

# “Indian offshore firms are game-changers in Europe”

**PETER SCHUMACHER**, president and CEO, Value Leadership outlined two key changes that have occurred in the area of offshoring and outsourcing: one, that overseas companies are not looking at offshoring just for gaining labour arbitrage. Instead, they are also looking at offshoring as a means to create competitive value for their businesses that goes beyond the low-cost advantage.

Another key development is that the social backlash that was created in the US due to offshoring and outsourcing has begun to taper off. In fact, companies in the US now openly talk of their offshoring strategies to analysts and the investor community. “The backlash debate has almost disappeared from the public forum in the USA. Companies are communicating their offshoring plans more openly and the analyst community is forcing publicly-traded companies to discuss and present their offshoring plans in a substantive way,” he explains.

In an interview with *Indian Management's* **Tarun Narayan**, Schumacher dwells on the trends in offshoring knowledge process outsourcing (KPO) and India's ability to garner offshored business in the years ahead. Excerpts:

## **What are the current trends in offshoring?**

There are several key trends that we are observing. One of the most important trends concerns Europe. Currently offshoring demand from Europe is growing faster than from the USA. We have been noticing a significant increase in interest in offshoring in Europe for the last two years. Now this increase in demand is starting to show up in revenue numbers and in the number of European companies setting up captive offshore centres. In-

dian IT services firms have become the fastest growing firms in Europe. We estimate that by 2009, the top Indian firms may generate revenues totally as much as euros 4.5 billion annually in Europe. With this, comes an enormous shift in market power and value towards the offshore vendors. The Indian offshore firms are game-changers in Europe.

Another key trend we see is European and US companies making a more strategic commitment to offshoring. The recent investment commitments

by IBM, CISCO, and several other firms reflect the new global significance that India is playing for these large companies. At Value Leadership Group, we are working with several companies to develop board level strategies for leveraging offshore for competitive advantage.

In India, world class HR capabilities are fast becoming a key strategic differentiator. The same concerns the ability to build a strong brand in India and abroad. All of these topics are interrelated and Indian IT services firms, in particular, the second-tier firms, must develop a vision for the future and invest more in building strong management capabilities. Firms that fail to meet the operational challenges in human resources (HR), brand building, and world class operational management will find it increasingly difficult to compete.

## **What are the new models in offshoring that corporates are experimenting with?**

We see that smart companies in Europe and the US are starting to leverage offshore opportunities to rethink their businesses and improve their organisations through inno-



vations in processes and design. Companies are starting to see the opportunity to create a globally integrated firm. This approach mandates holistic changes to the operating model. To make these changes to their operating models, companies are beginning to see that they need to take an entrepreneurial approach to develop these new global value creation and delivery models.

We know of at least one European manufacturing business that completely reinvented itself in India. The company shifted production to India, raised fresh capital and redesigned its global sales force around India. The company now operates an India-centric model and is better off across all metrics. We believe that many more European and US firms, from manufacturing and services, will be following similar reinvention strategies in the future.

But leveraging the offshore model for sustainable competitive advantage is a daunting challenge, involving significant risks. These risks may involve operational issues, intellectual property, distraction from core activities, and alienation of the "home" workforce, to name just a few. Implementing an offshore strategy also requires substantial upfront investment in infrastructure and people, as well as process and organisation re-design.

Cost cutting is the first and easiest step in developing an offshore strategy, but in itself offers little or no long-term competitive advantage. If a firm can cut costs offshore, its competitors can too and sooner or later they will. Companies with the most successful offshore operations — regardless of size — are those that leverage their offshore presence to do things they would not be



able to do otherwise. Going offshore allows companies to reconfigure their value chain and acquire new capabilities and competitive strengths.

#### **Which are the other countries in Asia that are emerging as competition to India in bagging outsourcing contracts?**

Global companies have a diverse portfolio of needs all of which cannot be met in India. These companies, for example, GE, need to tap into offshore capabilities in different countries. As a result, several countries in Asia are trying to position themselves in this trend by emulating the success of the India model. These countries include Sri Lanka, Philippines, China, and even Vietnam. The scale of these offshore markets is significantly smaller and the portfolio of

their capabilities is narrow when compared to India. While there will be some competitive overlap, we do not see any of these markets representing a significant competitive threat to India. People in India have been paying a lot of attention to the expansion of the offshore services industry in China. We don't see China developing an offshore industry that can compete with India for the next 10 years. Moreover, longer term China's negative demographic trends are likely to represent a natural ceiling limiting the growth of their offshore services industries. Also, European and US companies are not looking to put all their eggs in one bas-

## **OFFSHORING HAS BECOME A STRATEGIC IMPERATIVE**

ket. In services, India's superior legal system and strong corporate governance gives it an edge that will be difficult for China or other emerging market countries to emulate in the short-term.

#### **What should India do to raise its bar and enhance its competitiveness?**

As I mentioned earlier, the real, long-term gain from offshore strategy is not simply cutting costs, but using unique combinations of other strengths and assets to build a sustainable competitive advantage.

Companies in Europe and USA are increasingly looking to India to gain access to people with world class capabilities and excellent skills. This is critical because of unfavorable demographic trends in the USA and Europe. Take for example, the US company Lockheed Martin. This is a company that employs 135,000

people of which almost half are scientists and engineers. About one-third of Lockheed's employees is over 50 years of age. To sustain their talent base they must hire large numbers of new engineers every year. They are not alone. All companies in Europe and the USA face this same problem. While the demand for engineers is very high in these countries, fewer students are opting for an engineering degree in these countries. While this will create problems in the US and Europe, it represents a growing and an attractive opportunity for India.

So, India needs to significantly increase its investment in education to turn out larger



numbers of well-educated people. This concerns all levels of education, starting at the primary level, and across all disciplines. India needs more IITs and more IIMs. The same can be said for investments in research in India. International comparisons show that India is under investing in research.

There is no time to waste and step change increases in investment in education and people development need to be made now if India wishes to position itself where the buck will be in the future.

Other issues of concern include infrastructure that have already been widely discussed by experts. While infrastructure represents a burning platform, we are simply not seeing policy makers in India pursuing this with the necessary sense of urgency. More private-public partnerships are required as is more innovation in thinking.

**Recently, there was news of a BPO company exiting India even without a trace and leaving employees working in the set-up stranded. From a human resource standpoint, what kind of due diligence should employees do to assess the veracity of a call centre?**

I am not aware of this case. It seems like a highly unusual occurrence. It is very difficult for young workers, many of whom are just entering the work force, to conduct a great degree of due diligence about an employer, its practices, and what it is like to work at the firm. I would contribute a significant share of the industries' attrition woes to the lack of maturity amongst the work force. At the same time this is a very young industry that has seen explosive growth. These companies and their managers have little experience themselves.



Employers and employees are going through a phase that involves a lot of experimentation and trial and error. It is this combination of all these forces that creates a lot of volatility.

Nevertheless, some BPO and KPO companies have significantly lower attrition rates than others. Some of these firms tend to be niche players. Also, many captive companies have lower attrition rates because these companies are putting more emphasis on maintaining a stable and high quality workforce. While this comes at a cost, it gives these organisations more stability. Some captives are developing excellent HR programmes in their Indian operations that include significant technical, domain, language and intercultural training. These companies are developing a new kind of "social contract" that we see is delivering promising results. We know of one such company in Chennai that is experiencing only five per cent attrition.

Employees should do their homework and visit with several employers prior to making a decision.

**What are the key trends in KPO?**

As I mentioned earlier, companies are increasingly look-

ing to India for higher end capabilities. KPO services falls into this trend.

Europe is facing an interesting paradox. While unemployment rates remain stubbornly high, most economies face a shortage in skilled workers. These shortages exist across most science and technology professions. As a result of these shortages companies are facing many tough challenges and disadvantages when seen in the context of global competition.

**In what ways can knowledge of processes and systems get leaked to competitors in an offshoring set up? How should firms try and take preventive measures?**

Any company, regardless where it operates, must have controls and systems in place to prevent confidential data from being misused or being stolen. India is no exception. While there have been a few reported cases of fraud, it can be said that the industry is doing a lot to prevent these kinds of things from happening again. On a macro level, data privacy laws will need to be tightened in India in line with international standards.

This will give foreign firms and governments more comfort with the BPO industry.

**What should companies do to bring about cultural alignment with the offshoring partner?**

Creating organisational and cultural alignment with an offshoring partner is very important. In fact, we see this as a critical success factor. Too many offshoring projects, in the

USA and Europe, are not delivering the expected outcomes because of incompatibilities and interface problems.

Operating globally distributed teams represents a new way of working for most people and organisations. Managing the globally distributed model successfully requires European and US companies to develop new skills and capabilities in their organisations, and new job positions need to be created as well. Creating these prerequisites relates to the holistic changes to process and organisation that I alluded to earlier.

A compatible working model is required to make offshoring work long term and to ensure it is embedded in the client organization. This mandates investment in an ongoing offshoring education program that includes the development of strong intercultural skills at both ends. In addition, domain and contextual knowledge needs to be developed to overcome "communication problems." Based on our observations at our clients, the Indian offshore vendors need to increase their investments in building domain knowledge. Companies are looking to the Indian firms for more support and they are not getting it.

Building these forward looking capabilities really starts at the top of the organization. The executive mindset need to be reengineered and offshoring must become a priority on the executive agenda. This is a prerequisite to a company making meaningful investments in building offshore market knowledge and developing new onshore capabilities and skills.

We are seeing that many captives are taking the right steps. For example, smart companies are holding executive

## CAPTIVE COMPANIES HAVE LOWER ATTRITION RATES



board meetings in India on a regular basis. These board meetings are instrumental to building a shared vision around the future significance of offshoring for the company and what needs to be done to effectively and efficiently manage offshoring.

Aligning mindsets, building capabilities, creating a new globally-minded and integrated organization culture are all measures that take time to develop and implement. Most companies underinvest and underestimate the chal-

lenges this entails.

**How should they manage negative press or social backlash arising out of an offshore deal?**

Changing entrenched paradigms, attitudes, and mindsets is difficult. This will also require a change in approach on part of many offshore vendors who continue to pitch a commodity proposition that is focused on labor arbitrage.

Tacit attitudes and perceptions towards offshore continue to be rather negative

amongst many decision makers, IT managers, and staff. These fears, uncertainties, and doubts represent invisible and intransigent barriers. At most companies many middle managers have not yet bought into the idea and do not actively support it. However, these observations are not unique to offshoring. Most new topics face this dilemma. The rapid increase in offshore volume growth shows that companies are finding ways to overcome these internal challenges.

We know of several com-

panies from the USA and Europe that have developed proactive and integrated communication strategies to address the concerns of analysts, employees, customers, and other stakeholders.

Offshoring has become a strategic imperative. Companies that are not thinking about this strategically are likely to miss this opportunity. Developing a communication plan is an integral part of such strategies. ■