

August 20, 2008

PAGE ONE

For India's Tech Titans, Growth Is Waning

By **NIRAJ SHETH**


August 20, 2008; Page A1

NEW DELHI -- India's information-technology industry, the engine of the nation's economic resurgence, is losing steam.

A decade ago, a host of Indian companies -- led by **Infosys Technologies Ltd.**, **Wipro Ltd.** and **Tata Consultancy Services Ltd.** -- shot to global prominence by helping fix the "millennium bug" that threatened to crash many of the world's computers at the end of 1999. Often growing at 40% a year or more since, they quickly helped build a global tech-outsourcing industry that has changed how the world does business and how it views India.

Now that growth is slowing sharply. The credit crunch and spending slowdown in the U.S. are hurting the companies' biggest market, while a cheaper dollar shrinks their profits. Longer-term problems are surfacing. Competition is rising from other low-cost nations, ranging from Eastern Europe to the Philippines and Vietnam. And India's own success has raised labor expenses, cutting into the companies' low-cost advantage just as their revenue growth is slowing.

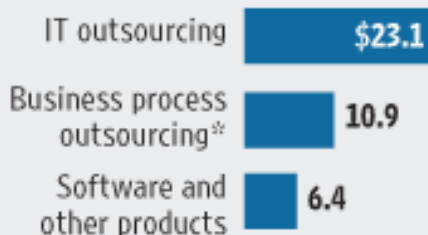
DOW JONES REPRINTS

 This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit:
www.djreprints.com.

- [See a sample reprint in PDF format.](#)
- [Order a reprint of this article now.](#)

Outsourcers First

Fiscal 2008 revenue from exports for Indian technology companies, in billions



*including call centers and administrative processing

Source: Nasscom

Infosys expanded its corps of software engineers by one-third between 2006 and 2007, adding 15,000 people. Its average salaries are rising 12% a year, and increasingly high turnover is forcing the company to spend more on training. Growth in profits fell to 18% in the most recent fiscal year, which ended March 31, compared with 56% the previous fiscal year. Tata Consultancy Services posted just a 4.9% increase in net profit in its latest quarter, compared with 37% in the same period a year earlier. Wipro's earnings growth slowed similarly, to 11.6% in the fiscal year ended March 30, down from 42.3% in the previous year.

The Indian tech industry's trade group, Nasscom, projects revenue to grow at 20% to 25% in coming years -- still heady by the standards of most industries, but barely half the recent rate. "The first round of growth is always easier," Nasscom President Som Mittal said last month. "The next 10 years is going to be different."

To compensate, India's outsourcing giants are trying to pivot into more ambitious -- and in some cases unfamiliar -- enterprises. In a project called "ShoppingTrip360," a team of Infosys engineers is pitching retailers on a wireless-equipped shopping cart that charts the most efficient path through a store based on a consumer's shopping list. Wipro won a contract to help design a water-flow system for the toilets in Airbus's new A380 superjumbo jet. Tata Consultancy Services has set up an "Innovation Lab" in Chennai where, for instance, engineers are trying to develop software that airlines could use to improve their customer service; the idea came from TCS executives' own airline peeves.

The efforts haven't yet been much help to the bottom line. Basic outsourcing remains the overwhelming share of their business -- 84% in the past fiscal year, according to Nasscom. But the revenues of Wipro's product-development unit rose by almost 50% in the past two years combined, to \$686 million last year. The Indian tech firms are hoping they can leverage their ties to companies around the world to sell them on new ventures.

"We're in a challenging environment for growth," said S. Ramadorai, chief executive at TCS, India's largest technology company by sales, in an interview in Mumbai. The next opportunities won't be based merely on low-cost labor, he said, but on "innovation and strategy."

The industry's predicament is a rare setback for India's greatest business success story. In some recent years, technology companies have combined to hire more than 300,000 workers to keep up with soaring demand, as large Western companies sought to cut costs by sending back-office work overseas.

The change comes as India's broader economy already is slowing. Economists estimate that growth in gross domestic product will ease to between 7% and 7.5% this fiscal year, after five years of averaging almost 9% annually. The Indian economy depends heavily on service industries for expansion, and technology -- though a small piece of the overall pie -- has been India's fastest-growing sector for several years. It accounted for 4.5% of India's GDP in the year ended March 31, up from 2.5% in 2004. In contrast, agriculture, India's staple, has declined to 17% of GDP from 20% during that period.

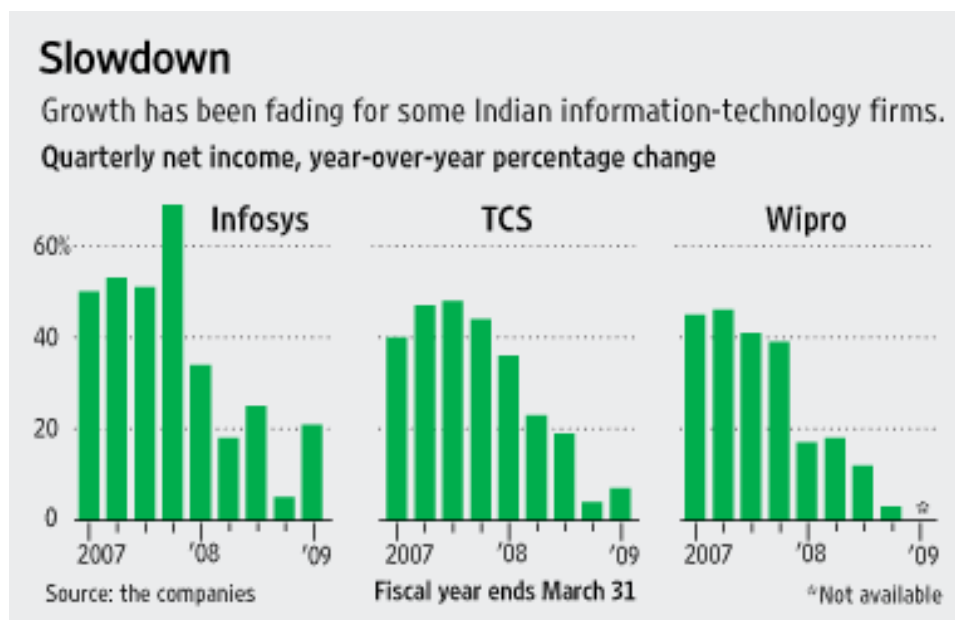
The tech boom has especially transformed the southern cities of Bangalore and Hyderabad. American and European architects designed steel-and-glass high rises surrounded by manicured, palm-lined

campuses, as a rural, developing region evolved into a driver of the globalization of the technology industry.

Global Phenomenon

Of course, tech outsourcing as a global phenomenon remains relatively new, and India's giants are still well-placed to gain a big share of new work. About 11% of the \$1.7 trillion spent on technology worldwide last year was sent to tech outsourcers, according to the industry. The same companies also do outsourcing of back-office operations such as payroll processing, as well as call centers, though recent growth there also is reduced. "There is so much of outsourcing yet to be done," said K.R. Lakshminarayana, chief strategy officer at the Wipro Technologies division. "There is enough head space for all of us."

But snags started appearing two years ago. India's rupee, the currency in which the industry's costs are measured, began appreciating against the dollar. Most of the companies' sales were in dollars, so their revenues were worth relatively less when translated back to rupees. Between June 2006 and earlier this year, the rupee rose 16.4% against the dollar to 39.3 rupees from 47, though it has since given back about half of that gain.



Investment from private-equity firms and venture capitalists in India's smaller technology companies also started drying up, as investors became jittery over a stronger rupee and the U.S. slowdown. In the first half of 2008, such investments fell by 63% from the same period a year earlier, to \$151 million, according to Chennai-based research firm Venture Intelligence.

The industry's frantic hiring drained the pool of skilled workers, drove up wages and increased turnover as employees job-hopped for more pay. The attrition rate for employees at Infosys was 13.7%, up from 11.2% in 2006.

To replenish the pool of recruits, India's tech giants are spending more on training and on educational

initiatives at Indian universities, efforts that add to their expenses. Infosys sends trainers to nearly 500 colleges to teach engineering-school instructors how to foster discussion and collaboration in classes and rely less on rote memorization. TCS this year is training 1,500 college graduates who studied science to learn computer programming and communication skills, at a center it built for that purpose in Chennai.

The industry's biggest blow came last summer, when the meltdown in the U.S. subprime-mortgage industry and ensuing credit crisis froze new business from global banks and other financial institutions, which bring in close to half of the industry's revenues.

Earlier this year, TCS said two Wall Street banking clients had put a freeze on their tech spending until they could cope with the fallout. The Indian company now says that it expects sales in the banking sector to improve in the coming quarters. But other banks are asking for price reductions.

India's wage inflation, currency appreciation and high labor turnover have also started pushing tech work to smaller competitors in Eastern Europe and the Philippines that don't have the same problems. For example, Siemens AG has moved its in-house customer-service centers away from India. Over the past two years, Siemens has hired 1,500 workers to staff a customer center in Manila, where the company says the spoken English is closer to the American dialect of its U.S. customers. In the Philippines, Siemens says it has a 2.5% monthly turnover rate, compared with the 20% turnover it had in its India call center.

"India is still one place where a cost benefit is possible, but not always as much as it was before," says William McNamara, head of IT strategy for the company's North American office.

All that has added pressure on India's technology companies to find other sources of sales. In a departure from the tech companies' usual reliance on tech services provided at the behest of a customer, they are increasingly developing products on their own, then trying to pitch them to customers.

Engineers at Wipro in Bangalore are building a set-top box for digital-television subscribers that they hope to sell to cable companies. They started working on it two years ago after the U.S. Congress passed legislation mandating a move to digital cable by 2009. Now, the company is shopping its set-top box technology to American cable companies, targeting its cheaper, off-the-shelf box to smaller cable providers that may not want to pay for a fully customized product.

Infosys engineers have designed a cosmetics mirror that turns into an information screen when a radio-tagged lipstick is brought close to it, to recommend coordinating colors and products to customers. They got the idea while doing work on inventory-maintenance applications for retailers in Singapore and elsewhere in Southeast Asia, where they learned that Asian shoppers don't trust salespeople to give them advice as much as computers, which are seen as more objective. The company has two pilot projects running in the Asia-Pacific region and is in talks with an American retailer to put some of the gadgets in U.S. stores.

They also are working on "smart shelves" that automatically track which piles of shirts customers have picked up the most often. That way, retailers know when their shirts attract a lot of attention but, for some reason, don't get bought. The company showcases the technologies to interested retailers at a mock

apparel store on the company's campus in Bangalore, complete with a working checkout counter and muted classical music playing in the background.

The 'Innovation Lab'

At TCS's "Innovation Lab," the company's top programmers and engineers use experience gathered from working in certain industries to come up with products and services they hope to sell to clients. They've used information collected from TCS's airline clients to analyze passenger complaints and design marketing campaigns aimed at defusing them. One gadget: a radio-tagged pass that passengers only need to swipe at a terminal to check in, instead of manually typing in last names or confirmation codes. They've also developed software for handheld computers that lets the flight staff know frequent flyers' preferences -- if one needs a blindfold to sleep, for example.

Another group at TCS has hired life scientists and pharmacologists to do data analysis on clinical drug trials for pharmaceutical companies pursuing drug approvals from the Food and Drug Administration. They have secured contracts with **GlaxoSmithKline** PLC and **Eli Lilly & Co.**, and the group is preparing to write applications to the FDA on the companies' behalf.

The tech companies also have been expanding into consulting, where they say revenue per employee is higher than in outsourcing. But they've struggled to break into the market, which is dominated by well-known names such as International Business Machines Corp. and Accenture Ltd., finding many of their own clients prefer to take advice from those companies rather than the Indian ones better known for their outsourcing. In the year ended March 30, TCS's consulting business contributed 3.4% to the company's total revenue -- the same as in the previous fiscal year.

India itself is emerging as a promising market after years when the companies generally sniffed at doing local work in favor of more lucrative and prestigious overseas assignments. One of the biggest recent orders in the industry was a \$400 million government contract to build the technology to support India's new electronic passports, which have electronic chips to store information and make them harder to forge. After a 12-month bidding process, TCS won. The company declined to comment on the project, which is yet to be announced officially.

URL for this article:

<http://online.wsj.com/article/SB121919218719255181.html>

Copyright 2008 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.

RELATED ARTICLES FROM ACROSS THE WEB

Related Articles from WSJ.com

- [Overseas Demand Helps EMC](#) Jul. 23, 2008
- [For Employment Law, Pfizer Turns to One Firm: Jackson Lewis](#) Aug. 19, 2008
- [UK Health Chief: High Drug Prices Fatten Pharma Execs' Paychecks](#) Aug. 18, 2008
- [How Do You Say 'Retail Clinic' In Spanish?](#) Aug. 15, 2008

Related Web News

- [India's economy expected to grow 7.7 pct this year](#) Aug. 13, 2008 [usnews.com](#)
- [Whole Foods Takes a Bruising - Barrons.com](#) Aug. 07, 2008 [online.barrons.com](#)

[More related content](#) *Powered by Sphere* 