Business Process Outsourcing : An Overview

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Dragging economies and sagging markets continue to pressure global firms to find new ways to remain competitive. After several years of cutting jobs, merging operations and over-hauling under performing businesses, major industry players are now increasingly turning to outsourcing to slash costs further.

Once upon a time, not long ago, a layman believed Business Process Outsourcing (BPO) is nothing but call centres and medical transcriptions. As the concept of BPO is getting mature world over, its universe is also expanding, with more and more companies providing value and insight that go beyond running voice calls.

A more traditional meaning might define BPO as contracting non-core duties to an outsider provider in order to achieve some cost saving and perhaps improve productivity.

We can say BPO means the delegation of an intensive business process to an outside provider, who owns, administers and manages it according to a defined set of metrics. Typically, Information Technology (IT) is leveraged extensively in carrying out the function, and more recently, the offshore model has been used in providing cost - effective services. For this reason, BPO is referred to as IT enabled services (ITES). But it doesn't include outsourcing of manufacturing / assembly.

In simple terms, ITES involves the offering of services from remote locations by harnessing the power of IT through telecommunication / data networks. Such services could be offered domestically or to companies in other parts of the globe either by a third party (outsourced partner) or a subsidiary of the client company (remote operations or out - location).

Global Trends of Outsourcing:

- 70's : Manufacturing Outsourcing
- 80's : BPO Success Stories: Convergys, Paychex, Fiserv, Exhult etc. of US
- 90's : IT Services Outsourcing Success Stories: TCS, Wipro, Infosys, etc. of India
- 2000's : Business Process Outsourcing... Success Stories...?????

Why Outsourcing:

The few reasons why companies go for BPO are:

a) Cost Management
- Capital investment avoidance
- Variable cost opportunity
- Lower costs

b) Performance and Best Practices
- Access to the best practices
- Enhanced performance
- Greater experience base
- Obtaining greater access to skilled people
- Turnover impact
- Access to cyclical needs
- Employing up-to-date business technologies without upfront costs.

The Indian Scenario

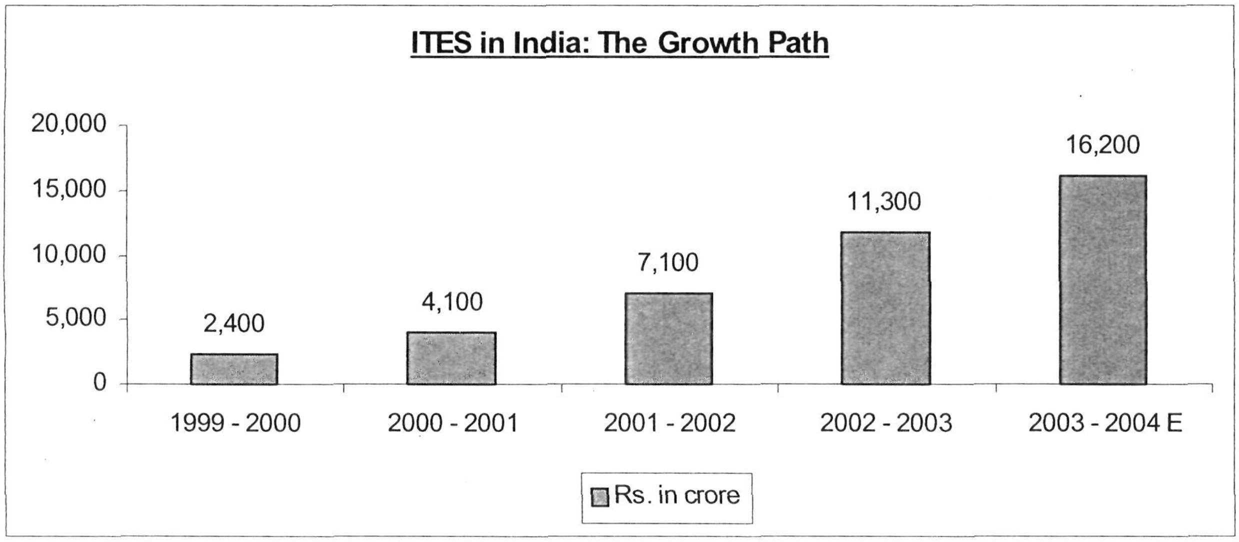
According to industry estimates, the ITES market globally was of the order of US$ 13.5 billion during 2000 and is expected to grow to US $ 142 billion by 2008. As per Nasscom-McKinsey report 1999, the Indian ITES industry can attain revenues of US $ 17 billion by 2008 and capture 12% of the market.

Software and Services exports growth

(Rs. in Crore)

	2000-01	2001-02	2002-03
IT services, products and tech services	24,100	29,400	34,800
ITES BPO	4,250	7,100	11,300
Total	28,350	36,500	46,100

Indian IT players have in fact already made great strides in the ITES/BPO market. What began as an activity that was confined to MNCs that set up captive ITES facilities in the country, India today has a large base of third party BPO companies that are bagging prestigious remote services projects from leading global organizations.



The BPO market remained a high growth segment for the Indian software and services industry during 2002-03. Despite the adverse global economic conditions, Indian players in this space logged in high growth rates. In 2002-03, the Indian ITES sector grew at the rate of 59% and clocked revenues of Rs. 11,300 crore, up from Rs. 7,100 crore ($ 1.5 billion) in 2001-02. The industry is projected to register a growth of 54 % to clock revenues of Rs. 162 billion ($ 3.6 billion) in 2003-04. There are about 459 BPO players in the country.

As on 31st Mar '03

Professionals employed	1,71,000
Investment	$ 1 billion
Space covered	7.5 million sq. ft.
Revenues	$ 2.3 billion (Rs. 11,300 crore)
Growth Rate	59.2 % p.a.

In terms of cost savings that a company can accrue, India is far ahead of any other competing region. According to another study, the 45-55 percent cost saving enabled by setting up a centre in India is significantly higher than the APAC average of 40-45%. While Mexico and other Central American countries offer 35-40% saving. Canada, which is a preferred destination for many US, companies for near shore operations offers only 20-30%. And this comes down even further to 15-25% on reaching Europe.

Even in terms of quality offered India stands 30% higher than any other region. The fact that almost 60% of the work undertaken is repeat business further strengthens the argument in India's favour.

Comparison of Operating Cost for ITES sector in India and the US

(US$ cost per FTE)

Components	United States	India	India as % of US costs
Personnel	42,927	6,179	14%
G&A Expenses	8,571	1,000	12%
Telecom	1,500	2,328	155%
Property Rentals	2,600	847	33%
Depreciation	3,000	1,500	50%
TOTAL EXPENSES	**58,598**	**11,854**	**20%**

SWOT Analysis of Indian BPO Sector

Strengths:

- Cheaper workforce than their Western counterparts. According to NASSCOM, the wage difference is as high as 70-80 % when compared to their Western counterparts.
- Lower attrition rates than in the West.
- Dedicated workforce aiming at making a long-term career in the field.
- High quality orientation - major expansion in base of ISO, SEI CMM Level 5 companies.
- Strong cost value proposition.
- Experience on state-of-the-art hardware and software platforms.
- On time, on schedule delivery of projects & experience in large projects.
- High reliability factor of Indian software export companies with a vast base of Fortune 500 customers who are increasingly outsourcing to India.
- Strong project management skills.
- Strong educational orientation - perfect for producing high-class engineering graduates skilled in computer science and software, with vast base of English speaking.
- Focus on high value, software off shoring model.
- India is able to offer a 24x7 service and reduction in turnaround times by leveraging time zone differences. India's unique geographic positioning makes this possible.
- Many state governments in India are offering incentives and infrastructure for setting up ITES and setting up STPs.

Weaknesses:

- Recent months have seen a rise in the level of attrition rates among ITES workers who are quitting their jobs to pursue higher studies. Of late workers have shown a tendency not to pursue ITES as a full-time career.
- The cost of telecom and network infrastructure is much higher in India than in the US.
- Low presence in global packaged software market.
- Low telephone, PC and Internet penetration.
- India lacks in proper branding and social approach.
- Competition in home market amongst small players is taking its toll in quality.

Opportunities:

- To work closely with associations like Nasscom to portray India as the most favoured ITES destination in the world.
- Indian ITES companies should work closely with Western governments and assuage their concerns and issues.
- India can be branded as a quality ITES destination rather than a low-cost destination.
- Major demand for IT professionals in Europe (Germany, UK, Italy, France) can be exploited to push India's skilled manpower.
- Major opportunities in ITES segment (contact centres, back office operations, GIS/engineering services, medical transcription).
- Opportunities to increase off shoring. Number of global customers expected to offshore projects to India expected to increase rapidly.
- In the domestic market - the corporate, the Government and segments such as banking, finance and insurance are expected to computerise heavily.

Threats:

- The anti-outsourcing legislation in various US states like New Jersey, Connecticut, Missouri, Wisconsin etc.

- Workers in British Telecom have protested against outsourcing of work to Indian BPO companies.
- Other ITES destinations such as China, Philippines, Ireland and South Africa could have an edge on the cost factors. Also they are emerging as software development and ITES destinations.
- Visa restrictions and protectionism by export destinations.
- Inadequate growth in the domestic market.
- More high quality manpower is required - focus should move from 'quantity' to 'quality'.

Captive Units

Captive centres are those specialised internal departments that execute some processes that are internal to the company and have been improved and optimised over years. These are usually cost centres.

It is well known that the entire BPO trend was started after a handful of giant MNCs took the pioneering steps to make India their base for carrying out back office and customer interaction processes. While common belief is that it was GE, which did it single-handedly, a few other pioneers are often ignored-Amex and British Airways being the major names.

Captive Units: Pros and Cons

Advantages Disadvantages

• Securing data is less complicated • Capture margins that would otherwise go to TPSPs • Decision making authority contained within the organization • Tighter management control • Have a brand to attract employees • No need to worry about business and focus purely on service delivery • Help in disseminating process knowledge faster • Expensive specialist skill in host countries • Compliance and legal restrictions • Unavailability of skilled manpower due to market stagnation • Requires considerable effort in terms of managements time and attention to establish the unit • Cost structure is high • Boring and monotonous job profile

The larger companies with deep pockets & the ability to wait out a few years before seeing any return on investment might set up a captive unit to handle non-core processes. Typically, captive units look at the pay back period of around 3-4 years. However, as outsourcing migration normally takes more time than an in-sourcing migration.

After US, UK is becoming sensitive to the offshore model due to cost pressures. And this is a market that is not so mature in outsourcing. This has resulted in a lot of captives by UK companies.

Some of the international companies having their operational captive units in India:

ABN AMRO	Citicorp	Hewlett-Packard	Prudential
American Express	Dell	HSBC	Quark
AOL	Deutsche Bank	Hutchison	Siemens
AXA	D-Link	JP Morgan	Standard Chartered
BMG	eBookers	Logica	Suzlon
Cadence	eFunds	Lufthansa	Swiss Re
Capital One	Emirates Airlines	Microsoft	Unilever
Casio	Fidelity Investments	Morgan Stanley	United Health Source
Churchill	GE Capital	P&O Nedlloyd	World Bank

Third Party Service Providers (TPSP)

In a TPSP, there is delegation of an intensive business process to an outside provider, who owns, administers and manages it according to a defined set of metrics. It exists as a separate profit centre.

TPSPs also ensure that the organization benefits from best of breed solutions rather than depending on internal staff that may always not be best team available of delivering the required services. Outsourcing to external service providers brings out the hidden cost and makes it easy to monitor and manage expenditure. It also adds flexibility to operations since the number of people working on the specific job or the infrastructure dedicated can be changed & paid for accordingly as per changing requirements, without having to suffer from the burden of excess capacity or the challenge of insufficient capacities.

TPSP : Pros and Cons

Advantages Disadvantages

• Focus on core business issues • Benefit from best -of - breed solutions • Better quality at lower cost • Better process maturity, resource flexibility and economies of scale • Flexibility in developing new technologies • Burden of excess capacity or challenge of insufficient capacity • High unit personnel cost • Tight business margins • Not enough financial muscle to sustain very tight payback period

Most customers are worried about running captive centres due to operational risks and the time it takes to manage offshore operations. That is why the most companies look to third-party vendors to provide outsourcing services. More and more MNC third party service providers are making their presence in India. Some examples are Exult, ADP, SITEL, Convergys, ACS etc. From $ 769 million in 2001-02, TPSPs have touched $ 985 million in 2003-03 showing a growth of 28%.

TPSPs and Captive Units: A Comparison

It is not surprising that in the initial years, the captive centres accounted for most of the process outsourcing work that came to India, with few Indian players in the fray till 1999. It was expected that as more players joined, the share of Indian companies in the total business would grow. In fact, that was not an unfounded belief. In 2000-01, the third-party companies, accounted for a healthy 57% of the total work, measured in terms of revenue, according to Nasscom.

Surprisingly, in 2001-02, the share of the third party companies dropped a little. What was alarming was that in the following year, it dropped drastically. In 2002-03, while captives grew by a staggering 90%, third parties grew by only 28%. The industry grew at a healthy 59%. But by now, the captives had a share of 58% of the industry, up from 48% in 2001-02. In other words, in two years, the balance was reversed in favour of captives.

Savings by outsourcing work to

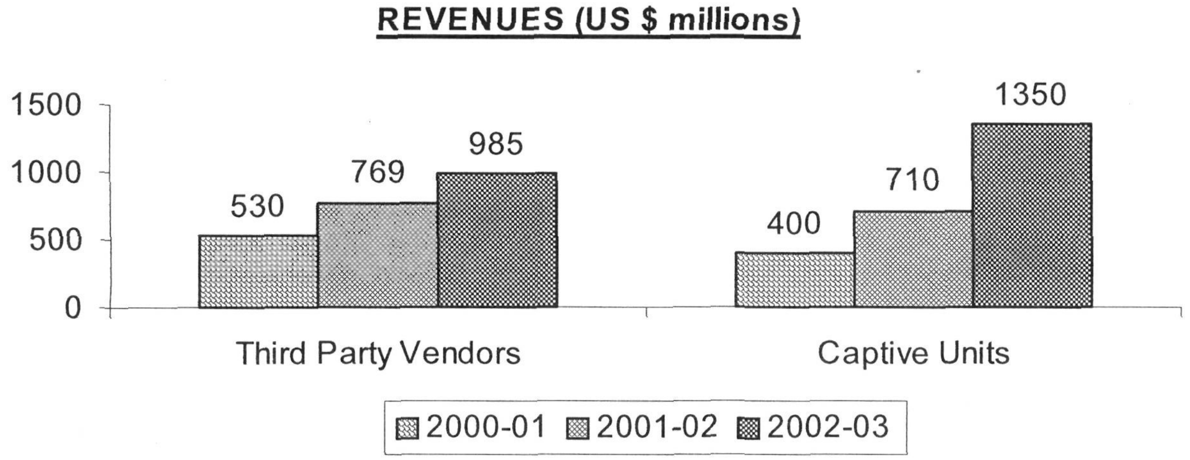
TPSPs Captive Centres

• Usually TPSP has already has expertise and experience with other clients in similar business lines. • Very competitive prising / flexibility to assess various TPSPs • No infrastructure / capital investment • Payback period very less (usually between 6 months to 1 year) • Can exit from one relationship and move to another • Retains decision making, therefore relationship with TPSP is clear (fees based, quality based); No staff backlash · As TPSP works towards a profit there is more business commitment • Customised solutions ensure data security and safety • Flexibility to source multiple TPSPs • Build expertise from scratch by redeploying resources. Later option is more expensive • Unit costs higher • Captive units are usually cost centres • High capital investment • Payback usually between 3 and 5 years • No exit possible without incurring high costs • May or not retain decision-making. Possibility of backlash - from senior management personnel • Long term strategy looks for establishing centres to first move work as is, and save costs first • Commitment to bring in economies to scale, hence the need to establish sufficiently large centres.

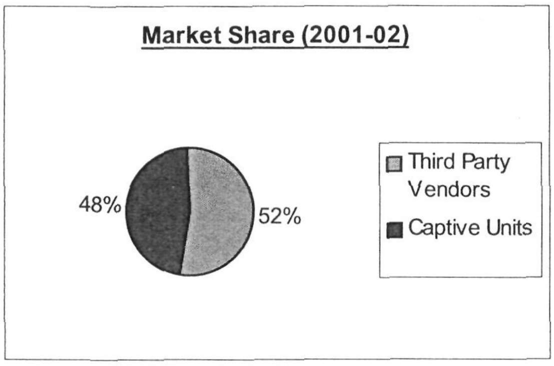
Many companies are uncomfortable with the idea of outsourcing to TPSP due to two main reasons:

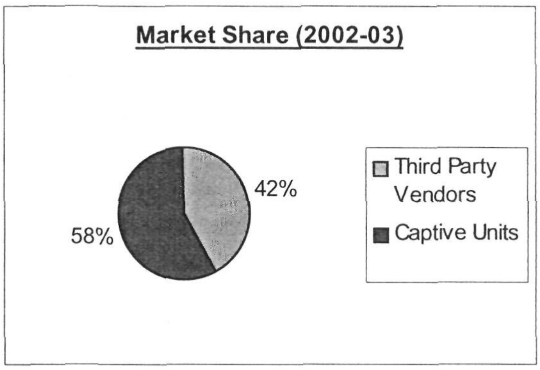
- Firstly, the company might have some intellectual property, which it doesn't want to fall into outside hands.
- Secondly, the outsourcers may not be convinced about the TPSP's capacity to handle the volume of activity that needs to be supported.

Security & privacy issues are other key factors.



Captive Units grew by 78% in 2001- 02 and by 90% in 2002 - 03. While TPSPs grew by 45% in 2001 - 02, which fell down to 28% in 2002 - 03.





Captive units have a comfort level as the assets remain with them. Also the jobs go to its own company. And they get to capture the margins, as much as 20-30%, that would have otherwise gone to third party. For large companies, the risk involved in investing in a captive unit is less. Captive units can understand the issues involved in knowledge transfer & employees loosing jobs. TPSPs on the other hand are insensitive companies have ventured into the ITES arena. Additionally, there is an increase in M&A activity within the country. All of these are fundamentally changing the competitive landscape in the industry.

- Captive Units have grown at an increasingly higher rate as compared to third party vendors.

- More and more MNC third party service providers are making their presence in India. Some examples are Exult, ADP, SITEL, Convergys, ACS etc.

- As outsourcing process is getting matured and customers are looking forward at outsourcing their 'core and critical' work, the option of setting up or ramping up the captive units seems to be taking precedence over giving work to the third party companies. However, many companies are following a hybrid or mixed model, in which they set up a captive unit, but also use MNC or Indian third- party service providers. Hence, the smaller players need not feel threatened by the entry of MNCs.

Future Trends

- ITES segment is projected to register a growth of 54% to clock revenues of US$ 3.6 billion contributing about 29% to the total software and service exports in the year 2003-04.

- As per NASSCOM estimates, by 2008, the ITES market will increase to $21-24 billion.

- Growth of fast-paced BPO sector will slow down due to the recent government decision to tax captive BPO units of multinationals. Otherwise, MNCs might just move back-office jobs to cheaper, competitive locations like China and Philippines, which offer tax breaks.

- Captive Units will continue to grow at a faster pace than third party vsendors. Captive units will constitute more than 50% of the outsourcing business over the next few years. Even in a mature market like US, 80% of the work is captive.

- MNC-owned captive call centres will fuel opportunities for Indian third-party centres too. Captives will not only complement growth but will also act as a catalyst for third parties.

- TPSP shall continue to be an integral part of this industry. However, the large scale outsourcing commitments shall remain with in captive centres, because of the nature of control and complexity of product lines.

- As these players expand it is conceivable that these BPO captive centres will be spun off as independent mega suppliers.

- We see the emerging captives as future acquisition opportunities. As they mature, many will be carved out. For example, WNS, which was among the first captives (of British Airways) in India, has turned independent. In fact, another airlines BPO, Airlines Financial Services (AFS), have also been acquired by the parent Swissair from TCS.

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