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European Share, Reduced Dependency on Top Clients to Determine Next Winners Among Indian IT Mid-Tiers

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The Indian IT services industry is not only composed of companies of varied sizes, but these firms also have very distinct features. While top-tier IT services companies have a more balanced geographical distribution of their revenues, mid-tier IT firms typically face a concentration risk in this aspect. For instance, the US market provides more than 65 per cent of revenues for most mid-tier IT firms, with less than 20 per cent coming from the European continent, as shown in exhibits 1 and 2. This is in sharp contrast to their bigger counterparts.

Apart from lesser European share in the top line, mid-tier firms also face a huge client concentration risk, as shown in exhibits 1 and 2. Usually, their dependence on top 10 clients makes these firms' P&L accounts vulnerable to sudden disruptions and restricts their growth opportunities.

So, to make their business model resilient, mid-sized IT firms have to build up capabilities in the European continent and grow revenue from a large set of clients.

Exhibit 1: FY20 Revenue Contribution of Tier-1 Indian Service Providers

Service Provider	Revenue % From Europe	Revenue % From Top 10 Clients
TCS	30.6%	NA
Infosys	24.1%	20.6%
HCL	27.4%	22.85%
Wipro	24%	19.7%
Tech Mahindra	26.9%	31.1%

Source: Company Financials, EIIRTrend

Exhibit 2: FY20 Revenue Contribution of Mid-Tier Indian Service Providers

Service Provider	Revenue % From Europe	Revenue % From Top 10 Clients
LTI	15.7%	45.3%
Mindtree	17%	44.7%
Coforge	37% *	38%
LTTS	15.2%	34.5%
Cyient	26.35%	NA
Zensar	15.2%	47.7%
Persistent	9.5%	51.7%
Hexaware**	15.3%	45%

Source: Company Financials, EIIRTrend

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Europe is the soft underbelly of mid-tier firms

The European continent remains a soft spot in the financial results of most mid-sized IT firms. While most IT biggies draw an average of a quarter of their top line from this geography, it remains around 15 per cent for most mid-tier firms.

- In the last financial year (FY20), the market leader TCS drew 30.6 per cent from the Europe, which was the highest among all Indian IT firms. For Infosys, the European continent contributed 24.1 per cent.
- The third largest IT services company, HCL, drew 27.4 per cent of its revenues from Europe, whereas it stood at 24 per cent for Wipro and 26.9 per cent for Tech Mahindra in FY20.
- In contrast, mid-sized IT firms such as LTI drew 15.7 per cent of their top line from Europe in FY20, which was at 17 per cent for Mindtree. Similarly, Europe contributed 15.2 per cent of revenues for both LTTS and Zensar, whereas it was a tad higher for Hexaware Ltd at 15.3 per cent during 2019 (January-December cycle). For Persistent, revenues from Europe stood at only 9.5 per cent in FY20. Engineering services provider Cyient was the only exception as it drew 26.35 of revenues from Europe, which was at par with most IT services biggies.

The datasets make it clear that unless share of revenues from Europe improves, mid-tier firms will continue to depend heavily on the US, thus limiting their growth opportunities and exposing them to geographical risk.

Heavy dependence on a few clients make business model riskier

A risk management strategy always emphasizes diversification. In this perspective, any enterprise that draws more than half of its revenues from its top 10 customers exposes itself to client-specific risks. Indian mid-sized IT firms face this risk, although they are slowly diversifying, whereas the risk is much less for their bigger counterparts.

- Infosys, for example, drew 20.6 per cent of its turnover in FY20 from its top 10 clients, whereas it was at 22.85 per cent for HCL and 19.7 per cent for Wipro. Tech Mahindra was the only IT company among the tier-I firms which drew more than 30 per cent of its revenues—which was at 31.1 per cent—from its top 10 customers.
- However, mid-sized IT firms, on an average, drew 45 per cent of their earnings from these big clients with a few exceptions. The highest among the mid-tier firms was drawn by Persistent Systems in which its top 10 clients contributed 51.7 per cent to the company's top line in FY20. This was followed by Zensar at 47.7 per cent.

- One of the fastest growing firms in the mid-tier space LTI received 45.3 per cent of its revenues from the big clients, whereas it was at 45 per cent for Hexaware during 2019 (January-December cycle). The top 10 clients contributed 44.7 per cent of its revenues from Mindtree, whereas it was at 38 per cent for Coforge).
- Engineering services firm LTTS was best placed among the mid-sized companies as 34.5 per cent of its revenues came from these customers.

These facts indicate that mid-sized firms have to work expeditiously to mine more clients, failing which their ambition to join the big league may be held hostage to the growth curve of these top clients.

Road bumps on the path to diversification

IT service providers often face challenges in their efforts of geographical and client diversification.

- The IT market in the European continent is not homogenous. Like every other continent, each nation within this landmass has its own set of features, which must be negotiated to win the confidence of clients to bag outsourcing deals. For instance, the United Kingdom is considered to be the financial hub of Europe, with London leading the show. Germany, apart from other industries, is the leading automotive hub, whereas France is home to major aircraft producers with many downstream industries.
- In this perspective, mid-sized firms have to invest in these markets by setting up centers or hiring professionals or by acquiring small firms with a sound presence to bag contracts. Unlike big IT firms, mid-sized companies have limited resources, and this can be a major challenge to expand their presence in the European continent.
- The ongoing uncertainty about Brexit coupled with COVID-induced slowdown are other hurdles that can hold back mid-sized firms from investing in these markets as cash conservation becomes a priority.
- Typically, the gestation period of investment in the European region is longer than typical projections. As most of these companies are publicly-listed, they face constant scrutiny by the investor community. So, top management face the dilemma of taking big bets in new markets.
- The client-vendor relationship in some key markets such as Germany, France, Italy, and Nordic countries is strong with big home-grown enterprises preferring local vendors. In this scenario, mid-sized firms have to unsettle the local incumbents to win deals, which can be prove to be difficult. Language, especially in non-English speaking regions, can add to this difficulty level.
- Diversifying the client base requires a good sales engine, which requires initial investment. So, resource constraint can be one of the major hurdles in increasing one's client list.

- Similarly, as COVID has accelerated the pace of vendor consolidation, mid-sized firms will have to compete more aggressively to increase share of wallet of their clients.

It is often not a lack of intent but prioritization of resources that stops mid-tiers from increasing investments in geographies and client diversification.

Bottom line: Opportunities are beckoning, and mid-tier firms should use it to diversify their geographical mix and grow a large set of client accounts for growth.

Opportunities are beckoning offshore service providers as the work-from-home experience has made clients more comfortable with offshoring. Similarly, cloud is reaching the tipping point and more enterprises will invest in cloud and larger digital technologies.

Mid-sized service providers can win customers due to their agility and focus. They need to put greater focus and investment in Europe and the next set of clients. They need to build capabilities around them in geography, services, and verticals both organically and inorganically.

As the IT industry recovers from the impact of the global pandemic, diversification of client base and an increasing share of European revenue will play a critical role in determining the winners in the post-COVID world. Always remember what brought you here might not take you to the next level!

About the Author

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Pareekh Jain is Founder and Lead Analyst of EIIRTrend and Pareekh Consulting.

EIIRTrend.com is a neutral platform to discover emerging engineering, IoT, Industry 4.0 and R&D (EIIR) trends across 12 industry verticals. Pareekh Consulting is a focused analyst and advisory firm for EIIR.

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He is regularly quoted in the media on engineering services, IoT, and outsourcing trends, including Harvard Business Review (HBR), NDTV, Times of India, Economic Times, Business Standard, Hindu, Business Line, Livemint, Financial Express, Rediff, Voice of America, and Business Insider.

Pareekh is a thought leader, having authored various publications on topics related to EIIR outsourcing. He loves business fiction writing in his free time, and has authored a novel, Who Is That Lady?

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