



Riding the waves of digital transformation

Emerging Markets Equity team

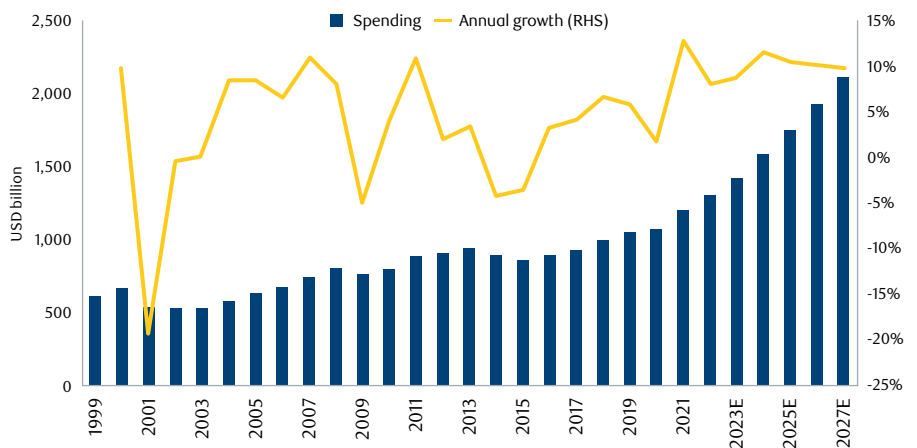
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“The IT Services industry is expected to continue to grow strongly, driven by digital transformation, cloud migration and AI.”

The IT Services sector has been evolving for decades, with changes taking place in technological waves, and today it plays an ever-important role for clients in helping them to develop their digital strategies. Here we look at the characteristics of the industry, the nature of this journey and the key emerging markets (“EM”) regions for IT Services.

The IT Services industry is expected to continue to grow strongly, driven by digital transformation, cloud migration and AI. The sector is a USD1 trillion-plus industry globally and the market is expected to increase at an annualised growth rate of more than 10% from 2023-27¹ (Exhibit 1). Industry growth has been strong in recent years – in particular, it accelerated following the pandemic, which served as a catalyst to put the importance of digital transformation top of mind for many businesses – and we expect this to continue.

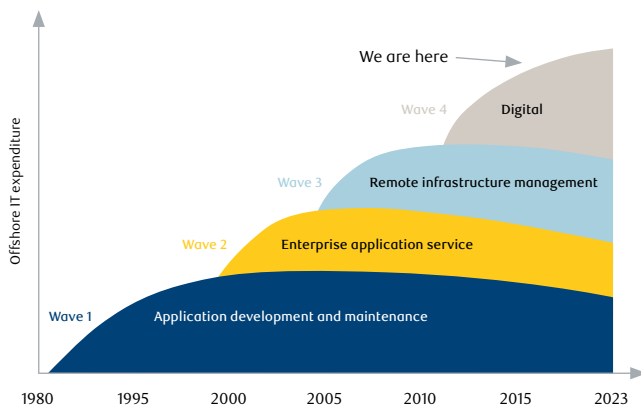
Exhibit 1: IT Services spend is expected to surpass USD2 trillion by 2027



Source: Gartner, JPMorgan, as at January 2023. ‘E’ refers to ‘expected’ and represents forecasts.

¹ Gartner estimates.

Exhibit 2: The IT Services industry has evolved through four technological waves



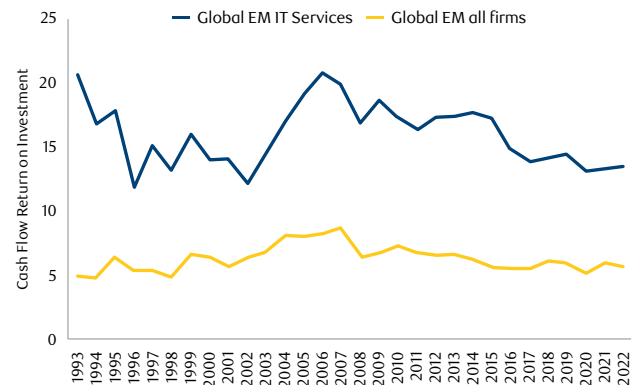
Source: CLSA, RBC BlueBay, as at December 2023.
Note: Digital encompasses social, mobility, analytics and the cloud.

The outsourcing of IT Services began in the 1980s and has since evolved dramatically in both scale and scope. The four waves show how IT Services providers have added value to clients. The most recent wave was the 'Digital wave', which started around 2014-15 and is still ongoing and relevant, as the world becomes increasingly digitalised (Exhibit 2).

Industry characteristics

IT Services businesses tend to be asset light and cash generative, as talent is the asset and source of competitive advantage. Exhibit 3 shows how EM IT Services companies have consistently yielded higher Cash Flow Return on Investment ("CFROI") (economic return) compared to an aggregate of all EM firms, spanning nearly three decades. Due to their asset-light nature, these companies have been able to achieve sustainably high CFROIs over the long term.

Exhibit 3: IT Services companies in EM have yielded consistently higher economic returns versus the average EM firm



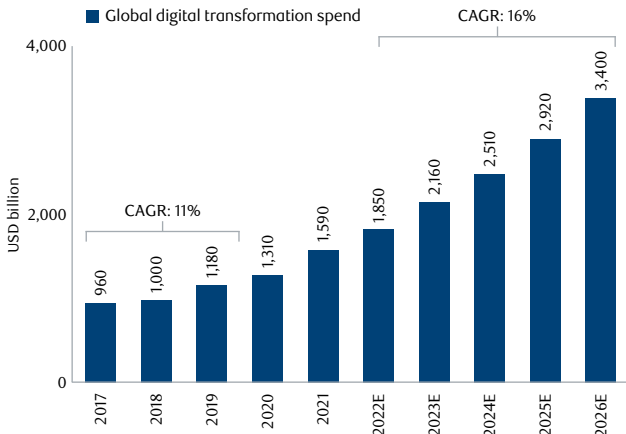
Source: Credit Suisse HOLT Lens, as at December 2023.

The industry is fragmented, and the largest global player represents less than 5% of the total market. While some consolidation may take place, the space will likely remain fragmented for many years to come. IT Services companies are very dependent on client relationships that are built up over time. Building strong, long-term relationships with key vendors is also important for many clients, while simultaneously allowing businesses to build durable, long-term contextual knowledge of their customers. For many such companies, the majority of their annual revenue growth comes from the deepening of existing client relationships.

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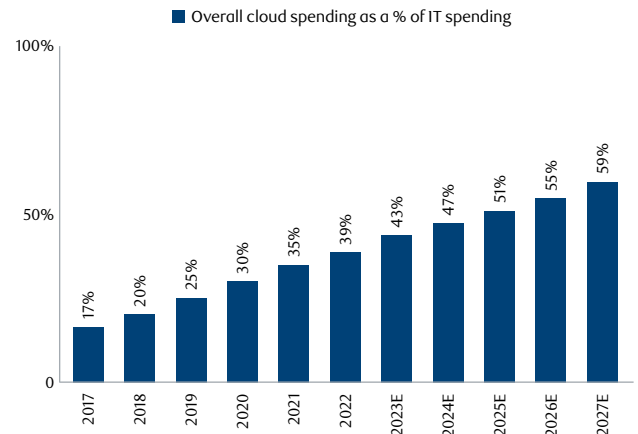


Exhibit 4: Spend on digital transformation will likely accelerate over the coming years



Source: Statista, as at August 2023.

Exhibit 5: Cloud spend is rapidly increasing its share of IT spending



Source: Gartner, JPMorgan, as at March 2023.

Digital transformation

Digital transformation has been, and will likely continue to be, a key driver of growth for the IT Services industry. The pandemic was a catalyst to propel the digital transformation wave further, by highlighting how critical it is for businesses’ long-term sustainability. As shown in Exhibit 4, global digital transformation spend is expected to accelerate, as companies move to take advantage of the latest technologies. Growth in this spending is expected to continue, from 11% per year in recent years to 16% per year in the coming years.

Data and analytics are also gaining significant traction, spurred by advancements in AI capabilities. Cloud migration has become a priority for many businesses, owing to its significance as a key enabling technology for digital transformation, with a hybrid multi-cloud architecture emerging as the most popular pathway. Exhibit 5 illustrates how overall cloud spending has rapidly grown its share of IT spending.

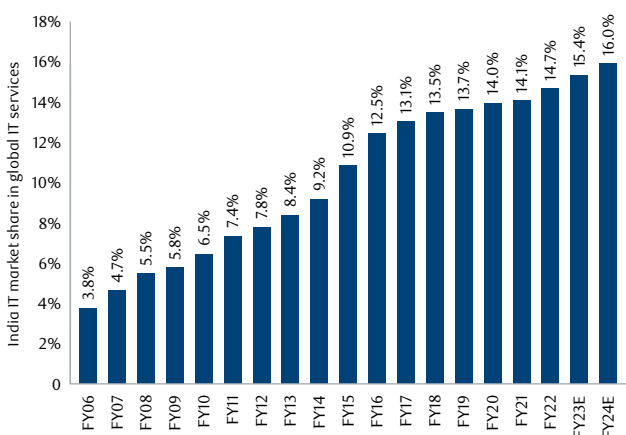
Key EM regions for IT Services

India is a key destination for outsourced IT Services, due to its availability of a skilled talent pool available at a significant labour cost arbitrage compared to developed countries. It is also home to established IT outsourcing players who have decades of experience in meeting customer expectations for high quality delivery. India has steadily increased its share of the global IT Services space over global peers (Exhibit 6). Currently, the country’s market share in the global IT Services industry is around 15%.

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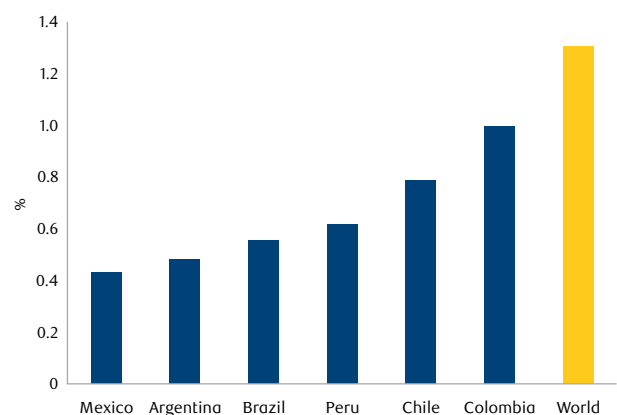
Latin America is another promising region for IT Services. The region’s countries are underpenetrated compared to the world average, when looking at IT spending as a percentage of GDP (Exhibit 7).

Exhibit 6: Indian IT Services players have been steadily increasing share over the years



Source: Gartner, Nasscom, JPMorgan estimates, as at January 2023.

Exhibit 7: IT spending as a % of GDP for Latin American countries



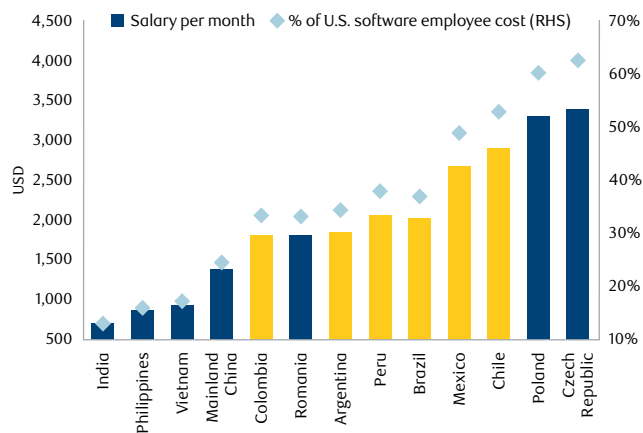
Source: HSBC estimates, as at 2022.

IT Services companies in Latin America have strong growth prospects, driven by a push for nearshoring coupled with tensions in Eastern European tech hubs (Russia, Ukraine and Belarus). The region is also benefitting from a domestic digital drive and an influx of graduates entering the technology talent pool.

“Wages in India are by far the lowest, when compared to U.S. software employees.”

One important advantage for India over Latin America and other regions is its labour cost structure. Wages in India are by far the lowest, when compared to U.S. software employees (Exhibit 8). They are only 13% of equivalent wages in the U.S., while wages in Latin America are 50-70% lower than the cost of comparable roles in the U.S., which is still significant.

Exhibit 8: India has the lowest wages but Latin America is still significantly below the U.S.



Source: Recruitment websites, HSBC estimates, as at September 2023. Note: Blue represents technology hubs for other regions, yellow represents Latin America countries and salary numbers represent HSBC estimates for an employee with mid-level experience (5-6 years).



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Christoffer is a portfolio manager on the RBC Emerging Markets Equity team at RBC GAM and is currently responsible for research in Latin America and Korea. During his time at RBC GAM, he has also specialised in India, China and Taiwan. Prior to joining the firm in 2013 as an investment analyst, Christoffer worked in the investment management division of a Nordic-based financial services group in Copenhagen. He started his career in the investment industry in 2010.

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