# OFFSHORE BUSINESS PROCESS OUTSOURCING AND IT ENABLED SERVICES

Current industry state and key trends

Country Focus: India

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## SUMMARY

- Pure IT service companies such as Wipro, Infosys and others will build offshore BPO capabilities rapidly to challenge existing Indian vendors.
- Most foreign firms such as CSC, IBM-GS will continue to be ambivalent about offering viable offshore processing capabilities to their clients for internal organizational reasons, and in fear of cannibalising high margin business carried out onshore. Even when they do decide to commit to India, they face a long learning curve ahead to build capabilities.
- Large clients who can benefit from a feasible captive offshore operation will seek BOOT (Build, Own, Operate and Transfer) deals from current vendors who will face conflicting interests in offering such deals.
- Excessive hype and adverse publicity may lead to a limited protectionary backlash in the US and other places; the Indian government, Nasscom and the industry at large will need to pool their efforts to counter paranoia in some sections of the US political apparatus.
- Rapid technological advancements in self service applications combined with imaging and workflow software will make for an even more compelling case for organizations to outsource offshore.
- With increasing experience and maturity, Indian ITES and BPO vendors will improve the superiority of their value proposition by offering multi-process integration that will go far beyond the mere take over of current processes, as is currently the case for most deals.
- Increasing scale and the need to serve the Western SME sector will underpin the emergence of a variety of specialised common technology and process platforms. This will require the combination of both ITES and IT skills, further enmeshing the two.
- As offerings increase in sophistication and quality, pricing will firm up for the top-tier of Indian vendors.
- Industry consolidation will gather steam as new players with financial muscle seek out existing established players, and mid-tier companies merge to achieve scale.

## 1. Introduction – what is Business Process Outsourcing about?

On its website, Accenture, a leading provider of outsourcing services in human resources and accounting and finance defines outsourcing as “Contracting with an external organization to take primary responsibility for providing a business process or function”. Said differently, outsourcing reflects an opportunity for an organization to leverage the concept of specialization in a way that can enhance profitability within a value chain by adding, rather than subtracting, a link in that value chain. Proponents of outsourcing argue that this sourcing model provides a number of benefits including, but not limited to: reduced cost, enhanced focus on core competencies and access to a greater depth and breadth of knowledge ultimately delivering increased value. Additionally, proponents would argue that outsourcing frees up management resources and has the capacity to significantly improve the quality of service to the end user.

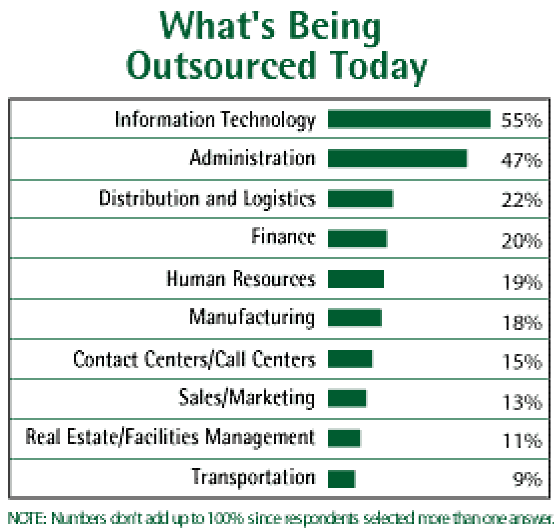
During the 1990’s, we saw the emergence of IT outsourcing to countries such as India, where vendors delivered IT ‘outcomes’ to companies, relieving them of the complexity of managing in-house IT departments. IT outsourcing took the form of programming, software development, data center management and network administration. The growth of IT outsourcing was extremely rapid as non-technology companies found it increasingly difficult to attract and retain qualified IT personnel in the U.S. The bursting of the IT bubble in 2000 has impacted the growth of IT outsourcing – though not significantly. The difficult economic conditions however have brought increased attention to whether the concept of outsourcing can provide additional savings if applied to other functions.

The concept of business processing outsourcing is not at all new. Firms such as ADP, Accenture and others have taken on organizations' routine operations and built it into a profitable franchise. In its simplest form, BPO arrangements have existed for years as many companies outsourced non-strategic and low risk services such as security, document production and catering. The use of outsourcing vendors for IT services however, was truly a catalyst in opening executives' minds to the possibility that many other functions could be outsourced as well.

The outsourcing decision is often perceived to be limited to those functions not considered to be the company's core competency. However, the definition of core competency and non-strategic functions continues to change rapidly. BPO arrangements continue to expand into functions that traditionally have been viewed as "strategic". The extent of functions outsourced by many companies would surprise the average customer. Microsoft for example, outsources almost all of its processes – from manufacturing to distribution. Microsoft has only retained the development of its source code, its strategic asset[1]. As another example, many famous clothing lines, such as AnnTaylor, outsource nearly their entire operation, with the exception of the design of clothing. The following chart summarizes

[1] Unseem, Michael and Harder Joseph "Leading Laterally in Company Outsourcing" Sloan Management Review Winter 2000.

research by the Outsourcing Institute outlining the broad array of services / functions that are outsourced:




This mix of outsourced functions continues to change as outsourcing of business process functions continue to move further up an outsourcer's value chain and organizations become more comfortable releasing control of functions formerly viewed as mission critical. An Accenture survey seems to validate this trend. In fact, a recent survey by Accenture indicates that 65% of companies are outsourcing processes of "medium to high strategic value" due to confidence in providers, the need for cost savings and their desire to focus on longer term strategic goals[2].

**Outlocating vs. outsourcing:**

[2] Linder, Jane; Cantrell, Susan and Crist Scott "Business Process Outsourcing Big Bang: Creating Value in an Expanding Universe" August 2002

A popular form of deriving the advantages of outsourcing is outlocating[3], i.e., establishing a captive unit in a low cost location, be it offshore or onshore. It should be noted that this report is primarily limited to third-party outsourcing and does not address outlocating, or captive BPO subsidiaries. Outlocating relates to a company's decision to geographically distribute its operations to a location deemed to have certain advantages (i.e. lower costs of labor in India, lower risk of terrorist incidents in Iowa as compared to New York). The outlocator maintains control of the operations and the employees continue to work for the outlocator.

## 2. Estimates of addressable market size for Business Process Outsourcing

Depending upon how BPO is defined, and the sources and studies one considers, there are varying estimates of how large the market is. However, there is agreement that the market is growing very rapidly as companies race to cut costs, reduce operating leverage, and deal with a shrinking talent pool while at the same time deliver outstanding service to their clients.

Consider the following:

- A recent report by IDC published in the Financial Times estimated that the outsourcing market as a whole (IT and business processing) would grow from $712 billion to $1,200 billion by 2006 with IT outsourcing growing at 12% per year.

[3] Term for captive BPO subsidiaries used in the KPMG/CII report 'IT Enabled Services in India – A focus on competitiveness'

- Gartner suggests the BPO market could grow to $178.5 billion in 2005[4] from just over $120 billion today.
- C. E. Unterberg, Towbin, estimates worldwide BPO revenues for 2004 to be in the region of $300 billion[5].
- Business process outsourcing in Europe alone is expected to grow from 43 billion euro in 2002 to 72 billion euro in 2005[6]. The growth in Europe is expected to primarily be driven by outsourcing of payment systems, warehouse management and human resources management. Significant growth is expected to continue in financial services, telecommunications and energy companies. These companies, due to the volatile and market sensitive nature of their business, spend almost twice as much on outsourcing as the average business, with IDC estimating spending of $20 to $25 million.

There is no doubt that the outsourcing market, and BPO in particular, represents significant revenue opportunities for existing players and is ripe for new entrants in some fields.

The key functional areas where these revenues will result are given in the table below:

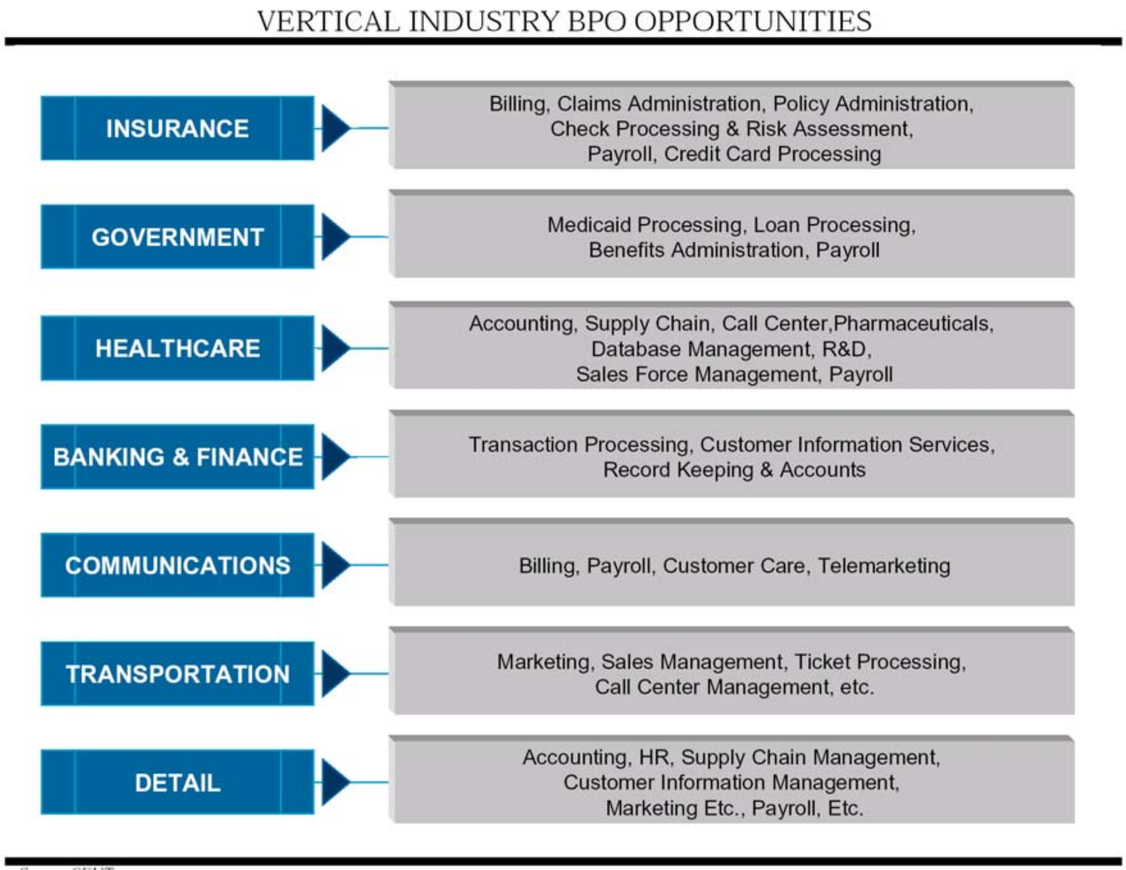
[4] "The Case for, and Against, Shifting Back Office Operations Overseas", Wharton Business School, University of Pennsylvania, September 2002
[5] C. E. Unterberg, Towbin Industry Report on Business Process Outsourcing, citing Dataquest and Gartner. C. E. Unterberg, Towbin is an investment banking firm
[6] Skapinker, Michael "Outsiders with a Key Role at the Heart of Business", Financial Times, 20 September 2002, pg I.

| WORLDWIDE BPO FORECAST BY PROCESS, 1999-2004 | | | |
|---|---|---|---|
| Administration | 1999 | 2004 | CAGR |
| Tax processing | $0.69 | $1.39 | 15.0% |
| Claims processing | 4.40 | 8.33 | 13.6 |
| Asset management | 1.28 | 3.37 | 21.4 |
| Document management | 2.45 | 6.74 | 22.4 |
| Other administration | 0.00 | 0.01 | 14.3 |
| Sum / average | 8.82 | 19.84 | 17.6 |
| Finance | | | |
| Billing services | 5.76 | 14.70 | 20.6% |
| Accounting transactions | 3.24 | 7.54 | 18.4 |
| General accounting | 1.30 | 4.52 | 28.3 |
| Tax consulting & compliance | 0.43 | 2.00 | 36.0 |
| Risk management | 0.65 | 3.13 | 36.9 |
| Financial reporting | 0.14 | 2.26 | 73.3 |
| Financial analysis | 0.14 | 2.02 | 69.5 |
| Financial management | 0.29 | 1.51 | 39.1 |
| Other finance | 0.00 | 0.02 | 39.2 |
| Sum / average | 11.96 | 37.70 | 25.8 |
| Human Resources | | | |
| Benefits administration | 9.42 | 23.70 | 20.3% |
| Education & training | 3.23 | 11.47 | 28.8 |
| Recruiting & staffing | 2.10 | 9.17 | 34.3 |
| Payroll services | 10.10 | 26.75 | 21.5 |
| Hiring administration | 0.67 | 2.52 | 30.3 |
| Records management | 0.27 | 1.3 | 36.9 |
| Other HR | 0.39 | 1.53 | 31.4 |
| Sum / average | 26.19 | 76.44 | 23.9% |
| Payment Services | | | |
| Credit/Debit card services | 13.92 | 36.24 | 21.1% |
| Check processing | 2.32 | 5.14 | 17.2 |
| EDI | 1.16 | 5.37 | 35.9 |
| Other transaction processing | 0.00 | 0.01 | 26.4 |
| Sum / average | 17.40 | 46.76 | 21.9 |
| Logistics/distribution | | | |
| Materials management | 2.14 | 4.49 | 16.0% |
| Distribution/warehouse mgmt. | 11.25 | 29.41 | 21.2 |
| Logistics management | 4.69 | 11.44 | 19.5 |
| Procurement | 12.85 | 36.35 | 23.1 |
| Other operations | 0.00 | 0.01 | 29.6 |
| Sum / average | 30.93 | 81.70 | 21.4% |
| CRM | | | |
| Database marketing / customer analysis | 1.42 | 4.77 | 27.4% |
| Telesales/telemarketing | 3.31 | 7.36 | 17.3 |
| Customer care | 5.10 | 18.22 | 29.0 |
| Web sales & marketing | 0.68 | 5.43 | 51.5 |
| Other SMC (advertising, PR, etc.) | 0.83 | 2.98 | 29.1 |
| Sum / average | 11.34 | 37.76 | 27.9 |
| **Total Worldwide BPO** | **$106.6** | **$301.2** | **23.1%** |

Source: Dataquest / Gartner Group January 2001. Numbers in billions of dollars.

The diagram below[7] shows the key BPO opportunities by verticals, as opposed to process as analysed in the previous table:

[7] C. E. Unterberg, Towbin study



Source: CEUT

## 3. Why would customers want to outsource their business processes?

In most respects, many of the overall factors driving the need for technology outsourcing solutions are similarly driving customers' need for business process outsourcing solutions. However, to better understand these factors in the context of BPO, we review a number of key customer trends and needs below:

### 3.1. Desire to gain process improvement

Value today within organizations is increasingly being realized not in tangible assets such as machinery, equipment and products, but in intangible assets such as customer service, branding and relationships, and, most importantly, the aggregation of key informational assets i.e., optimizing business processes. Accordingly, by utilizing a BPO vendor, customers can not only access experienced technology operations and management capabilities (i.e., keeping an application or other technology running 24x7 with optimal performance and security levels), but also best-practice process disciplines, workflows and methodologies. As a BPO vendor refines and enhances certain business processes over time, its customers are able to gain immediate access to new and fine-tuned best practice methodologies—another benefit to outsourcing.

### 3.2. Focus on core operations

Organizations, more than ever, are trying to focus on what they do best. Operational personnel want to focus on product research, development and marketing, and outsource non-core activities.

### 3.3. Reduced costs

As a result of process improvements, coupled with economies of scale from technology and process management services, BPO customers are able to generally realize material cost savings. BPO cost savings, on average, tend to be slightly greater than those of pure technology outsourcing.

### 3.4. Single point of accountability

BPO takes the concept of being the single point of contact a step further. The BPO vendor is responsible for delivering an overall process, not just the technology supporting it. This is particularly compelling for companies whose need to focus on operating their core assets is paramount.

### 3.5. Improved business agility

By making a fixed cost a variable cost; gaining access to ongoing, updated best-practice disciplines; and intensifying focus on core operations, BPO customers can make their businesses more agile in responding to rapid changes in their given markets. As product cycles shrink and the pace of business continues to accelerate, greater agility is becoming more important.

### 3.6. Shortage of labor

Companies are increasingly facing problems in hiring and retaining qualified staff, particularly qualified IT personnel. Moreover, this shortage of qualified labor is not unique to technology personnel; the continual churn of many back-office personnel creates process instability within organizations. Finally, with many of the back-office functions BPO targets, internal personnel at potential BPO customers are viewed as “cost centers” as opposed to revenue generating employees. In contrast, at BPO vendors, back-office support staff are revenue-generating employees.

## 4. Enter Offshore BPO

Business process outsourcing has been around for many decades, indeed ADP, the US based payroll and benefits administration outsourcing company, was setup in as far back as in 1949. The industry is now passing through a period of discontinuous change brought about by rapid changes in information and communications technology. The paperwork involved in any business process now largely takes the form of a computer record – bringing with it the benefits of exact and costless duplication, and simultaneous availability and usage. Combined with advances in networking and data communication and storage technologies, geography too has been rendered irrelevant for a vast majority of business processes insofar as the performance of a business process and the usage of its outputs is concerned.

Remote located services, or 'offshore' business process outsourcing, is a large industry today – with the 'offshore' signifying the location of a business process as being reasonably far away from the main business of an enterprise – and for the purposes of this section of our report, OBPO largely refers to a business process performed in a low cost country such as India or the Philippines.

## 5. Offshore Business Process Outsourcing and IT Enabled Services

IT enabled Services (ITES) is defined as business processes and services performed or provided from a location different from that of their users or beneficiaries and delivered over telecom networks and the Internet.[8]

ITES and OBPO often mean the same thing and can be used interchangeably. ITES is a phrase that emphasizes the vendor perspective, while OBPO is a term more relevant from the customer's viewpoint. From the available literature and research on the subject, we find little difference between the two. A fine distinction between the two may be made on the reasoning that ITES includes remote service provisioning for activities that would always be purchased externally, OBPO only includes processes or activities that are generally performed in-house.

An additional complication that makes the analysis of OBPO slightly more difficult is that OBPO is part of a larger IT outsourcing and services marketplace, and bundled contracts for IT services and business process related work are becoming increasingly common blurring the distinction between IT outsourcing and traditional BPO.

We believe the distinction between ITES and OBPO to be debatable and of little commercial consequence. ITES is a more generic industry standard term than OBPO and will therefore be the terminology of choice in the rest of this paper.

[8] Giga report, quoting Nasscom

**The rest of this paper will use the terms OBPO and ITES interchangeably to mean the same thing.**

## 6. What is driving increasing Offshore BPO activity?

As noted above, potential growth in the outsourcing market is expected to be substantial. In addition to the increased supply of vendors and continued positive press documenting the success of these arrangements, several key factors have contributed to the substantial growth in this industry and are expected to continue to impact growth for the foreseeable future. Historically, cost savings has been the most publicized benefit of outsourcing relationships. Recent economic conditions have provided increased pressure on executives to identify creative sourcing solutions. Changes in the global business environment have continued to make outsourcing an extremely attractive option.

### 6.1. Cost Pressures

As mentioned above, cost is the most widely quoted rationale for organizations to choose outsourcing as a strategic option. The prolonged recession in the U.S., Europe and Japan has only increased the importance of this metric. A survey of senior executives at 304 leading multinationals in 14 countries performed by PWC Global and published on their website (now IBM) indicates that 66% believe that "BPO helps companies become more profitable leading to improvements in shareholder value". Many studies of best-in-class outsourcing arrangements in a variety of industries appear to validate the belief that outsourcing results in significant potential cost savings. For instance, Xchanging, an outsourcing firm providing services to BAE expects to save BAE 10% in the first year and 15% in the second, while providing at least the same quality of service as when BAE ran the operations themselves[9]. These cost savings are also believed to be possible in the growing number of outsourcing relationships entered into by financial services companies. For instance, insurance companies using offshore BPO models predict double digit cost savings[10]. Also, the recent $30 million outsourcing agreement between GreenPoint Mortgage and Progeon has publicized an expected reduction in GreenPoint's loan servicing costs of 20% to 50%[11]. McKinsey talks of a 40-60% cost saving in outsourced processes in the McKinsey-Nasscom Report 2002 published earlier this year. With continued pressure on profits and continued softness in the developed economies, the opportunity for substantial cost savings provided by outsourcing arrangements is viewed as a potential panacea for many corporations.

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[9] Maitland, Alison "Case Study: BAE Systems; Benefits Begin to Show Through", Financial Times, 20 September 2002, pg II.
[10] Vallance, Matthew "Outsourcing: Does it Offer the Holy Grail of Reduced Costs", Lloyd's of London Press Limited 24 October 2002.
[11] Case Study: Inside the Progeon – Greenpoint Mortgage Transaction, Wharton Business School, University of Pennsylvania.

The impact of the economy and the need to assuage investors points companies to outsourcing for many reasons. Outsourcing not only provides the opportunity for companies to reduce costs, but also to transform fixed costs into variable costs by shifting the burden of managing the business cycle to the outsourcing provider through volume driven fee arrangements. Although certain investments will still need to be made by the outsourcer, proper negotiations can result in the vendor taking on many of these costs and allowing the corporation's expense to move more closely to its revenue. According to a survey by IDC and CapGemini Ernst & Young, the desire to mute the volatility in earnings has driven industries most subject to that volatility such as financial services, energy and telecommunications companies to the outsourcing trend at a faster pace than others[12]. Accomplishing this goal allows corporations to generate more predictable profit margins which are highly valued by the financial markets as they are less susceptible to the business cycle. It also relieves the burden of having to make significant technology investments in the event of regulatory or market changes.

### 6.2. Growth of educated labor market abroad

While the popular outsourcing locations offer a variety of different benefits, the cost savings discussed above are primarily achieved by the excess availability of qualified resources. This scenario is evident in many of the

[12] Goepfert, Jessica "Transformational Outsourcing: Helping Companies Adapt to a Volatile Future. An IDC White Paper Sponsored by Cap Gemini Ernst & Young", 1 November 2002

more advanced developing nations and is a significant attraction to those considering outsourcing in certain locations. Many nations, particularly in Asia, are awash with qualified recent university graduates who speak English. In most instances, these individuals are extremely well educated and come at a very low cost compared to their U.S. or European peers. India, for example produces 2 million English speaking college graduates per year. These individuals are willing to work in call centers and processing facilities, occupations that may not be viewed as attractive to many U.S. or European college graduates. The comparative cost of this human capital is extremely low. For instance, GreenPoint Mortage outsources in loan servicing function to Progeon in India using staff that would make 10x more if they were located in the U.S. despite the fact that the individuals working in these jobs would most likely not be college graduates.

In some countries, excess availability is so large that many companies are overwhelmed by applicants for outsourced operations. For instance, Spectramind in India hires 200 to 300 new employees each month – from over 2,800 applicants. Other countries, such as the Philippines have a glut of individuals with specialized skills, such as finance or accounting[13]. All attractive outsourcing destinations have one thing in common – skilled labor at low costs compared to their U.S. counterparts.

[13] Kulkarni, Sangeeta "The BPO Question: To Specialize or Not" The Times of India Group, 16 October 2002.

### 6.3. Growth of Information Technology

Moore's law indicates that computing capacity doubles every 18 months, while related costs decrease by 50% in the same amount of time. The continuing technological advancement in software and telecommunications have allowed companies to outsource entire business processes, or significant components thereof, and continues to provide new opportunities for outsourcing. Imaging of documents, reductions in cost of networking and more reliable data processing have resulted in rapid growth of the industry in many outsourcing destinations. BPO in India, driven by call centers, credit card processing and collections, has grown by 50% each of the last three years. This growth can be attributed to a substantial reduction in costs of telecommunications infrastructure and improved reliability. Additionally, increasing use of the internet for data transfer has significantly reduced costs of transaction processing. This has been well timed for the Indian outsourcing industry as many IT providers have seen significant slowdowns in development since early 2001[14]. Instead of the infrastructure built during the 1990s being underutilized, it has been leveraged to handle BPO processes – with significant returns.

### 6.4. Review of Core Competencies / Critical Business Processes

Another factor driving growth in outsourcing is the recognition that outsourcing can provide strategic, as well as cost advantages. It is only fair to

[14] Merchant, Khozem "Call Centres in India: Fresh Initiatives Win Clients in the Business Process Outsourcing Market", Financial Times, 20 September 2002, pg V.

note that this has come to light as many companies reevaluate outsourcing relationships that did not deliver the expected cost advantages. In the past, many companies have hesitated to outsource functions because of their perceived importance to the organization. There has been a realization that very few functions are truly strategic or core to an organization and are necessary for its survival. Core competencies are now understood to be functions that not only are performed satisfactorily or according to some measure of efficiency but are tasks that deliver value in terms of financial results and are the basis of a firm's competitive advantage. In fact, it has been published that "60 percent to 90 percent of [companies'] in-house activities are services that are neither being performed at best-in-world levels nor contribute significantly to competitive edge". Once an organization can overcome this mental hurdle concerning core processes, more functions will be viewed as appropriate for outsourcing. As customers continue to seek cost cutting measures in these difficult economic times, their consultants, and outsourcing vendors will provide the influence and information to overcome these hurdles. As that occurs, outsourcing vendors that can deliver solutions for more critical processes such as accounting, finance, human resources and call center operations to the back-office processing of investment management businesses will continue to flourish. It is clear that this trend is already beginning to take hold. A recent survey by Gartner of small to medium sized businesses indicates that 45% of companies are planning to outsource a business process function in the next 12 months, compared to 22% who are outsourcing now[15].

Finally, many organizations have realized that outsourcing can be viewed as a means to a strategic end. For instance, Bank of New York's recently announced relationship with ING in Europe is an opportunity for BNY to strengthen its presence in global custody across all of Europe while providing both organizations access to each other's customer base in order to enhance cross-selling opportunities. This strategy is expected to enhance both organizations' service offerings though the cost advantages alone may not be significant.

### 6.5. Diversity of Processing / Disaster Recovery Issues

Business continuity and disaster recovery planning have recently become important to (and potentially a driver of) the BPO discussion. The scale of the disaster following the attacks on the World Trade Center in New York, and the threat they posed to the financial markets because of its impact on organizations like the Depository Trust Company, Bank of New York and JP Morgan Chase has forced U.S. regulators to press for more well-thought out disaster recovery and geographic diversity plans that take into account the possibility of a regional disaster (as opposed to a fire in one building). While this trend could provide a lift to outsourcing vendors, it does bring attention to

[15] Fisher, Andrew "Executives Rethink Their Attitudes", Financial Times, 20 September 2002, pg. VI.

the risks associated with certain locations: India, Indonesia, etc., which are discussed in the next section.

## 7. Analysis of Potential Outsourcing Locations

Like much in business, outsourcing is about location, location, location. Although India has a clear edge as the current outsourcing destination of choice (primarily due to its first mover advantage in IT outsourcing), many other developing nations are beginning to demonstrate that they have an environment ripe to challenge India's dominance. Among the locations vying for outsourcing opportunities are:

- China
- Philippines
- Jamaica
- Ireland
- Malaysia

Of the above, only China, and to some extent the Philippines, can pose a threat to Indian dominance in the offshore BPO market. For example, in preparation for the 2008 Olympics in Beijing, China has been aggressively training its populace in English. Indian ITES vendors will need to contend with the Chinese competitive threat, along with a continued but less severe threat from Ireland and Philippines[16].

[16] "India Gains Ground Over Rivals In ITES", The Financial Express, July 22, 2002.

Several key indicators are relevant for a potential outsourcer in deciding which location is most suitable, including the extent of availability of advanced IT infrastructure, availability of educated human capital and experience with supporting offshore BPO and the overall economic stability of the country and region.

### 7.1. Availability of Telecommunications

Deregulation and advancement of the telecommunications system in India played a significant role in the country's ability to compete during the IT outsourcing boom. While deregulation, and quality improvements continue, other outsourcing destinations are beginning to make up some ground. In the Philippines for instance, the cost of a T-1 line between the U.S. and Manila has declined nearly 70%[17] and deregulation of the telecommunications system has resulted in service that is considered by many as more reliable than India's. Jamaica has also begun liberalizing its telecommunications industry in an attempt to draw call center operations – though costs still are above that of India's. China scores highly when it comes to providing bandwidth and connectivity in the major centers, but deregulation and privatization in nearly all countries will mean that this will not be a major sustainable competitive strength for any country.

[17] "In a Global Economy, Competition Among BPO Rivals Heats Up", Wharton Business School, University of Pennsylvania, September 2002.

## 7.2. Availability of Inexpensive Skilled Labor

India's production of 2 million university graduates annually is unrivaled in the developing world. However, this advantage is also eroding – at least somewhat. According to the Contact Center Association of the Philippines, the country has 29 million skilled personnel and 325,000 college graduates per year. Other developing nations also continue to improve educational systems and produce more university graduates than they can employ.

Several factors will impact the perception of the quality of the workforce in developing nations. Literacy rates are a key indicator of the progress developing nations are making towards advancing the education of their labor force. Despite its significant edge in annual college graduates, India continues to lag behind other outsourcing destinations with a literacy rate (for men and women ages 15-24) of 74% compared to the Philippines at 98.8%, China at 98.2%, Malaysia at 97.9%, Jamaica at 94.5% and 77% in Ireland[18].

Another indicator where India may be considered to be behind the curve is the number of its population who have used the internet (a proxy for technological acumen?). With only 0.68 people per hundred, compared to 23.31 people per hundred in Ireland and nearly 24 people per hundred in Malaysia, the use of

[18] UNESCO survey, 2002, milleniumindicators.un.org

technology in India is not as pervasive as in some other developing nations – despite the affects of the IT boom in the 1990s[19].

The mere size of India's labor force and the resulting expectation of continued excess capacity makes the human capital issue a sustainable competitive advantage, at least in the absence of increased immigration out of the country.

### 7.3. Electricity

OBPO firms entering India should also consider the fact that India has a hard time providing adequate, reliable electricity at competitive rates. India's existing installed capacity is not adequate to meet India's growing requirements. Because many Indian states are frequently faced with an acute shortage of power, they often resort to power outages to regulate the supply of electricity. Much of the burden of rationing shortages and poor quality of power has fallen on the industrial sector. As such, prospective OBPO vendors need to include the costs of provision uninterrupted power supply as they consider outsourcing in India[20].

### 7.4. Experience

There is no doubt that experience with outsourcing is one of India's primary competitive advantages compared to some of its rival nations. In the call center arena for example, Jamaica has 3,000 people employed at call centers

[19] UNESCO survey, 2001, milleniumindicators.un.org
[20] "Indian Electricity Industry", BSES Limited, May 2001

compared to India's 15,000[21] in 2000-01 (33,000 in 2001-02). India's advantage is further demonstrated by the infrastructure focused on outsourcing – such as Nasscom, the industry group and the level of support provided by the Indian government. Nasscom's existence by itself is a significant advantage as it provides potential outsourcers with a one-stop shop for learning about India's capabilities, the economic and political environment and providing contact information to get a company started in the process. Our research revealed that none of India's chief rivals had anything on par with Nasscom, if at all.

### 7.5. Advantage India

India continues to retain several key advantages - the presence of Blue Chips such as GE and American Express only help the situation. The publicity around the Kashmir situation has not helped the perception of India's stability, but with significant Muslim populations throughout Asia, the terrorism risk is no more than most of the other destinations discussed. Ultimately, India retains a significant advantage in available supply with the world's second largest population. For the very same reason, its biggest rival yet may be China, where the government is moving aggressively towards setting the stage for competing with India in the export of services. China however, is focused on IT related outsourcing and has not focused on the push to attract a significant amount of BPO.

[21] http://www.nasscom.org/artdisplay.asp?art_id=236

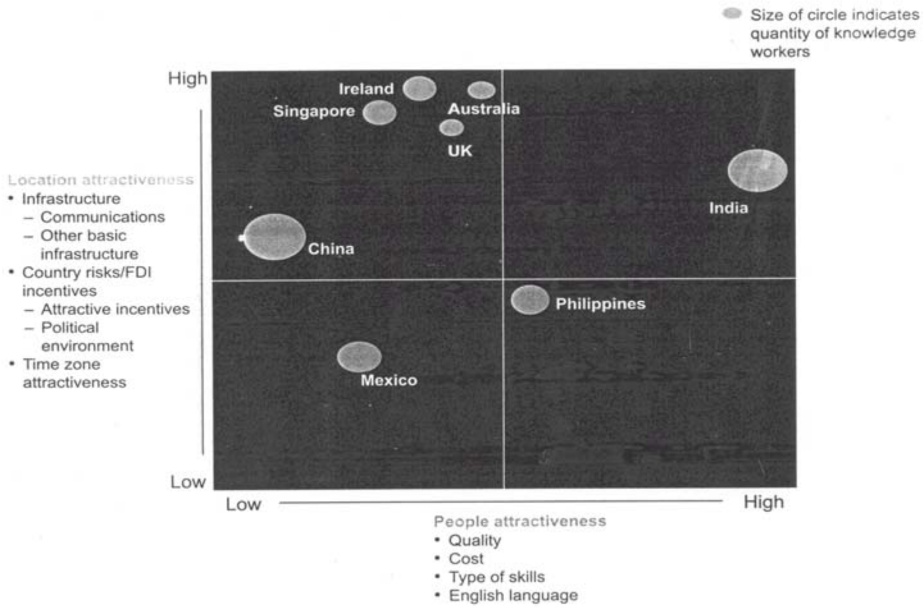
In the ultimate analysis, India offers two unmatched advantages:

- the cost advantage offered by a skilled English speaking resource pool large enough in numbers to allow rapid scalability, and
- continuous improvements in business environment, including infrastructure, regulatory environment and the political landscape.

The head start that many Indian companies have from their existing client base helps them in selling to even more US/Europe based clients who wish to minimize risk, further entrenching the market position of the Indian vendors.

The above reasoning is further brought out by the graph below[22] that rates countries' attractiveness along two dimensions – people and location attractiveness. People attractiveness relates to the size, quality, cost, and English-language capabilities of the people, while location attractiveness considers infrastructure readiness (i.e. telecom bandwidth and power availability), political environment and government incentives.

[22] Nasscom-McKinsey Report 2002




## 8. The state of competition in the global BPO market

### 8.1. Categories of global ITES providers

Based upon their historical background and service offerings, there are four major categories of ITES providers globally[23]:

- **In-house/captive centers:**

  These include shared service centers of organizations that perform consolidated processing for multiple divisions/business units. Examples of in-house or captive centers include Dell's service center in Glasgow and American Airlines' European reservation center in Dublin.

[23] Nasscom-McKinsey Report 2002

- **Spin-offs:**

  These are made up of the erstwhile processing divisions of organizations which have been spun off as independent entities and now provide services to third parties. Examples include Convergys (spun off from Cincinnati Bell), eFunds (spun off from Deluxe, a US based check printer), First Data (spun off from Amex) and Sabre (spun off from American Airlines).

- **Focused BPO providers:**

  This segment consists of third-party vendors for whom business process offshoring is the only line of business, examples include the ones cited earlier, i.e. ADP, Exult etc.

- **Broad-based services providers:**

  These include third-party vendors for whom BPO is one of the many service offerings (e.g. consulting, IT services etc).

## 8.2. Key players

Similarly, when we look at the larger focused BPO companies in the US, we find significant revenue generation in their areas of focus. Some of the big players in the US BPO market are listed below[24]:

[24] Nasscom-McKinsey Report 2002, citing Hoovers and company web sites

| BPO provider | Year founded | BPO revenues (2000, $ bn) | Services |
|---|---|---|---|
| ADP | 1949 | 7.0 | HR |
| Ceridian | 1957 | 1.2 | HR |
| Paychex | 1971 | 0.9 | HR |
| Teletech | 1982 | 0.9 | Contact center |
| Sitel | 1985 | 0.8 | Contact center |

In addition to the focused players above, consulting firms, the big-5, and IT providers are all breaking into the BPO market. These players include PricewaterHouseCoopers, Accenture, EDS, ACS and others.

## 9. Emergence of the Indian OBPO industry

With this global perspective, we move on to look at the current state of the Indian OBPO/ITES industry, the key players, the services offered, the customers, untapped market niches and strategies for the future.

Riding on a significant cost advantage, the Indian offshore business process outsourcing industry has shown tremendous growth over the past few years. However, as a proportion of the global opportunity, the size of the Indian industry remains insignificant. The total revenues of the Indian ITES sector which were

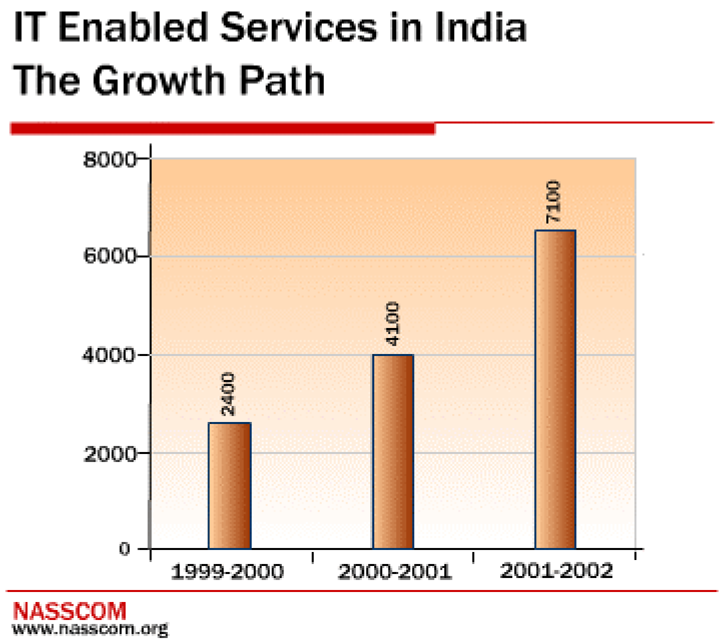
USD 522 million[25] in the year 2000 rose to USD 1479 million[26] in 2002, while in the same year the number of ITES providers registered as such with Nasscom was in the many hundreds. However, with forecast growth rates for the next many years in excess of 60% per annum, the industry is all set to grow offering great value creation opportunities to firms that can participate in this growth. The Indian government has set an aspirational target of reaching $17 bn in revenues from ITES/OBPO by the year 2008.

Call centres, also called contact centers or customer service centres, are the most visible face of the ITES boom. There are currently about 350 contact (customer service) centers in India. At this time, the sector employs around 100,000 personnel. The growth in ITES has been supported by the Indian government, financed by an influx of venture capital funding, and lauded in the media. American companies are the major client group for the ITES vendors.

### 9.1. The growth path for the Indian ITES sector

The graph below[27] reflects the growth in the Indian BPO sector:

[25] KPMG report citing Nasscom
[26] Source: Nasscom website
[27] ibid




**All figures in Rs. Crores (Rs. 1 crore = Rs. 10 million ≈ US$ 208k)**

## 9.2. Change in composition of India's export earnings from services

The massive growth in ITES, albeit from a small base, has allowed it to capture a greater proportion of India's net earnings from hitech services exports in recent years. The table below[28] shows the increasing proportion of ITES earnings as both IT services and IT enabled services grow at a blazing pace, with ITES growing even faster.

[28] ibid

**Increasing Contribution by IT Enabled Services in Total Exports**

| | IT Enabled Services | IT Services |
|---|---|---|
| 1999-2000 | 14% | 86% |
| 2000-2001 | 14.5% | 85.5% |
| 2001-2002 | 19% | 81% |
| 2002-2003 | 24% | 76% |

NASSCOM
www.nasscom.org

Table 2.2 Source:NASSCOM

## 10. Factors fuelling the growth of Indian ITES

Process outsourcing to the lowest cost provider is emerging not merely as a cost saving technique, but as a best practice that must be adopted as a strategic necessity for mere survival. Economic and capital market pressures are forcing organizations to focus on core activities and outsource as much of the non-core processes as possible. The location of India lends itself to servicing America's time zones, thus making round-the-clock customer care possible. In addition, India boasts a large pool of motivated, well-trained potential employees who speak English and take their customer care responsibilities seriously. Next, the professional services class in India has been accustomed to exporting IT services for years; this familiarity led to the development of IT development centers in the country such that it was not a large leap to transition into the ITES market. In kind, several large international firms such as GE, American Express, and others had already made significant investments in India for IT-related services and are experienced in doing business in that country. The main appeal, however, has to be the significant cost efficiency of the Indian work force. The monthly cost of a American call center employee is roughly equal to the annual salary of a comparable Indian employee providing the same services.

A little earlier, we have considered the key drivers for increasing global BPO activity, an increasingly important part of which will be offshore BPO. The following factors will fuel the growth of the Indian ITES market:

### 10.1. Economic downturn

The current economic downturn is forcing companies to consider offshoring activities when this would not have been an option in the good times. Offshoring allows firms to convert their fixed costs into variable costs, a key advantage.

### 10.2. Talent acquisition

Companies in the west are finding it increasingly difficult to staff routine operations such as call centers with adequately qualified people who will consider their jobs to be a career. Offshoring helps attract qualified talent in niche areas.

### 10.3. Technical viability

Offshoring to India was practically impossible just a few years ago with telecommunications and networks often posing insurmountable challenges. This has completely turned around in the past 2 years.

### 10.4. Emergence of new a breed of vendors

Vendors with proven process capabilities and the ability to integrate IT outsourcing with BPO contracts will further enhance the ITES market.

## 11. Customer groups for Indian ITES vendors – domestic and foreign

While customers can be segmented by industry, geography or services provided, the most significant customer classes for the Indian vendor would be domestic customers and foreign customers.

Currently, most Indian vendors are targeting foreign customers due to higher ‘per seat’ or per hour charge-out rate and consequently higher profitability, and practically that is the only customer group getting any attention from the major ITES players.

The domestic demand is practically non-existent due to a variety of factors, one of which is the ‘do-it-yourself’ approach of large Indian industrial groups who consider themselves to be in a position to derive the same cost efficiencies that a local external vendor can offer. In fact, many large Indian groups have launched their own ITES shops and are scouting for foreign business.

Even though the Indian economy is large in absolute terms, and on a PPP measurement basis is the fourth largest economy in the world ($14^{th}$ largest in nominal dollars)[29] and growing at approximately 6% annually, structural problems in the product markets, excessive fragmentation, limited competition and erosion of manufacturing competitiveness make the domestic market unlikely to be a significant source of business for Indian ITES vendors in the near term.

## 12. Customer choices when offshoring

Before we present the options a corporation considering outsourcing to India might pick from, it is useful to understand the factors intrinsic to the customer that ultimately determine the model chosen.

### 12.1. What determines customer choice?

A customer's choice of the offshoring model is a function of two parameters:

#### 12.1.1. Cross-border operations sophistication

This defines the level of comfort within the organization to outlocating business process to India. Companies that have had business operations in India, or have in the past managed IT services relationships in India, or were otherwise exposed to

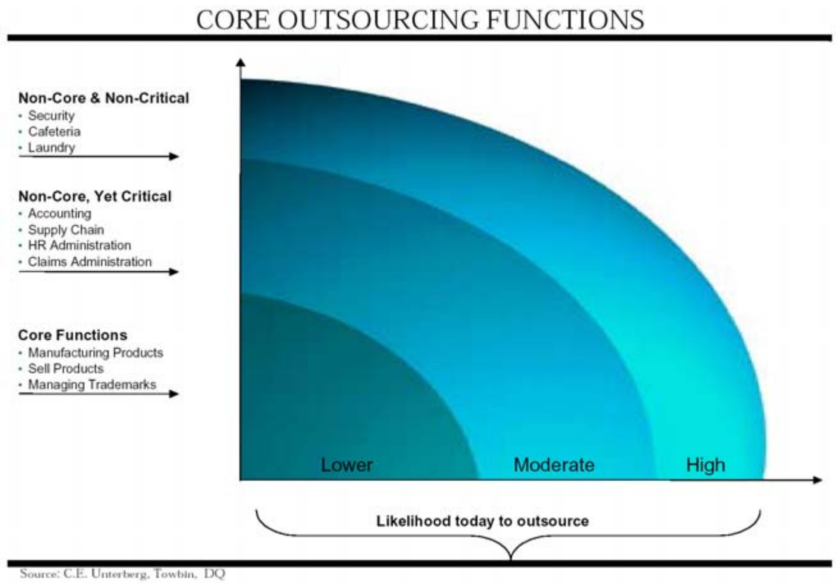
[29] Source: EIU

buying services from Indian firms (for example, contract jobs as part of their Y2K exercise), or have successful senior executives of Indian descent are more likely to outsource than those who do not enjoy such exposure.

#### 12.1.2. Feasibility of outsourcing the process

This is a function of the criticality of the process, and availability of credible vendors for the same. Not every process can be, or should be outsourced. Many researchers have drawn the distinction between core and non-core processes to highlight and identify processes that are capable of being outsourced. The diagram below[30] shows exactly the same reasoning that allows a process to be assessed in terms of its criticality to business operations and the feasibility of its being outsourced.

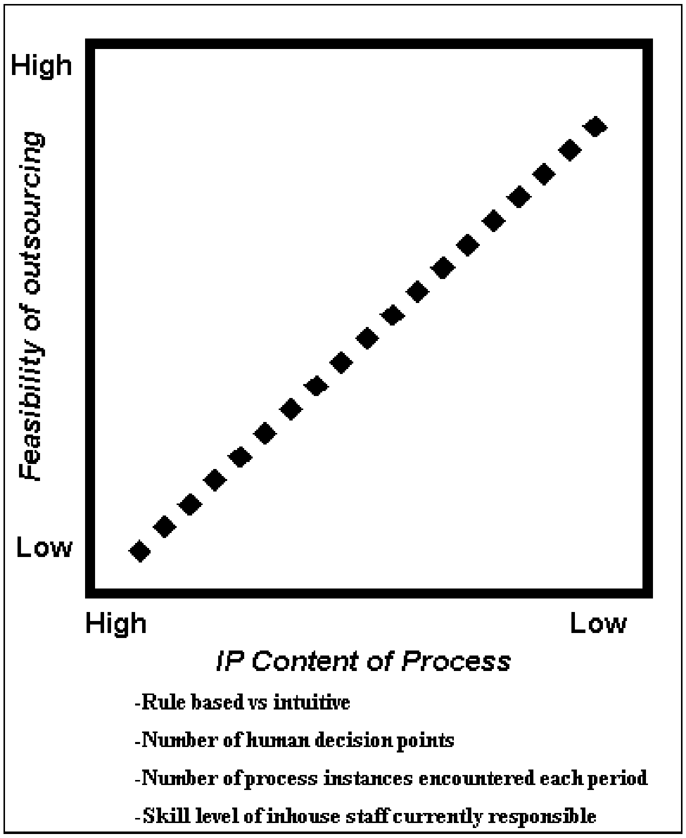
[30] C. E. Unterberg, Towbin Industry Report on Business Process Outsourcing




## 12.2. Alternative view of determining feasibility of processes amenable to outsourcing

We believe that an alternative view of processes that considers their intellectual and human capital content can provide a better guide as to the feasibility of outsourcing a process.

Repeatable, rule based processes containing process logic that can be embedded in flow charts, workflow analysis or in computer programs are the most amenable for outsourcing, irrespective of their criticality to an organization. No one can argue that claim processing is not critical to an insurance company, however, that is a process which is often the first to be outsourced. Processes that require human judgment and dealing with ambiguity, and those that require an input of organizational and cultural issues and need to be influenced by management thinking will be the least feasible to outsource. If outcomes can be defined clearly, in some cases even product development can be outsourced.



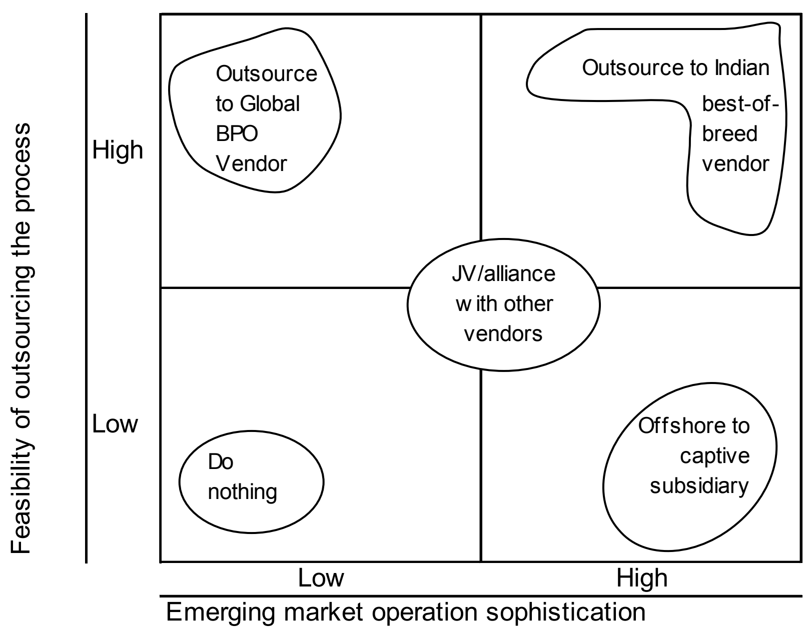

## 12.3. Choices available to customers

Having considered upon where a process falls along each of these dimensions (i.e. exposure to India and feasibility to outsource), a different approach is likely to be adopted.

Basically, the following options are available to customers who are looking to outsource a process:

1. Do nothing – keep the process as it is,
2. Outsource to Global BPO major – such as EDS, Accenture. This approach does not necessarily involve India or any other low-cost location.
3. Form captive subsidiary in India,
4. Enter into JV with other vendors or customers,
5. Outsource to Indian best-of-breed vendor.

The option likely to be adopted depending upon the feasibility of outsourcing and emerging market sophistication can be plotted on a two-dimensional grid as follows[31]:




[31] Adapted from Nasscom-McKinsey report

The choice of model by the customer is likely to be dynamic as customers gain experience in offshoring processes and become increasingly skilled at running operations in a remote location. Several examples of changing offshoring approaches have already been witnessed in India. For example, Convergys started with outsourcing simple call center services to a third party vendor (24x7) but rapidly built its own center to handle the whole range of its service offerings. Today, a very small segment of its services are sourced from that vendor while its own center employs over 600 people and has ambitious growth plans.

## 13. Business models for the Indian OBPO/ITES markets

Options available to customers are likely to significantly influence the business models that Indian OBPO/ITES vendors can follow. When faced with a business process situation that can be advantageously outsourced to India, customers in the west do not automatically think of India. Most current outsourcing to India is coming from global majors that have experience and sophistication of operating in the Asia Pacific region, or have pre-existing hubs in India, or have been exposed to high quality and dependable service in one of their IT outsourcing deals.

On the basis of the above, in the long term Indian ITES vendors will need to concentrate on one of the following four business models:

### 13.1. Service factory

Here, the vendor is the back-end offshore processing arm/third-party provider for a global BPO major.

### 13.2. Process expert

Player specializes in a process (e.g. payroll, general accounting) which may or may not be specific to a vertical and offers services directly to customers.

### 13.3. Service line aggregators

Player specializes in a group of related processes (e.g. payroll and benefits) and offers services directly to customers.

### 13.4. Bundled services provider:

Vendor offers combined IT outsourcing, consulting and BPO services to customers.

In the long term, two parameters will differentiate the business models of successful ITES players: first, the level of intellectual property – a reflection of the part of the value chain a player operates in; and, second, the number of processes in which the player specializes.

The capabilities required to operate each of the four possible models vary widely and so do the key success factors. For example, the bundled service provider model requires an extensive understanding of business processes as well as of IT services. The key success factors for evolving to this model include the capability to manage people with diverse sets of skills, a command over the business process and the underlying IT infrastructure. The existence of a strong and credible brand is yet another key success factor common to most of the above models. On the other hand, the service factory model involves handling only back-end operations while customer relationships are managed by a global BPO vendor. The key success factors for building a service factory are strategic relationships/contracts with major BPO vendors, state of the art facilities, qualified manpower and excellent delivery mechanisms.

Each of the above models is viable on a stand-alone basis and there is likely to be enough business (and competition) at each of the points in the value chain that these models represent. Each model however requires a different organizational structure, a different talent pool and different front-end and account management skills. Each player will need to assess their competence and position themselves accordingly.

**The current state of play:**

As of today, the sharp differentiation suggested by the above classification of business models is only starting to emerge. Most current vendors look alike, with an opportunistic business model where they are likely to accept any business that they can capture. Over a period of time, greater polarization will occur and the above models will be better visible as the Indian offshoring industry matures and reaches some stability.

## 14. The marketplace: rankings of current ITES vendors (by revenue)

Call center and BPO services provide traditional back office services such as voice (call centers, inbound and outbound etc), process outsourcing (accounting services, claims management etc) and email (e.g. technical support)

### 14.1. Top 10 Indian third-party ITES companies (Call centers and BPO) [32]:

1. EXL Services.com(I) Pvt Ltd
2. Daksh eServices Pvt Ltd
3. GTL Ltd
4. Spectramind (now acquired by Wipro)
5. Datamatics Technologies Ltd
6. Tracmail India Pvt Ltd
7. Brigade Corporation
8. Epicentre Technologies Pvt. Ltd
9. Firstring
10. 24/7 Customer.com

[32] Nasscom

### 14.2. GIS, Multimedia, Engineering and Design

GIS (Geographic Information Systems) companies (e.g. RMSI) provide 'spatial solutions', for example remote sensing (e.g. satellite image interpretation), image processing (e.g. processing high-resolution imagery into quality raster data products, including removal of distortions in the images - geo-rectification, ortho-rectification - and ensuring that the output is of high quality in terms of clarity, resolution, and color). Multimedia companies provide animation, motion picture and graphics services. Engineering and design companies specialize in computer aided design and manufacturing services (CAD/CAM).

Top 5 ITES companies in the GIS, multimedia, engineering and design category:

1. Pentamedia Graphics
2. Rolta India
3. Infotech Enterprises
4. Geometric Software
5. RMSI

## 15. Vendor differentiation

According to Mr. Rohit Kapoor of EXL Services, currently there is little differentiation between various Indian ITES vendors. This was confirmed by visits to the websites of various vendors, and we found that nearly all of them promise to do anything and everything. Service descriptions and product offerings often tend to be sweeping in scope and most vendors are targeting similar business.

According to Mr. Arijit Sengupta of Daksh, the same group of 7-8 top vendors end up competing for nearly all jobs.

For example, EXL Services' offerings straddles all three main offshore BPO categories – email, call centers and back office processing. In Mr. Kapoor's view, specialization and vendor differentiation will start to emerge over the next 3 to 5 years as companies mature and their capabilities get more defined according to the industries or processes served.

This is bound to happen as so far only the 'quick wins' have been targeted by both customers and vendors, and the largest third party vendor activity has been in call centers, followed by back office related work. As other practice areas, such as HR, benefits administration etc start gaining traction, differentiation will start to emerge.

## 16. Major service areas[33] for Indian ITES vendors

Significant opportunities exist in several ITES areas in the medium term. According to a joint Nasscom-McKinsey study, capturing a very small portion of

[33] Nasscom-McKinsey Report 2002

the total market should allow Indian third party vendors to achieve significant growth rates in the coming years. The table below[34] shows estimates of the total worldwide market for some illustrative processes, and the opportunity that exists for Indian vendors to capture.

| ***Process*** | ***Worldwide addressable market (2005, $ bn)*** | ***Opportunity for India (2005, $ bn)*** |
|---|---|---|
| Credit/Debit card services | 45-50 | 1.6-1.7 |
| Inbound call centers | 70-75 | 1.4-1.5 |
| Engineering and design services | 65-70 | 1.4-1.5 |
| Benefits administration | 25-30 | 1.0-1.1 |
| Telesales/telemarketing | 20-25 | 1.0-1.1 |
| Web sales and marketing | 30-35 | 0.7-0.8 |
| Payroll services | 30-35 | 0.6-0.7 |
| Database marketing/customer analysis | 15-20 | 0.3-0.4 |
| Claims processing | 10-15 | 0.3-0.4 |
| Billing services | 15-20 | 0.3-0.4 |

Different studies have classified processes in different ways and provided different total market size estimates. However, the fact that Indian vendors currently have a very small share of the total addressable market implies that very high growth rates are sustainable over the next many years.

[34] ibid

Each vendor has a different take on what processes can be outsourced, and the ones that they offer as a core offering. We spoke to Mr. Rohit Kapoor, the President and CFO of EXL Services, the largest Indian offshore BPO firm and obtained the following information on the various processes that EXL specializes in and a breakdown of each activity. This is reproduced below. The value of this list lies in the understanding it provides on the real business operations of an offshore vendors.

**Examples of tasks carried out for Life Insurance clients**

- Agency Administration
    - Licensing and contracting
    - Correspondence
    - Renewals
    - Return mail and address change
    - Terminations
    - Commissions
    - Debt Management
    - Special compensation
    - Abandoned properties
- New Business
    - Pre-screening and input
    - Underwriting support
    - Policy issue
- In-force business – Servicing
    - Policy changes
    - Reinstatements and quotas
    - Policy benefits

    - Premium administration
    - Worksite billing
- Business termination
    - Claims processing
    - 1035 exchanges
    - Surrenders
- Balance Sheet management
    - Agency suspense accounts
    - Premium suspense accounts
    - Day end cycle balancing
    - Suspended policy cleanup
- Agency administration
    - Contracting
    - Address change
    - Debt management
- New business
    - Fixed annuities
    - Variable annuities

**Examples of tasks carried out as part of voice based customer support**

- Inbound customer service call center

  Customer queries with regard to existing and new insurance policies such as:

    - Change of beneficiary
    - Claims on current policy
    - Information on face amounts on current policies
    - Status of claims
    - Preferred doctor networks
- New business call center

    - Existing licenses
    - Contracts
    - Outstanding commissions
- Sales support call center
    - Agent queries with regard to current and impending sales for new clients
- Retirement processing call center
    - Change of beneficiary
    - Claims on current policy
    - Information face amounts

**Examples of accounting processes carried out**

- Premium accounting: Reconciliation of premiums that have been received in the past and are to be applied to the appropriate accounts.
- Pre-authorized checks: The process involves placing the insured on automatic billing and drafting in addition to updating the accounting in case of return check or draft. This process also involves maintenance of the policy (change in the premium account, draft date, address change and mode change) and covers all the systems.
- Lockbox processing: This process involves application of the moneys received in the Lockbox Bank Account which the bank is unable to apply and has to be applied manually by the processor to the respective policies towards premiums or loan as the case may be.
- Cycle balancing: The process involves balancing the cycle for all the premium administration functions namely direct, lockbox and worksite on a daily basis. The process generates reports and incorporates data from the GL sheets created by the lockbox, direct and worksite processor before balancing the two.

As is clear from the above, processes that represent opportunities can be identified only if the vendor has a detailed understanding of the industry. What is critical is this in-depth understanding, and classifications and groupings only have academic significance.

According to Nasscom, the opportunities for India are mainly in the following areas:

| *Opportunities* | *CAGR 1998-2008* |
|---|---|
| Customer Interaction Services | 18 |
| Finance & Accounting Services | 26 |
| Translation, Transcription & Localization | 4 |
| Engineering & Design | 21 |
| HR Services | 29 |
| Data Search , Integration & Management | 71 |
| Remote Education | - |
| Network consulting & Management | - |
| Website Services | - |
| Market Research | - |
| **Total** | **30** |

## 17. Current state of services provided

Apart from telesales, telemarketing, inbound call centers and data entry/translation/transcription services, activity in other service areas is too insignificant to count. A large opportunity exists in Human Resources process management, but this is yet to take off. Some vendors are building capabilities in this arena. Similarly, some vendors are currently (Q3-2002) conducting pilots for outsourcing payment services for the financial services sector, but real business is so far negligible. Engineering and design, another potential major revenue earner, is in its infancy with some players offering spatial solutions (GPS and mapping data management for navigational systems, animation etc).

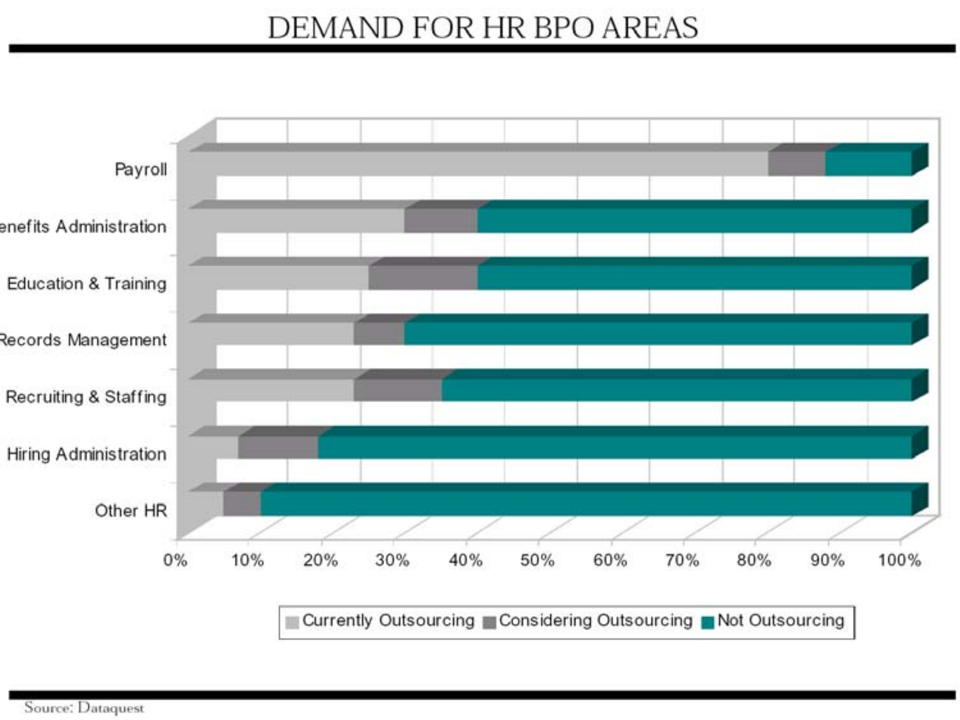
The following chart shows the employment and revenue in different market segments[35]

| IT Enabled Services : Market Segmentation | | | | | | | |
|---|---|---|---|---|---|---|---|
| | 1999-2000 | | 2000-2001 | | 2001-2002 | | |
| (Rs. Crore)[36] | Employment | Revenues | Employment | Revenues | Employment | Revenues | Growth Rate (%) |
| Customer interaction services including call centers | 8,600 | 400 | 16,000 | 850 | 33,000 | 1,790 | 94 |
| Back office operations/Revenue Accounting/Data Entry/Data Conversion incl. Finance and Accounting/HR Services | 15,000 | 950 | 19,000 | 1,350 | 35,000 | 2,850 | 111 |
| Transcription/Translation services | 5,000 | 120 | 6,000 | 160 | 6,200 | 150 | (6) |
| Content Development/Animation/Engineering and Design/GIS | 15,000 | 820 | 27,000 | 1,600 | 30,000 | 2,100 | 31 |
| Other services including Remote education, Data Search, Market Research, Network Consultancy and management | 1,400 | 110 | 2,000 | 140 | 3,000 | 210 | 50 |
| TOTAL | 45,000 | 2,400 | 70,000 | 4,100 | 107,200 | 7,100 | 70 |

[35] Nasscom
[36] 1 Crore = 10 million, Rs 1 Crore ~ $ 209,000 at current exchange rates.

**About opportunities in Human Resources[37]:**

Although HR is not the largest overall area within BPO, it has one of the oldest and best known service segments: payroll. Payroll outsourcing (i.e., check distribution, payroll processing and administration, etc.) is a transaction-intensive function that bridges HR and finance, and has become widely associated with such vendors as ADP and Paychex. Payroll services accounted for roughly 40%, or $10 billion, of a $26 billion HR BPO market in 1999. Payroll services are expected to continue rising at over 21% per annum over the next few years.




[37] Adapted from the CE Unterberg Towbin report

## 18. Dealing with growth

Given the astronomical growth forecasts for ITES, it is a pertinent question if adequate capacity exists to deal with the growing business. The answer to this is an emphatic yes, in fact in Q3-2000 we witness overcapacity with companies of all shades and stripes wanting to gain their share of the pie.

A visit to Nasscom's website reveals 300+ companies in their list of ITES service providers, not all of whom have enough business to utilize their current capacity. In fact, many of them are merely players only in name as they have no clients whatsoever. According to a recent press article quoting Gartner, "…BPO might be headed for another dotcom type bubble burst…. If we are not careful in terms of expectations, very soon, we could be witnessing another dotcom like scenario with investments not matching returns, according to Gartner India country director Sujay Chohan."[38]

According to Mr. Rohit Kapoor, President and CFO EXL Services, ramping up capacity in response to a large client order is no big issue in India. It is possible to hire 3000 graduates in less than a month without compromising on the quality of the intake. He also felt that excess capacity was an issue only for the smaller shops and that the current customer pipeline for EXL was bigger than what they could handle. The biggest risk that larger players like EXL needed to guard against was over committing and failing in execution.

[38] The Times of India, September 6, 2002

## 19. Characteristics of a good offshore BPO vendor – client perspective

Prospective clients looking to offshore a business process should look for largely the same characteristics that they would shop for if evaluating a domestic company. The key factors to consider would be:

### 19.1. Standardization

Over a period of time, as in the case of current onshore BPO providers, offshore BPO vendors with more standardized offerings will be able to achieve greater repeatability across multiple customers and drive toward profitability more quickly. For larger BPO vendors, highly standardized offerings will enable improved profitability through greater scale. However, standardized offerings often are best suited to smaller customers since many large customers still require significant levels of customization.

Currently, nearly all offshore BPO deals focus on customized solutions. Standardization is better for the vendor, customization is more desired by the customer. However, over a period of time as the industry matures, vendors that strike the appropriate balance will enhance profits, while still delivering measurable value to customers.

### 19.2. Centralized processing

Technology has made offshore BPO possible, and will continue to play an increasing role in driving growth. Drawing upon the experience of successful US based outsourcing vendors, BPO services that are heavily dependent on technology processing and less labor intensive should have models largely based on centralized processing centers. This delivery model should enable BPO vendors to create greater scale, lower their costs, improve knowledge-sharing and innovation, and generate greater overall customer value.

### 19.3. Strong balance sheet

Because their services involve owning more than just hardware and software to support a function, but also all of the process labor and related infrastructure, offshore BPO vendors must be prepared to make significant capital investments in infrastructure. Moreover, because the deployment, management and operations of a large outsourcing contract are material costs, we suspect vendors already offering parts of an overall offshore BPO solution will be better positioned to leverage existing infrastructure and more easily capable of delivering efficient services.

### 19.4. Industry knowledge

Ultimately, customers like to work with vendors that can not only solve their functional issues, but also understand their industry and can add value through their industry expertise. Thus, vendors with some element of industry positioning will create better competitive differentiation.

### 19.5. Brand and proven excellence

BPO vendors with an established track record of service-excellence should be more likely to convince potential clients of their technical innovation and value proposition than other BPO vendors. Specifically, BPO vendors that can leverage their brand from other adjacent sectors, such as technology outsourcing or consulting, should have an easier time gaining credibility. At the same time, access to these skills while having a developed BPO offering can be a distinct advantage.

### 19.6. Quality certifications

For the IT industry, the SEI-CMM Level-5 certification, the highest possible process maturity rating, emerged as the gold-standard and soon became a competitive necessity from being a competitive advantage in the early days. The certifications currently used by the BPO vendors are discussed in detail in section 25 later in this paper.

## 20. Key success factors for Indian ITES providers

Nasscom and McKinsey have identified four key success factors for third-party ITES providers. These are:

### 20.1. Customer access

Customer access at the right level is essential for success. Customer access depends upon:

- Relationship with potential customers
- Brand
- Level of trust and credibility
- Reference customer set

Currently, not many Indian vendors have the ‘C-Level’ access (i.e., to the CEO, COO, CIO etc) and they interface with senior managers below the C-Level. This is different from the likes of Accenture, KPMG and other service providers who consistently use such high level customer access to enhance their offerings to their clients. Indian firms will need to continue to work to develop improved front-end skills, including hiring high-fliers who can manage the senior level relationships for them.

### 20.2. Innovation

Innovation is about technology, and the capability of identifying opportunities for the client. Factors affecting this key success factor are:

- Technology
- Service lines served
- Delivery mechanism
- Process transformation capabilities

- Marketing prowess

Indian firms have not so far been lacking in innovation, but they will need to be relentless in their efforts in offering a superior value (both perceived and real) to their clients in order to ward off emerging competition from China and other sources.

### 20.3. Infrastructure scale

As noted earlier in the section outlining the characteristics of a 'good' offshore BPO vendor, a pre-existing and credible infrastructure capability is a must for client acquisition and retention. Covered by this key success factor are:

- Physical assets
- IT skills
- Financial muscle
- Scalability

Most large Indian vendors score well on the above scales, though the same cannot be said for some of the smaller players.

### 20.4. Execution

Successful execution is the ultimate determinant of long term success – this key success factor spans:

- Price to performance ratio
- Domain expertise, which can be horizontal or vertical

- Process transition methodology
- Adherence to SLAs

Strong execution and delivery skills is where Indian IT firms have distinguished themselves and it is unlikely that the BPO firms will be found lacking.

Of the above four, players must be seen to be distinctive in at least one key success factor if they are to be successful. At the same time, while achieving distinction or best of breed capability in at least one, they should also be well developed in all the other levers with performance reaching a minimum average threshold necessary for survival.

## 21. Building a BPO business: prospects for start-ups

The market currently is positioned to strongly favor the incumbents. Nasscom publishes regularly updated and audited rankings of ITES vendors. These rankings are widely published, quoted in the popular media, and are used and quoted by research firms. Consulting firms advising clients on offshoring possibilities use these rankings for their recommendations.

This has provided a strong boost to the credibility of the top Indian ITES vendors and brought visibility to their business and offerings. (In fact, so much so that when we approached Spectramind (gross revenues for year ended March 31, 2002: $10 million) seeking information for this paper, they mentioned they were tired of analysts and researchers approaching them and taking up their time, and that we should base our research on public information already available on their website[39].)

This has had a very positive effect for boosting the business of the top players, and when companies short-list offshore BPO vendors, they tend to approach the top 7-8 vendors with a request-for-proposal or request-for-information, and a final selection is made from this short-list.

On the flip side, this visibility and publicity by Nasscom and others has also inadvertently raised the barriers to entry for new players. It is extremely difficult for any new player to get their first customer. The dynamics of the business are such that a credibility is all important, and that can only come with an established client portfolio. Existing clients have a snowballing effect when it comes to new customer acquisition, and this factor is currently playing out very strongly in the vendor marketspace.

According to EXL Services and Daksh, today it is nearly impossible for a new start up to break in into the market.

### 21.1. Entry strategy for new entrants

Any initial customer for an new vendor is generally taking on a disproportionate burden of performance risk on the vendor's part that cannot

[39] We spoke with Mr. Edward Quintero of Spectramind.

be offset by cut-rate contracts or promises of superior performance. Therefore, in the initial start-up phase any new vendor will have to focus primarily on getting lighthouse anchor customers. To do that, they will need to decide on a broad service offering and develop robust (and defensible) value propositions for target customers.

Needless to say, getting the first customer in the current market environment is a tricky task to say the least, and new entrants should press all levers available to them to get the first customer. There are various things that can be tried to get onto the customers' radar screens:

- **Inorganic growth**: Those with financial muscle can choose to acquire smaller existing customers with an established client portfolio and build upon that.
- **Partnership or JV with an existing BPO company**: This may not be a viable route for all unless the new entrant brings something to the table that is of value to the potential partner.
- **Use current business relationships from unrelated businesses**: This can be a viable approach where the new entrant uses the business relationship and networks of its investors and promoters to acquire a first customer that can help build critical mass.

At the same time, we believe that while incumbents have a very strong position, the market is expanding rapidly and there will always be opportunities to pick up. New entrants must not forget that the current incumbents were also new players not so long ago, and just as each one of them has a different story to tell about how they got their first clients. (Conseco, for example was the owner/promoter of EXL Services, Daksh got Amazon.com from pure sales pitches and a client management in Amazon that was not averse to giving business to startups). Each new player will have to forge its own way and will have a different story to tell after a few years.

### 21.2. Scaling up for established players

Once a vendor has anchor customers in place, the business can be scaled up rapidly with these customers serving as credible reference points. Growth can pursued along the following dimensions:

- Expanding the services on offer
- Expanding the base of customer verticals served
- Expanding into newer geographies, e.g. continental Europe and not just the UK or the US

## 22. Transition methodology in a new offshoring engagement

A key component of success after a client has been acquired is a robust transition methodology. We spoke to Mr. Rohit Kapoor, President and CFO of EXL Services, and Mr. Arijit Sengupta, Manager East Coast for Daksh, and we realized that the importance of the transition methodology is certainly not lost on the vendors. Both companies have established processes, documentation standards, process experts and business analysts who devote an extraordinary amount of time and effort in ensuring that the transition of a business process is as methodically done as is possible.

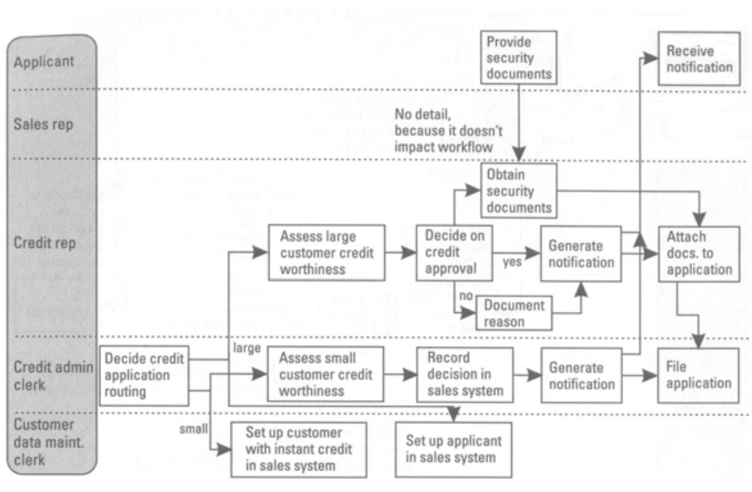
The client has as much of an interest in a successful transition as the vendor. While the vendor with its domain expertise can be expected to lead a transition effort, clients should watch out and monitor all transition activity very diligently. Key elements that any company considering offshoring its process should consider are:

- **Proper documentation:** Adequate and stand-alone documentation is required of not only the 'as-is' process, but also of the 'to-be' process and how the gaps are planned to be addressed.
- **Clear and understandable migration plans:** The sequence of activities that will lead to the ultimate migration together with the project people accountable should be clearly documented.
- **Clarity of performance targets:** Metrics to measure the success of the providers' efforts along different dimensions such as financial (e.g. cost savings) and operational (e.g. error rates) should be clearly agreed upon.
- **Backup/contingency plans:** The contingency plans to roll-back operations if the migration were to be aborted should be in place.

Similarly, systems and infrastructure backup plans should also be prepared ahead of the transition.

- **Clear documentation of the process:** A clear documentation of the process with clarity on process activities and actors should be clearly defined.

The processes should be defined with clear boundaries, identifiable discrete tasks and people who carry out the process. Swimlane diagrams are a useful way to capture a business process. One such swimlane diagram[40] – one that identifies clear responsibilities for each of the process 'actors' – is shown below:



A milestone level diagram for a to-be process.

[40] 'Workflow Modeling' by Alec Sharp and Patrick McDermott, ISBN 1-58053-021-4

## 23. Best Practices while outsourcing processes offshore

### 23.1. Best Practices – Identifying Key Performance Indicators

A recent survey published by Richard Flavell, a Risk Management consultant at Ernst & Young in the U.K., indicates that many outsourcing arrangements fail because the corporation outsourcing the function does not clearly define the measures that would determine its ultimate success[41]. Often, the survey indicates, management and the vendor become overly focused on costs and lose sign of the reasons why outsourcing really delivers value to the organization. Additionally, management often fails to understand the nature of the costs involved in the function, including the associated indirect costs such as overhead, training, recruiting, etc. – resulting in the full costs not being considered[42]. While costs are a key driver of the outsourcing decision (35% of respondents to Flavell's survey indicated that this was the most important consideration), cost structures often change and, in many cases, estimates of costs are not fully understood – creating ambiguity and a lack of comparability in management's and the vendor's estimate of the value delivered. Also, cost may not be the most relevant consideration to determining the appropriateness of outsourcing. A recent survey by the Outsourcing Institute summarized below indicates the growing dominance of non-financial factors (although cost continues to be a significant issue):

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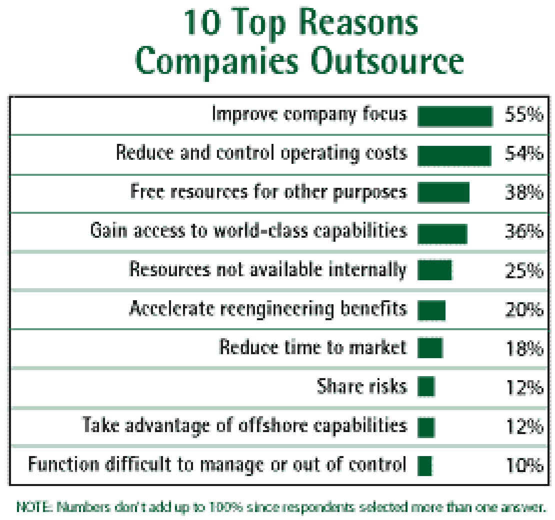
[41] Flavell, Richard, "Pulling in the Same Direction: Can Outsourcing Deliver Value?" Ernst & Young Cross Currents, August 2002.
[42] Stratton, Ronald A. and Langenberg, Peter M. "Outsourcing: A Director's Guide to Minimizing Risks in Finance and Accounting Outsourcing", Director's Monthly, February 2002.




The failure to appropriately identify the rationale for outsourcing and then measuring and compensating the vendor on those factors significantly affects the relationship's perceived success. This phenomena clearly impacts the results published in the Banker in 2001 that more than 50% of outsourcing relationships are considered failures[43]. Flavell's study cited above suggests that organizations should consider measures other than cost such as the impact of the relationship on innovation, quality, its alignment to the firm's strategy and its affect on employee satisfaction, among other things. Additionally, contracts are best negotiated with performance based pricing – keeping the pressure on the supplier to continually improve and deliver quality service. Again, these standards need to be set and agreed upon during the contract stages to ensure the customer's ability to demand compliance.

[43] The Banker, September 2001.

## 23.2. Best Practices – Monitoring Procedures

A critical objective often quoted as the reason for outsourcing a business process is the possibility of reducing the amount of time a senior executive spends on a particular function. Although a quarter of respondents in Flavell's survey indicate that outsourcing increased management time, ongoing monitoring of the relationship, key performance indicators and performance against service level agreements are crucial steps to ensure that a company mitigates its reputational, financial, legal and regulatory risks. Along with key performance measures, these factors also need to be clearly laid out in the outsourcing contract and a well-defined monitoring process should be agreed upon prior to commencing operations. This process should prevent executives from exercising too much control over a particular process – preventing the outsourcing provider from operating effectively. To be most effective, the executive responsible for the outsourced function must begin to act more like a customer than a boss – focusing on user satisfaction and results as opposed to process. An outsourcer should consider carefully the individual responsible for this function and their mandate. In some cases, an executive is hired with the sole focus of identifying, analyzing and monitoring outsourcing opportunities – coined, the Chief Resource Officer by the Outsourcing Institute. American Express for instance, has wrapped these responsibilities into a position titled - Director of Resource Strategy. A study published in Director's Monthly also cites the importance of identifying members of senior management and / or the Board to participate in the monitoring process. In particular, monitoring of outsourcing relationships relating to the accounting and finance functions should include a member of the Audit Committee.

An effective monitoring process does not require a significant degree of creativity, intelligence or technological advancement. Instead, communication seems to be the clear route to success. In one outsourcing relationship between a large diversified financial institution and a NY based processing bank, the organizations effectively manage their outsourcing relationship (despite the high degree of competition between the two organizations in other business lines) with an extensive combination of both formal and informal communication. Bi-weekly conference calls between operations personnel and formal reporting on the status of customer accounts are complemented by an extremely cordial relationship between the two relationship managers – both of whom know that they can pick up the phone at any moment and get the other to resolve their issues. The need to resolve these issues at this level however does not arise often as there are multiple layers of individuals at both organizations that interact on a frequent basis. The importance of communication was also cited as a focus in the Progeon – Greenpoint Mortgage outsourcing arrangement where up to three international conference calls a week occur[44]. These processes can also ultimately be considered as management's primary method to ensure it is satisfying its reporting

[44] Case Study: Inside the Progeon-Greenpoint Mortgage Transaction, Wharton Business School, University of Pennsylvania, September 2002.

requirements under the Sarbanes-Oxley Act a consideration described earlier in this report.

### 23.3. Best Practices – Training

One of the most obvious concerns about the potential success of an outsourcing relationship is the vendor's ability to operate under the outsourcer's corporate or national culture or at least operate with differences transparent to the customer. Most of the large outsourcing vendors have identified this issue and recognize the answer is extensive training. This training should cover the industry, the corporation itself, the cultural norms of the customer's home country and, for call centers in particular, language training and accent reduction. E-telecare – a outsourcing vendor in the Philippines, for instance, puts each employee through four weeks of training prior to dealing with the customer. Training includes language, geography, current events – even popular television shows. Westcom, a call center firm in Jamaica, trains each employees for over two weeks on the client's corporate culture in addition to training designed to slow their speech down from 220 words a minute to 180 words per minute – closer to U.S. standards[45]. In many cases, the training is so pervasive that the caller cannot recognize any trace of an accent from the employee nor do they ever recognize they are not speaking to an employee of the company they called.

[45] "In a Global Economy, Competition Among BPO Rivals Heats Up", Wharton Business School, University of Pennsylvania, September 2002

## 24. Key Client Risks

Despite the rapid growth in outsourcing, companies are not taking the decision lightly. Many factors need to be considered in assessing the appropriateness of a decision to outsource. Following is a discussion of these risks:

### 24.1. Reputational Risk

Most organizations relate the reputation of their brand very closely to their success. Positive reputations have been built by recurring, successful, long-term interaction with customers. For many processes considered for outsourcing, particularly call centers, direct contact with the end user is given up to the service provider. Missteps in dealing with the customer by a call center operator could slowly erode the reputation in the market and spell doom for an organization. Additionally, an outsourcing organization needs to carefully consider the impact of providing the vendor with information specific to its processes or its customers.

In financial services for instance, the issue of customer privacy has come top of mind for organizations planning to outsource a function that would ultimately provide a vendor with access to a customer's credit history, buying history or other data protected by financial privacy laws. This concern over privacy is not only true in the U.S. but throughout the world. For instance, in the European Union a customer must consent to the release of their information to parties outside of the E.U.[46] Any violation of this implicit (and now legally explicit) contract with a customer, by an outsourcing vendor, could seriously damage the outsourcer's reputation (and potentially could have significant legal ramifications). Finally, organizations should consider the impact of moving jobs offshore, particularly in the current economic and political environment. A move such as this could have an extremely negative impact with a corporation's relationship with labor unions and government officials.

## 24.2. Financial Risk

As noted above, despite the growing focus on non-financial factors, the primary driver in the decision to outsource remains an expectation of cost savings. Though many organizations explore the cost savings potential in an outsourcing arrangement, it is clear that there are significant pitfalls that result in outsourcing arrangements ultimately destroying shareholder value. Underestimating taxes, inflation and interest rate risk or economic instability could result in the outsourcer losing all of the expected cost savings. In the worst case scenario, outsourcers would be forced to find new vendors which would result in significant unplanned costs for training, technology and rewriting contracts. Outsourcers also need to be cognizant of the impact of economic conditions on the vendor's ability to satisfy its service level

[46] Heys, Catherine, "Call Centres – Reverse Charges", Banking technology, 30 September 2002.

agreements. As with any other companies, vendors will reduce staff in tougher economic times, potentially affecting service levels, availability and quality.

### 24.3. Viability of Providers

A significant risk for corporations seeking to make substantial investments in outsourcing arrangements is the viability of the vendor. The technology bubble of the 1990s and rapid growth in business process outsourcing is bound to result in an influx to the market of vendors – many of whom do not have the intent or ability to compete long term, but recognize the short term profit opportunities. Choosing a more opportunistic vendor is likely to guarantee that the corporation will receive less than satisfactory service and may need to switch vendors in the relative near term – a costly exercise. Outsourcers need to look at the track record, credit history and financial stability of the vendor. The recognition of this risk by potential customers is a distinct competitive advantage for the established vendors and subsidiaries o f multinational corporations such as IBM and EDS.

### 24.4. Geopolitical Risk – Increased Focused on Disaster Recovery and Business Continuity

Geopolitical risk is OBPO's very own "double-edged sword". The terrorist attacks on September 11$^{th}$, 2001 brought the issue of business continuity planning and disaster recovery to the forefront for many large corporations. Many of the old paradigms surrounding availability of systems and the potential for a wide-scale geographic disaster were completely washed out as soon as the Twin Towers fell. The Federal Reserve, for example, provided guidance to money center banks indicating that 500 miles was an appropriate distance for backup sites related to processing operations with significant impact on the financial markets. This expectation is very different from the pre-September 11 model where Chase and Bank of New York had back-up sites within 50 miles (and in some cases, much closer) of their primary processing sites for government securities clearance. These factors could actually open up corporate executives minds to the concept of outsourcing or outlocating certain operations overseas.

On the other hand, one must consider the geopolitical risk outside of the U.S., particularly in the Middle and Far East, as substantially higher than within the U.S. The conflict over the Kashmir region, while it has been significantly played down by outsourcing vendors in India, has received substantial press in the U.S. media and raises the specter of large-scale disasters that could significantly affect a businesses' operations, something that was nearly unthinkable prior to September 11th. The risk associated with India is not unique, the bombings in Bali and the Philippines by Islamic militants will also cause significant concern. Real or perceived, these risks will impact a potential outsourcer's decision. China, though more stable and controlled also presents specific risks as a businesses' success will be heavily dependent on the fact that legal and economic reforms continue.

## 24.5. Regulatory Risk

The introduction of the Sarbanes – Oxley Act of 2002 provides a new wrinkle to U.S. corporations seeking to outsource back office processes – particularly those outsourcing accounting and finance functions. Among other things, the act requires that a CEO and CFO certify financial information included in SEC filings. Additionally, the act requires that management certify the effectiveness of internal controls affecting the financial reporting function. Improper certification will result in criminal liability. Both of these certifications become somewhat more difficult to make if the functions are managed outside of the organization's direct control and as a result, may make management more hesitant to outsource these functions. For companies with existing outsourcing arrangements, the impact of Sarbanes – Oxley will make them evaluate existing monitoring procedures over these key functions potentially resulting in increased cost and additional management focus.

In addition to Sarbanes - Oxley, many regulators are focusing directly on the risks of outsourcing and management's ability to control these functions now performed by individuals not under its direct control. The Federal Reserve in particular has set clear guidelines and expectations outlining what an organization needs to consider and the processes organizations should implement to manage and monitor the risks associated with outsourcing, including outlining specific KPIs and service level agreements in contracts, detailing audit and information review rights, maintaining and testing contingency plans and restrictions on use of data[47]. All of these factors could also increase the cost and effort associated with an outsourcing arrangement, decreasing its potential benefits.

## 25. Quality certifications

Often, a key vendor selection criteria is the quality certifications obtained by the vendor. This section briefly lists the main certifications that vendors are currently touting:

### 25.1. SEI CMM

This standard has been issued by the Software Engineering Institute at the Carnegie Mellon University, and primarily applies to software. SEI CMM (Software Engineering Institute – Capability Maturity Model) can be used to rate organizations' process maturity at 5 levels, with an increasing number indicating a more reliable and controlled process. The table below lists the various levels of capability maturity[48]:

| **Level** | **Name** | **Description** |
|---|---|---|
| Level 1 | The Initial Level | This represents an unstable environment for building software, characterized by unsound management practices and |

[47] SR 00-4 Outsourcing of Information and Transaction Processing, February 29, 2000
[48] Source: 'Key Practices of the Capability Maturity ModelSM, Version 1.1', http://www.sei.cmu.edu

| Level | Name | Description |
|---|---|---|
| | | ineffective planning |
| Level 2 | The Repeatable Level | At the Repeatable Level, policies for managing a software project and procedures to implement those policies are established. |
| Level 3 | The Defined Level | At the Defined Level, the standard process for developing and maintaining software across the organization is documented, including both software engineering and management processes, and these processes are integrated into a coherent whole. |
| Level 4 | The Managed Level | At the Managed Level, the organization sets quantitative quality goals for both software products and processes. Productivity and quality are measured for important software process activities across all projects as part of an organizational measurement program. |
| Level 5 | The Optimizing Level | At the Optimizing Level, the entire organization is focused on continuous process improvement. The organization has the means to identify weaknesses and strengthen the process proactively, with the goal of preventing the occurrence of defects. |

## 25.2. ISO 9000

The ISO 9000 family of standards is issued by the International Organization for Standardization located in Geneva, Switzerland. This family of standards represents an international consensus on good management practices with the aim of ensuring that the organization can time and time again deliver the product or services that meet the client's quality requirements. These good practices have been distilled into a set of standardized requirements for a quality management system, regardless of what an organization does, its size, or whether it's in the private, or public sector[49].

ISO certifications come in three flavors as follows:

| ISO | Description |
|---|---|
| ISO 9001 | Applies to an organization whose business processes range all the way from design and development, to production, installation and servicing. |
| ISO 9002 | Applies to an organization which does not carry out design and development, Identical to ISO9001 except that it does not include the design control requirements of ISO 9001. |
| ISO 9003 | Applies to organizations whose business processes do not include design control, process control, purchasing or servicing, and which basically uses inspection and testing to ensure that final products and services meet specified requirements. |

### 25.3. COPC

The COPC-2000® Standard[50] (COPC itself being the acronym for Customer Operations Performance Center) was written in 1995 by a group of users of call center services and associated distribution fulfillment operations, and is now administered by a number of companies that include Microsoft, Motorola, Convergys and others.

The COPC-2000 standard can be obtained by call centers, transaction processing centers and others.

[49] Source: http://www.iso.org/iso/en/iso9000-14000/index.html
[50] Source: http://www.copc.com/standards/docs/COPC-2000_R_Standard_Release_32B_08_22_02.pdf

## 25.4. eSCM

The eSCM certification is being developed by the Carnegie Mellon University's Institute for Software Research, International (ISRI) with Satyam Computer Services Limited as the founding partner in a 'global consortium'.

eServices Capability Model (eSCM) aims to provide IT-enabled outsourcing service providers with a reference model and appraisal methods to improve their capability to consistently deliver high quality services in the networked economy. The model and methods are aimed at aiding service providers in establishing, managing and continually improving relationships with clients. Focused on the offshore BPO industries, the eSCM model claims many improvements over the other quality standards that have been adapted for use by the ITES industry.

It is yet to be seen if eSCM reaches critical mass and is adopted by rival ITES vendors. (It is interesting to note that though both eSCM and SEI-CMM are associated with the Carnegie Mellon University, they originate from different departments (eSCM from ISRI, the Institute for Software Research, International and CMM from SEI, the Software Engineering Institute) and from their public websites, it seems that these are independent and rival efforts driven by different groups of academicians.)

## 26. Key trends

On the basis of our work, and our conversations with people in the industry, we believe the following factors will shape the Indian offshore BPO industry in the coming years.

### 26.1. Pure IT services companies getting into the business

The Indian BPO activity is currently shared by BPO pure-plays or captive subsidiaries of large US/European companies.

As noted earlier, the market now has strong established players in place, effectively creating a sort of comfortable oligopoly where barriers to entry for new players are considerable. Smaller players will struggle to get client access, limiting their ability to become credible players in the market.

However – this barrier is not insurmountable. This is due to two main reasons:

- Market opportunities are expanding rapidly, and even though most companies looking to outsource to India tend to send their RFPs or RFIs to the established top 5-7 companies, newer business areas may offer an opportunity to the newer players. Even within existing business areas, smaller players may succeed in getting some business that can help them get started.

- With low break-even points, building critical mass is not too difficult in this industry. Often, just one medium to large size assignment may help recoup the fixed costs creating a net positive cash flow needed for survival for a vendor.
- The skills on offer are largely undifferentiated, and intellectual property inherent in the business is available to all and does not offer a protected franchise.

Given the above, the companies that are best positioned to take advantage in this growing business are those that have client acquisition capabilities. There are two strong groups of contenders that will pose a challenge to the current players:

1. **International service firms with a presence in India** – These include US/Europe based service and consulting firms with strong operations in India. The consulting offshoots of the Big-5 accounting firms, systems integrators such as IBM-GS etc who have strong client bases they supply other services to are uniquely positioned to take advantage of their client access. Their efforts are discussed in section 26.2
2. **Indian IT services firms** – Indian IT services firms have been so busy reaping the rewards of the IT outsourcing boom (which was accelerated significantly due to the business brought in and the resulting visibility afforded by Y2K) that nearly all of them missed

getting on to the BPO bandwagon early on. In a way, that was fortunate for the overall Indian services exports sector as it further broad-based the spectrum of Indian companies exposed to the western markets.

However, nearly all Indian IT services companies are currently busy building capabilities for offering BPO services to their clients. As they do so, the following factors will help them build sizeable BPO practices:

- The financial clout and the resulting ability to build a credible infrastructure,
- Established client relationships,
- Proven record of offshore execution albeit in a different field but one that has strong parallels to BPO

The table below lists some of the big IT players and their BPO subsidiaries that they have recently launched or acquired.

Top Indian IT services player and their BPO subsidiaries[51]

| **IT services firm** | **BPO subsidiary** |
|---|---|
| Infosys | Progeon |
| Wipro | Spectramind |
| Satyam | Nipuna |

[51] Source: News reports and company websites

| IT services firm | BPO subsidiary |
|---|---|
| NIIT | Smartserve |
| Polaris | Optimus |

### 26.1.1. Strategies of Indian IT services players[52]

We look at some of the strategies adopted by the larger Indian IT services players to break into the BPO market.

#### 26.1.1.1. Infosys

Infosys has set up a separate subsidiary named Progeon for its entry into the BPO space. An Infosys spokesperson was quoted in the press[53] as saying, "Our BPO foray is part of our initiative to increase the length and breadth of our services and extend relationships with our clients. But we set up the BPO company as a separate entity as the skill-sets, resources and execution model are different from that of our core business."

Clearly, Infosys recognizes two things: firstly, that the BPO business is distinct from the IT services business and competencies required for success in each are different. Secondly, they leave no doubt that Infosys will be exploiting

52 This section draws extensively upon a report published in the Indian Express of December 16, 2002
53 Indian Express, December 16, 2002

existing client relationships to muscle in and capture value in this growing market.

Progeon also plans to use the frameworks developed for business process management by Infosys as part of their IT services (the "Infosys Influx methodology"). Progeon will focus on transaction processing and accounting services for the banking, financial services and insurance (BFSI) sector. Progeon already has three clients, and per recent news reports[54] was negotiating with Fidelity for a 250 seat call center.

#### 26.1.1.2. Wipro

Wipro, another large Indian IT-services company, used its financial muscle to acquire Spectramind, one of the top-three Indian BPO vendors by revenue. Balakrishna R, practice head for BPO at Wipro[55] commented on the Spectramind acquisition in these words: "The key for us was to get a quick start with an established player and experienced management team. It would have been time-consuming to build this from scratch. Additionally, the investment in Spectramind is a fair investment from a financial standpoint. The call center business has good growth potential, and this investment allows

[54] Times of India, November 29, 2002
[55] ibid

us to participate in this business opportunity as we go to market initially with this offering. With this strategic investment, Wipro has strengthened its BPO offerings with the inclusion of backroom processing services and customer contact services in its portfolio of services."

Spectramind was the first Indian company to achieve COPC certification[56] using the Six Sigma platform.

Says Balakrishna, "BPO is a key strategic initiative for Wipro and will be a growth driver. We see synergy in terms of a common client-base and an expansion of our service offerings. The key message is that in this space value is delivered in three waves. The first wave is delivered by moving operations offshore. Wipro already has a strong presence here and has an established and proven process for transitioning and sustaining operations. The second wave of value comes from process optimization. This comes in two ways—by redesigning the process; and by changing the IT solution that supports the process. These processes are transaction-driven; processes such as Six Sigma can be very effectively used to take out cost on a continuous basis, which constitutes the third wave.

[56] The COPC certification is a quality certification for call centres. (Refer section on certifications for more details).

This along with Wipro's financial stability and strong account relationships helps us in being a serious player in this space."

#### 26.1.1.3. Satyam

Satyam, another big-league IT service player, has also joined the BPO race through its subsidiary, Nipuna, which is looking to start operations by setting up a 250-seat facility. Customers targeted by Satyam are no different from those targeted by its competitors, it intends to provide services to "lucrative sectors like insurance and banking, besides manufacturing, automotive, transportation, energy and utilities". It is clear that Satyam has little competence in any of these sectors and is open to grab any business that comes its way.

Nipuna will be using Satyam's eSCM[57], an e-services capability model developed by Carnegie Mellon University with help from Satyam.

### 26.1.2. Efforts by middle tier IT services companies

[57] eSCM – acronym for eServices Capability Model, is yet another certification effort for BPO companies. eSCM has been developed by Carnegie Mellon University in partnership with Satyam. More details available on http://itsqc.srv.cs.cmu.edu/escm/eSCM_Model.pdf

#### 26.1.2.1. Patni Computer Systems (PCS)

Helped by a $100m equity infusion by General Atlantic Partners, PCS, the sixth largest Indian software services company, is looking at establishing three new BPO facilities within the next two years[58]. The BPO arm of Patni is already handling two Fortune 500 telecom companies, a credit card company and is currently running a pilot project for an insurance company. "We are trying to leverage on Patni's software and services clients and are aiming at 8 to 10 large projects by December 2002", PCS's BPO-head Sanjeev Kapoor is reported to have said.

#### 26.1.2.2. Polaris

Polaris has launched Optimus Outsourcing in Jun-2002, a 100% subsidiary offering BPO services to existing banking and financial services clients on the back of its existing software products that it offers, viz. 'Orbi-cash', 'Orbi-card' etc. In addition, part of Polaris's strategy banks on acquiring capabilities, Optimus has announced plans[59] to purchase iBackoffice, which is a customer interaction services company, to provide it with instant access to trained manpower and ready-to-use infrastructure.

[58] Source: 'Patni Computer To Play Big In BPO', Financial Express, November 20, 2002
[59] Source: Informatics, 10-Dec-02 (Informatics is an electronic information provider and aggregator.)

#### 26.1.2.3. Zensar

While most software companies are concentrating on the low-end of the BPO business, Zensar is looking at playing in the high-end segment. Says Ganesh Natarajan, the company's managing director, "Zensar sees BPO as integral to its practice-based organization. We focus on a few sectors, and within that provide comprehensive outsourcing solutions that include consulting and IS architecture creation, package implementation, application development and maintenance, and BPO. I believe that IT services companies are best equipped to enter the high-end of BPO, while commoditized call centers can be set up by anybody with deep pockets. Hence our interest is in the MSP and ASP space, in addition to providing data center and Web helpdesk support for clients." Going forward, Natarajan expects that BPO would contribute 15-20 percent of the company's revenues by 2004.

#### 26.1.2.4. Datamatics Technologies

This company insists that BPO is nothing new to it. Says Manish Modi, the managing director and CEO, "Datamatics was the first Indian company to offer outsourcing services in India (for Wang Labs) way back in 1983. Datamatics has had very extensive experience in setting up and managing dedicated facilities for companies such as EDS and British Airways. Over the years, we have been able to evolve the processes and methodologies necessary for an outsourcing relationship. We are now positioned as an end-to-end BPO solutions provider to the publishing, legal, healthcare, tax and financial accounting industry verticals." To position itself differently in future, Datamatics is looking at leveraging its domain expertise in the knowledge management and data processing space. Besides these services, Datamatics provides clients with services like claims processing, taxation write-up, and accounting.

#### 26.1.2.5. NIIT

The IT training industry was among the most affected sectors in the global tech meltdown and its resultant aftermath. But companies like NIIT have managed to survive by constantly evolving their business model. After trying its hand at training and then services, NIIT has now forayed into the BPO space. SmartServe, the company's 560-seat facility in Gurgaon, provides services like back-office operations, contact center operations and helpdesk support to verticals like insurance and financial services. It also provides support for remote learning services. NIIT SmartServe recently bagged a $10 million order from UK-based Misys Independent Financial Advisory Services (MIFAS), a leading provider of software products for the international banking and healthcare industries. With this deal, NIIT now plans to shift its focus to other verticals like healthcare and banking.

#### 26.1.2.6. VisualSoft

Primarily a product company, VisualSoft plans to concentrate on high-end data processing and areas such as helpdesk for IT support.

#### 26.1.2.7. Kale Consultants

As part of its strategy, Kale Consultants is focused on the airlines segment. In this space, Kale's key BPO clients include Qatar Airways, Air Luxor and Canadian North. The BPO strategy has worked out for Kale; during FY 2001-02—its first year of BPO operations—the BPO segment contributed an impressive 13.4 percent to total operating revenues.

#### 26.1.2.8. Cognizant

Cognizant's strategy is summarized by Raju Bhatnagar, head of the BPO division at Cognizant Technology Solutions, "Our

> strategy is to first approach our existing customers with whom we have a relationship and who are looking at outsourcing their business processes. To begin with, we will concentrate on the banking, financial services and insurance sector, which contributes more than 35 percent of our IT services revenue. Later, we will look at the healthcare sector, which contributes more than 25 percent of our IT services revenue." While the focus will remain on the mid- and high-end of the BPO market, Bhatnagar says that it will also take on some portion of low-end work as a bundled offering, thus projecting itself as a one-stop shop for outsourcing.

Effectively, the truth behind the blurb is that nearly all these companies are willing to accept any profitable business that comes their way, and there is some way to go before they establish serious capabilities and market credibility, or any differentiation in offerings.

Not all of these ambitions will be realized though, and the chances of success for the larger IT services players are significantly enhanced by their financial clout and client access.

### 26.2. Competition from US firms

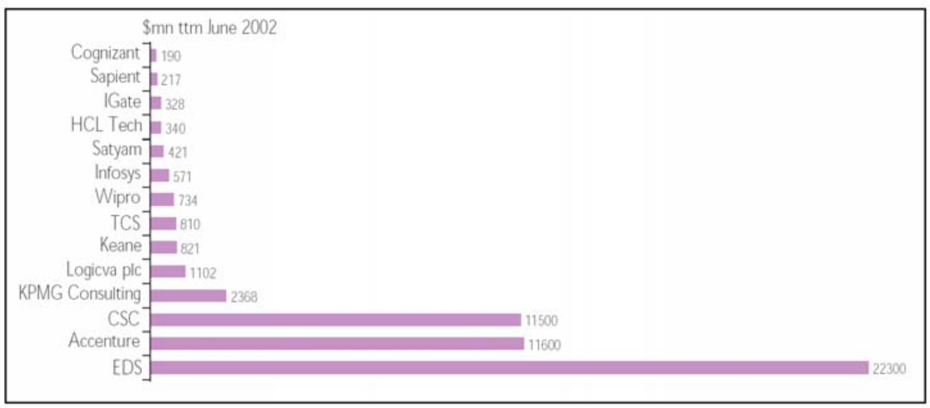
Global BPO majors such as EDS, Accenture etc who have traditionally offered BPO services in the US and in Europe are clearly in no position to match the cost advantage offered by their Indian counterparts. However, there is little to stop them from setting up Indian operations and tap the same resource pool that Indian vendors draw their competitive advantage from. When the IT boom was occurring, not many US based firms showed any strong inclination to offer their clients alternative offerings based out of India at similar cost structures as those offered by the likes of Infosys and Wipro.

A similar situation exists today in the BPO marketspace. Even though many US based firms have offices in India, their offerings out of India are relatively less mature and small in size. One reason the global majors are yet to jump on the Indian bandwagon is because of the current small market share enjoyed by the Indian firms. The market is increasing extremely fast, however, having started off from a very tiny based, astronomical growth rates translate to very small absolute numbers to interest the global majors. For example, the estimated revenues of EXL Services, the largest Indian BPO company, are $30 million for the calendar year 2002[60]. This pales in comparison when placed in the

[60] 'EXL plans to de-risk business model' – Indian Express, October 21, 2002.

context of ADP's revenues, approximately $7 billion for the same year[61]. Additionally, a large portion of the offshore BPO activity in India is generated by captive subsidiaries of companies such as Amex, GE etc.

The chart[62] below shows the comparative revenues of Indian and global IT services companies – and given that Indian IT services companies are way ahead of the game than their BPO counterparts, the differences in BPO revenues is even more pronounced.




We expect that as the market expands US-based vendors will step up competition with the Indian vendors by offering low-cost remote programming resources. Some US vendors, including IMB, EDS and Accenture, have had low-cost labor options for years, but have been reluctant to publicize these resources either because they don't pass the

[61] Source: Company Website (www.adp.com), total revenues for the year ended June 30, 2002
[62] IT Sector Update issued by Girish Pai of S.S. Kantilal Ishwarlal Securities Pvt. Ltd. (SSKI), December 2002

savings along to the clients, or because of the past prejudice against offshore work[63].

Recent geopolitical trends may result in more U.S. based companies seeking to outsource with U.S. based providers – even if they are located offshore as political uncertainty becomes a considerable concern. Additionally, the substantial requirements of the U.S.'s Patriot Act, enacted after September 11th, 2002 place increased pressure on organization's needs to understand their business partners – customers and suppliers. Finally, the pressures resulting from the economic downturn have forced more U.S. consultancies to explore and ultimately, invest in offshore business process outsourcing as evidenced by IBM's purchase of PWC Consulting. All of these trends will result in increased competition from large, multinational providers, many of whom are establishing subsidiaries in popular outsourcing destinations such as India and the Philippines. The experience of these providers, the concerns about the viability of non-U.S. based providers and perhaps most importantly, their relationships with potential U.S. based outsourcers could significantly affect the ability of the local Indian firm to compete for U.S. based business. At a minimum, it will result in increased pressure on margins.

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[63] 'US-Based IT Firms Ramp Up Offshore Engagement Competition With Indian Vendors', Stephanie Moore, Giga Information Group, March 29, 2002

However, in the short term we believe US vendors will suffer from two significant disadvantages when compared to their Indian counterparts.

1. **Unviable offerings:**

Just because a reputable global provider has an entry in the offshore outsourcing category does not mean that this is a viable or a scalable entry. Merely having an office and staff in India does not imply the ability to effectively support offshore work and maintenance needs. It takes significant investment in time and money to make an offshore relationship work, regardless of the vendor brand name or the quality of the staff. A viable offering will require investment in quality and remote management processes and training of internal US based engagement and project managers in these processes. Unless this investment is made, a quality client experience will be difficult to deliver.

On the other hand, Indian vendors have not only invested in quality processes and the Software Engineering Institute's (SEI) Capability Maturity Model (CMM), but have also marketed their capabilities in this arena to such an extent that SEI CMM is now the gold standard for assessing all outsourcers.[64] US vendors such as EDS now find themselves playing catch-up as they struggle to get their offshore facilities to be as highly rated as their Indian competitors' facilities, or develop a marketing

[64] ibid

spin that explains why their facilities haven't been assessed at the highest level.

**2. High cost structures:**

In spite of a decade of liberalization and opening up to the world, India can still be a very difficult place to do business. As US vendors set up large operations in India, they run a real risk of burdening themselves with a higher cost structure than their local competitors. In a country where everything is negotiated, US vendors may find themselves offering higher salaries, paying more for physical facilities, and have a heavier overhead that is associated with any large corporate setup. US vendors carry large tort-insurance covers, whereas Indian vendors governed by Indian laws do not feel the need to do so. At Daksh, for example, not even the CEO travels business class. In large American multi-nationals, people tend to fly from all over the world for wasteful meetings and workshops. Arijit Sengupta, responsible for the East Coast operations of Daksh, in a meeting with the authors of this report commented that 'Amex pays 50% more for the vans they hire to transport their staff. They pay more for everything.'

**3. Environmental difficulties**

A successful prospective foreign entrant into the Indian OBPO market will need to be adept at navigating the Indian business environment. In the past, many policies have made it difficult to do business in India. As such, would-be multinational OPBO operators should be wary of joining the horde of aspiring OBPO providers who are "making a beeline to [India]", as Indian enterprises are purposefully working to fight market entrance from foreign players[65]. In recent years, however, the Indian government has taken steps to improve the hospitability of the Indian business climate. These steps are only expected to continue in the near future.

The Indian business market is replete with protectionist policies that inhibit competition. To make matters worse, this policy regime may be characterized as arbitrary, ambiguous, or even corrupt. For these reasons, one strategy for the prospective foreign investor may be to form a joint venture with Indian call centers[66].

According to Mr. Rohit Kapoor of EXL Services, global players offered no competition at all. Since the primary driver for the client in offshoring processes is cost (productivity and quality gains are secondary), none of the international players can offer than.

[65] "Call Centers Must Rev Up Domain Expertise", The Hindu Business Line, May 19, 2002
[66] "India – From Emerging To Surging", The McKinsey Quarterly, 2001 Number 4: Emerging Markets

However, we realize that none of the above disadvantages will sustain over the long term, and even though it may take many years, competition from global vendors is inevitable

### 26.2.1. US vendors' offshore strategies[67]

In the sections that follow, we look at the approaches followed by some of the US vendors to leverage the cost advantage offered by India. Some have established their own offshore centers, while others have partnered with a local vendor. Clients feel the most comfortable when dealing with the vendor's own wholly owned subsidiary.

It is very clear that most US vendors' offshore strategies are at a rudimentary stage of formulation, and in many cases neither the strategy nor the intent to commit to India is as yet clear.

#### 26.2.1.1. IBM Global Services

IBM GS has strong offshore capability, in fact IBM Global Services Limited in India is the sixth largest software company in India with 3500 employees in Pune, Bangalore and Delhi. All of IBM's Indian facilities have achieved SEI-CMM Level 5 certification. IBM's presence in India started off as a joint

[67] 'US-Based IT Firms Ramp Up Offshore Engagement Competition With Indian Vendors', Stephanie Moore, Giga Information Group, March 29, 2002

venture with Tata, now a competitor, but all the facilities are now wholly owned by IBM.

#### 26.2.1.2. Pricewaterhouse Coopers

Now a part of IBM GS (discussed earlier), PwC has a large facility in Calcutta with approximately 500 staff. While it has a small offshore presence, that has been generally sufficient to support the BPO business that has come PwC's way.

#### 26.2.1.3. CSC

Even though a large player in the US, CSC is new to the offshore outsourcing game. CSC has a total of 1000 offshore staff spread in many countries – Canada, Ireland, South Africa, Australia, Singapore, Malaysia and India. It has two development centers in India, Indore and New Delhi with a total of about 450 staff. This compares to its global staff strength of about 68,000. CSC has partnered with many Indian vendors to afford its clients the ability to outsource work. These include L&T Infotech, Satyam, Cognizant, HCL etc. Clearly, many of these alliances are opportunistic with profit opportunities shared on a deal by deal basis. Since the 'partners' are competitors as well, CSC is probably just off the block when it comes to offshore capabilities.

#### 26.2.1.4. EDS

EDS has offshore centers in as many as 17 countries, however EDS has not exploited the offshore opportunity to the extend that IBM has. Currently, EDS has a development center in Chennai in India. EDS is yet to achieve SEI CMM Level 5 rating for this facility – it is currently certified at Level 3. Given that Levels 4 and 5 are a prerequisite for global firms looking for offshore engagements, EDS is at a distinct disadvantage here.

EDS, like all vendors, faces the problem of cannibalizing their US resources by supplanting them with low-cost offshore resources. There will be internal organizational resistance from sources opposed to reducing deal size by leveraging offshore resources.

#### 26.2.1.5. Accenture

Accenture has had a local consulting practice in India since the early eighties. It currently has 200 staff in India and is planning to significantly beef up its presence. It is also in the process of offshoring its own internal business processes to a BPO center it is setting up in Bangalore. Accenture has never been a cut-rate consulting firm, and is unlikely to venture in that direction even with the arrival of offshore BPO. It will offer an offshore option to its clients without compromising on margins in the US. Accenture is expected to soon announce an alliance with MsourcE, the call center subsidiary of MphasiS BFL Group[68]. The alliance will make MsourcE the preferred execution partner for large business process outsourcing deals that Accenture bags.

#### 26.2.1.6. Deloitte Consulting

Deloitte did not have its own low cost development or delivery centers until it entered into a joint venture with Majesco, an Indian vendor based in Mumbai. Majesco is SEI CMM Level 5 certified and has strong offshore management experience. That notwithstanding, Deloitte is new to the game and does not currently have significant experience in managing offshore engagements.

#### 26.2.1.7. KPMG

KPMG has not had any offshore offering or offshore management experience. It has been present in India as an

[68] ‘MsourcE plans BPO business tie up with Accenture’, The Economic Times, December 12, 2002

audit firm since the mid-nineties[69]. In February of 2002, it announced a ‘global strategic alliance’ with TCS, but apart from that there is little offshore capability that KPMG can boast of.

**26.2.1.8. Sapient**

After the dot-com bust, Sapient has moved nearly half of its staff offshore. However, Sapient is not into offering cut-rate bodies, it does offer its clients two options – a US-only price, and an India/US price. Nearly a third of all its engagements have some offshore component.

Sapient has eschewed the need for SEI CMM certifications, claiming that it hires only the cream of the crop in terms of personnel. It also claims that it has such strong processes that it is able to do collaborative, iterative development in India.

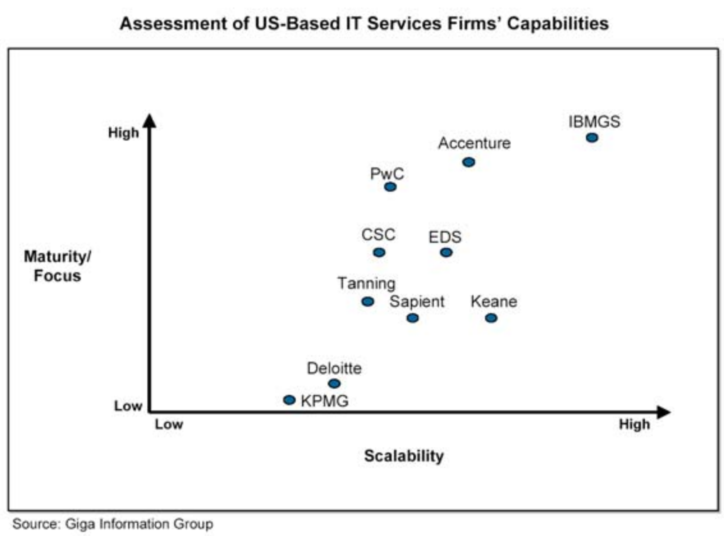
**26.2.1.9. Keane**

Keane has taken the acquisition route to exploit the low cost advantages that India has to offer by acquiring SignalTree, a 750 person consulting firm for $62 million. SignalTree is a US based Indian vendor with 400 employees in two SEI CMM

[69] Prior to the mid-nineties, KPMG in India was represented by A.F. Ferguson, a local accounting firm.

Level 5 facilities in India. It will take Keane some time to become familiar with the offshore model.

As is clear from the above discussion that nearly all global players, whether in IT Services or IT Enabled Services, are making a foray into India and once they have progressed sufficiently along the learning curve, they will have a powerful combination of on-site, onshore, offshore and nearshore resources to accommodate clients.




The table[70] following provides information on the expansion plans of global service providers.

[70] 'IT Sector Update', by Girish Pai of SSKI Mumbai

| Service Provider | Current headcount | Planned expansion | Comment |
|---|---|---|---|
| IBM Global Services | 3,100 | 6,500 by 2004 | Addresses both Indian and global markets from India. Has relationships with Indian companies like i-Flex and Satyam. |
| Accenture | 300 | 5,000 by 2004 | Works with Indian companies such as Satyam and Wipro. |
| EDS | 800 | 5,000-6,500 by 2004 | Working with Satyam, and is expected to bid for large IT outsourcing contracts with other Indian IT services companies. |
| CSC | 700 | 7,000 in 5 years | Collaborates with Satyam. Has a CSC development centre, the only one in Asia, which exports software to US. |
| Perot Systems | 1700 | NA | Has a 50:50 JV with HCL Technologies, called HCL Perot Systems. |
| Deloitte Consulting | ~100 | ~500 in 2 years time | A JV with Mastek. Also has an independent unit that undertakes SAP implementation and support. |
| Xansa | 1,200 | 10,000 in 2006 | Formerly called FI Group. Bought Indian company IIS Infotech. |
| Dimension Data | | Invests in Nihilent Technologies | At present, Nihilent has a small operation, with 300 people. |
| Keane | 450 | 700 by end-2002 | Acquired Signal Tree, an Indian company. |
| Oracle | 2,200 | 4,000 by 2004 | Provides global support services from its offices in India |

*Source: Press reports, industry, SSKI*

In the coming years, Indian ITES vendors will face increasing competition from global majors. Large foreign players, even though at a short term disadvantage due to the factors identified earlier, have long term strategic advantages as outlined below

| **How Indian and MNC players compare**[71] | |
|---|---|
| **Indian** | **MNCs** |
| Narrow range of services | End-to-end |
| Primarily US focused | Global Outlook |
| Relationship with IT managers | CIO/CEO level relationships |

[71] Nasscom-McKinsey Report 2002

| How Indian and MNC players compare[71] | |
|---|---|
| | |
| Limited brand recall | Globally reputed brands |
| Looked upon as organization of Indian Engineers | Global talent pool with diverse background |
| Primarily based in India | Facilities in many other emerging economies |

### 26.3. New deal formats – BOO and BOOT

Most outsourcing arrangements to India take the form of either a full outsourcing to an Indian vendor, or the foreign company setting up a captive subsidiary. Setting up a captive subsidiary in India can be a challenging and consuming task, and requires a great deal of sophistication in doing business in India and also process management and integration.

Advising companies on how to exploit BPO opportunities in India is emerging as a new source of revenue for consulting firms such as Accenture and KPMG.

Many firms in the west require assistance in setting up Indian operations and the concepts of BOO (Build, Operate and Own) and BOOT (Build, Operate, Own and Transfer) where an Indian vendor helps set up a subsidiary that is ultimately transferred back to the client when operations have stabilized is gaining ground.

Speaking to vendors, we found that their response to BOO/BOOT requests from clients was that there is so much independent business out there that getting into these deals was probably not worth their time. Why share value created when you can keep it all for yourself?

We believe that there will be a strong demand from mid to large sized companies whose scale justifies independent operations will demand BOO/BOOT services from existing vendors. If the current players with demonstrated capabilities do not meet this demand, these customers will go to either existing consulting firms, or to tier-2 players.

According to a recent news report[72] quoting its president and CEO, Pioneer Online, a Hyderabad based ISP, has floated a new division called ‘Pioneer Infra’, which would provide all kinds of IT infrastructure services in the BOO and BOOT modes. "Pioneer Infra possesses the necessary expertise, technical capability and manpower to implement any kind of IT project, whether it is e-governance, ERP implementation, call center operations, BPO operations or any other IT services on BOO or BOOT modes," Mr. Reddy, CEO Pioneer Online, said.

Pioneer sees a vast scope for tapping the market, particularly multinationals, who are keen to have either call centers or BPO facilities in India at the

[72] ‘Pioneer Online Moots BOOT, BOO Schemes For IT Projects’, Financial Express, December 12, 2002

shortest possible time in a cost-effective manner. Pioneer sees opportunities to tap the same, Mr. Reddy said adding, "The company is looking at IT infra projects above Rs. 10 crore." "We have earmarked Rs 50 crore to fund the initiative initially. Based on the response and the projects we get, we will hike the investments. The company is in an advanced stage of negotiations for two projects," he added.

## 26.4. Backlash in the US

Two members of the New Jersey senate have introduced identical bills (bill numbers A2425 and S1349)[73] directing certain government departments to specify in their contracts that these contracts or an subcontracts resulting therefrom may only be carried out by US citizens or legal aliens residing in the United States.

Interestingly, the bill is motivated by the following reasoning: “Recent published reports have indicated that telephone inquiries by welfare and food stamp clients under New Jersey's Families First Program were being handled by operators in Bombay, India after the contractor moved its operations outside of the United States as a cost-cutting measure. The bill is intended to

[73] Source: New Jersey Senate website on http://www.njleg.state.nj.us

ensure that State funds are used to employ people residing in the United States and to prevent the loss of jobs to foreign countries."[74]

However, this bill is still not law, and even if were to be passed, it would still be applicable to only one state, and even then only to some government departments and not the private sector. Just as pure cost advantages allowed China to become the manufacturing hub of the world, the move to offshore BPO will be unstoppable.

However, the mere introduction of this bill should caution the Indian industry to ensure that they do not fall behind in arresting any unnecessary build up of public opinion that may be more expensive to counter later. Nasscom and the Indian Government need to be active in lobbying with and liaising with American law makers to highlight the benefits that offshore BPO can bring to both economies.

### 26.5. Technological innovation will strengthen the case for more offshore BPO solutions

Just as the availability of high bandwidth reliable electronic networks and telecommunication systems has made offshore BPO a reality, changes in technology and software will continue to drive more internal processes into the 'feasible to offshore' zone.

[74] Source: http://www.njleg.state.nj.us/2002/Bills/S1500/1349_I1.PDF

We see improvements in the following enabling technologies working in tandem making it possible to outsource offshore an increasing number of business processes.

### 26.5.1. The rise of 'self-service' applications

Self-service applications hide the complexity of underlying technology by presenting a simple web-based interface to complex IT applications. For example, procurement software incorporating the purchase to pay process is allowing companies to bring out processes and lay them bare in front of the actual decision makers in a convenient web-based format much like an internal corporate Amazon.com. In other words. people who buy, receive and accept goods and services in a company, and approve payment. All the back office work then related with such a process becomes entirely rule-based and can be offshored out with much greater ease.

### 26.5.2. Imaging technologies

Improvement in bandwidth and falling computer storage costs allow companies to implement sophisticated imaging software which can make movement of paper redundant. Physical movement of paper, such as customer contracts, supplier invoices, GRNs etc is no longer necessary as long as an electronic image with its inherent advantages of immediate availability and costless reproduction is available.

#### 26.5.3. Workflow software[75]

What workflow software can do is that using a business determined definition of each process, it drives the entire process from initiation to completion. It uses business rules and decides which path to route the process along, obtains approvals where human judgment is required, and sends out information to those who need to know. While it is doing all this, it can also captures valuable information about the process – such as how long did each sub-task take, how often was a particular decision taken, what transactions were initiated during each process, who did what and which transactions are in what state of completion at any given time. Since all of this information is electronic in form, it allows subsequent analysis which can be used to fine tune the process itself. Workflow software is relevant to offshore BPO as it allows the breaking down of a large process into discrete chunks each of which can be performed at a different physical location.

**Putting the above technology pieces together:**

[75] ‘Workflow – are you ready?’ at http://www.financeoutlook.com/workflow.htm

To put the above three together, imagine this: An invoice is received in the United States. An imaging solution is used to scan it locally. Workflow directs the invoice image to an operator in India who reviews it, marks it to the attention of a US based manager (which is the next step in the workflow driven process) who upon receiving an email with a browser link, uses Accounts Payable self-service to approve it electronically on screen. Thereafter, operators in India pick it up and process the invoice in a series of sequential steps governed by the workflow software. These steps would include matching the approved invoice to a purchase order, entering in the accounts payable ledger, coding to the general ledger, data-entering in the fixed assets system if it happens to be a fixed asset related invoice etc. Finally, once all validations have been carried out, the payment is generated on the due date and approved again using self-service by a controller carrying out exception checking in the US. The entire process is driven by workflow, and underpinned by the imaging software, and incorporates human judgment by allowing accept/reject/comment/escalate possibilities as part of the self-service software.

## 26.6. Multi-process integration

In the ultimate analysis, each business represents one single core process – that often referred to as the 'cash-to-cash' process, with cash being spent to buy inputs, and collected in the end from the customers, hopefully with the latter being greater than the former.

Today, the vast majority of offshore BPO solutions are delivered in a discrete, or stand-alone, fashion, i.e., a BPO vendor operates and delivers a specific function regardless of other outsourcing services used by a customer. Often a single software application or discrete BPO solution can't truly address an entire business process, as these solutions are more focused on sub-functions within overall evolving processes. As a result, we expect Indian BPO vendors to begin offering multi-process integration to create more strategic value for customers, further enhance their margins, boost revenues, and create greater barriers to exit for customers (or entry for competitors).

Already, many Indian vendors have considerable domain expertise in the banking, financial services and insurance verticals. It is only a matter of time that the distinct offerings in this area get combined into what may be an integrated 'super-offering'.

Multi-process integration implies greater complexity since a BPO vendor isn't just managing a second, additional business process, but also manages the interactions among different processes. This implies that multi-process BPO clients view their vendors as more strategic partners since they are taking over more strategic elements of a client's business.

Some of the most likely combinations of processes are certain administration, HR and finance functions such as integrating a payroll solution with a tax processing and/or general accounting solution. Another good example is integrating claims processing (administration BPO service) with benefits processing (HR BPO services). This trend towards integrated processes is already evident in the west, for instance, in April 2000, Nortel Networks outsourced to PwC some HR processes (payroll, employee training), financial processes (accounts payable, capital services), and supply chain processes (non-production purchasing).

Indian BPO vendors are already at work attempting to integrate more and more processes as they gain experience and get to understand their clients' business. Many BPO vendors claim increasing business from the same client pool much of which is coming from an expanded multi-process offering.

We believe this trend will only strengthen due to the willingness of Indian vendors to pick up new business in every form – and with access to highly qualified, ambitious and at the same time low cost staff at mid and senior organizational levels, they certainly have the intellectual muscle required to carry out this integration. Unlike niche players in the west (e.g. ADP), Indian vendors are not currently limiting themselves to a single process.

## 26.7. Emergence of a common technology and process platform

Currently, nearly offshore BPO arrangements take the form of India based staff taking on responsibility for a process that is being carried out in the west. As a part of the transition, some process changes may be made to improve process effectiveness, but by and large the same tasks are carried out with the only change involving the process actors, i.e. the people who do the job. In most cases, the staff employed by the Indian vendors continue to use the same software application as the client – so for example if the client is using Oracle CRM, the Indian team taking on the process will also use Oracle CRM. When a new client using Siebel comes in, a new team will be put in charge of that account and will use Siebel. In such scenarios, the only value creation comes from wage differentials between India and the west, and from any productivity gains that might have been achieved as part of the transition.

We believe that over time Indian vendors will develop a better and more in-depth knowledge of a process than the clients they serve. They will also be in a position to offer their clients a superior value proposition by offering the use of a common technology platform that may provide for the needs of the client much better than the technology that clients themselves may have in place for their internal systems.

This transformation will be driven by the following factors:

- **Increasing domain and process experience of Indian vendors:** With the passage of time and maturing of capabilities and client relationships, Indian vendors will be in a position to advise clients on best-of-breed processes instead of using the client processes as-is.

- **The combination of IT services firms with ITES businesses:** This will create opportunities for advantageously combining the IT skills of the software firms with the process knowledge of the BPO firms to create generic software and processes that work more efficiently with the vast amounts of transactions that are required to be processed. Pure ITES players with few IT skills will need to either develop some software skills in-house or partner with other IT services vendors.

- **The vast SME market:** Currently, Indian vendors are focusing solely on large deals. According to Mr. Arijit Sengupta of Daksh who we spoke to, anything less than a 100 seat assignment (even though the client may start initially with less) is not feasible for them to support over a long run. However, there are a large number of small and medium enterprises who can benefit from offshore BPO facilities. For example, a small internet store that needs a 10-person call center to manage customer queries can save over $250k each year by basing the facility in India. Only a large vendor running a common software offering that each client has to accept can possibly hope to serve such a client. ADP, the US payroll outsourcing giant, has over 21000 customers who it serves using a common software platform.

We expect the move to some sort of standardization and commonality in each of the major processes over time, be they call centers, or accounting processes.

### 26.8. Pricing

Notwithstanding the current downturn, pricing will stay firm, and may even trend up[76]. The cost advantage to clients from moving processes to India is so strong that $25/hour/seat or $20/hour/seat really does not make too much of a difference to a client. On the other hand, clients are willing to pay for an established brand name and a guarantee of quality, and are not scouting for cut-rate deals.

At the same time, clients are also demanding more features – for example redundant operations in multiple locations, even multiple countries, and more quality certifications etc. The costs of these bells and whistles can be passed on to the clients. The current downturn is actually proving to be a driver for increasing the demand for offshore services – creating even more pricing power for the top vendors.

[76] Based upon discussions with Mr. Rohit Kapoor of EXL Services

In fact, an interesting parallel can be drawn between ITES today and IT services a decade ago when Infosys started off offshore programming at about $15/hour, and subsequently as the industry matured offshore rates from top firms such as Infosys firmed up to $50 an hour, before declining to $35 approximately where they stand today.

### 26.9. Industry Consolidation

Consolidation is taking place in the Indian OBPO industry. Consolidation typically involves a merciless process of acquisition of smaller players, the death of unmarried general service providers, and the existence of profitable but wary niche players who serve market segments that the consolidated entities can not or chose not to serve. We posit, then, that over the next few years, potential new entrants should decide whether they plan to be a dominant aggressive acquirer of smaller firms, a successful provider seeking a suitor, or a niche player providing a service that larger firms either choose not to provide or can not provide profitably. The point is that the OBPO providers will likely need to be adept at varying headcount until some semblance of steady state – whether from acquisition, being acquired, or establishment as a successful niche player – emerges.

This trend implies a lot of business for investment bankers and deal makers. Firms will be looking to acquire and also to be acquired, both in India and abroad. We have already seen a lot of M&A activity among BPO firms – a trend that is likely to continue over the next couple of years.

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This report was written as part of the Executive MBA-Global program of the Columbia Business School and London Business School. The authors are currently candidates in this MBA program. They will be qualifying as MBAs in January 2003.

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