The Uncertain World of Software Services

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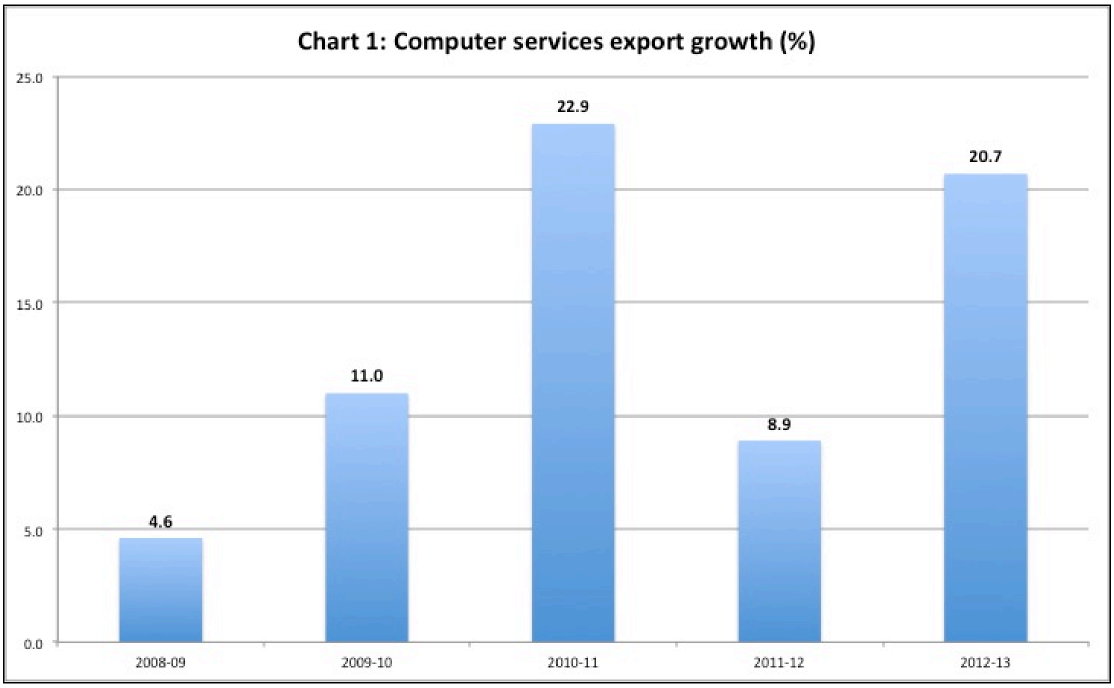
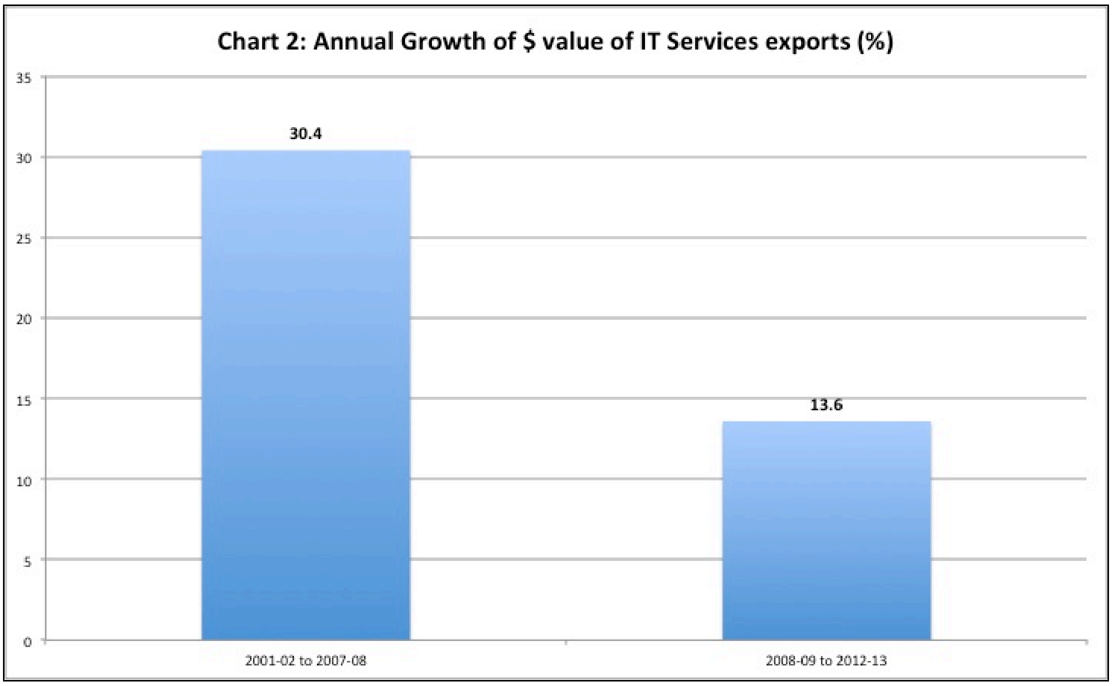
The Reserve Bank of India's seventh survey on India's exports of computer related services points to a revival of India's exports after the downturn triggered by the Great Recession. In dollar terms, exports grew by 20.7 per cent in 2012-13, as compared with just 4.6 per cent in recession year 2008-09. According to the RBI's Balance of Payments Statistics, Software services exports at Rs.3583 billion in 2012-13 amounted to 45 per cent of services exports, 21.5 per cent of merchandise exports and as much as 3.5 per cent of GDP. So a revival here is some cause for comfort both from a growth and balance of payments point of view.

There is, however, reason to be cautious. To start with, India's IT services exports are closely tied to economic performance in the US and the EU. The export recovery since 2008-09 has been bumpy, with rates of growth first rising from 4.6 to 11 per cent in 2009-10 and 22.9 per cent in 2010-11, before falling to 8.9 per cent in 2011-12 and then rising again to 20.7 per cent in 2012-13 (Chart 1). The decline in 2011-12 was in all probability due to the intensification of the crisis in Europe. So long as global conditions remain uncertain there can be little certainty about India's export performance.



Secondly, India's computer services export growth has slowed hugely during the period since the recession. The average annual growth rate in computer exports was a creditable 30.4 per cent during 2001-02 and 2007-08. The figure for 2008-09 to 2012-13 was a much lower 13.6 per cent (Chart 2). While the latter cannot be scoffed at, the kind of promise held out by the industry since the Y2K boom (when systems had to be reprogrammed to recognise 00 as 2000 instead of 1900) is no more in sight. The pre-crisis boom in the developed countries underpinned India's success, and the absence of a similar boom dampens India's post-2008 performance.



There seem to be three factors accounting for this performance record. The first is India's continued dependence on US and European markets for computer services exports. In crisis year 2008-09 too the US accounted for 61.5 per cent of India's exports, and Europe for another 27 per cent. In 2012-13, with Europe performing poorly, the US accounted for 64.1 per cent and Europe for 20.2 per cent. The second is that measures adopted by the US to respond to domestic union and worker pressure and restrain onsite provision of software services by Indian firms, have possibly affected India adversely. The share of export revenues from on-site services provision for Indian firms (excluding their foreign affiliates established abroad) fell from 32.2 per cent in 2008-09 to 15.8 per cent in 2012-13. Since many services are better or more easily provided on-site, this would in all probability have affected aggregate export revenues as well. A third, and more medium term, trend adversely affecting India is the failure of the industry to move adequately into software product development. In fact the share of software products in total export revenues fell from 8.9 per cent to 5.6 per cent between 2008-09 and 2012-13. A larger presence in software products may have helped India derive greater benefits from both the domestic and export markets.

At the level of individual firms, one way in which the effects of the export slowdown could possibly be neutralised is to establish affiliates abroad that can acquire a share of the "local" market in the developed countries. Inclusive of sales by affiliates abroad (which are not included under exports in balance of payments statistics) India's computer services export revenues stood at $69.1 billion in 2012-13, as compared with $62.6 billion when such sales are excluded. What is more, the share of such sales in total revenues had declined from 16.8 per cent in 2008-09 to 9.4 per cent in 2012-13. Affiliates of Indian firms are also, therefore, extremely vulnerable to changes in global economic conditions. This is partly because 61 per cent of the software business of Indian affiliates abroad was with US counterparties, and that figure had risen to 71.3 per cent by 2012-13. As in the case of exports from India, such dependence seems to increase India's vulnerability.

Clearly India has to work to change the structure and destinations of its computer services exports. It must also look to the 'next big thing' outside of computer services that can sustain its export growth.

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