PRICEWATERHOUSECOOPERS

Indo American Chamber of Commerce

The Evolution of BPO in India*

April 2005

*connectedthinking

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FOREWORD

I am pleased to present "*The Evolution of the BPO Industry*" from the Indo-American Chamber of Commerce, and PricewaterhouseCoopers. This is part of a continual initiative to bring to light, the service-provider's perspective of the key trends and challenges of the Indian BPO Industry.

The report, culminating from a Survey, aims to capture the changing hues of the offshoring industry and provide critical insight into the key strategic and operational issues that service-providers are being asked to address. The report contains best practices with respect to delivery models and implementation plans, reflecting the growing competitiveness and uniqueness of the sector.

I would like to thank all the respondents of the survey, who spared their valuable time to share their experiences with us. I hope that the report will help them assimilate and learn from best practices shared by others in the industry.

Our thanks to PricewaterhouseCoopers, our partner for this Survey, for their detailed work and for sharing their knowledge.

Ashank Desai
Chairman, Mastek Limited
Regional Vice President, WIC IACC

PREFACE

Outsourcing is a management process in the globalized business context that has been well understood, tried and tested by successful organizations across the world. The competitive pressures arising from the emergence of a 'boundary-less' global economy, have spurred the faith in the process - as a means for providing significant cost savings, flexibility and improved operational performance. Offshoring is no longer being considered a short-term tool for cost-savings - the focus is steadily shifting to long-term competitive advantage, an integral part of the global corporation's strategy.

However, the process of transitioning to a BPO-based model is not easy. It raises many questions, presents many challenges and poses many risks. Further, with the BPO industry of India entering into a phase of maturity, a significant change in the nature of opportunities and challenges is being witnessed. Concerns and solutions are no longer the same as they used to be.

It is in this light that IACC-PwC have jointly carried out a survey, aimed at highlighting the finer nuances of the evolution of the BPO service provider in India; the shift in complexity of processes and the strategic and operational risks involved.

The objective of the report is to illustrate the emerging issues of the sector from structural changes in the industry to the human resource challenge, from migration strategies to governance and monitoring. The issues identified reflect the changing concerns of the global market, from a position of 'whether to offshore' a few years ago, to the current perspectives of 'how to best manage' this global inevitability.

We thank all the participants who took time from their schedules and shared their perspectives on the industry. We are confident that this report will help us learn from our shared experiences, to proactively manage and leverage the emerging trends of the offshoring industry.

Joydeep Datta Gupta
Executive Director
PricewaterhouseCoopers Pvt.Ltd.

APPROACH AND METHODOLOGY

The aim of this survey has been to identify key strategic and operational trends of the BPO industry in India, from both a customer's and a supplier's perspective.

The sample of respondents consisted of a judicious mix of 20 key service providers in India, with respect to ownership type (captives, joint venture companies, and third party vendors), nature of services being offered (voice, non-voice) and functional offerings (niche vertical players, general players etc.) This was to ensure that the analysis drawn and recommendations made, were representative of the Indian offshoring industry.

The methodology deployed for this survey consisted of primary research, with insights being captured through questionnaires and face-to-face discussions with senior management of participant organizations. Inputs from potential customers to this industry have also been collated, with respect to their key concerns while considering outsourcing to India. The analysis was further supplemented by PwC knowledge-bases and published data to validate trends and best practices, emerging from primary sources.

Our analysis and findings are based on consensus findings from the survey and are supported by quantitative and qualitative inputs from the respondents.

The data presented in this report is based on information received from the respondents and has been collated to represent an industry trend. Nowhere in this report have individual company statistics been published.

EXECUTIVE SUMMARY

Business process outsourcing (BPO) is not a new management strategy, but has received heightened interest in the past several years because of its potential economic and strategic impact. Companies look to outsourcers to provide process efficiencies and economies of scale, as well as continued investment in the latest technology, which can be more effectively cost-justified when spread across multiple organizations.

The report aims to highlight the changing trends of the Indian offshoring industry, as it shows indications of entering the next phase of maturity. The changes are all-encompassing, driven by key participants of the BPO sector - service-providers, clients, employees, external stakeholders and the Government. Below is an overview of our major findings:

- The supplier-side of the global offshoring market is anticipated to become more competitive in light of the emerging preference for presence in offshore as well as near-shore locations. Canada and Ireland, traditionally perceived as high-cost locations, will emerge as strong contenders.

- The structure of the Indian offshoring industry is witnessing steady change, with the emergence of domain/industry specialized BPO's. A noticeable change in the service offerings of service-providers is being witnessed; service providers are migrating to higher-end strategic processes. Correspondingly, the traditional growth drivers of the industry (voice, data processing), will lose focus.

- The objective of offshoring has progressed from being a mere cost-saving initiative to one that is adopted for realizing process improvements, and enhancing efficiencies. This shift has resulted in maturing of the client-vendor relationship, to a partnership based approach.
- Service-providers are realizing that the traditional sources of cost advantages - manpower and infrastructure costs, may no longer be sustainable. Service-providers have initiated significant cost-control and reduction initiatives, such as efficient utilization of capacity, accurate cost planning techniques, training on cost consciousness, to meet the challenge.

- Service providers are diversifying their geographic bases, by creating new infrastructure in Tier II cities, in order to leverage the lower costs and lower attrition rates, as well as to find access to a larger talent base. This also helps service providers to better equip themselves from a contingency perspective.

- The BOT model of deal-structuring has been cited as an emerging area of preference for clients, due to lower risks with higher control, and for service-providers, due to higher levels of profit margins.

- Pricing models are being centered on achievement of SLA's, indicating movement away from the traditional fixed price model.

- Migration strategies, risks and costs are increasingly becoming the area of focus for clients. Leading service-providers are leveraging this concern to differentiate their service-offerings by providing value-add services during the stages of transitioning including knowledge management, performance improvement, base-lining etc.

- The focus for clients with respect to risk identification and mitigation, has broadened to include internal risks including transition risks, data security risks, loss of control, brand damage, weak governance etc. Service-providers are able to play a critical role to mitigate the risks.

- Exit clauses are being diligently built into contracts, clearly specifying reasons for exit, notice-periods and issues related to intellectual property security etc.

- To meet the challenge of high rates of employee attrition, service-providers are aiming to reposition the BPO industry as a long-term career option. In addition, the focus has shifted to ensuring that the recruitment processes are aligned with retention strategies, by utilizing competency based frameworks for recruitment.

In conclusion, the changing trends have resulted in increased client and service-provider concentration on BPO Assurance, encompassing areas of program management, project management, performance monitoring, SLA management etc. The ROI aspect of offshoring, is now assumed as a given. It is the Governance, Risk and Compliance aspect that clients are now taking note of. The psychological leap that clients must make to offshore is requiring them to be sure of the risks that they are facing and the strategies that must be in place to manage them.

THE BPO LANDSCAPE

An Overview

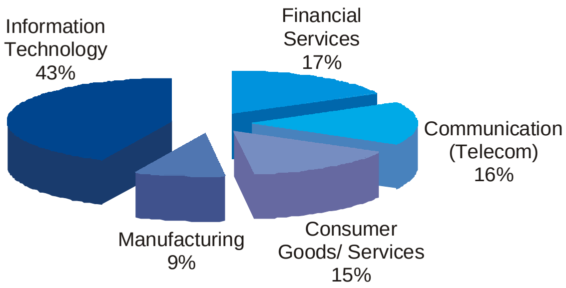
Reduced international trade barriers and improved telecommunication and IT capability over the past decade has led to a situation where organizations across the world are increasingly interlinked with each other. This has resulted in intense global competition, challenging business managers across the world to find ways to reduce the cost of conducting business and accessing global resources in meeting the need of global markets. In such a context, the reorganization of business models to leverage benefits of outsourcing and focus on core competencies, has become a key strategy pursued by large corporations across the world.

BPO service-providers are expected to provide a wide spectrum of benefits to their customers, ranging from having greater expertise in the outsourced processes, lower costs achieved through economies of scale, scalability and the ability to absorb cyclicality of loads.

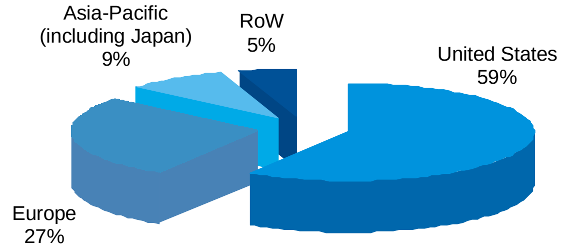
Demand-Supply Equations

According to market analysis firm Gartner, the global outsourcing market in 2000 was approximately $119 bn and will touch $234 bn by the end of 2005. The market is expected to grow to about $310 bn by the end of 2008. Contribution from the North American continent stands at about 59% of the total market, with Europe contributing about 27% and Asia-Pac region (including Japan) contributing the remaining portion of the market.

Global BPO Market by Industry



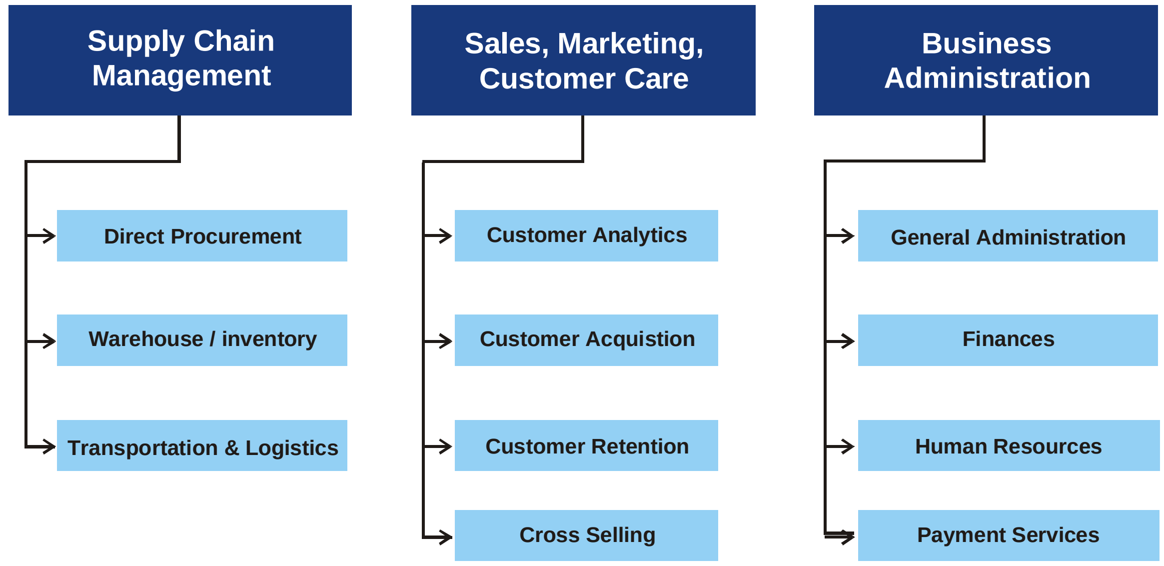
Global BPO Market by Geography



In terms of vertical contribution, the financial services industry contributes approximately 17% of the total market size, followed by the Telecom sector (16%), Consumer Goods and Services (15%), Manufacturing (9%) and the rest by the Information Technology sector.

The BPO market can be broadly broken down into three areas of functional operations:

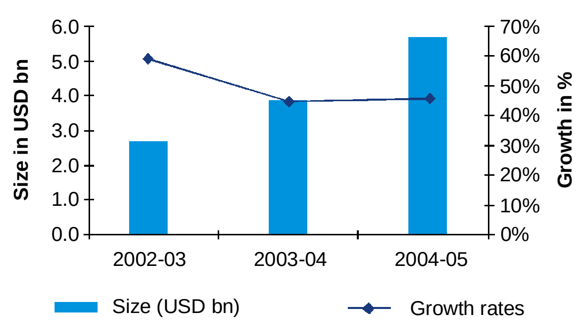
i. Business administration (falling under G&A expense costs)
ii. Supply chain management (COGS), and
iii. Sales, marketing and customer care (selling and marketing costs)



India has emerged as one of the bright stars in the global Business Process Outsourcing market and has maintained its global competitiveness by offering the best combination of cost, quality and scalability.

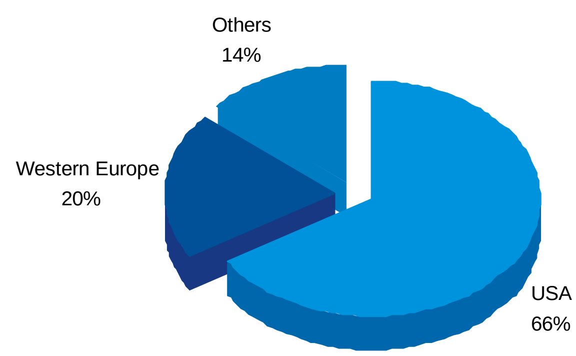
The growth rates* of the Indian BPO-ITES industry have been 59%, 45.3% and 44.4% in years 2002-03, 03-04 and 04-05 with revenues of over $3.9 billion in FY 2003-04 and expected to touch $5.7 bn in FY 2004-05.

Size and Growth of BPO in India



Currently the sector employs approximately 2,45,100* people and another 94,500 jobs are expected to be added in the current financial year. There are over 400 ITES-BPO companies operating in the Indian market, including captive units (of both MNCs and Indian companies) and third-party services providers.

Export Revenues by Geography



In terms of markets, the US continues to be the main consumer of India's ITES-BPO services (with a 66% share of the market), followed by Western Europe (including the UK), which accounted for 20% of export revenues. In terms of functional service offerings, Customer Care and Support services contributed approximately 34% of the industry's revenues with the other leading service lines including Finance (with a contribution of 22%), Administration (13%) and Content Development (19%). The global financial services vertical remained the largest user of Indian ITES-BPO services, followed by telecom, healthcare and airline segments. Captive units continued to dominate the ITES-BPO industry, accounting for over 65 percent of the value of the work offshored to India.

* NASSCOM

Advantage India

Despite a growing number of offshoring location options available with organizations today, India has emerged as one of the most preferred locations for outsourcing.

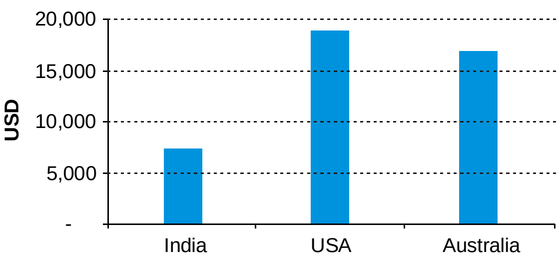
The primary factors in consideration while deciding on an offshore location include:

- Cost Competitiveness, which consists of cost of labour, infrastructure costs and currency exchange rates
- Labour Competitiveness, consisting of the size of the available labour, level of education, domain skills, fluency in the English language, cultural compatibility to western markets and attrition rates
- Other factors, which consist of existing business and political risks associated with the country, geographic location (time difference), tax regime and regulatory considerations such as Data Security and IPR issues

A country-level analysis of people and cost competitiveness reveals that India has greater traction primarily due to the availability of adequately trained manpower. It offers a large (over a million graduates each year with 350,000 engineers), well-qualified, English speaking labor force to offshoring organizations. It is on this parameter that potential and existing outsourcers perceive it more favorably than other low-cost countries such as Brazil, Hungary, Philippines and China. Canada, a viable "near-shore" option for many organizations, recognized for its people competitiveness, is however, considered a high-cost location.

The cost advantages of offshoring to India are significant. It costs less than US$ 7,500* annually to hire a call center agent in India (cost to company) as compared to US$ 19,000 in the United States and US$ 17,000 in Australia. It is also estimated that the average annual salary of graduates in India is just US$ 2,400 as compared US$ 2,900 in Philippines and US$ 19,500 in Ireland. Moreover, with a favorable exchange rate with the US Dollar, BPO service providers are able to pass on these benefits to the customers, making it one of the more attractive destinations.

Call Center Employee Costs



In conclusion, India is uniquely positioned to leverage its cost and quality advantages, to cater to the escalating demand for offshoring of transactional and strategic business processes.

* Gartner Research

Mode of Operations

Our survey found an interesting trend with respect to the choice of the outsourced location. The general perception that organizations prefer a single outsourcing location is misleading. In reality, organizations have multi-locational outsourcing strategies to ensure business continuity in case of a disaster in the primary location, as well as to expand the access to resources and talent in other locations.

Most industry players believe that the BPO-ITES would move to a "Global Delivery Model" wherein the service provider has a delivery presence in the market that they are serving. This model is more suited to mid-market clients who still look for physical presence as a pre-requisite for outsourcing. The perception amongst the service providers is that middle-market customers, who in the past, have had experience with near-shoring, are much more receptive to the idea of considering a mixed model of delivery where part of the processes are delivered from the India centre and part of it from the near-shore facility. The proof-of-concept, in these cases is done from the near-shore facility and eventually the large share of processes are carried out in India, with a small part of the processes continuing to be carried out from the near-shore facility.

Cost Control and Reduction Techniques

- Efficient utilization of capacity - servicing multiple geographies, offering multiple services – time dependent and offline offerings
- Enhancing internal efficiencies through process improvement
- Accurate cost planning techniques
- Training programs on cost consciousness
- Setting up new facilities in Tier II cities

However, some respondent's state that though people competitiveness is one of the primary factors for India's attractiveness as an offshoring destination, the recent double digit wage increases coupled with high rates of attrition are acting as dampers to the success story. Until now, these wage increases have been offset by the large decline in telecommunication costs, which have currently stabilized – resulting in service providers looking at other means to reduce costs.

Based on our survey respondents, it appears that the potential challenge for the BPO industry could be the perceived lack of regulation around issues such as Data Security and IPR issues. Moreover, with respect to ease of operations in setting up shop and running a BPO centre, respondents state that clients do not perceive India to be as competitive as countries like Philippines, Australia, Ireland. We discuss the potential risks in a typical offshoring arrangement in subsequent sections of this report.

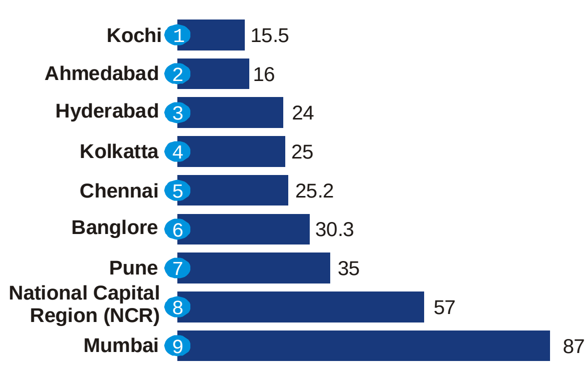
Location Analysis

Although India's position as a preferred location for offshoring is well established, the growth of the industry has been concentrated around a few key cities such as Bangalore, Delhi-NCR, Chennai, Hyderabad, Mumbai etc. Discussions with service-provider reveal the following advantages of these cities -

City Ranking on Power Scenario

City	Load Shedding (Hours per day)	Cost (Rs per unit)	Rank
Kolkata	--	3.1	1
Chennai	--	4.1	2
Hyderabad	--	4.3	3
Ahmedabad	--	4.8	4
Mumbai	--	5	5
Kochi	0.3	3	6
Bangalore	2.4	4.1	7
Pune	4	4.1	8
NCR	4.6	4.2	9

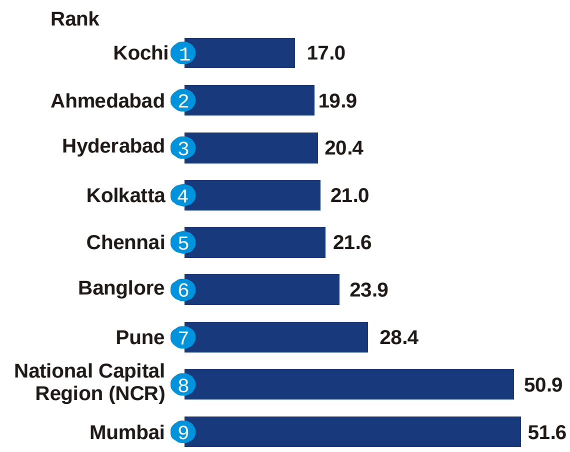
City Ranking Based On Real Estate Prices (Rent per sq ft / month)



Source: Knight Frank, Cushman & Wakefield, Colliers Jardine

- Established connectivity to international and domestic cities
- Well-established physical infrastructure e.g. power, water, telecom etc. However, cost of infrastructure for these locations seems to be an area of immense concern for service-providers and clients

City Rankings Based On Manpower Rates (Rs./hour)



Source: Knight Frank, Cushman & Wakefield, Colliers Jardine

- Availability of well-qualified, adequate and low-cost manpower
- Well-developed social infrastructure to support residing population
- Well defined real estate laws, regulations on ownership and transfer of property

Respondents reveal that infrastructure costs constitute a major cost for a service provider. However, there is an emerging trend to minimize this cost to be able to maintain cost margins and enhance profitability. Consequently, service providers are increasingly looking beyond the traditionally favored destinations towards Tier II cities such as Jaipur, Pune, Chandigarh, Indore, Ahmedabad, Cochin and Nagpur.

Tier II cities offer a cost advantage due to the relatively lower cost of living. For instance, according to a BPO major currently considering setting up operations in Chandigarh, for employees, it is 60% more expensive to live in Delhi-NCR, a traditional BPO hub, as compared to Chandigarh, a Tier II city.

Tier I cities have witnessed attrition rates as high as 60% over the past few years. Service providers and clients have becoming increasingly concerned about this trend as it translates into increased recruitment and training costs, impacts service quality and also poses a significant data security threat. However, survey respondents state that smaller towns have relatively lower employee attrition rates of around 10-15 %, making them an attractive destination, especially for transactional offshoring. In addition, location specific sops (like tax holidays) from state governments enhance the investment attractiveness of the Tier II cities.

However, the decision to move to Tier II cities, the respondents believe is not without its negatives. For one, training costs for employees are higher (especially for voice-based processes). Secondly, cost of maintaining 24x7 operations in Tier II cities is inflated (especially due to the lack of infrastructure – e.g. frequent power outages), resulting in a cautious and a 'wait and watch' approach being adopted by most service-providers.

An advantage of a strategy that leverages Tier II cities is that these cities, though low in infrastructure, are significant contributors to the talent pool. In other words, whilst infrastructure is concentrated in Tier I cities, human resource talent is distributed all over India.

Industry Structure

The growth of BPO in India can be classified into four distinct phases:

The First Wave: Company Owned Units Pioneered BPO in India

- Company owned units such as American Express, General Electric (GE), Citibank, and AOL etc. triggered the trend of outsourcing back office operations and call centre services to India.
- Since then several banks, insurance companies, airlines and manufacturing companies have set up back office service centers in India.

The Second Wave: Venture Funded New Companies

- Over the last few years, a number of experienced professionals have set up start-up operations in India. Generally such start-ups have been funded by venture capital funds.

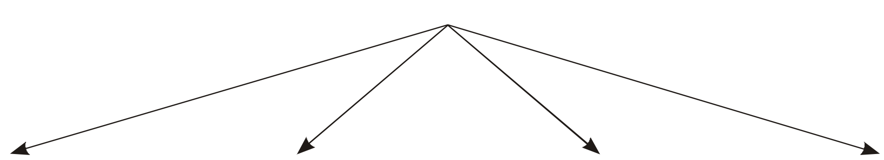
The Third Wave: Leading IT Services Companies enter BPO

- Given the magnitude of such opportunity, natural synergies with the software services business and the ability to leverage their high-end physical infrastructure and management band-width, most large IT services companies have ventured into ITES.
- Consolidation of the market with the smaller players merging with each other/ larger companies for economies of scale

The Fourth Wave: Domain / Industry Specialized BPO's

- Niche players in industry verticals or specific business processes have setup BPO businesses. Many of these players have had vast experience in the domestic market and are now offering offshore BPO services
- Generalized large BPO players are now focusing on "verticalizing" their competencies and structures

A majority of the key players in the BPO industry in India are captive units of MNCs and international BPO companies desiring to take advantage of the cost arbitrage offered by India. For the Indian ventures of these MNC's the risks are limited since they are captive units and volumes are assured. Many of the BPO ventures of MNCs are now trying to offer their services to other companies. Several ventures have been hived off into independent companies to attract other customers and become profit centres as opposed to the cost centres they used to be earlier. Examples include eServe International, World Network Services (British Airways) and GECIS.



MNC subsidiaries

- GE
- British Airwasys
- eServe, HSBC, Scope, AmEx
- Hewlett Packard

International BPO Campanies

- Convergys
- Sitel
- eFunds

Diversified

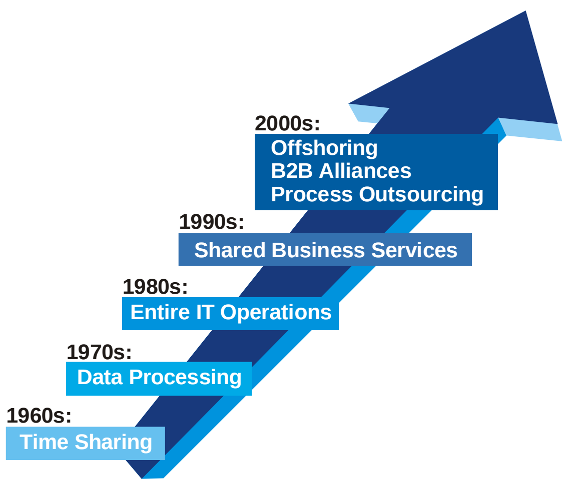
- Daksh
- Brigade
- Talisma
- Hero

IT Companies

- Infosys (Progeon)
- Wipro (Spectramind)
- Satyam
- HCL

THE EVOLUTION OF BPO

Amex and GE pioneered the trend of outsourcing to India by setting up facilities in Gurgaon, near Delhi, in the early 1990s. Some of the other early birds were companies such as British Airways who have also been operating their back office in India since the mid-1990s. The early reasons for considering offshoring to India were centered around reducing costs and minimizing the effort spent on "non-core" activities. With increasing confidence of the companies in the capabilities of Indian operations, higher value added activities such as processing of HR, accounting and other non-core functions is reaching the Indian shores.



Why outsource?

- Refocus energies on strategic and core issues
- Access to world-class capabilities
- Capital Reallocation
- Reduced Operations expenses
- Reduced time-to-market
- Risk mitigation

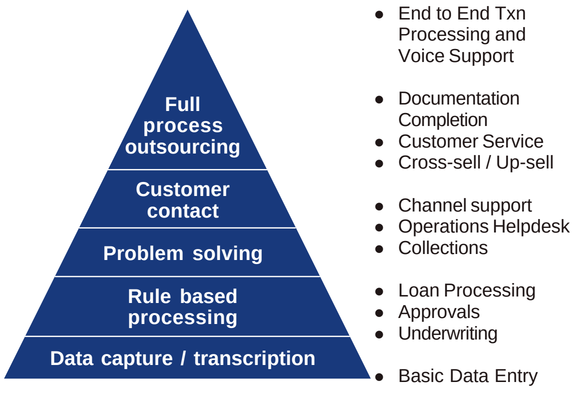
An interesting trend witnessed as part of this survey was the perception of service providers that customers considering offshoring are doing so to "*Build on distinctive competencies and retain the competitive edge to create value for stakeholders*". As per our analysis, the focus of an offshoring arrangement is on business outcomes, not just infrastructure or tasks. The main goal is to achieve sustainable enterprise-level service improvements by transforming processes.

With maturity building in offshoring programs, the management focus on the decision-making process has crystallized around the availability of a highly-skilled workforce and the scope of scalability, with cost advantages being now taken for granted.

Apart from the traditional back-office processes, some of the participants in this survey are engaging in performing high end services including research in global markets, credit rating, lending limits, customer analytics

In this light, the traditional growth drivers of the industry (voice, data processing services) will lose focus, and processes higher in the value chain (such as Financial Close, Order Booking, General Ledger, Research and Analytics) will gain the attention of the industry; a fact that has been corroborated by all of the organizations participating in this survey.

From a supplier's perspective, there is a definite need to move up the value chain. Most respondents to the survey concur to the fact



that in order to improve profitability they would need to move to high-value processes. In addition, attrition rates have been observed to be lower for higher-end processes, translating into lower costs.

In this maturing paradigm of offshoring, clients are no longer passive participants. Their expectations have risen, their involvement has deepened and their approach has become more cautious. They demand more than a temporary answer to tighter budgets, seek a balance between cost, quality and control, and expect lasting partnerships, that continuously deliver quality and affordability over the total lifecycle. This has an implication on the nature of relationship between the service-provider and client, maturing to a deeper 'partnership' approach – based on long-term stability, commitment and mutual benefit.

The partnership approach becomes all the more critical as companies start moving higher-end processes to their offshore facilities. Typically higher-end processes are more critical to the business and have a greater degree of integration with the company's global processes in other countries.

BPO is therefore evolving from a solution that can dramatically lower cost in the short run – almost as an alternate or interim solution to automation, to an approach to access global talent.

THE GOVERNANCE, RISK AND COMPLIANCE PERSPECTIVE

As offshoring moves towards the mainstream, addressing governance issues up front is essential to long-term success. Doing it right the first time is more critical now than ever. In the past, offshoring generally involved outsourcing single functions within specific business units. Risk and governance issues surrounding offshoring did not rise to the organizational level. However, integrating offshoring, especially captive sourcing, into a company's global business model demands strong controls, robust reporting and management processes and risk management strategies that are aligned with the company's global operations. It is imperative that companies take an enterprise-wide, holistic view of governance and risk issues.

DEAL STRUCTURING AND PRICING

The importance of picking the right deal structure in offshoring, is critical in light of the long-term strategic implications it has on cost savings and performance quality. The choice can be a difficult one – between pursuing a captive model, doing a BOT (build operate transfer), doing a joint venture with a supplier, or going straight to the supplier for a direct services relationship.

The deciding factors depend broadly on the level of flexibility that an organization is willing to assume and the degree of control that it wishes to exert on the overall operations. In addition, there may be other factors such as tax and legal considerations, cultural issues and time to market aspects that may influence the choice of model.

Respondents state that there is no one 'most suitable' model that exists in the industry, stemming from the fact that the requirements, expectations and risk appetite of clients vary significantly. Interestingly, the requirements of a specific client may also vary with time - the prime reason for the emergence of a market for BOT models with call options, which clients may or may not chose to exercise.

> "The core competency of having an in-house captive unit and the advantages associated are tremendous compared to third-party outsourcing in terms of committed employees, infrastructure understanding and customization of processes to specific and changing business needs."
>
> *- Agilent Technologies, India*

Industry research indicates that currently, the captive model of offshoring is predominant. The reason for this, respondents' state, is that the early adopters of the BPO concept simply had no other choice, thereby being forced to adopt the 'do it yourself' model. The industry did not have a critical mass of third party players to whom processes could be offshored or those with whom more sophisticated arrangements such as BOT or joint ventures could be entered into. The captive model offers companies high management control over the operations, which was critical during the early 'proof of concept' stage of the industry. Further, business continuity risks are perceived to be low and data security is more reliable.

Some of the respondents however feel that the captive model of offshoring may witness reduced activity in the years to come. The

PARAMETERS	CAPTIVE	THIRD-PARTY	JOINT-VENTURE
Investment	●	○	◐
Time to market	●	○	●
Perceived level of data security	●	◐	◐
Control over operations	●	◐	●
Management bandwidth	●	◐	●
Exit costs	●	○	◐

● High ◐ Medium ○ Low

prime reason stated for this is the high lead time for operationalizing the center. With offshoring perceived to have entered the next stage of maturity, global organizations feel that the time-to-market needs to be minimized to the greatest extent possible to retain competitive advantage. In addition, the requirement of substantial management bandwidth, scaling up of leadership and organizational capabilities in the subsequent stages of the project, pose formidable challenges to the operational feasibility of the model. Nonetheless, some respondents state that clients are steadily questioning the applicability of the third-party model, in an era where taking control of product and service quality has become a critical success factor. Further, with the feasibility of transaction-oriented offshoring having been tested, clients are now willing to experiment with offshoring their core processes for which access to knowledge, proprietary systems and intellectual property is preferred to be retained in-house.

The third-party offshore model has witnessed considerable activity over the past few years, a direct consequence of the emergence of world-class service providers with significant critical mass. Respondents stated that the preference for this model may be attributed to the shorter payback period (between 6 months to a year), and lower exit costs. In addition, clients believe that the third party models hold the maximum potential of leveraging economies of scale – thereby reducing costs and maximizing efficiencies. However, the nature of work outsourced is typically non-core and non-critical, in light of a perceived lower level of data security.

An emerging trend with respect to deal structuring is preference for BOT models, a majority of the respondents stated. It is a win-win situation, with suppliers keen to participate on account of the opportunity to earn higher margins and clients navigating the learning curve with experts and assuming control only on stability of the outsourced process. However, some respondents suggest that the BOT wave is only temporary. Cost savings are the maximum in the first few years of offshoring, stabilizing to approximately 10-15% thereafter, making it an unattractive proposition for clients to maintain the offshore center themselves.

> "It is unlikely that the future deals will converge towards any one model. All these models will continue in the immediate future."
>
> *- Survey Respondent*

A hybrid approach, wherein a client outsources a set of processes to a third party and simultaneously operates a captive for other processes, may also assume importance in the years to come. This flexible structure enables clients to simultaneously leverage the benefits of scale for volume driven processes, and address risk-management concerns for other core activities.

As the BPO sector matures, it has also been privy to evolving pricing models. These range from the traditional vanilla time-based models to the more value based pricing mechanisms and complex management fee models that are emerging. These pricing models may depend on one or more of the following variables:

- Full Time Equivalent
- Time-based
- Volume-based
- Per-seat
- Fixed
- Fixed plus variable
- Gain share

For captive units, the respondents state that the pricing techniques are based on the cost-plus approach, ensuring that offshore centers operate as profit centers and are incentivized to adopt a 'cost-minimization' approach.

> "A key challenge that is faced for pricing is to come up with a comprehensive solution that will be able to capture time and cost at the required level of granularity."
>
> *- Survey Respondent*

Standard CAPEX items such as cost of bandwidth / connectivity, infrastructure and facilities costs and technology costs also need to be factored into pricing models to arrive at an optimal pricing strategy**.**

An interesting pricing model cited by a respondent is based on a ‘step-down’ pricing approach, wherein the pricing reduces with pre-defined time milestones, allowing operators to build requisite skill sets to maximize operational efficiency and effectiveness.

In this manner, service providers are willing to customize pricing agreements to client and process specifications to ensure a collaborative approach to profit maximization. However a large number of respondents in the survey highlight an intensification of client’s preference for SLA-linked or gain share models, incentivizing service-providers to achieve and surpass SLA targets. On the flipside, there has been a trend towards more stringent enforcement of penalty clauses for non-achievement of targets, which had traditionally been viewed as a mere contractual necessity by clients.

MIGRATION STRATEGIES

Migration is the first test of the offshoring relationship, and often the most difficult. It involves migration of people, processes, technology and in some cases, culture. The psychological leap the organization is required to make at the time of offshoring can be challenging. Even with detailed planning, it is often a learning curve for both parties, wherein several steps may be taken to reduce the risk of subsequent failure.

Migration Success Parameters

- On time
- Least cost
- Least process disruption

Transitioning involves knowledge transfer to a large block of new resources with no previous knowledge of the systems, corporate culture and industry. It is an area that is being planned minutely by clients, with detailed transition plans being created - addressing methodologies, milestones, documentation and costs. In specific cases, respondents shared that the plans also describe strategies to mitigate risk and manage productivity during the period of transitioning. Capacity planning and technology issue analysis also form integral parts of the overall transition plan. The client's objective, respondents state, is to minimize the costs and avoid any surprises at the later stages of the project. In this light, clients also address issues of onsite redundancy, re-organization and retraining in the transition plan.

The principles of migration are centered on minimizing the implementation risk, costs and disruptions to the business and realizing the benefits as soon as possible. Based on these principles, there exist two basic models of migration wherein the processes to be offshored may be improved onsite and then migrated, or simply migrated on an As-Is basis.

A majority of the respondents claimed that clients prefer the latter route for migration, with processes being migrated in their existing states, and being improved only on achieving stability in the offshore location. 'Clients don't want to deal with too much change at once', a respondent cited. A phased, ramp-up approach is typically preferred by clients, offshoring one process at a time, and identifying improvement opportunities at later stages. The Big-Bang approach of offshoring multiple processes simultaneously is adopted in exceptional cases where the client faces an urgency with respect to timelines.

With the methodology of transitioning agreed upon, the next step involves an assessment of the client's existing processes, and corresponding people and technology support. For this, a cross-functional team, spearheaded by an expert in the function being outsourced is created – both by the client and the service-provider. For the client, this team is often a part of the Program Management Office (PMO), constituted to support the project during the lifecycle of the project.

This stage of knowledge transfer between an onsite and offshore team is one of the most vital to the success of transitioning a project offshore. There are various modes of migration that may be adopted including onsite shadowing, remote transitioning or a hybrid of the two. However, survey respondents highlighted that from their perspective, the preferred route for knowledge transfer is when it takes place at the client's location, with the vendor team being able to appreciate and experience the work environment and more importantly, the organization's culture. Shadowing of resources by allowing the offshore resources to visit onsite, and then using a train-the-trainer approach at the offshore location also helps the project to adhere to budgetary limits. In addition, respondents state that this approach allows them to study the ripple effect of offshoring on the upstream and downstream processes being retained in-house.

Key Service-Provider Differentiators

- Migration Methodologies
- IT Security Strategies
- Business Continuity Planning
- Change Management Support
- Risk Management Methodologies

During the stage of knowledge transfer, the service-provider's team gathers existing documentation from all sources (company repositories, IT resources, business end-users), analyzes and understands the existing internal processes to identify minor adjustment areas. These learning points are consolidated and presented to the other members of the teams, subsequent to which the transition commences. This rigorous approach is often adopted for migration of the first few processes or for critical processes. However, some respondents state that as clients develop a degree of comfort with the service-provider, migration may also shift to a pure remote migration model, currently being adopted on a limited basis for capacity ramp-up offshoring initiatives.

> "Proven transition methodology is a guarantee for success in the BPO space."
> *- Pradip Advani, Nipuna*

Migration techniques adopted by leading service providers, are structured around six-sigma methodologies. Respondents stated that in addition to risk management strategies, IT security policies, BCP and change management, the robustness of the migration methodology is often a key differentiator for a service-provider. Leading players of the industry have customized or proprietary transition toolkits – each with detailed processes that include steps, check points, milestones, documentation and templates. Examples of specific value-add features being provided by leading BPO players, as specified by a survey respondent, include:

- *Knowledge Management and Business Intelligence:* Knowledge assimilation and dissemination around transitioning, ensuring shorter transition cycles and greater client satisfaction.

- *Performance Improvement during transitioning:* Some service providers offer performance improvement initiatives prior to actual transitioning, which includes upstream and downstream process analysis.

- *Base lining:* A test run of the process offshore is done within the transitioning phase itself and helps establish a clear baseline.

- *Comprehensive Service Level Agreements* backed by stringent reporting systems.

Respondents state that transition for BPO outsourcing may take anywhere from 5-7 months for the first process outsourced, which may reduce in subsequent transitions. However, this may be influenced by factors such as process complexity, availability of documentation and communication plans and prior experience of service-providers. This time-frame also includes development and implementation of training programs, establishment of Service Level Agreements, full responsibility transfer and integration of operations.

RISK ASSESSMENT AND MANAGEMENT

Offshoring services can reduce costs, provide higher quality processes and allow management to focus on core business. But it also introduces substantial risk management challenges, which when combined with increasing regulatory scrutiny and negative public sentiment about moving jobs overseas, make risk assessment and mitigation imperative.

External risks

- Country infrastructure
- Management challenges
- Business continuity
- Vendor selection
- Cultural and language differences
- Geo-political concerns

The risks of flawed location selection, provider selection, and poor management are considerable, attracting substantial management time and investment. However there are some other risks which are not so obvious but impact the business and its interests. Respondents to the survey state that as clients become more knowledgeable about offshoring, greater emphasis is laid on assessing risk areas where there may be significant impact on people, processes, technologies, on existing facilities, and on regulatory and legal requirements both in the home and offshore environments. A noticeable trend, as per the survey, indicates the steady shift in the focus of clients from external to internal risks.*

Internal risks*

- Transition risks
- Data Security risks
- Loss of control
- Brand damage
- Weak governance
- Staff resistance
- Hidden costs

Transition Risks

As a part of internal risks, transition risks have been cited to be the most severe. These risks include errors in estimating overall time for migration, intensity of efforts involved and costs that shall accrue. To mitigate these risks, clients are adopting sophisticated approaches for identifying the critical path for successful transition and understanding the level of risk associated with realizing each key benefit area. Sensitivity analyses are also conducted to assess the probability and impact of any delay and reduction of benefit levels due to uncertainties or inter-dependencies with other projects, operations or functions during planned transition.

* Source: Mercer Management Journal 18

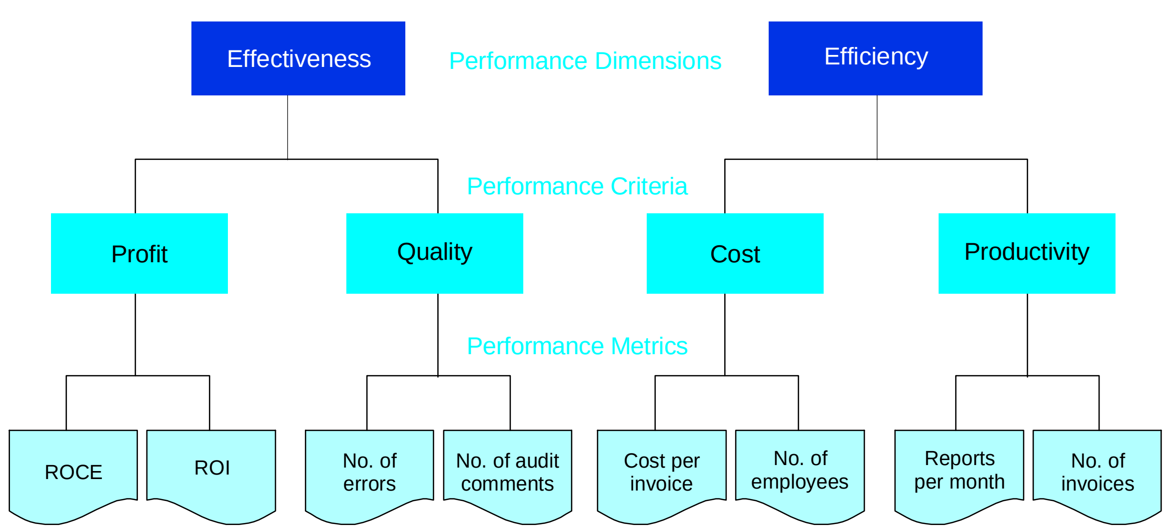
Data Security Risks

Global customers consider network security, physical security, customer privacy and information protection to be critical. A few respondents state that the criticality of data security is more concentrated in the areas of voice-based offshoring, with employees often gaining access to customer id's, pin codes and other confidential data. In addition, the importance is magnified in specific strategic processes such as financial reporting, tax and legal support and in the verticals of healthcare and insurance. Service providers are aware of the privacy and IP related concerns of their clients and in a large number of cases, as per the survey, are compliant with global standards such as BS 7799, ISO 17799, COBIT and ITSM, now considered 'must-haves' for the larger players. Further, most respondents have taken steps in the areas of physical security, technological initiatives, policies, ethical guidelines on their own initiative, to ensure that data confidentiality is maintained. Regular training on issues of security awareness, non-disclosure agreements, screening of employees and periodic compliance audits are some of the best practices that had been observed in the survey. In addition to the above, clients have also begun to detail specific steps that they expect the service providers to take to ensure data confidentiality. Security clauses at network and data level are built into contracts. Further, technological arrangements between clients and service-providers may ensure that offshore employees are unable to enter the client's system, with all offshore inputs being mirrored onto the master database on a periodic basis. SLA's also cover relevant laws that offshore providers are to comply with, detailed with actions that can be taken in case of breaches.

Managing Data Security Risks

- Security certifications e.g. BS 7799, ISO 17799, COBIT
- Non-disclosure agreements between clients and employees
- 'Clean-Desk' policies – no paper, no pens on workstations
- Disabled technologies e.g. floppy drives, CD drives
- Employee screening for cell-phones
- Dedicated seating
- Firewall arrangements
- Employee awareness programs

PERFORMANCE MODEL*



*Source: Barrar, Wood, Jones, 2002

Loss of Control Risks

Loss of control on offshored operations is an area that clients have traditionally been concerned of in light of the cultural, administrative and geographic distance between the client and the service-provider. The anxiety accrues due to two prime factors respondents cite – perceived inability to influence the quality of the service and the inability to determine what is going wrong due to inadequate or inaccurate information. The implication of the perceived loss of control has been on high expectations from service providers and the detailed drafting of SLA's with respect to quality controls and communication flows.

Although SLA's encompass all areas of client and service-provider rights and responsibilities, the expected quality of the service and the evaluation criteria for measuring the service delivery is the one of the most critical aspects of the contract. In addition to the traditional metrics of quality such as accuracy levels, rejection rates, field error rates, turnaround time etc., the role of softer aspects of quality such as client and end-user satisfaction is being highlighted. This change is being stressed in light of the maturing drivers of offshoring, moving away from a pure cost-saving objective to one enhancing overall productivity and quality of service. Although leading service providers invest continually in quality initiatives such as six sigma, COPC, lean-service models, respondents foresee that in the years to come, these initiatives will progress from being service differentiators to 'must-haves'.

To corroborate adherence to the defined quality standards, respondents state that the role of presenting accurate, consistent and timely information has also become critical. Dashboard and MIS report structures are defined for each stage of the project clearly specifying aspects such as frequency, time, content, initiator, participants and medium. In addition, escalation timelines and levels are specified to ensure de-bottling of communication flows. In terms of operational communications, immense importance is being attached to the documentation of communication flows between the clients and service providers. This also facilitates compliance with the legislations such as Sarbanes Oxley and SAS 70, detailed in later sections of the report.

Brand Risks

Brand risk is another area of concern for clients, stemming from poor service by service-providers resulting in end-customer dissatisfaction or service-provider practices not being in line with stated practices (ethical or otherwise) of the regulated entity. The magnitude of reputational risk is amplified with the political overtones of offshoring for which clients have begun to develop proactive external communication plans.

Risk of Arrested Evolution

An emerging area of concern for clients is the risk related to arrested evolution. These risks relate to the inability of an outsourcing solution, defined from a short-term perspective, to respond to changing business requirements. Due diligence in this respect is being carried out, with focus on issues of scalability and robustness of proposed technology platforms to underpin transition of existing operations, support ongoing business and enable any future expansion of offshore strategy such as significant increases or spikes in transaction processing requirements.

Risk of Hidden Costs

In the financial domain, risks that clients are becoming wary of include hidden costs - not foreseen in initial stages of projects. Respondents cite examples of the costs of evaluating vendors, managing major contracts, travelling to offshore sites, enhancing security, and paying severance for laid-off workers as instances of hidden costs. Exit costs are another hidden risk, as ending an arrangement prematurely exposes both buyer and provider to litigation. Clients are resorting to careful cost modelling and scenario planning which include benchmarked information and sound understanding of current activity-based performance and costing.

While most companies are focused on risk issues at the offshoring decision point (e.g., contract signature/change of control/ physical move), it has been observed that the focus fades with time. It is critical to keep the ongoing commitment to risk management; risk profiles and exposures change over time, and while some risks can be eliminated or mitigated, others must be actively managed.

Cost of Outsourcing

Service providers are getting affected with what is being termed as the "Hidden Costs" in an outsourcing arrangement. The respondents in this survey pointed out the importance of educating the end customer on the actual cost of outsourcing, which can vary significantly from the initial figure that the customers have in mind. The variation in estimation can depend on the number of factors that the customer considers while considering an outsourcing contract. Typical areas where cost estimates can go askew include, "costs of layoffs, cost of vendor selection, transition costs, and also cost of ramping up".

This survey reveals that the variation in cost estimates can end up being as high 38%. The only way to avoid such variations, service providers believe, is to be as transparent as possible. The table below reveals indicative areas where costs can get overlooked/ not accounted for.

Costs associated with	Indicative Figures (in%)
Ramping up	1 to 10
Selection of a provider	1 to 10
Contract Management	6 to 10
Transition	2 to 3
Layoffs	3 to 5
Total	**13 to 38**

Source: Overby, 2004

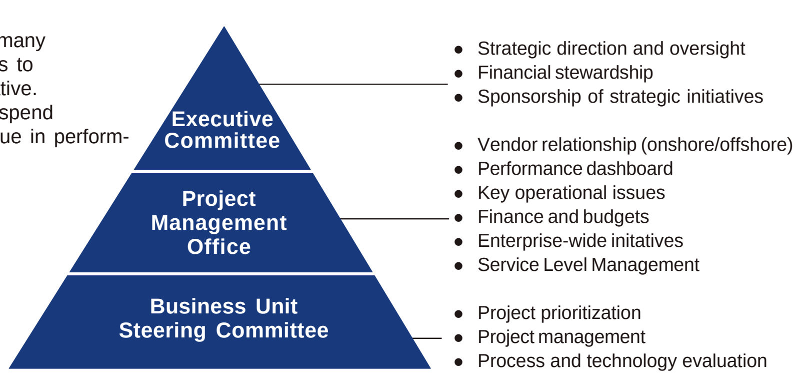
GOVERNANCE AND MONITORING

A large number of companies did not anticipate the complexities of managing large outsourced relationships. Services were outsourced on an *ad hoc* basis, resulting in responsibility for performance diffusing throughout the organization. As a result, organizations began to lack coherent policies and conditions and were unable to leverage the benefits of significant outsourcing volume. However, with the maturing nature of the offshoring concept, clients are now becoming aware of the role of strategic suppliers as true partners and are developing formal partner management principles, processes, and governance in collaboration with them.

The survey reveals that most companies establish a steering committee at the beginning of the offshoring process to oversee initial deployment and on-going operations. These committees are constituted of functional heads in the areas of finance, human resources (HR), legal etc. Respondents state that in the past, these functions had played only supporting roles in structuring the offshore operations. This practice is changing as risk, HR, regulatory and tax issues are coming to the surface and are being considered critical functions. For instance, tax has not been a high priority thus far, but with cost-reductions having been achieved and organizations seeking more sophisticated ways to enhance profitability, this trend is witnessing a change. In addition, in light of compliance requirements such as Sarbanes Oxley and Basel II, the role of the risk and legal functions has begun to assume dominance as compared to previous trends.

Under the steering committee, a small high-caliber team is created to retain strategic direction and control of the activities. Commonly known as the Program Management Office (PMO), it is a strategic entity that is formed at the corporate level. Although exact structures vary with the nature of outsourcing agreement, respondents state that the team is often cross-functional, constituted to support project management methodology, training, internal consulting etc. In certain cases, service-providers reveal that the PMO is specifically spearheaded by an executive of Indian origin, to leverage cultural similarities

In an effort to maximize cost savings, many organizations fail to dedicate resources to successfully manage an offshore initiative. It is recommended that organizations spend approximately 2.7% of the contract value in performing management activites.



Source: Renodis Global Outsourcing Solutions during the project. In other cases, the survey reveals that the management of the function that is being offshored drives the PMO. (e.g. IT for applications development). The objective of the PMO is to monitor the operational aspects of the projects, by ensuring that all projects are controlled by experienced project managers, project quality is continuously monitored and areas of risk are regularly identified and mitigated. More importantly however, the PMO is responsible for ensuring that aspects of cost, quality, scope and exception reporting are being effectively communicated across geographies.

The critical role of the PMO is to monitor achievement of SLA's during the lifecycle of the project. Respondents revealed that in the initial stages of the project, interactions with the onsite PMO team are fairly regular, and may take place on a weekly basis. The objective of these discussions is to highlight risk areas and report process exceptions. In the subsequent stages of the project, the PMO is responsible for oversight and decision-making in the areas of training, recruitment, SLA monitoring, process improvement opportunities etc.

A key input provided to the PMO is MIS reports and dashboards, containing summaries of performances and adherence to SLA targets. Respondents stated that the typical areas highlighted in MIS reports include volumes, accuracies, employee attendance and exception reporting. In addition, a large number of service-providers stated that clients were becoming increasingly demanding with respect to the information provided in MIS reports. For instance in a specific case, a client stipulated that the MIS report contain details on the number of errors per day segregated by the nature of error viz. typographical errors, casual errors etc.

Types of MIS Reports Produced:

- **Production Reports:** Production Report measures the operational efficiency of individual processes by evaluating the output against the inputs received.
- **SLA Compliance Report:** SLA Compliance Report measures the SLA compliance with regard to quality and timeliness.
- **Case Tracker Reports:** This lists out the cases that are yet to be completed although acted upon.
- **Weekly and Monthly Review Reports:**(On Production, SLA Compliance, and Errors etc) The Weekly and Monthly report facilitate review of weekly/monthly production statistics, error analysis, SLA compliance and pending cases to be resolved. This facilitates a causal analysis to identify error prone areas and to prevent recurrence of the same in future.
- **Project Management Office (PMO) Reports:** This includes daily reports to be submitted to the PMO which incorporates details on Idle Hours, Production Efficiency, SLA compliance, QC, Errors etc.
- **Senior Management Reports:** Typically, a performance summary of activities during the course of the evaluation period would be of interest. These reports are adapted in close consultation with the client.

- Survey Respondent

CONTRACT RENEGOTIATION AND EXIT STRATEGIES

One of the prime advantages of outsourcing is that it enables a company to respond quickly to changing market needs. In the same context, a change in the geopolitical climate or in the client's focus or profitability could necessitate renegotiating or worse, ending an outsourcing relationship. Whether it is the relationship ending prematurely or simply having run its course, the only safeguard that exists is diligent structuring of contract tenures and incorporation of contract renegotiations and exit clauses into contracts.

The survey highlighted that the typical tenure of contracts ranges between 2-3 years, followed by renewal on an annual basis. Service providers indicate their preference of entering into long-term contracts, a minimum of 2 years, to allow time for processes to stabilize and subsequently identify process reengineering opportunities. However, respondents state that there is an emerging trend of contract renegotiation and exit clauses being diligently incorporated into contracts.

> "Contract renegotiations are not necessarily a 'bad thing' - they may be a critical opportunity to ensure long-term success."
>
> *- Survey Respondent*

Survey respondents cite that contract renegotiations are more common than might be expected. Clients and outsourcers see the advantages of structuring "better deals" up-front. The best antidote to renegotiation has been to build greater flexibility into contract structures, to allow for changes without end-to-end renegotiation. They claim that contract renegotiation is not necessarily a "bad thing" from the outsourcers' perspective, and in fact, may be a critical opportunity to ensure long-term success or salvage a failing relationship in need of review and updation. As per respondents, renegotiation is most often a result of business change, a more routine function to adjust service levels, or is a prescribed part of standard contract terms (such as a formalized annual renegotiation). A few service-providers have also shared experiences of contract renegotiation taking place for additional data security and legal compliance requirements.

Why clients may want to exit:

- Dissatisfaction with performance levels
- Change in control through M&A activity
- Pricing issues
- Political requirements

Relationship breakdowns are being anticipated and built in to contracts through well thought-out exit clauses. Respondents state that the most prominent reasons for client exit may include continual quality failures for a pre-defined time period, and merger and acquisition activity in the client's organization leading to a change in the strategic imperatives. In addition, clients may realize that the process is more convenient to retain in-house in light of its critical upstream and downstream linkages. Exit due to pricing issues has also been cited as a reason by some respondents. Contracts today have in-built clauses which allow clients to benchmark prices to competitors after pre-defined periods, usually 12-18 months. In case clients feel that an opportunity for cost-savings exists, they may chose to terminate the contract. However, with intensified focus on a collaborative, partnership approach to offshoring, respondents anticipate that that not only will the average contract tenures get extended, but the number of premature exit options exercised by clients will reduce to a minimum.

Contract termination from a service-providers perspective is a rare finding. A typical condition for this to take place is continual non-payment of dues by clients.

A majority of the survey respondents reveal that the typical notice period for exit is 3-6 months, which takes into account the time needed by the client to transition the outsourced business functions onsite or to another local vendor. However the industry trend is primarily that of a ramp-down approach, wherein the client gradually reduces the depth and breadth of offshoring with the service-provider, and eventually exits.

In specific cases, clients require service-providers to cooperate during the transition phase leading up to and following termination of the outsourcing agreement. Further, options to acquire key resources of the vendor and retain critical assets, including intellectual and knowledge assets, may also be built into contracts. Specifications on the amount and timing of compensation, if due, are also pre-defined.

IMPACT OF COMPLIANCE LEGISLATIONS

One of the most important pieces of legislation impacting the BPO industry today is the Sarbanes Oxley Act. This act, which has been enacted for all companies listed on US stock exchanges, requires management to certify the internal controls of the company for financial reporting (S404) and directly impacts processes which are considered "financially-significant" to an organization's business. Generally, an outsourcing situation would need to consider a Section 404 assessment only when outsourced activities constitute a significant process or when the function performed by a third party generates information significant to the financial reporting process.

This has led to a situation wherein many clients have been forced to have a re-look at their outsourcing strategy. In case of "financially significant" processes being outsourced, the service provider has to provide assurance to the auditors of the user organization as to the robustness of the controls existing at their end. In these situations, certifications such as SAS 70 (Statement of Audit Standards No.70) are being adopted, which require an independent auditor ("service auditor") to issue an *opinion* on a service organization's description of controls through a *Service Auditor's Report.* As a result of this, auditors of the user organization are no longer required to audit the internal control frameworks of offshore locations.

In conclusion, a number of service providers in India are either already SAS 70 certified, or have initiated the certification process, rapidly emerging as a required factor for most clients considering an offshoring option.

THE HUMAN RESOURCE CHALLENGE

With employee turnover in the Indian offshoring sector ranging over 40%, it is not surprising to find attrition being cited as one of the main causes of concern for the BPO industry. It has attracted the attention of the top management of both clients and service-providers, who are now viewing this as an area of strategic importance, rather than an operational issue.

Although the respondents to the survey agree to average attrition statistics ranging between 40% and 60% for the industry as a whole, the actual company rates may vary based on regional presence, functional offerings and even process offering within specific functions. For instance a few respondents state that their centers in Tier II cities such as Jaipur, Managalore, Coimbatore and Chandigarh witness a lower degree of turnover as compared to metros. Reasons cited for this include the psychographic profile of the residents or could be simply because of the lower density of offshoring setups in the city. Other trends that service-providers highlighted include attrition rates being higher in voice-based processes vis-à-vis non-voice based processes and declining attrition rates as processes move up the value chain within functional offerings.

Explaining attrition is often challenging, in light of the innumerable causative variables - behavioural, organizational and industrial - which may be involved. This challenge is magnified in the offshoring industry on account of the absence of any historical industry precedence compounded with the typical demographic profile of the employees, often in their early twenties. However, respondents to the survey identify three prime reasons to explain the high-attrition phenomenon, which include perceived lack of growth opportunities in the organization, migration to more stable work environments and most importantly, search for higher pay-scales.

Employee Retention Strategies

- Clearly defined career paths
- Tie-ups with educational institutes for post-graduation programs subsidized by the service-provider
- Informal anti-poach agreements with competitors
- Cross functional training
- Performance-linked remuneration
- Tenure-linked bonuses
- Recognition schemes
- Flexible working hours

To counter each of the above, organizations have been focusing minutely on designing and implementing the best-in-class retention strategies.

The respondents stated that the most far-reaching yet implicit strategy being adopted by service providers is that of repositioning the BPO industry as an attractive long-term career option, so far considered a ‘stop-gap’ solution to fresh graduates – the target employee segment. A majority of the respondents have taken proactive measures such as detailing career growth plans for employees and communicating the intent to potential candidates through campus road shows and employment fairs. However, service-providers assert that for the image makeover of the industry to fructify, solitary efforts are inadequate, requiring the industry to collectively make compelling efforts in this area. In their individual capacity however, service-providers are striving to reinforce the power of their brand, an important pull factor for employees of the industry. Mid-sized industry respondents state that in a considerable number of cases their employees chose to move to global or large Indian service-providers, resulting in a high degree of 'brand-switching' within the industry itself.

In the same light, the intent of getting a majority of organizations to develop an informal "no-poaching" agreement is another retention strategy being deliberated, requiring collaborative effort of the industry. However industry experts agree that a more viable model in the short-term is the signing of bilateral agreements between companies, as industry-wide agreements may require a longer time frame to materialize. All respondents cite the requirement of organizations to adopt responsible behavior in order to ensure that the industry does not become a victim of its own actions.

In keeping with the strategy of positioning the BPO industry as a serious career option, service-providers have entered into exclusive tie-ups with educational institutes to provide professional degree courses to their employees. This allows employees to pursue their academic interests and simultaneously remain employed.

In addition, performance-linked remuneration, transparent recognition schemes, cross-training etc. are other practices being adopted a majority of the survey respondents. Although constrained by time-zone differences, a few respondents state that they try to accommodate flexible working hours wherever possible, aiming to minimize the outflow to sectors such as retailing and hospitality, which compete for similar skill-sets.

Recruitment Strategies

- Use of competency frameworks
- Hiring from the higher-age bracket of population. Example : officers who have taken VRS from banks

In addition to pursuing innovative retention strategies, respondents state that the focus is steadily shifting to ensuring that recruitment processes are aligned with retention strategies. The effectiveness of any system depends on the quality of the inputs, in this case the new employees. A few respondents to the survey have realized this, and correspondingly made a paradigm shift in their hiring process by focusing on competency frameworks and other selection instruments. In some cases, respondents highlight that clients take an active interest in the recruitment process, clearly identifying profiles and positions. This is especially true for BOT models, wherein the client is preparing to take over all assets – human and physical after a pre-defined period. In addition, an interesting strategy being adopted by a few respondents includes recruiting employees belonging to an older age bracket, for want of a higher degree of employee stability and commitment.

It is estimated that, by the year 2008, India would have approximately five million people employed by the ITES industry.[1] In order to ensure a consistent flow of trained manpower in the future, the industry is exploring the possibility of working with the government to introduce courses at a school and college level, in line with the requirements of the ITES-BPO industry of India.

Although service providers are focusing on recruitment and retention of skilled manpower, steps are also being taken to reduce the adverse impact of attrition on business continuity through building robust processes especially with respect to data security, reducing dependency on individuals by making relationships and processes system-driven rather than person-driven, increasing back-up bench strength and investing in adequate succession planning.

[1] NASSCOM

CHANGE MANAGEMENT

Offshoring poses significant cultural and change management challenges, which companies today cannot afford to overlook. Engaging the work force to ensure success requires aligning all levels, functions and businesses with the strategic outsourcing vision and gaining a collective commitment to the vision. Most companies realize the importance of the task but require support to translate the knowledge into action.

> "Change management is often an overlooked aspect in offshoring – but has the potential to emerge as one of the biggest barriers to its success."
> *- Survey Respondent*

Offshoring strategies create a fundamental shift in the human resources models and force organizations to reassess and actively manage their human assets. The shift can take place at two levels:

- Roles retained in-house with increased/ changed responsibilities
- Changed roles with new characteristics, skills and expertise relevant to both in-house and offshore centers

Respondents cite that clients are becoming increasingly concerned of the risks of inadequately planned change management initiatives, which they believe result in lowering of staff morale, productivity and service quality.

To mitigate change management risks, respondents state that in many cases, the clients' senior management has begun to assume the role of evangelists, winning over resistance by clearly communicating, to all key stakeholders, the strategic payoffs from outsourcing. In addition, the management takes initiatives to sensitize employees to the new paradigm and helps them ease into it by clearly outlining the new structures, work processes, roles and responsibilities well in advance. The areas on which employees are sensitized include working in remotely-enabled business environments and cultural issues.

> "For effective change management, communication is the key to success."
> *- Survey Respondent*

A few leading respondents state, that in specific situations they have provided advisory inputs to their clients on issues relating to change management. For instance, service providers have conducted workshops and seminars to stress the requirement of executive commitment at the highest level and have highlighted the leadership on the strategic importance of offshoring initiatives from a change management perspective.

In addition to the above, respondents cite the following aspects which are typically addressed in change management initiatives:

- Timely, honest and consistent internal and external communication plans
- Two-way cultural orientation, identification of discrepancies and similarities among corporate cultures
- Retention strategies for key personnel and contractors
- Compensation to the retained organization for successful operation of the offshore center
- Cross training, job rotation and job mobility programs

- SLA's between onshore and offshore operations

Nearshore facilities allow service-providers to assist clients in change management, by absorbing a part of the displaced workforce. A trend which service providers are observing is the timely action being taken by clients with respect to change management. They state that as soon as the decision to offshore has been taken; organizations identify affected roles, positions and individuals - an activity traditionally left to the last stages of the project. For employees to be retained in-house, new roles are clearly defined and integrated into a performance management system. This includes developing a comprehensive change management process and ongoing tools for evaluation and monitoring. For instance, a respondent cited the example of an Application Engineer's role changing from primary involvement in technology development to vendor management of an outsourced contract. The client took timely action to not only address the change in the employee's job description, but also on the related aspects of the compensation structure, HR metrics and required training and development to ensure continued productivity.

Given the increased participation of various functions in the offshoring process and their mounting importance, respondents state that it is becoming crucial to establish appropriate governance structures, not only for the program itself, but for the ongoing management and oversight of offshored operations.

CONCLUDING REMARKS

The BPO industry is drawing significant attention and India, by virtue of its dominance in this sector is at the center of this attention. The shift of the Indian economy towards more service-orientation suggests that in the long term, India will continue to be a major player in the global BPO industry.

Despite the growth that this industry is witnessing, there are certain areas that require greater attention going forward from service providers to ensure that the industry remains firmly on the growth path.

This survey was conducted with the objective of analyzing some of the key trends that will drive the future direction of the industry. We have endeavored to highlight some of the key risks that the industry faces and will face as the industry evolves. We have also discussed the corresponding risk-mitigants that service providers and companies are focusing on, to manage the risks.

We hope that this survey provides service providers with a deeper understanding of the industry they operate in and acts as an important input to potential customers considering outsourcing their processes to India.

APPENDIX

Discussion Document (Guideline document for discussions)

Section I: Strategic Issues

1.1 Business Case Development

- Key aspects that clients must address in business cases
- Instances of under/over estimation of offshoring benefits, which the business case failed to capture
- Experience and case studies of participation with clients for developing business cases. Ones that worked and those that did not.

1.2 Process Selection Framework

- Trends of the BPO industry expanding to include more strategic service offerings, rather than being (just) volume driven
- Views on emergence of niche players resulting in industry re-structuring along verticals rather than functions
- Future for pure voice-based BPO service providers?

1.3 Deal Structuring

- Models (JV, co-sourcing, hybrid) holding growth potential in the future and the drivers thereof
- Future of BOT models in India and the growth enhancers/inhibitors? Are you seeing more of these?

1.4 Pricing Framework

- Trends indicating a change in client preferences of pricing modes
- Experience in your organization in the emergence of new pricing modes and drivers of the same

1.5 Migration Strategy

- Success and failures stories of migration with emphasis of migration modes adopted
- Are you seeing clients simplify / standardise and then migrate? Or do see clients migrate processes and then standardize them?
- Typical time to migrate processes, and trends in reduction of migration time
- ‘Least time to migrate and ‘Maximum time to migrate’ – examples…
- Techniques adopted for reduction of migration time
- Assessment of costs of migration
- Trends towards additional service offerings to clients around migration of processes

1.6 Governance and Monitoring

- Client’s modes of addressing governance and monitoring issues? Are you seeing greater investments by clients on governance?
- Trends of changes in client involvement, monitoring etc. due to legislations such as Sarbanes Oxley, BS 7799….
- Are clients evolving with regards to looking at wider issues -beyond cost and efficiencies – to look at impact on brand, public perception etc.

1.7 Contract Renegotiation and Exit Strategies

- Experience in the recent past of contract renegotiation?
- Exit strategies for clients and degree of 'brand switching' in the industry?
- Are you seeing clients build exit strategies into their outsourcing plan from day 1?

Section II: Operational Issues and Challenges

2.1 HR Challenges

- Any experience in the depletion of high quality manpower resulting in skill unavailability? Are clients asking questions regarding scarcity of resources as demand rises? How do you see this panning out?
- New trends in training for skill upgrade, cost minimization…
- Attrition trends and retention strategies

2.2 Cost Challenges

- Future trends in changes of cost structures with the evolution and maturity of the BPO industry in India.
- 'Double digit wage increases in India.' Do you see a real threat of manpower cost advantage diminishing?

2.3 Quality Challenge

- Instances of breakthrough QC initiatives implemented in the organization
- Tools and techniques recommended for enhancing quality

2.4 Dispersal of Growth

- Plans and experience of expansion to Tier II ? Drivers/Inhibitors for expansion to Tier II cities

2.5 Consolidation of Industry

- Growth of BPO companies through acquisitions
- Acquisition of BPO companies by potential clients

About PricewaterhouseCoopers Pvt. Ltd.

PricewaterhouseCoopers Pvt. Ltd. (PwC) is one of the largest and most reputed professional services networks in India, providing industry-focused services to public and private clients. PwC specialists from the advisory and tax teams connect their thinking, experience and solutions to build public trust and enhance value for clients and their stakeholders.

PricewaterhouseCoopers' Business Solutions group offers comprehensive services designed to meet today's management issues in the areas of Business Planning, Finance Function Effectiveness, Shared Services, Corporate Governance, Supply Chain Improvement, Cost Reduction, HR & Organization Transformation and Technology Linked Solutions. The BPO sector is a key focus area for the advisory team at PricewaterhouseCoopers, with services and competencies that span Strategy, Process, Tax & Regulatory and Risk delivered through a global network of practitioners servicing clients across a range of industry verticals. The team's rich experience includes having previously set-up and managed PricewaterhouseCoopers' BPO practice in India. A Center of Excellence, showcasing the experience of clients, has been established in Kolkata. PwC has offices in Bangalore, Kolkata, Chennai, Hyderabad, Mumbai, New Delhi, Bhubaneshwar and Pune.

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