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Cost transformation & Indian service sector: A case study on companies in Gurgaon and Noida location

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Abstract

Purpose of this case study is to understand the upcoming concept of cost transformation in service sector. Identifying the major components of the cost and transforming cost with the help of studying and analyzing the cost structure of a service industry. Identifying the factors which lead to increase in cost in services sector for companies located in Gurgaon and how it can be reduced, if they can be shifted to Noida.

Cost transformation (CT) is an extended part of cost management and is an upcoming concept which gives long term impact of cost reduction in business. Reason for increase in focus on CT is the competitive market, it's very difficult to increase income these days and so company focuses more on CT apart from working on income generating model.

The service sector consists of the production of services instead of end products. Services also known as intangible goods, it includes attention, advice, access, experience, discussion, and affective labor. The tertiary sector of industry involves the provision of services to other businesses as well as final consumers. Services may involve the transport, distribution and sale of goods from producer to a consumer, as may happen in wholesaling and retailing, pest control or entertainment. The goods may be transformed in the process of providing the service, as happens in the restaurant industry.

Indian economy depends on Service Sector and it is also known as service sector economy. It is the most dominant sector in India's GDP. It is also attracted large amount of foreign investment flows. India's services sector covers a wide variety of activities such as trade, hotel and restaurants, transport, storage and communication, financing, insurance, real estate, business services, community, social and personal services, and services associated with construction.

Keywords: Service sector, cost transformation (CT), operating cost, maintenance cost, labor cost and service sector in Indian economy

Introduction

Cost Transformation is part of Cost management. Cost Management is a way to plan and budget operating and maintaining cost of the business. Cost management helps to manage expenses and budget, monitor and control the status of the business and measures performance. Steps included in cost management are:

1. Identification of Cost Sources
2. Estimating Cost
3. Transforming Cost

Identification of Cost Sources: Cost can be identified or can be majorly divided into two parts operating cost and overhead cost. And further these can be divided into two heads fixed and variable cost.

Operating Costs are the expenses which are related to the operation of a business. They are the cost of resources used by an organization just to maintain its existence. It can be classified into following categories:

1. Fixed costs, which are the same whether the operation is closed or running at 100% capacity. Fixed Costs include items such as the rent of the building. These generally have to be paid regardless of what state the business is in. It never changes.
2. Variable costs, which may increase depending on whether more production is done, and how it is done. If business is not in running position then there would be no variable cost for the business.

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Overhead Cost is not directly related to operation of the business but it is very much required to up and running of business administration and other departments. It can also be classified as:

1. Fixed Cost: No matter what your sales volume is, fixed costs must be met every month. Fixed expenses, depreciation on fixed assets, salaries and associated payroll costs, insurance, utilities, membership dues and legal and accounting costs.
2. Variable cost, are really semi variable expenses that fluctuate from month to month in relation to sales and other factors. Fitting into this category are expenses for telephone, office supplies, printing, packaging and mailing.

Estimating Cost: After identifying the sources of cost in service sector, then we have to estimate its value. We estimate value by considering various market factors which includes:

1. Inflation
2. Labor Cost
3. Set up Cost / Assets Purchase
4. External Working Capital Cycle
5. Maintenance Cost
6. Insurance Cost

Transforming Cost: It's an upcoming concept; it helps organization to reduce cost over long term in business. Major reason for shift in focus is to gain competitive advantage in the market, where it's very difficult to increase revenue directly. Cost transformation can include reduced spending, complexity reduction, platforms consolidation, increased operational efficiency and growth enablement.

Study on Service Sector

Service Sector produces intangible goods, i.e. it produces services instead of goods. It comprises various service industries including:

1. Warehousing and truck transportation services
2. Information sector services
3. Commodities, securities and other investment services
4. Professional, technical and scientific services
5. Waste management services
6. Health care services
7. Social assistance services
8. Arts, entertainment, and recreation services.

The Service Sector is the third part of economy:

1. The first economic sector is called as the primary sector, which covers the farming, mining and agricultural business activities in the economy.
2. The secondary sector covers manufacturing and business activities that facilitate the production of tangible goods.
3. The third economy is service sector, though classified as the third economic sector, is responsible for the largest portion of the economy's business activity. Businesses in this sector are rapidly placing more focus on what is becoming known as the "knowledge economy," or the ability to surpass competitors by understanding what target customers want and need, and operate in a way that meets those wants and needs quickly with minimal cost.

Technology in the Service Industry: It's specifically information technology systems, are shaping the way businesses in the service sector operate. In nearly all industries within the sector, businesses institute technology to bolster production, increase speed and efficiency and cut down on the number of employees required for operation. This cuts down on costs and improves incoming revenue streams.

The Future of the Service Sector: As of 2015, the growth of the service sectors in China and the United States has seen a significant decline. Analysts are closely watching China over concerns that slugging demand trends in the country will affect economic growth globally. The service sector in the United States, while showing signs of a noticeable slow down through the fourth quarter of 2015, still has a steady amount of growth.

Countries with economies centered on the service sector are considered more advanced than industrial or agricultural economies. According to the International Monetary Fund (IMF) and the CIA World Fact book, the following countries are the largest by service or tertiary output as of 2016:

1. United States: \$14.76 billion
2. China: \$5.7 billion
3. Japan: \$3.5 billion
4. Germany: \$2.4 billion
5. United Kingdom: \$2.1 billion
6. France: \$1.9 billion
7. Italy: \$1.4 billion
8. Brazil: \$1.3 billion
9. Canada: \$1.1 billion
10. India: \$1.0 billion

Source: <https://www.investopedia.com/terms/s/service-sector.asp>

Study on Service Sector In India

The services sector is the most dominant sector in India's GDP. It also attracted large amount of foreign investment flows. India's service sector covers a wide variety of activities such as trade, hotel and restaurant, transport, storage and communication, financing, insurance, real estate, business services, community, social and personal services, and services associated with construction.

Market Size: The sector is estimated to contribute around 54.0 per cent of India's Gross Value Added in 2017-18 and employed 28.6 per cent of the total population. India's net services exports during reached US\$ 57.60 billion April-December 2017. As per Ministry of Statistics and Programmed Implementation's second advance estimates of National Income 2017-18, services sector GVA is expected to grow to US\$ 1,266.10 million in FY1819.

Investments: It has attracted FDI equity inflows in the period April 2000-December 2017, amounting to about US\$ 64.10 billion according to the Department of Industrial Policy and Promotion (DIPP). Some of the developments and major investments by companies in the services sector in the recent past are as follows:

1. Private Equity (PE) investments in the hospitality industry rose nearly three-fold to US\$ 119 million in 2017 from US\$ 43.58 million in 2016.

2. National Skill Development Corporation has signed a tripartite Memorandum of Understanding (MoU) with Tourism and Hospitality Sector Skill Council (THSC) and Airbnb to impart hospitality skills training to hospitality micro-entrepreneurs in India.
3. The domestic and foreign logistic companies are optimistic about prospects in the logistics sector in India, and are actively making investments plans to improve earnings and streamline operations.

Government has taken few Initiatives in the recent past.

1. Under the Mid-Term Review of Foreign Trade Policy (2015-20), the Central Government increased incentives provided under Services Exports from India Scheme (SEIS) by two per cent.
2. Ministry of Communications, Government of India, has launched DARPAN - "Digital Advancement of Rural Post Office for A New India" which is aimed at improving the quality of services, adding value to services and achieving "financial inclusion" of un-banked rural population.
3. Ministry of Civil Aviation, Government of India, launched 'DigiYatra', a digital platform for air travellers that aims to develop a digital ecosystem providing consistent service and a delightful experience at every touch point of the journey.
4. The Ministry of Electronics and Information Technology has launched a services portal, which aims to provide seamless access to government services related to education, health, electricity, water and local services, justice and law, pensions and benefits, through a single window.

Future of Service Sector: Services sector growth is governed by both domestic and global factors. The Indian facilities management market is expected to grow at 17 per cent CAGR between 2015 and 2020 supported by booming real estate, retail, and hospitality sectors. The performance of trade, hotels and restaurants, transport, storage and communication sectors are expected to improve in FY17. The financing, insurance, real estate, and business services sectors are also expected to continue their good run in FY17. The implementation of the Goods and Services Tax (GST) has created a common national market and reduced the overall tax burden on goods. It is expected to reduce costs in the long run on account of availability of GST input credit, which will result in the reduction in prices of services.

Study on Service Sector Companies in Gurgaon And Noida

There are various differences in cost of the companies located in Gurgaon and Noida and major factors are mentioned below

Increase in Fixed Cost: Fixed cost increased in Gurgaon in comparison to Noida. Major reason is Increase in rent prices of Land and Building. As per my analysis there is a slight increase in rates over the past two years in Gurgaon. Office space rentals in Noida and Greater Noida hover between Rs 50 and Rs 55 per sq ft, which are at least Rs 20 psf cheaper than the Millennium City (Gurgaon). In comparison, office spaces in Gurgaon command rentals of Rs 70 to Rs 75 psf.

Living Cost: Living cost is bit higher in Gurgaon; 20–30 % rent difference is there. So management of most of the companies is taking right decision for business and for employees to shift to Noida. Major reason is Gurgaon is more concentrated now.

Pollution and traffic: Pollution and traffic is bit higher in Gurgaon than Noida, Gurgaon has too much dust and seepage system is also too bad, an employee faces too many challenges.

Public Transport: Public transport of Noida has good options like buses and share autos, which are generally observed by people residing in Noida however in Gurgaon people, feel lack of public transport.

Apart of all these Noida has other advantages over Gurgaon:

1. Location
2. Lifestyle of People around
3. Infrastructure like roads, water, electricity
4. Value for Money spent on buying a house
5. Cost of Living
6. Traffic situation

Recommendation

Cost management is a key part of any business to manage their cost within the allocated budget. Companies should work on reducing their cost. In this competitive market businesses should work on this area. Moreover, Cost transformation is upcoming concept in the industry which doesn't only mean to reduce cost, but to work on model where company can take advantage of cost transformation model for next 4-5 years at least. Major concern is its very difficult to increase revenue in this competitive market and customer always look for an alternative and cost effective solution. As per this case study they should work on all the above mentioned parameters to transform their costs and make their business profitable. So companies are shifting from Gurgaon to Noida. Noida has better potential to accommodate and sustain it.

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