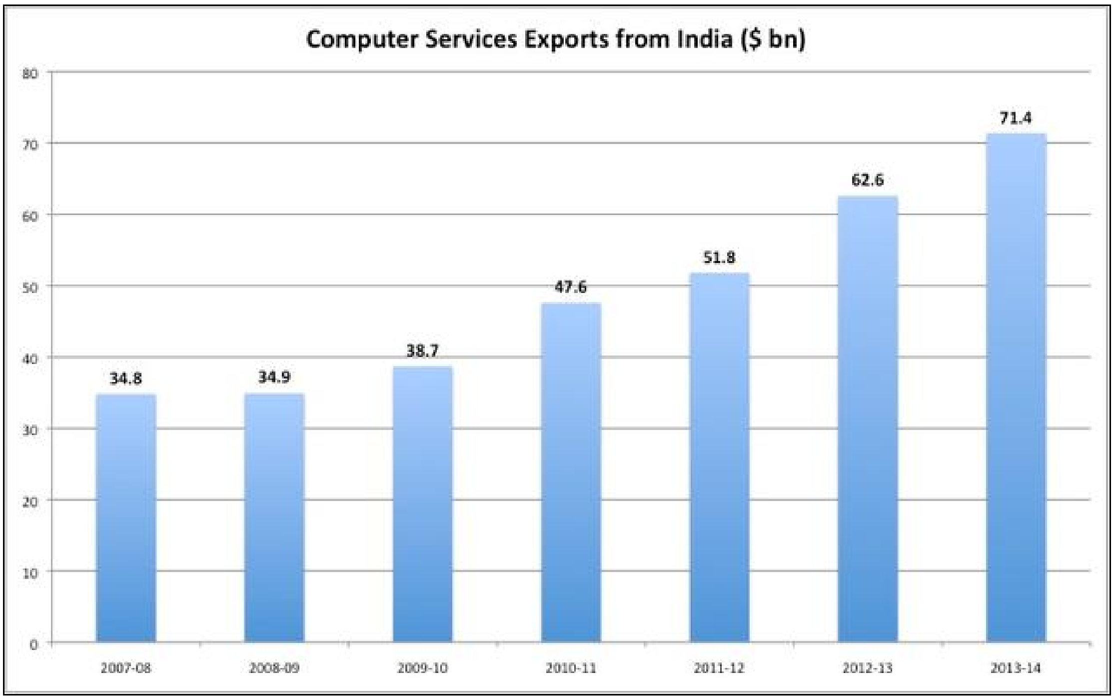
Software Services: Some cause for comfort*

C.P. Chandrasekhar

India’s software and IT-enabled services sector seems to have weathered the global crisis well. Figures just released by the Reserve Bank of India, which place computer services exports in 2013-14 at $71.4 billion, point to a continuation of the smart recovery of exports by the industry. After taking a hit in 2008-09, immediately after the crisis broke, the nominal dollar value of computer services exports from India has been growing at a compound annual rate of 16 per cent.

That may be low when compared to the industry’s export performance in the first decade of this century, but it is creditable and is achieved on a much higher scale. This performance is remarkable because India’s Software and IT-enabled exports are disproportionately directed towards a few markets. In 2013-14, USA and Canada accounted for as much as 63 per cent of Software Services exports.



Add on Europe and the figure rises to as much as 87 per cent. In 2007-08, before the financial crisis and the Great Recession these three destinations together accounted for 91 per cent. So there has not been much diversification away from the markets that dominated prior to the crisis, even though those were the markets most severely affected by the crisis. Yet computer services export growth has recovered and the industry seems to be doing well, while Europe remains mired in crisis and the US has registered a hesitant recovery, if at all.

One possible explanation for this paradox could be the very nature of the Software Services boom. Off-shoring and outsourcing of code writing and services, that can be remotely performed and delivered electronically is in essence a cost reduction exercise, where a combination of low wages and nil transportation costs delivered huge gains. That the Indian “software success” rides on the off-shoring drive motivated by the cost considerations of OECD firms is clear from the fact that IT services and business process outsourcing services (other than in engineering) accounted for 90 per cent of software services export in 2013-14, whereas software product development accounted for just 6 per cent. If a recession warrants further cost cutting to reduce losses or protect profits, these are not the activities that would be axed. In fact, the attempt could even be to increase the extent of off-shoring in these areas. That perhaps explains the resilience of the industry in the face of what was the worst recession after the Great Depression, which overwhelmed its dominant markets.

This, however, does not mean that the industry itself had not displayed competitive strengths. Exports would not have stayed strong and risen over time if the industry was not able to face up to competition from other countries with a low-wage, skilled workforce. In fact, the other paradoxical feature of India's software and ITeS sector is that, even though no high-technology is involved in much of the activities it is engaged in, it has managed to keep the competition at bay. Consider, for example, the WTO's statistics on trade in computer services and other business services (which approximates ITeS and BPO services). In both cases India figures among the top 10 exporters in the world in 2012. In the case of computer services exports India is only second to the EU, which is a group of 28 countries. Extra-EU exports of countries in the EU grouping accounted for 24.7 per cent of the exports of computer services from the top ten exporters.

That share for India was 22.4, to be followed by the US with just 5.4 per cent. In the case of "other business services" too India features at fourth place in the top 10 with a 4.9 per cent share of their exports, following the EU, the US and China.

Thus, the success of India's software services export industry is built on the ability to maintain its leading position among the top players.

For a country that consistently runs trade and current account deficits, and which has an insatiable appetite for gold imports, this is indeed some cause for comfort. Especially since the foreign exchange receipts from this source seems far more stable than the savings arising out of the decline in oil prices.

*** This article was originally published in The Hindu on February 25, 2015.**