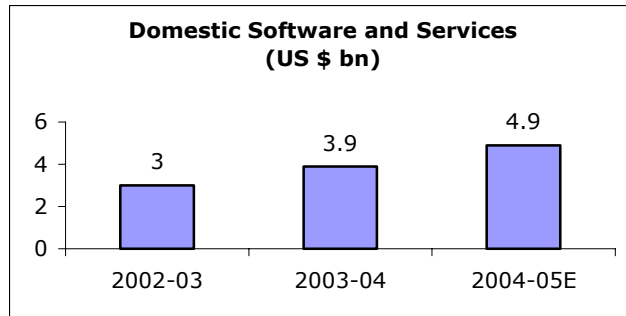


INDIAN DOMESTIC MARKET : NASSCOM ANALYSIS

Indian IT vendors are increasingly turning attention to domestic market. The Indian user industries are outsourcing parts or entire IT infrastructure to specialised vendors. Recognizing the growing importance of the domestic market, NASSCOM has put the domestic software and services segment at US\$ 3.9 billion during 2003-04, up from US\$ 3.0 billion in 2002-03.



Source: NASSCOM

***Software & Services includes IT services and Products & ITES-BPO**

However, despite this encouraging trend, the domestic software market size continues to grow at a marginally lower rate, as compared with software services exports, due to a higher level of piracy, pressure on software prices and lower level of sophistication in IT spending for most Indian companies.

Composition of the Domestic IT Market

(US \$ bn)	2002-03	2003-04	2004-05E
IT Services & Products	2.8	3.6	4.3
ITES-BPO	0.2	0.3	0.6
Hardware	3.3	4.3	5.3
Total Domestic IT Market	6.3	8.2	10.2

- In 2003-04, the hardware segment accounted for approx 50 percent of the domestic Indian IT market.
- The software and services segment accounted for 44 percent of the market in 2003-04.

The domestic IT spending in India is at an inflexion point and there are numerous opportunities in the domestic sector, which can help catalyze growth in the next 2-3 years. **The key drivers for growth in the domestic market include:**

- Opportunities in verticals such as Energy, BFSI, Manufacturing, Education, Telecom and Government
- Increased penetration of computers in the household and SOHO segments
- Increased investments in IT by the central and state governments in e-governance initiatives
- Rapid adoption of broadband
- Increased usage of non-PC devices especially cellphones
- Increased focus of Small and Medium sized software companies on domestic market

Quick facts

- The IT industry's contribution to the Indian GDP has increased from approximately 1.4 percent in 1998-99 to more than 3 percent in 2003-04
- Even from an industry perspective, the attention on the domestic front is quite limited with the domestic IT software and services market constituting around US\$ 3.9 billion in 2003-04 compared to the US\$ 12.8 billion software and service exports market. In fact, revenues from the domestic market account for only 10-30 percent of revenues for players in all segments
- However, the domestic market will become significantly more important, particularly for smaller players who will need to tap the domestic market to build scale
- Comparisons with other markets, like China, which have similar demographic and economic profiles, show that the Indian domestic IT market remains constrained largely because of three barriers:
 - Product market barriers: Corporate IT spend is largely determined by the need to be competitive. With key product markets still strongly regulated or in the process of deregulation, the corporate IT imperative is likely to take some time to emerge
 - Inadequate focus on the domestic market by industry players: Export billing rates have been and are significantly higher than domestic rates. This has led to an inadequate focus on developing customized solutions to meet domestic business needs
 - Low government IT imperative: With a majority of central and state government processes yet to be computerized, there has been an overall apathy from the government with the exception of a few state governments

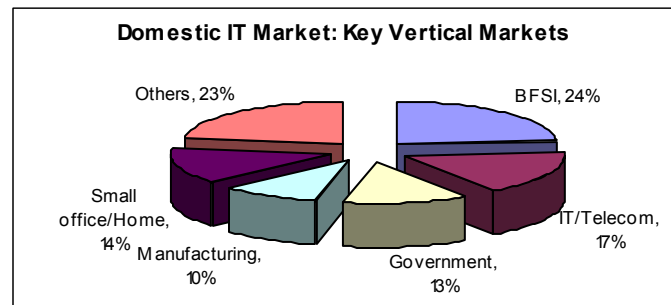
Domestic IT Market: Key Verticals

• **Banking and Financial Services:**

The BFSI segment accounts for the largest share of the domestic IT market. The major areas in which banks have undertaken IT related investments include computerization of branches, VSAT based networking among branches, installation of ATM networks, systems related to

handling of credit/debit cards and facilities for Internet banking. An interesting trend, which we are beginning to witness, is the implementation of technology for improved customer service and thereby greater customer satisfaction apart from other significant benefits in terms of increased productivity. Another sector that has seen high IT related investments has been insurance. The increase has been driven primarily by the increase in the number of players as a result of opening up of the sector. IT spending in insurance is likely to be primarily driven by office automation and customer relationship management applications for acquiring and managing customers

- **Manufacturing:** IT spending in the manufacturing sector increased by 40% in 2003-04 across both process and discrete manufacturing segments, contributing to 10% of the total domestic IT spending.



Some of the drivers for increase in IT spending in the manufacturing sector were:

- Adhering to the WTO norms
 - Indian manufacturing companies which were Tier 1 or Tier 2 suppliers to OEMs in India or abroad, to reduce time-to-market and product life cycles, put pressure on manufacturers to integrate with OEMs (both Indian and MNCs), Tier I suppliers, sub-contractors and distributors during product development and process manufacturing
 - Need to increase operational efficiency and capital productivity while reducing fixed and variable costs
 - Need for transactional systems that could integrate with core processes—sales, manufacturing, financial, procurement, inventory and supply chain.
 - Shrinking product lifecycle, mass customisation of products and increased globalisation led to an increase in Product Life-cycle Management (PLM) initiatives adopted by companies
- **Telecom:** Deregulation, mergers and acquisitions, and intense competition have thrown up multi-faceted challenges for the Telecom & Internet Service Provider communities. To sustain themselves in the highly competitive market, the players need to invest in infrastructure, improve quality of service, network efficiency and billing solutions.
 - **Healthcare:** Healthcare is one of the fastest-growing verticals in India. The Indian healthcare sector has started focusing on serving customers better, keeping in mind the need to balance a robust and profitable business operation and meeting broader social objectives. The main focus areas have been to improve service to the end-customer, the patient and to increase patient safety. IT has played an important role in providing better systems, thereby streamlining information processes of an organisation, ironing out inefficiencies that grow due to lack of information, increase the quality of healthcare delivery to patients and reduce costs.
 - **Retail:** The significant increase in activity in the retail sector has resulted in a growth in IT investments in this sector. Indian retailers have been spending more and more on setting up IT systems and, importantly, plan to hike up their investments in this area in the future. Retailers are also looking beyond basic expenses to higher levels of IT functionalities. Applications that are very commonly used by retailers include SCM, CRM and e-business solutions.
 - **Government:** Government spending on IT is expected to witness a significant increase, owing to initiatives by both the Central and State governments sector. The government will use web-enabling services, consulting for planning and implementation, apart from the hardware and software needed to build the e-governance platform.

Domestic Outsourcing

Domestic business process outsourcing (BPO) industry is emerging to be very important. The ability to transform business and add value is likely to catapult this still pre-nascent industry to success.

While IT outsourcing is a starting point in the domestic BPO segment, there is large potential in other areas like finance and accounting as well as many other activities. The ability among the domestic firms to 'value segment' is what will drive success in the industry. The strategy should include building delivery mechanisms at a cost that saves money for a domestic client while simultaneously building consulting capability around customer experience management.

Bharti's deal with IBM and the more recent managed networks deal with Nokia, the Bank of India-HP deal, the Dabur-Accenture deal and the Ministry of Finance-HP-Microsoft deal for setting up the income tax network, etc, point that the Indian market has matured and domestic outsourcing provides a huge opportunity for vendors.