8

Opportunities and Strategies in IT Enabled Services

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Introduction

This chapter looks at the trends in the industry, and at the specific attributes that have made IT enabled services such a dynamic sector. ITES has been a catalyst for change and innovation and also had significant economic and social impacts on the various countries that have embarked on that journey.

Global outlook

Contrary to what many thought at the beginning of the global financial crisis, the growth continues in this industry, albeit at a slower pace. Worldwide, expenditure on technology products and services in 2009 fell by 3 per cent from the forecast US$1.5 trillion. What seems to have declined since the crisis is the expenditure incurred on IT driven by hardware purchase. Business processing outsourcing (BPO) growth in spending has remained positive (Figure 8.1), even during the peak of the recession, and post-recession is well on the way to recovering to almost pre-crisis levels.
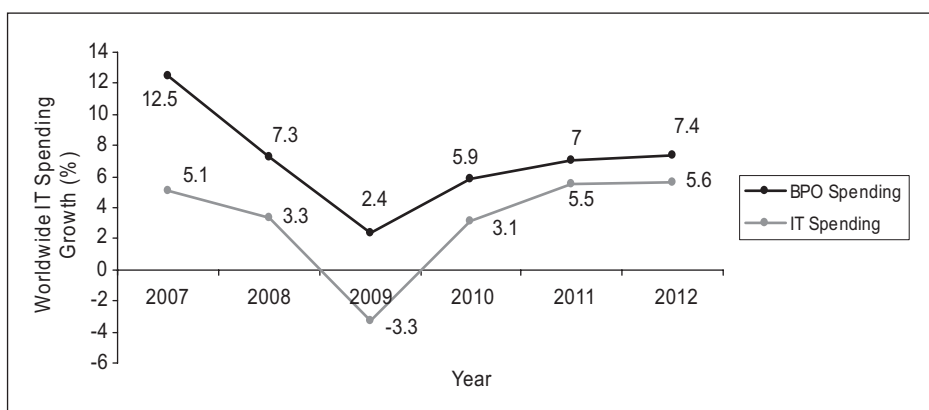

Figure 8.1. Technology and BPO spending, 2009
Source: NASSCOM Strategic Review 2010

Market positions have not changed. The US remains the largest market and India still leads in terms of a preferred destination. But, as will be made clear in this chapter, the internal dynamics are changing, providing an opportunity for all the new entrants as well as the countries that have already joined the fray to increase their market share, as the pie itself is getting bigger.

Industry Facts

McKinsey studies on the global IT/ITES sector estimated the potential market size as US$475 billion in 2007. It was further estimated that all players in the market penetrated only US$65 billion of this, suggesting that a mere 15 per cent of the market was tapped by all service providers. The key message is the untapped potential in the marketplace that new entrants as well as existing players can develop, as the market is supply constrained at present. This conclusion remains valid even though the pace of the market expansion has been more subdued than the annual growth rates in excess of 30 per cent prior to the GFC.

ITES is an industry that is primarily export driven, although there are near-shoring opportunities – meaning there is a market both within a country or region as well as outside. The industry is also one that stimulates foreign direct investment (FDI).

Positive social consequences

ITES has very positive social consequences. For instance, the amount of women employed in this industry is well above the average: in India, women make up about 35–40 per cent of the ITES workforce and the number is increasing, and in the Philippines it is about 65 per cent. The youth factor is even more phenomenal because about 90 per cent of the industry is under 35. The sector has also slowed the 'brain drain' in a number of developing countries. For instance, India, which is the global market leader, had high brain drain figures in the distant past, but today this sector has helped to get some of this talent back into the country.

Opportunities for public sector services

New opportunities are arising in the public sector where governments have looked at new ways of providing public services in the recession, and services are being outsourced through mechanisms like public–private partnerships. The public sector is therefore a lucrative client segment with significant upside potential.

Policy reforms

The industry has prompted policy reforms in various countries. These reforms include: labour laws to allow women to work long hours; buildings rather than a particular

area being designated as export processing zones (in India this has been credited as one of the key policies that made a big difference); land reforms; and FDI policy reforms. Given that the sector is new, such policy changes can make a difference, for example to avoid challenges from the usual entrenched interests or groups.

Rural BPOs

Many people view the ITES sector as very much an urban phenomenon but in South Asia rural BPOs are making the difference. For instance, in Sri Lanka a small rural BPO centre started operations in the local languages because English language skills were not available initially. The organisation initially concentrated on call centre skills or BPO skills working with local clients. The next step was to acquire English language skills, which was achieved thanks to a dedicated local teacher who himself learned English to be able to teach the village youth. Today, this small rural centre has clients in the US.

Incubating entrepreneurs

India probably has the most established IT industry in South Asia. But in the early 1990s there was hardly any venture capital industry in the country. IT enabled services brought that into the country and today the pharmaceutical industry, engineering, manufacturing are all benefiting from what is now a very vibrant venture capital industry across a number of economic sectors.

On the matter of demand-driven skills, all too often education systems in many countries appear to be disconnected from what the job market actually requires. This is sometimes referred to as the 'triple E connection', education, employment and the economy. The IT industry has made the connection far better than others because essentially it is teaching people job-related skills and now that it is filtering down into the secondary school system and the primary school system in a number of countries.

Cross-border collaboration

In terms of cross-country, cross-border collaboration the flow of people and goods can be highly emotive. Data packets and electrons are far less emotive when they go across borders and there are many positive aspects to this, but there are also negative aspects like pornography. However the positives far outweigh the negatives. This industry has huge potential to be a catalyst for regional collaboration and regional integration, where the geopolitics of one of the least integrated regions in the world, South Asia, have shackled the traditional sectors.

Socio-economic contribution of the ITES sector

What follows is based on the context of India but is relevant for any country with a fairly mature IT enabled services industry.

As the ITES sector grew its initial impact was felt directly in terms of its increasing share of GDP, foreign exchange earnings and employment generation. However, there were spillover effects within the society resulting from the development of other sectors such as logistics, transportation, catering, engineering, manufacturing and civil engineering. Being a new sector it provided the environment for a new generation of entrepreneurs to grow and created indirect employment in other service sectors (e.g. transport, catering) in regional growth poles like Bangalore and Hyderabad. As it catered to an international market the product and service quality improved, boosting the image of India in global markets.

A third level of impact was on workforce development with the upgrading of skills taking place and more youth and women joining the workforce in friendly work environments.

Market segmentation

The market is divided between the more traditional IT services and the IT enabled services, which began around 1994 with the introduction of the commercial internet. This made possible the business process outsourcing (BPO) services or back-office processing side, which has been followed more recently by the knowledge-process outsourcing (KPOs) segment (Figure 8.2).

IT Services		IT Enabled Services
Application services	Engineering services	Business process services
Application development & maintenance **System integration** · Analysis & Design · Development, integration and testing · Package implementation **IT infrastructure services** · Help desks & Desktop support · Data center services · Mainframe support · Network operations **Consulting** · IT consulting · Network consulting	**Manufacturing engineering** · Upstream product engineering · Downstream product engineering · Plant and process engineering **Software product development** · Product development/Gaming · System testing · Localization · Maintenance and support	**Horizontal processes** · Contact Centers/CRM · HRM, BFSI & Admin. · Supply chain **Vertical processes** · Banking & Insurance · Travel · Manufacturing · Telecommunications · Pharmaceuticals **Knowledge process** outsourcing · Business, financial, legal research · Animation · Other high-end processes

Figure 8.2. Market segmentation of IT and ITES
Source: A.T. Kearney et al.

Promoting IT Enabled Services

Verticals and horizontals

The words 'horizontals' and 'verticals' are used often in the context of ITES. Figure 8.2 clearly indicates the verticals – namely banking, finance and insurance – which are the largest and most mature sub-sectors. The horizontal services are key functions in an organisation, like human resources or finance. The actual value proposition changes for each service segment. So the rates for these services also have a stratification to add another dimension of complexity.

Is there scope for new entrants to penetrate the various market segments? According to various McKinsey estimates limited penetration could be expected in the addressable market for IT (20%), engineering (24%) and IT enabled services (30%) in 2010. Therefore, there is room for new as well as for existing players. Indeed, this sector is probably one of the few where a new country with a fairly robust telecommunications system and half-decent infrastructure can make an entrance and compete with those who have gone well ahead of them.

How does ITES actually divide across those verticals and horizontals? Using the example of India, because it has a good cross section of services and the literature and data is solid, Figure 8.3 shows how the pie breaks up. Again, banking, finance, and insurance take the lion's share, being the most mature segments, followed by the call centres, or contact centres, which are also now on the mature part of the IT/ITES product life cycle.
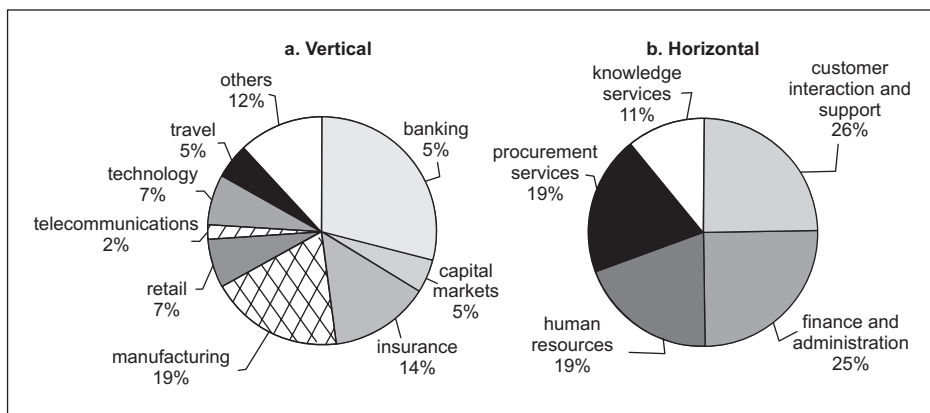

Figure 8.3. India's addressable market for vertical (sectors) and horizontal (domains) for ITES

Tier cities

An interesting trend in the industry is the rise of tier II and tier III cities, which managed to come into the fray because the tier I cities had such a high attrition rate and wages were going up. There is an opportunity and dynamism in the market for tier II cities in India and other countries that are trying to get on the bandwagon. In

the case of India, tier II and tier III cities are expected to increase 18-fold from 175 in 2008 to 3,250 in 2018 with more of the additional work going to the tier II cities. Both are increasing, but tier II is increasing at a more rapid pace.

Global sourcing landscape is maturing

The market is maturing for some of these segments. Figure 8.4 shows that the contact centres and the software IT, which have been around for a long time, are now reaching a plateau in their growth. There are a number of business models that have been established for a long time.
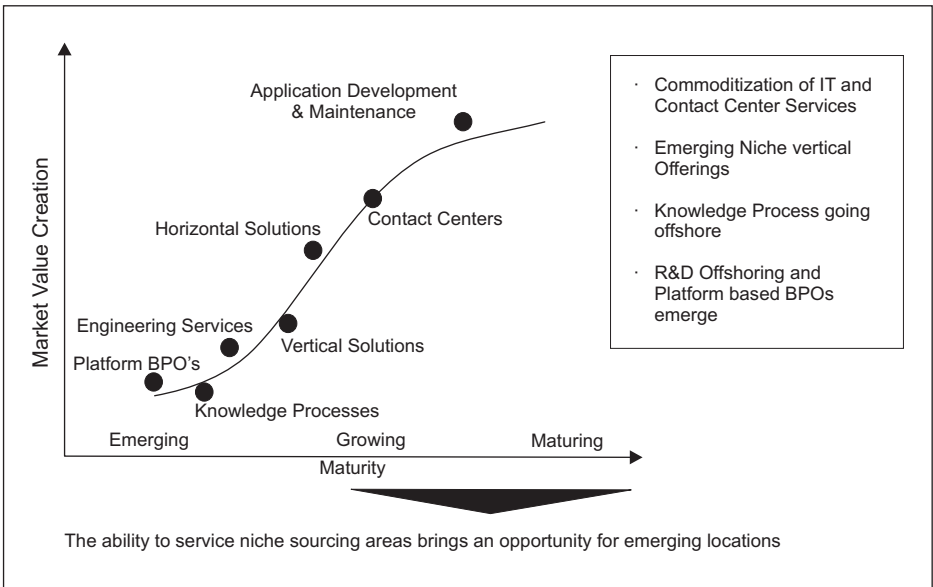

Figure 8.4. The global sourcing landscape is maturing

What is new is what is happening with platform-based BPOs, which is at the intersection with technology, BPO, analytics and domain knowledge. Platform-based services became popular during the global recession, when clients were looking for higher efficiency in services without incurring large upfront transformational cost. In this model, the matured service providers undertake the management and execution of clients' business processes on their own technology platforms. The model enables service providers to own processes, the underlying platform and application, people and infrastructure. It also allows the delivery to shift from being 'people centric', as in the traditional 'lift and shift' model, to being platform centric. BPO service providers, which have a strong presence in IT application development and maintenance, could comfortably adopt this model. They offer HRO platform, F&A platform, procurement platform and analytic platform BPO solutions.

Other key advantages of the platform-based services model are that it assures higher compliance with standardised processes, stringent security regulations, local statutory norms and internal controls; defines the ownership and accountability of the processes by resting ownership of all aspects of BPO with the service provider; allows buyers to reduce time-to-market by leveraging service provider's pre-configured business processes, pre-built deployment accelerators and organisation change management; and allows smaller buyers to leverage the best IT infrastructure to support their business processes.[1]

Vertical solutions are still dominant in the BPO segment and providing a large part of the growth.

Drivers for global sourcing

The main motivation behind the outsourcing is reducing costs, but customers are becoming more demanding and services providers are now expected to offer much more (Figure 8.5). Providers can fill this demand where they piece together business processes – for example, a consultancy component or a re-engineering component – and offer them as a package, along with the talent.
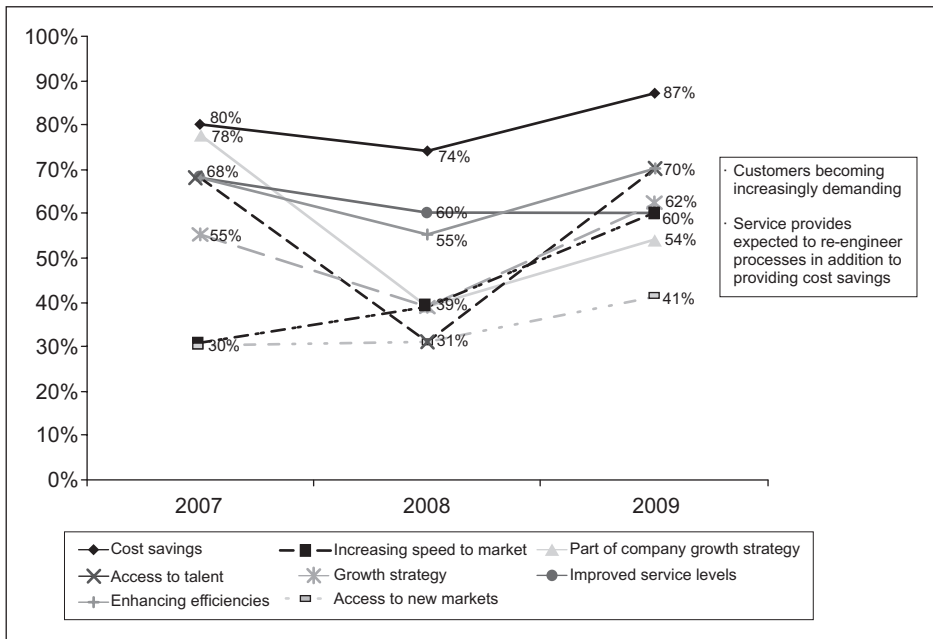

Figure 8.5. Drivers for global sourcing

Location attractiveness index

Figure 8.6 combines the four models or sets of criteria for a location attractiveness index of the major consultancy companies involved in the field – A.T. Kearney, Gartner, McKinsey, and Hewitt.

The list of criteria indicates what potential clients are looking for in an outsourcing location, so it is useful when putting a country programme together. It is important to have the statistics to feed all of these criteria, because when corporations hire the consultancy companies to assess a location, the do so based on weighted averages of available data. If they do not get good quantitative data, they will probably do approximations and the country being assessed would be the loser. Countries should keep the data up-to-date, adjusting it in keeping with performance improvements.

• **People & skills availability**	• **Business & Country Environment**
• Remove service sector experience, skills & quality ratings	• Govt. support, Enabling policies (IPR, e-Transactions laws etc.)
• Labor force availability	• Telecom & Labour Regulations
• Education, Culture exposure & language	• Political stability & Security
• Attrition risk	
• **Financial attractiveness**	• **Infrastructure**
• Compensation costs	• Power, Real Estate
• Infrastrucre costs	• Data, Road & Air Connectivity
• Tax and regulatory costs	• Logistics & other support services
	• Social infrastructure

Figure 8.6. Location drivers and destination attractiveness index

Industry trends

The global financial crisis has put more pressure on companies that were not in the outsourcing space to outsource. As a result more new companies in the US and other developed markets are getting on board, while the existing ones are looking to outsource even more functions. During the recession, this compensated for much of the demand that dropped off because there was always pressure to cut costs in shrinking markets. This is a trend that is going to continue and the demand post recession will return.

In the trend towards specialisation and innovative business models, the challenge is to constantly reinvent the wheel. For instance, the innovation of business 'software as a service', or cloud computing as already mentioned, warns against complacency in thinking that any business model is set in stone.

There will be more work for tier II and tier III cities as corporations begin to outsource functions once considered as the core competency and intellectual property of a company. For instance, General Electric (GE) is already doing this while other major national corporations are looking at the best ideas outside their companies and moving to farm out core research and development, with the right level of protection. Having in place good IPR and IP laws in a country takes on added importance if the goal is to take on this high valued added segment and by channelling educated people at very high value into smaller sized BPOs, to do this sort of work.

The global GDP is set to grow by 3.1 per cent, much of which is coming from the developing countries, although the US continues to be the main market.

In the BPO segment, the vertical is dominant but growth is coming from finance and administration, procurement and HR. Governments that are flush with money or investing money to stimulate demand are also an opportunity. Cost arbitrage is still a huge motivator; even after all these years mature market destinations like Bangalore or Manila still have an arbitrage of a factor of four with a tier II city in the US.

Developing a country programme

We will now illustrate how to develop a country programme using one model of the location attractiveness index (Figure 8.7). The Hewitt model highlights five criteria. These have been expanded to 5 drivers, about 20 factors, 40 parameters and 100 elements (for which Hewitt does not divulge the specific details). All of these are
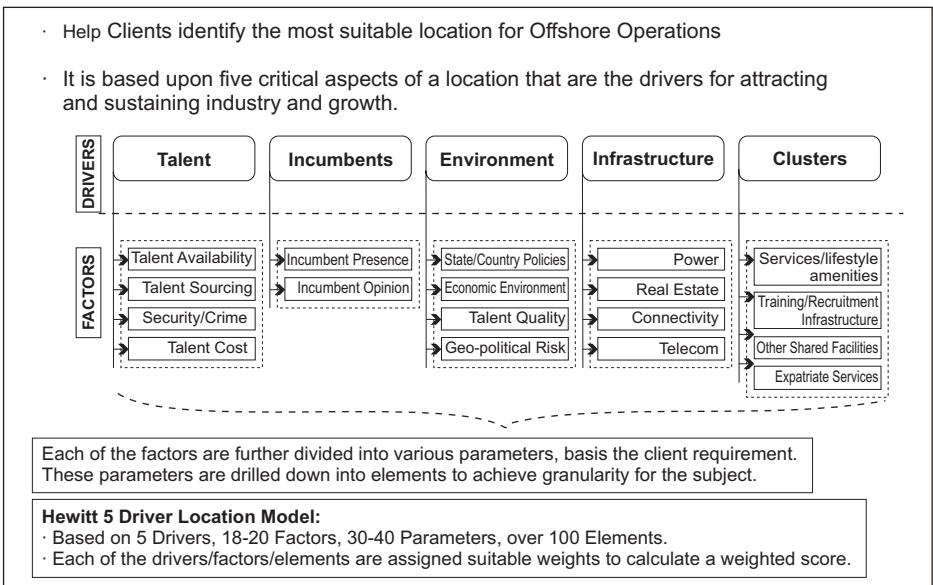

Figure 8.7. Location analysis – Hewitt's 5 Driver Model

combined into a weighted average for a city and/or a country, which is then looked at in comparison with other cities/countries.

Not all country programmes are put together in the same way. Following is one approach that has been used by some countries in South Asia:

Conduct a SWOT analysis for your country (or city/cities) using criteria (such as talent, infrastructure, business enabling environment, policies, etc.) from a location attractiveness index (or combination of indices).

Benchmark the findings against international norms for countries/cities, for example, the World Bank 'Doing Business' reports.[2]

Look at the market side and *decide what sort of companies to target* in the market segment or geography, given your competencies and skills. In terms of capabilities that you are hoping to work on and improve, it helps to set a baseline and then to do a comparison and matching once the improvements are made. New entrants should bear in mind that jobs at companies in sophisticated markets like the US and UK are large and complex, so they should obviously start by targeting smaller companies.

Weak areas are the basis of a country programme because they have to be fixed in order to reach the set target. Typically, most country programmes have an HR talent component – one of the biggest and a key driver that can make the difference – as well as a policy piece and a promotion piece. In addition, there is always bound to be some piece of the infrastructure that is weak or missing – an unreliable data centre or a flawed business environment or poor power supply. The solution, inevitably, is to create an enclave, a park, where things go right and everything works regardless of how bad things are outside. So the park becomes the crucial aspect of the initial programme.

Box 8.1. Bhutan: case study

If Bhutan can become an IT enabled services destination then everybody has a chance. Bhutan, a beautiful country, with only 600,000 people, is landlocked. It has one plane a day if it is not cloudy (the airport is right up in the Himalayan mountains) and it is often difficult to get a seat. The Prime Minister and the King of Bhutan backed the programme, convinced that it would help the country to make a leap from what is essentially a peasant agrarian economy.

Within two and a half years the programme was having some success. Against the background of the global economic crisis and a tailing off in private investment, Bhutan secured a private–public partnership with one of the world's leading providers. The company, Assetz, which is in Bangalore and in a number of other locations in Asia, is building an IT park in Bhutan. The government has allocated the land and made a commitment to lease back a part of the park for a data centre and some of the common provisions inside the park.

What Bhutan did was to leverage on its pluses, its positive reputation in tourism and its sustainable environment. So for instance, building on its green image, it is emphasising green data centres. The ITES sector has been the catalyst for policy changes that have also positively impacted a number of other sectors. Restrictive FDI policy, which previously had not allowed repatriation of capital, has been relaxed, as have regulations regarding ownership and leasing of land.

Bhutan got its promotion going by reaching out bilaterally to India, its big brother in the region. Indian bilateral aid includes support with financing and energy, and construction of a road to the IT park to make it much more attractive. With India's help Bhutan has been able to exploit its natural hydrogen and to promote the concept of a green data centre with green power.

Bhutan got the Indian private sector involved by leveraging on its tourism image to persuade NASSCOM[3] to hold its annual session there. As a direct result Narayana Murthy, founder of Infosys, established at his own cost a programme at the University of Mysore that is turning out 100 engineers every year; Genpact, one of the leading companies in the BPO segment, set up a centre at the university offering free training to the Bhutanese; and IIT Bombay, another giant in the field, is helping Bhutan to develop its business incubator to support the growth of hi-tech companies.

These sorts of partnerships are critical in making a success of a programme in a country that appears to be particularly handicapped like Bhutan. Still, there are always challenges. After all that work and leadership from the government, it turns out that the Bhutanese are not happy to go outside Bhutan to work. One of the World Bank objectives in helping Bhutan with financing is job creation. The issue in Bhutan is that when the job becomes available the graduate may refuse to go because the Bhutanese youth are very insular in that sense and love to stay at home with their parents. Willingness to work is another important factor.

Notes

1. *Source:* http://www.globalservicesmedia.com/BPO/Market-Dynamics/New-Face-of-The-BPO-Sector

2. http://www.doingbusiness.org/

3. NASSCOM® is the premier trade body and the chamber of commerce of the IT-BPO industries in India, with more than 1,200 members including Indian businesses and multinational companies that have a presence in India.