New H1B norms likely to hit IT firms' margins

Replacing H1B visa holders with more local hires will keep weighing on costs for big firms

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A further squeeze is expected in this financial year on the operating margin of Indian information technology (IT) companies.

Most of the top ones saw a margin dilution in 2018-19, with spiraling employee cost, triggered by massive hiring in onshore locations. The US is their largest market in terms of revenue contribution and they have been aiming at far more local hiring there. A shortage of new technology talent is another factor. Employee expenses account for 60-65 per cent of total operating cost and a report from rating firm CRISIL says employee expense and the cost per employee for tier-I companies rose at 17 per cent and 9 per cent in FY19, respectively, compared with around 6 and 3 per cent, respectively, a year before.

For mid-tier players, the increase in employee expense was around 13 per cent for the first nine months of FY19; many are yet to declare their fourth quarter results. "The cost per employee for tier-I players rose to ₹479,540 in the last quarter of financial year 2019, a sharp 9 per cent year-on-year increase, compared with less than 5 per cent in the previous eight quarters," wrote Hetal Gandhi, director at CRISIL. The increase in cost per employee could be attributed to the rising number of onsite local hires and higher (more than twofold) salaries of employees with digital skills, since the average wage hike was only 6 to 8 per cent for the period.

Margins have been declining structurally for the past five financial years, as billing rates and utilisation stabilised. Employee utilisation was high at around 85 per cent in FY19, with not much room for improvement. Billing rates are expected to remain under pressure as traditional services become

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commoditised. According to CRISIL Research, Indian IT sector revenue to grow by 7 to 8 per cent in dollar terms during 2019-20, helped by double-digit growth in digital services. However, the operating margin is expected to decline by 30-80 basis points as companies step up local hiring to fill onsite jobs. For which, they will have to pay at least 20-30 per cent more as compared to sending an H-1B visa worker from India, it said.

"Definitely (employee) costs are going up. The cost of replacement, the cost of fulfillment onsite — you're hearing this from industry. Some of that impacts us as well," C Vijaykumar, president, HCL Technologies, had said while announcing the company's March quarter result. Employee cost for the sector has risen for eight quarters, though staff addition was muted during FY18, probably on account of higher onsite cost for players, said CRISIL.

Indian IT firms have had an offsite-onsite employee mix ratio of 80:20. Employees with H-1B visas have been at the core of their strategy, as they cost 20 per cent less than US-based ones. Further, the unemployment rate in the US IT sector was only 1.8-2 per cent in calendar year 2018, compared with an overall jobless rate of 3.8-4 per cent. Translating to higher employee cost.

Among the top companies, only Tata Consultancy Services has kept its staff attrition levels under control. During the final quarter results' announcement, Ajoyendra Mukherjee, its then head of global human resources, had said there could be some cost pressure in the longer term if demand increased, with growth coming back. Experts said firms can try to optimise onsite costs by resorting to the pyramid model, wherein they can hire college graduates in a higher proportion paying lesser salary while the rest of the positions can be filled with a few domain experts at a higher cost.