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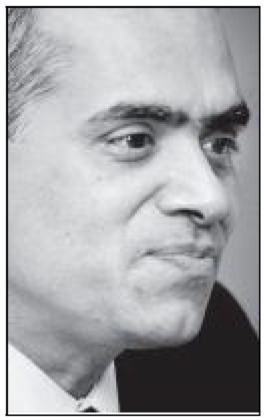
Date:05/07/2007 URL: http://www.thehindubusinessline.com/2007/07/05/stories/2007070550990800.htm

Rising rupee a blessing for China

K. Bharat Kumar

Software industry faces its biggest challenge yet



The appreciating rupee could turn out to be a blessing for China, which has so far struggled to match India's experience and expertise in the area of Information Technology offshoring (that is, the movement of technology jobs from high-priced markets to inexpensive ones). India's IT exporters are now walking the tightrope between escalating wages and the appreciating rupee, not to speak of demanding clients. China, with its control over its yuan and rather subdued wage inflation, could turn attractive for both American companies looking to set up their own offshore operations as well as for Indian IT services companies. These were some insights that came through in a chat that Mr Lakshmi Narayanan, Chairman of Nasscom, the Indian ITBPO industry's apex body, as well as Vice-Chairman, Cognizant Technology Solutions, had with Business Line.

Excerpts from the interview:

How badly is the rupee's appreciation affecting Indian companies?

The rupee has appreciated 9-10 per cent in the last two months. This is too rapid for the IT industry to digest. We could certainly have absorbed it if it had happened over a year's time or so. Someone asked me if we should not be proud of the rupee appreciating. He was surprised that the IT industry is complaining about it. We certainly should be proud of it. We are able to travel, able to buy things outside, and our imports becoming cheaper. It makes us feel good about our country's growth. It is very relevant in our context that we should leave it to market forces. Let demand and supply determine the rupee level without the government having to intervene, which is what the government has done.

But the flip side is that it is impacting the industry. The other problem is, the IT and BPO industry is different from other export oriented industries. Look at diamond exporters - 60 per cent of their cost lies in imported diamonds, on which they get the benefit because of the higher rupee. So the impact is not as high as it is for the IT or the BPO industry, where everything is created here.

Importantly, China holds its currency in a narrow band against the US dollar (the dollar is roughly available for eight yuan) and if we don't do it with the rupee, it impacts our competitiveness as a country. People would want to invest in China. Even Indian companies are starting to make those noises. I am sure those countries - such as China or Mexico - will use this to their advantage. Predictability is key here. In India, there are too many uncertainties - fluctuating rupee, rising wage costs and the like. It could soon be non-competitive compared to Mexico or China. That is a bigger threat. The investments going away from this country.

There is need for some action. What the industry is saying is that we don't want the government to intervene or make the rupee remain weak. That's not the intention. But the question to ask in the current context is `how can we help the IT industry?"

Extending the STPI scheme could make it easier for the industry. So, how do we get investments that are on the fence to come in, how do we get Indian companies to invest here instead of expanding in China, are questions to answer. There, some intervention has to happen. Extending the STPI tax benefits beyond 2009 could benefit smaller companies. If the rupee can be managed, that's great. If not, then we would welcome steps that make it easy for us on other fronts.

Certainty is what investors want. MNCs that want to create wholly owned subsidiaries in India say that they are not concerned about tax rates, FBT, etc. But lack of clarity and ambiguity could turn away investment. Suddenly companies here get slapped with tax notices. The STPI issue is there. Another thing I read today is about the SIRs (Special Investment Regions) that are to be between STPI and SEZ. While you have already so much confusion why introduce another angle?

The estimate for the coming year for IT-ITES industry is the $ 50 billion revenue milestone. What next for the IT industry, if things pan out reasonably well, including the rupee problem?

Clearly, we should be going after newer opportunities. And innovation would drive that. Animation, gaming and engineering services are areas with great opportunities. Despite all the talk that you have heard about these new domains, we have so far only scratched the surface. Legal- and accountingoutsourcing are areas to watch out for, too.

Is it scaleable?

It is, but the opportunity itself may not be as big at IT services, which is $300 billion. Animation may be a $50 billion opportunity. The size may be smaller, but these are all opportunities. The whole idea is to expand the pie. Keep expanding the addressable market. Even if you get the same proportion of the expanded pie, you continue to grow, instead of just going after an increase in market share of the existing pie.

This is the message we would like to leave with the government as well. Don't tax us on FBT and the like. You will automatically get more as we expand the pie. So please keep the tax rates and everything at the same level.

Geographically too we have opportunities. Europe is beginning to expand. Asia Pacific and even India are such opportunities. Domestic business gives us the opportunity to build scale and gain expertise. If IBM makes a pitch to the Indian Railways, it comes with experience it has with IT implementation with Amtrak.

Indian companies' experience in China has not been as exciting as expected, in terms of manpower ramp up. Can China still become a true competitor?

With China, it's a question of expectation matching experience. We have been operating in a certain manner in India. Could we see the same revenue growth along with similar manpower growth there? Maybe not. But if you go with the recognition that India has been doing this for 25 years, then the experience, coupled with the certainties on Chinese currency, infrastructure and tax-law fronts, could be benign.

If the rupee appreciation carries on gently, and your manpower availability problems don't worsen any, does the outlook remain bad?

Outlook is not bad. In terms of managing costs, companies would begin to accept lower margins, to look at alternate locations, invest a lot more in operational efficiency and productivity. We will have to work a lot harder, in order to remain where we are. For IT, the impact would not be that much, but textiles and other investments could be terribly impacted. Survival for IT companies is not in question. It would be, if the dollar touches Rs 35 over the next one year.

Smaller companies seem to want to change tariffs to rupee rates. Can bigger companies actually negotiate with clients to pay rupee rates?

One company actually had a currency fluctuation clause in the agreement. If the rupee depreciated, the client could gain some money. If it appreciates, the value of the project would be higher, in dollar terms. That practice is not widespread. But it could become. But it only takes care of situations where the currency is volatile. If it steadily appreciates, then the client would be unwilling to pay up more. You have to try various things.

Logically, to battle the rupee appreciation, companies should be going after more revenues and more profits, which means more manpower addition in India, right?

Yes, increase the pie, increase growth, go for higher value projects but increase productivity too. But these things cannot happen over two-three months but take longer. If the rupee appreciation and the adjustments that the industry is making go hand in hand, then the impact will not be felt much.

Are Chinese manpower costs really lesser than India's?

Earlier, manpower in Indian Tier II cities were cheaper by 10-15 per cent. Now it's on a par. With China's firm currency-pegging and the wage inflation being lesser than in India, China could become a true threat. That may not be the only factor, but is certainly a contributing factor. Our policy makers should be thinking on those lines.

I also want to point out that an recent OECD report says that India has the least unemployment among BRIC nations, which is fantastic news. The service sector is creating far more jobs than the manufacturing sector. Investments in the automotive industry may be high but they are automating everything. So, the government should promote the services industry, not just the IT industry. It seems that currently, the government is favouring the manufacturing industry. The context is that the IT industry has generated 1.6 million direct jobs and 6 million indirect jobs.