INTERNATIONAL JOURNAL OF ADVANCE RESEARCH, IDEAS AND INNOVATIONS IN TECHNOLOGY

ISSN: 2454-132X
Impact factor: 4.295
(Volume3, Issue3)
Available online at www.ijariit.com

A Research Paper on Assessment of Porters Five Competitive Forces in Indain IT Sector

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Abstract: ***The research paper discusses the concept of Porters Five competitive forces and its application to Indian IT sector. Porters Five Forces is a simple yet powerful tool in understanding where the power lies in a business situation and identify weather new products, services or businesses have potential to be profitable. The tool is very effective as it helps in understanding both the strength of our current competitive position and the strength of position that we are considering to move into. With an understanding of where power lies, a business can take advantage of its strengths and improve on its weakness.***

Keywords: Porters Five Forces, Strategy, Indian IT sector, Bargaining Power, Supplier, Customers.

INTRODUCTION

According to Nasscom, Indian IT sector is pegged at 150 Billion USD revenue as on FY2016 with presence across the globe with 670 development centers spread in 78 Countries. By the year 2020, IT sector is expected to generate direct employment 10 Million People and indirect employment to 20 Million People.

Indian IT industry can be classified majorly into:

- IT services with market Size of USD 75 billion for FY16E with 81% revenue contribution coming from Exports
- Business Process Management with market Size of USD 30 billion for FY16E with 87% revenue contribution coming from Exports
- Software Products and Engineering services with market Size of USD 30 billion for FY16E with 83.9% revenue contribution coming from Exports
- Hardware with market Size of USD 15 billion for FY16E with significant revenue contribution coming from domestic market

The contribution of IT sector to India's GDP has increased to 9.3% in FY15 from just 1.2% in FY98.
IT sector in India is driven by Global and Local firms who outsource their IT functions to an external vendor. IT functions which are outsourced range from routine and repetitive tasks like data entry and system support to a complex task like Solution Design, system configuration, and Analytics.

The main reason why organizations outsource their IT functions are:

- Cost reduction
- Coverage across Time zones thus improving output
- Improved Service level agreement
- Rapid deployment of new technologies

Porters five force model suggests that five underlying forces of competition determine the attractiveness of an industry. The industry attractiveness in the context of this paper refers to the value and profitability created by Indian IT sector.

Porters five force model was developed by Michael Porter in 1979 and this framework looks at five specific factors that help in determining whether or not a business can be profitable. According to Porter, the origin of profitability is identical regardless of industry and it is industry structure that ultimately drives competition and profitability. If the forces are intense no company earns attractive returns on investments. If the forces are Benign, many companies earn an attractive return on Investment

Theoretical framework
Porters Five force model proposes that an Industry's structure depends on five competitive forces. These forces are:

1. Threat of New entrants
2. Bargaining power of Suppliers
3. Bargaining power of Buyers
4. Threat of Substitutes
5. Intensity of Rivalry

The cumulative strength of these forces helps in determining the profitability of existing and new firms in the sector. The main factors impacting each of the above forces are discussed below in the context of Indian IT sector.

Threat of New Entrants
The threat of new Entrants is affected by the ability of people to enter your market. If it costs little in time or money to enter your market and compete effectively, if there are few economies of scale in place, or if you have little protection for your key technologies, then new competitors can quickly enter your market and weaken your position. If you have strong and durable barriers to entry, then you can preserve a favorable position and take fair advantage of it.

According to Porter, new companies bring new resources and can drive down product prices and further reduce the profitability of the industry. The threat of new entrants is extremely high for Indian IT Sector owing to low setup cost and requirement of infrastructure. There are thousands of new start-ups in IT industry which started in last few years catering to the clients across the globe. The IT sector is characterized by high dependency on skilled manpower. So smaller firms having good funding can afford to get the best talent in the industry.

Large players, however, make it difficult for small and medium players to win large deals as they are in better position in terms of infrastructure and resources. The top five IT firms in India contribute to around 25% of total industry revenue indicating a fairly competitive market. TCS is clearly a market leader accounting for a market share of 10.4% of India's total IT sector revenue in FY16.

The IT projects are seeing a significant shift from few large size deals to multiple small size deals making it easy for smaller players to compete. India is the base for a fourth largest base for new businesses in the world and has around 3100 technology start-ups which are set to increase to 11,500 by the end of 2020 as per NASSCOM.

Having said that larger players are in a position to provide a wide range of capabilities which helps them to gain ground as they move from system support to full-service player offering a complete gamut of services right from Consulting to system integration and Infrastructure.

Bargaining Power of Suppliers
Bargaining power of suppliers depends on the level of supplier concentration, the volume of work and threat of forwarding integration. According to Porter, suppliers are powerful when they are concentrated and there is a high threat of forwarding integration. Supplier's strength is also driven by other factors like a number of suppliers available for each key input, the uniqueness of their product or services, their strength and control over your business and cost to switch from one supplier to another.

The suppliers for Indian IT industry consists of IT infrastructure and Hardware providers, transport service providers, Recruitment firm /engineering colleges and office space suppliers. The bargaining power of suppliers is very low since they are fragmented and are providing services without much differentiation.

Apart from above Government and policy makers also plays an important role in providing required infrastructure, land and resources.

To motivate IT firms to spread their Business, Government has allocated land and resources in Tier 2 and Tier 3 cities at a very low price.

The government has extending Tax holidays to IT sector in the form of STPI and SEZ. The government is making efforts for proving a liberal system for raising capital and seed money for new start-ups. As a part of union budget 2016-17, the government has made changes in the custom and excise duty of IT hardware products.

Bargaining Power of Buyers
The simple way to access the bargaining power of buyers is to ask one simple question, how easy it is for buyers to drive the prices down. This is driven by a number of factors like Importance of each individual buyer to your business, the cost for buyers to switch from your business to that of your competitors or availability of substitutes for your product and services. When you deal with few powerful buyers, then they are often in a position to dictate terms to you.

IT services can be broadly classified as Niche and Conventional.
Niche services are implementation projects which involve the use of new technologies like Machine learning, Big data, Artificial Intelligence, ERP implementations etc. These services involve high client engagement, significant product differentiation and strategic impact on Clients Business. The bargaining power of customers is low as these are partnership style engagements where both the risk and rewards are higher and also the margins in these deals are high.

Conventional IT services involve mostly repetitive work with little client engagement. The reason why clients engage with Indian IT firms for conventional IT services is the onsite-offshore model providing round the clock support to clients at less price. Many clients have started setting up their own captive unit in India to take care of conventional IT services.

So as far as Niche services are concerned, the Bargaining power of Buyers is low and for conventional IT services, the bargaining power is high as there are many IT firms in India who compete for similar projects. The customers are moreover spread across only US and Europe which further increases their bargaining power since there are many suppliers who are dependent on these geographies. The customers can play one supplier on another, drive down prices, introduce stiff penalty clause and insist on quick delivery.

Companies are expanding their business from the developed economies toward the developing economies to Asia-Pacific, Latin America, and Eastern Europe.

The threat of substitutes:

The threat of substitutes is affected by the ability of your customers to find a different way of doing what you do. If substitution is easy and substitution is viable, then this weakens your power.

The threat of substitute is medium as new geographies like China and Philippines are emerging and gaining ground fast due to low cost and availability of skilled workforce.

Also, there has been a steady trend observed where big organizations are starting their own captive IT units for doing high-end IT consulting and outsourcing the low value added and repetitive work to IT companies.

IT sector in India will also get impacted by automation as it is expected that the sector will lose about 6.4 lakh low skilled jobs to automation in coming 5 years. This impact will be significant in IT BPO and infrastructure management space. The majority of these jobs are low skilled repetitive jobs. In short term automation will lead to loss of low skilled jobs but in long term will increase high-skilled jobs.

Competitive Rivalry
Competitive Rivalry is driven by the number and capability of your competitors. If you have many competitors, and they offer equally attractive products and services, then you'll most likely have little power in the situation, because suppliers and buyers will go elsewhere if they don't get a good deal from you. On the other hand, if no-one else can do what you do, then you can often have tremendous strength.

In other words, the Competitive rivalry is high when there is just few business equally selling a product or service when the industry is growing and when consumers can easily switch to competitors offering for little cost. When the competitive rivalry is high intense advertising and price wars can lead to a severe impact on business’s bottom line.

Competitive Rivalry can be classified into three categories:

1) Services offered

The Indian IT service market is highly competitive comprising of both Domestic and International Players. These firms offer conventional IT services like Application development and maintenance, Infrastructure management services, IT Network management, and data center services

Competitive Rivalry is high for conventional IT services due to less product differentiation and multiple firms offering same services in the same market. However, for Niche IT services like big data, Mobility, Internet of Things etc. which offers product differentiation, the competitive rivalry is low.

2) Geographical Presence

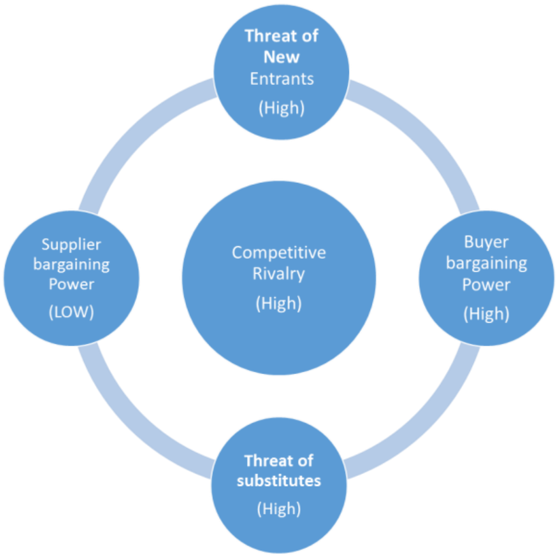
United states are the biggest importer of IT services accounting to around 62% of total IT services export from India. United states are followed by UK and Europe which contribute to about 27% of IT export from India. All the big IT companies in India have a healthy presence in the US, UK, and Europe. Apart from these three big markets, Indian IT companies are trying to build a Niche in emerging markets of Australia, New Zealand Asia Pacific and the Middle East where the competition is relatively low.

3) Verticals catered

The main business verticals catered by IT sector in India are BFSI, Telecom, Manufacturing, and Retail contributing to 85% of IT exports from India. The competition is extensively high to provide services in these sectors. However, there are emerging sectors like healthcare, tourism, e-commerce and logistics which are expected to grow faster than the conventional sectors and accelerate revenue for IT services. The competition to provide services to these emerging sectors is relatively low amongst the IT companies.

CONCLUSION

In a current scenario High bargaining power of Customers, Intense competitive rivalry, High treat of substitutes and Low entry barrier makes Indian IT sector unattractive. However, this applies more in the case of conventional IT services because companies will be under tremendous pressure to deliver at low cost and compete with peers who offer same services at low cost. Also, there will be a significant focus on automation thus replacing repetitive jobs requiring low skill sets.



However, the Indian IT sector is still attractive for Companies willing to venture in Niche verticals, explore new geographies and invest in new technologies thus providing a unique value proposition with respect to its peers. The sector needs to move aggressively from providing enterprise services to someone providing Holistic enterprise solutions Involving product innovation right from conceptualisation to delivery and Product development across the entire lifecycle.

The domestic market in India is also experiencing a significant growth due to Governments initiatives for Digitalization and penetration of personal computers in rural parts. The growth of E-commerce and Make in India Initiatives will push demand for IT services from SMEs.

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