

The Information and Technology (IT) Industry Outlook

7th April, 2020



Mr. Vipin Malik, Mentor, Infomerics Ratings

&

&Mr. Sankhanath Bandyopadhyay, Economist, Infomerics India Foundation

Industry Outlook

The software sector is closely linked to the global economy and the way European and American economies are impacted due to coronavirus; the adverse impact on the industry is quite visible. Many companies is likely to opt for cost saving and a survival mode because of what they are undergoing at present. Even before the Covid-19 crisis, software was slowing down because of technology disruptions, base effects and due to a lot of platforms and other systems taking over. Covid-19 has made the sector more underweight.

China is the world's biggest manufacturing hub. The country became an attractive market for Indian IT firms when the US clamped down upon on H-1B visa issuance, and when the UK and Singapore tightened work-related immigration. Typically, Indian companies are present in China as branch offices, subsidiaries, joint ventures, or wholly-owned foreign enterprises, hiring more than half of their workforce locally. There are three IT corridors set up at Dalian Guiyang and Xuzhou to facilitate partnerships between Indian and Chinese companies, focusing on emerging technologies like Artificial Intelligence, Internet of Things and Big Data.¹

¹ <https://www.livemint.com/news/india/india-s-it-industry-braces-for-coronavirus-impact-11582267149734.html>

With India's IT sectors being utilised around the world, it would be easy to assume that companies would simply shift these coders and developers to a work from home model during the COVID-19 pandemic. But it's turned out to be much more complicated than that, however. Moving millions of desktops to employees' homes, configuring software to allow for slower bandwidth and ensuring cybersecurity -- it's a mind-boggling physical and logistical exercise for some companies. Many of the companies that provide business services such as call centres, information technology services and business process automation were not prepared for work-for-home arrangements.

While market share gains helped firms, such as TCS, report higher incremental revenues, the sector did face headwinds, including price resets and a greater shift towards insourcing. If more and more clients are affected by lockdowns and social distancing, and their impact on the global economy, Indian IT firms would soon witness another round of price resets.

Midsized IT companies face similar challenges as large IT firms. But due to their client concentration and greater exposure to discretionary spends, they are more susceptible to sudden demand shocks. Top 10 clients of Hexaware, Mindtree and L&T Infotech, for instance, generate 43-47% of their revenues. Comparatively, Infosys derives less than one-fifth of its revenue from the top 10 clients. TCS has stopped disclosing metrics related to client concentration. The travel, transportation and hospitality business segments, which have almost frozen due to global shutdowns, contribute substantially to the revenues of some midsized firms. L&T Technology Services Ltd, the other tech company from the L&T stable, derived 36% of its revenue from the transportation segment in the December quarter. For NIIT Tech, the segment contributed to nearly 30% of its revenues.

Industry Risk

Top software exporters Tata Consultancy Services (TCS), Infosys, and HCL Technologies will be impacted by the reduced technology spending by clients in the US and Europe following worldwide lockdowns. Revenue of the IT sector is

likely to decline by 2-7% in next six months. IT companies are likely to face challenges of pricing pressure, revenue loss due to lockdown, client bankruptcy and slow pace in decision making coupled with lower discretionary spends. Many firms have indicated that they expect near-term pain till the first-half of FY21, as the lockdown could impact pricing, signing of deal and furloughs, despite the tailwind of rupee depreciation, lower travel, utility cost etc.

The manufacture of computers, smartphones, and components are likely to be impacted with the closure of factories in China and the quarantining of workers. Major players including Apple and Microsoft have issued warnings of potentially lower-than-expected earnings due to globalized supply chain issues and lower consumer demand in China.

There will be spending cuts and possible pressure on pricing as all the major industries including have been adversely impacted, also unemployment rate in the U.S. is rising. The current year is likely face a flat or negative growth for the IT industry amid Covid-19 pandemic. In 2008 after the global financial crisis, Indian IT companies had some growth because at that time, recovery happened fast, which is less likely in Covid-19 crisis scenario.² The impact would depend on the extent of the duration of the Covid-19 spread in Western geographies, especially the US, which contributes ~55-60% of revenues for Indian IT; and extent of spread in India, which can further disrupt service delivery for clients.

The Way Forward

Though the pandemic has created havoc on the global economy including the IT industry; it may go through a temporary setback during the first half of FY21, but is expected to recover during the second half. There could be a short-term impact on the revenues, but in the long term certain deals may get re-sized. Larger firms (Mphasis, LTI, Mindtree) have been more efficient; smaller companies have been hit hard, given their concentrated delivery. The problem is more on the demand

² 'Flat Or Negative Growth For Indian IT This Year, Says Former Infosys CFO'(4 April 2020) Bloomberg
<https://www.bloombergquint.com/business/flat-or-negative-growth-for-indian-it-sector-this-year-balakrishnan-2>

side than on supply side. Certain companies like Infosys remains relatively impact-free from such huge disruptions because its engagement with its partner network has expanded beyond certifications to co-innovation centres, building industry solutions, ISV partnerships, and joint sourcing of deals.³ These partnerships play a significant role in implementation, rollouts and upgrades, validation and support services.

----- XXX -----

³ 'IT sector to revive in second half of FY21'(5 April 2020) The HinduBusinessLine
https://www.thehindubusinessline.com/info-tech/it-sector-to-revive-in-second-half-of-fy21/article31263136.ece?utm_source=pushnotifications&utm_campaign=pushnotifications&utm_medium=ALL_USER