



Riding the waves of digital transformation

For professional investors only | Marketing communication

Emerging Markets
Equity team

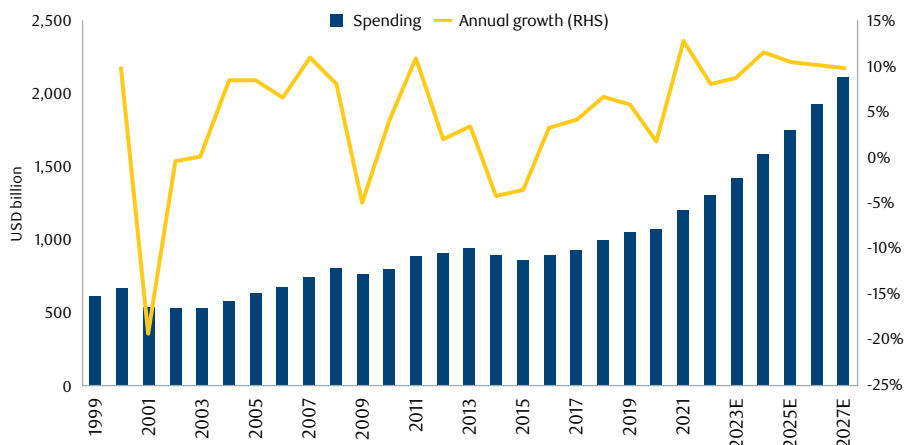
Published January 2024

“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.

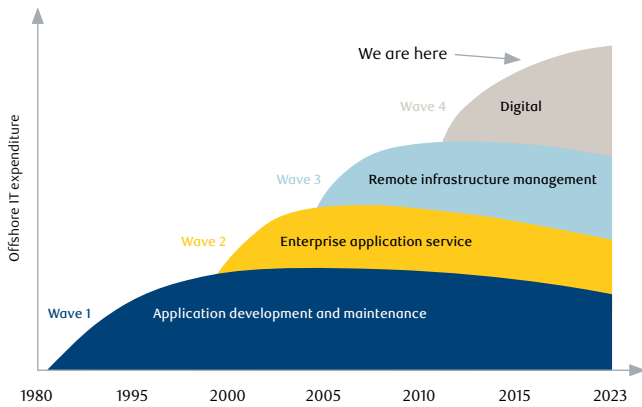
Exhibit 1: IT Services spend is expected to surpass USD2 trillion by 2027



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



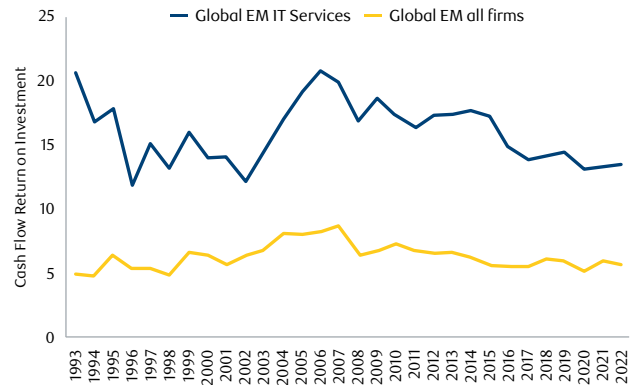
Source: CLSA, RBC BlueBay, as at December 2023.
Note: Digital encompasses social, mobility, analytics and the cloud.

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



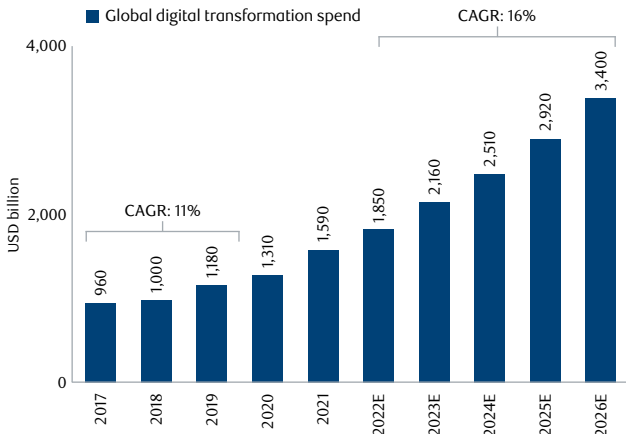
Source: Credit Suisse HOLT Lens, as at December 2023.

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.

“The outsourcing of IT Services began in the 1980s and has since evolved dramatically in both scale and scope.”

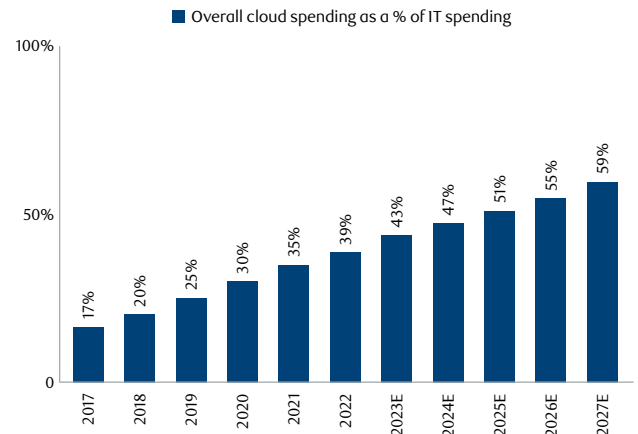


Exhibit 4: Spend on digital transformation will likely accelerate over the coming years



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.

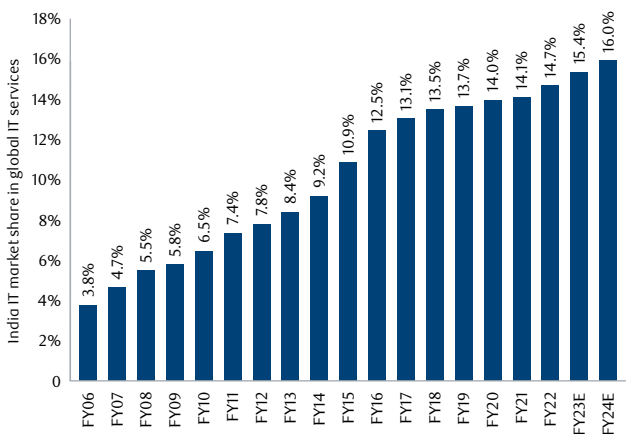
Key EM regions for IT Services

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%.

“Digital transformation has been, and will likely continue to be, a key driver of growth for the IT Services industry.”

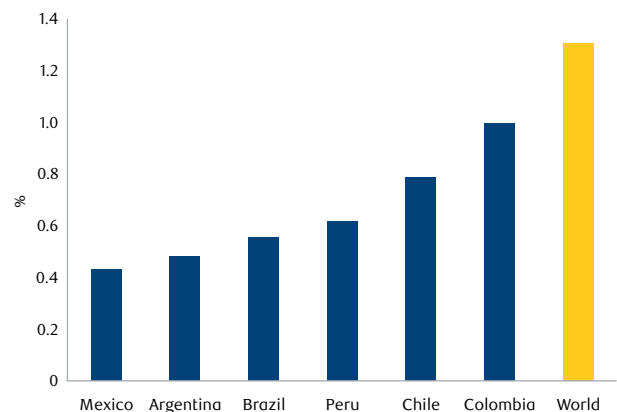
Latin America is another promising region for IT Services. The region’s countries are underpenetrated compared to the world average, when looking at IT spending as a percentage of GDP (Exhibit 7).

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



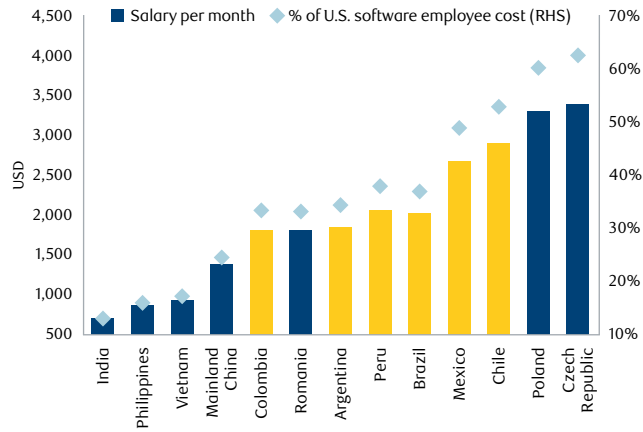
Source: HSBC estimates, as at 2022.

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).



Author

Christoffer Enemaerke

Portfolio Manager



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.

This document is a marketing communication and it may be produced and issued by the following entities: in the European Economic Area (EEA), by BlueBay Funds Management Company S.A. (BBFM S.A.), which is regulated by the Commission de Surveillance du Secteur Financier (CSSF). In Germany, Italy, Spain and Netherlands the BBFM S.A is operating under a branch passport pursuant to the Undertakings for Collective Investment in Transferable Securities Directive (2009/65/EC) and the Alternative Investment Fund Managers Directive (2011/61/EU). In the United Kingdom (UK) by RBC Global Asset Management (UK) Limited (RBC GAM UK), which is authorised and regulated by the UK Financial Conduct Authority (FCA), registered with the US Securities and Exchange Commission (SEC) and a member of the National Futures Association (NFA) as authorised by the US Commodity Futures Trading Commission (CFTC). In Switzerland, by BlueBay Asset Management AG where the Representative and Paying Agent is BNP Paribas Securities Services, Paris, succursale de Zurich, Selnaustrasse 16, 8002 Zurich, Switzerland. The place of performance is at the registered office of the Representative. The courts at the registered office of the Swiss representative or at the registered office or place of residence of the investor shall have jurisdiction pertaining to claims in connection with the offering and/or advertising of shares in Switzerland. The Prospectus, the Key Investor Information Documents (KIIDs), the Packaged Retail and Insurance-based Investment Products - Key Information Documents (PRIIPs KID), where applicable, the Articles of Incorporation and any other document required, such as the Annual and Semi-Annual Reports, may be obtained free of charge from the Representative in Switzerland. In Japan, by BlueBay Asset Management International Limited which is registered with the Kanto Local Finance Bureau of Ministry of Finance, Japan. In Asia, by RBC Global Asset Management (Asia) Limited, which is registered with the Securities and Futures Commission (SFC) in Hong Kong. In Australia, RBC GAM UK is exempt from the requirement to hold an Australian financial services license under the Corporations Act in respect of financial services as it is regulated by the FCA under the laws of the UK which differ from Australian laws. In Canada, by RBC Global Asset Management Inc. (including PH&N Institutional) which is regulated by each provincial and territorial securities commission with which it is registered. RBC GAM UK is not registered under securities laws and is relying on the international dealer exemption under applicable provincial securities legislation, which permits RBC GAM UK to carry out certain specified dealer activities for those Canadian residents that qualify as “a Canadian permitted client”, as such term is defined under applicable securities legislation. In the United States, by RBC Global Asset Management (U.S.) Inc. (“RBC GAM-US”), an SEC registered investment adviser. The entities noted above are collectively referred to as “RBC BlueBay” within this document. The registrations and memberships noted should not be interpreted as an endorsement or approval of RBC BlueBay by the respective licensing or registering authorities. Not all products, services or investments described herein are available in all jurisdictions and some are available on a limited basis only, due to local regulatory and legal requirements.

This document is intended only for “Professional Clients” and “Eligible Counterparties” (as defined by the Markets in Financial Instruments Directive (“MiFID”) or the FCA); or in Switzerland for “Qualified Investors”, as defined in Article 10 of the Swiss Collective Investment Schemes Act and its implementing ordinance, or in the US by “Accredited Investors” (as defined in the Securities Act of 1933) or “Qualified Purchasers” (as defined in the Investment Company Act of 1940) as applicable and should not be relied upon by any other category of customer.

Unless otherwise stated, all data has been sourced by RBC BlueBay. To the best of RBC BlueBay’s knowledge and belief this document is true and accurate at the date hereof. RBC BlueBay makes no express or implied warranties or representations with respect to the information contained in this document and hereby expressly disclaim all warranties of accuracy, completeness or fitness for a particular purpose. Opinions and estimates constitute our judgment and are subject to change without notice. RBC BlueBay does not provide investment or other advice and nothing in this document constitutes any advice, nor should be interpreted as such. This document does not constitute an offer to sell or the solicitation of an offer to purchase any security or investment product in any jurisdiction and is for information purposes only.

No part of this document may be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, in whole or in part, for any purpose in any manner without the prior written permission of RBC BlueBay. Copyright 2024 © RBC BlueBay. RBC Global Asset Management (RBC GAM) is the asset management division of Royal Bank of Canada (RBC) which includes RBC Global Asset Management (U.S.) Inc. (RBC GAM-US), RBC Global Asset Management Inc., RBC Global Asset Management (UK) Limited and RBC Global Asset Management (Asia) Limited, which are separate, but affiliated corporate entities. ® / Registered trademark(s) of Royal Bank of Canada and BlueBay Asset Management (Services) Ltd. Used under licence. BlueBay Funds Management Company S.A., registered office 4, Boulevard Royal L-2449 Luxembourg, company registered in Luxembourg number B88445. RBC Global Asset Management (UK) Limited, registered office 100 Bishopsgate, London EC2N 4AA, registered in England and Wales number 03647343. All rights reserved.

Published January 2024

RE/0022/01/24



RBC BlueBay
Asset Management