of India (STPI) tax scheme will sunset, which means that the tax holiday which for so long the Indian IT and the ITeS industry have been enjoying on their export profits is going to expire. When this happens, and it will eventually, Indian companies will find their payable taxes increase by 10% to 15%, thus denting their profit margins significantly. The tax holiday allowed for a 10 year exemption from Corporate Income Tax, Sales Tax, Customs Duty, and Excise duty. The tax relief in combination with easier FDI norms and availability of economical and skilled talent pool provided the impetus for India to become the destination of choice to both multinational and domestic companies.

Most large corporations have invested in SEZs to avail the tax benefits as the March 31, 2011 sunset period does not apply to them under the current tax legislation. It is however the small and medium enterprises which operate on a wafer thin margin who can't afford to setup units in SEZ and are going to be most affected. We will have to wait and see how impact-full any extensions, if made, are going to be on SMEs.

The outsourcing industry needs to start accepting that tax breaks provided in the past have been the catalyst and boosters used to provide that initial extra thrust to establish a roaring business model. The challenge ahead would be to try and accommodate the taxes payable to the government thereby contributing towards the development of other sectors as well, and at the same time maintain similar or achieve even higher profit margins.

The global outsourcing location landscape has matured into a force to reckon with. These destinations now have large number of professionals engaged in ITO/BPO, impressive revenue and growth numbers along with long-term contracts and large cash reserves. Initially, these incentives were provided by countries around the world to kick start businesses, promote the sector and attract investments.

The discussion underway is whether the current deadlines should be extended or not – if not for the big firms, at least for the SMEs. What the industry should realize and come to terms with, is the fact that sooner or later tax benefits will go away. Question is how much longer the governments can/will shelter a profit making industry?

It also must be kept in mind that this opens the doors for emerging outsourcing nations like China, Brazil, Philippines, Chile, Russia, Vietnam, Poland, among others to successfully compete with India for attracting outsourcing work and related investments.

It has been fascinating to be a part of and follow the dynamic global outsourcing industry. I believe that time has come for the outsourcing industry to prepare, re-invent and transform itself and drive into a new dawn of opportunities.

If you have any questions or comments about this article please contact at avi@tholons.com

