CHAPTER 4

PROFILE OF THE BPO SECTOR
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SECTION - I

4.1 INTRODUCTION

Outsourcing has been around for as long as work specialization has existed. Outsourcing is not exactly new to the world. It was successfully applied in the Manufacturing Industries of the US and Japan. It is the spread of this smart innovative business strategy to the Service Industry that has virtually taken the world by storm since the last part of the previous Century. Ever since Outsourcing of services started, there has been a paradigm shift from seeing the world as separate countries with differing efficiencies to one large productive world. The global strategies are becoming increasing efficient in sourcing work from the ‘best destinations’ across nations and combining these factors to result in ‘optimal solutions’ in providing services.

The internet which is referred to as the ‘operating gift of the 20th century to mankind’ has brought about certain unimaginable changes. In recent times, companies have begun employing the outsourcing model to carry out various processes including very specific, narrow functions, such as payroll, billing and data entry. With the use of the internet, specialized tools, special facilities and specially trained staff, these processes can be done very efficiently and hence more cost-effectively, by other companies. For Service providers who are situated in countries other than the place where the sourcing company is situated, the use of the internet makes all this possible easily, in a profitable and optimal manner.

To understand the growth of the BPO Sector, particularly in the Indian context, it is essential to trace the history of its growth. In this Chapter, the background, profile and growth of the BPO Sector have been dealt with in three parts. In the first part, the historical background, Policy issues and other factors that encouraged the growth of this Sector in India have been discussed. Brief overviews of the Policy measures, both in India and at the International scene that have had an impact on the growth of the IT/ITES Industry have been examined.
In part two of the Chapter, the profile of the BPO Sector has been drawn by highlighting the classification of BPO activities, ownership models prevalent in this Sector and touching upon the phenomenon of Mergers and Acquisitions.

Lastly, this Chapter throws light on certain macroeconomic indicators and Industry related information which also gives an all encompassing profile of the Industry.

4.2 HISTORY OF THE IT & ITES SECTOR IN INDIA AND POLICIES SUPPORTING ITS GROWTH

Since 1950, India had been following a fairly self sufficiency oriented, insular developmental Policy. This was believed to be imperative for the insulation of Indian Industry from its Global counterparts in the backdrop of India’s newfound Independence. Restrictions on imports of computer hardware through high tariffs, limits on Foreign exchange allocations and other curbs have surely had their share of impact on keeping IT growth in India on a very low key till the 80’s. The Government even resolved to require foreign corporations to enter into partnerships with domestic companies. In fact the non compliance with the requirements of FERA and other controls, led to the forced departure from India of IBM, one of the largest globally known Computer firms in 1978, apart from Companies like Coca-Cola.

With the exit of IBM, the cost of manufacturing hardware and import of computer technology increased phenomenally. It is this development that has led to the growth of domestic software skills. The major positive turning point in the growth of the IT Industry came about with the introduction of the Computer Policy in 1984, when Rajiv Gandhi assumed office as the Prime Minister and also certain other policies in the years that followed.

The following section gives an overview of the Computer Policy and the other Policies.

**Computer Policy:**

The Government introduced a Computer Policy in November 1984 where 'Software' was recognized as an 'Industry'. With the term Industry, came along several investment incentives that other domestic Industries received. Import tariffs on
intermediate parts, peripherals, software and personal computers were lowered from 100% to 60%. Simultaneously a 200% tariff was imposed on import of finished computers.

The Government announced the Computer Software Export Development and Training Policy in 1986 which liberalized access to the latest technologies and software tools that were indispensable for the development of the domestic software industry. This was done with an aim to make the Indian IT Industry become globally highly competitive and to capture a significant share in global software exports. This Policy also allowed import of software in any form, invited foreign investment and access to venture capital.

These Policy changes were introduced with an idea to give Indian companies exposure to Multinationals and later competitors in their own right. The Government additionally granted one year visas to foreign software trainers.

These Policies were the most significant deviation from the earlier policies of self reliance and import substitution which prevailed since Independence.

In the History of the growth of India’s IT Industry, another memorable and important event was the visit of Jack Welch, then Chairman of General Electricals (GE) in 1989. While he visited India with the hope of tapping the growing market for medical equipments here, it turned out that he got convinced of India as a potential supplier of low-cost, high quality software for GE’s businesses worldwide. His breakfast meeting with Sam Pitroda, the Chief Technology Adviser to the Prime Minister Rajiv Gandhi, led to GE’s Technology partnership with India which began in 1991. It also led the famous quote by Jack Welch –

‘70% of GE’s work will be outsourced. Of this amount 70% will be done in off shore development centres and of this amount 70% will be done in India’.

Coming from the Chairman of a global giant such as GE, 70:70:70 became the thumb rule for outsourcing world over. Since then there has been no looking back for the Indian IT & ITES Industry and India has come a long way in attaining the status of the best Outsourcing destination globally.
Further Policy changes in the 90’s

While the Policy changes in '84 and '86 did in fact succeed in removing the barriers in the growth of the IT Industry and setting the ball rolling, the really proactive phase advanced after the Reforms in 1991. The economic reforms covered a range of areas including the Industrial Policy, Foreign Trade policy, Foreign Investment Policy, IT Promotion Schemes. Most of these measures have had a significant role in boosting the IT Industry directly. In the process however, the ground was prepared for a resounding success of the services that evolved with the use of IT and the Telecom services, better known as the Information Technology Enabled Services and Business Process Outsourcing services.

Among these Policies, apart from the Computer Policy, the Industrial Policy has an important bearing on the BPO Sector.

Industrial Policy: Industrial Licensing has been virtually abolished in the Electronics and Information Technology Sector except for manufacturing electronic aerospace and defence equipment since 1991.

There is no reservation for the public sector enterprises in the Electronics and Information Technology Industry. Electronics and Information Technology Industry can be set up anywhere in the country, subject to clearance from the authorities responsible for control of environment pollution, local zoning and land use regulations.

Large and Medium Industries are exempted from licensing. They are only required to file information in the Industrial Entrepreneurs’ Memorandum (IEM) with the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion, Ministry of Commerce & Industry, Government of India. Small Industries are required to register with the District Industrial Centres (DIC). Forms can easily be downloaded from the website of the Department of Industrial Policy and Promotion, Ministry of Commerce & Industry, thus simplifying procedures to a great extent.

An efficient Telecommunication Sector is an important pillar on whose support the success of the BPO Sector stands.
**Telecom reforms:** Telecommunications reforms began in the mid 80's with the introduction of a regulatory authority and with privatization. Amidst protests from the Public Sector monopolies, the dilution of ownership of the Telecom Industry led to telephone call rates becoming highly competitive and cheap in India. The National Telecom Policy (NTP), introduced in 1999, deregulated the telecom sector. It opened up national, international calling and internet connectivity to competition, bringing down costs and improving quality drastically. Infact till such time, despite tremendous efforts by the IT Industry players, they had ended up merely providing programming services on-site, usually in the US on contract basis. These changes have also enabled India to actively participate in claiming a fairly profitable portion of global bandwidth, although there is always scope for taking this further. VSNL has played a pivotal role in this regard by offering dial-up Internet access in 1995 in India. It has also been responsible for bilateral relations with international traffic carriers in over 75 countries.

The liberal approach towards the Foreign Trade Policy has also played a crucial role in the progress of the trade in IT and ITES Services.

**Foreign Trade Policy:** All Electronics and IT products are freely importable, with the exception of some defense related items. The same are freely exportable, with the exception of a few items like high power microwave tubes, high end super computer and data processing security equipment. Even second hand capital goods are freely importable now.

The Export Promotion Capital Goods Scheme (EPCG) allows import of capital goods on payment of 5% customs duty. Special Economic Zones (SEZs) were and continue being set up to enable hassle free manufacturing and trading for export purposes. Sales from Domestic Tariff Area (DTA) to SEZ's are being treated as physical export. This entitles domestic suppliers to Drawback benefits, exemption and Service Tax exemption.

Apart from the broad policies measures related to trade, certain specific schemes were introduced by the Government of India under the title of 'Export promotion schemes'.
Export Promotion Schemes:

**STPI's:** In 1990, the Ministry of Communication and Information Technology, Government of India introduced the scheme of Software Technology Parks of India (STPI) with the major objective of encouraging, promoting and boosting the Software Exports of India. The first STP's were established in Bangalore, Pune and Bhubaneshwar. STPI's were given the following facilities:

- Tax exemptions /holidays up till 2010.
- Guaranteed access to high speed satellite links.
- Regular electric power.
- Basic infrastructure including core computer facilities, ready-to-use office space and communication facilities.
- Import of equipment without license or duty.
- 100% foreign ownership in exchange for an export obligation.
- Permission to repatriate capital investment, royalties and dividends.

However they had to provide 150% export of the cost of their hardware imports within four years. With the birth of STPI’s in India between 1992-93 and 2002-03, i.e. just a decade, WTO observes, that the share of Units in STPs in India’s software exports has gone up from a mere 8% to 81%. This is a noteworthy growth.

Infact, although the STPI’s were directly under the shadow of the Government, rather than function like a typical Government Department, they were more of a Service provider which could be leveraged by Software Companies. Although the benefits of the STPI’s are expected to end in 2009, it is believed that the Government intends to extend these benefits to the IT-BPO Sector by introducing similar provisions in the Special Economic Zones (SEZ) Policy.

The Government of India also introduced several other schemes with the intention of promoting the IT and thus the ITES Industries. These were the Export Oriented Unit (EOU) Scheme, the Electronics Hardware Technology Park (EHTP) Scheme and the...
Export Promotion Capital Goods (EPCG) Scheme. Duty Exemption and remission Scheme is yet another scheme which enables duty free import of inputs required for export production. The Remission schemes consists of (a) Duty Free Replenishment Certificate (DTRC) and (b) Duty Entitlement Passbook Scheme (DEPB). While DFRC permits duty free replenishment of inputs used in the export product, the DEPB allows drawback of import charges on inputs used in export promotion. In fact, more recently, in 2003, Call Centres were included in the category of ‘Auxiliary Business Services’ thus giving them exemption from service tax under the Finance Bill of 2003. This measure has been widely acknowledged by stakeholders as a very favourable one.

Yet another essential aspect of any growing sector is the need for capital. The liberalization of Foreign Investment Policy in India during the 90’s has been a crucial catalytic force to reckon in the growth of the IT-ITES/BPO Sector.

**Foreign Investment Policy:** Foreign Direct Investment Policy for Information Technology - FDI upto 100 percent is permitted for E-Commerce activities subject to the condition that such Companies would divest 26 percent of their equity in favour of the Indian public in five years, if these companies are listed in other parts of the world. Such Companies would engage only in Business to Business (B2B), e-Commerce and not in retail trading, implying that existing restrictions on FDI in domestic trading would be applicable to e-Commerce as well.

**Other factors supporting the growth of the IT/ITES Industry:**

Apart from these Policy changes, certain other associated factors have been very much responsible for the take off and remarkable growth of the IT and eventually the ITES Industries in India in the 90’s and early part of the 21st Century. The readily available supply of Engineers was never a short coming for a country which always spent disproportionately large sums on higher education. The popularity of the highly respected Institutes such as IITs and NIT’s which also partially have a share in the success story of the Silicon Valley in California, has stood India in good stead. Approximately 25000 graduates of IIT’s have settled in the US since 1953. Just four States, Karnataka, Andhra Pradesh, Tamil Nadu and Maharashtra which accounted for only 27% of India’s population, produced more than 64% of Engineering College
intake for the year 2003 in the country. Thus slowly after the liberalization in early 90's, without State help, private education also started supporting, the Software Industry’s boom in a big way.

Further, the Y2K crisis had its share in giving Indian Engineers a widespread global popularity and acceptance. The expertise which Indian engineers developed in the late 80’s and 90’s in converting applications to comply with Y2K needs, led to the rising demand for Indian Engineers abroad and the mushroom growth of IT Companies. With knowledge of UNIX, these engineers were able to go through lines of programming code, in search of the millennium bug which could otherwise ruin substantial important data. Thus, by 1999 the IT Industry had reached an all time high in terms of growth.

While Policy changes within India have certainly created the environment for the growth and progress of the IT-ITES/BPO Sectors since the 90’s, the formalization of Services exports in greater detail at International levels has had its share of contribution. The role of WTO is of immense importance in the IT growth story.

4.3 International Policy: WTO: GATS

In the context of trade in the World, the most significant step taken at international level aiming at reducing barriers to trade, both tariff and non-tariff was the General Agreement on Tariffs and Trade (GATT), which was founded in 1947. The major aim of GATT was to oversee trade in goods and to liberalize trade by progressive reduction of tariffs. Initially 23 countries were members of the GATT. The GATT was a set of rules, a multilateral agreement, with no institutional foundation, only a small associated secretariat which had its origins in the attempt to establish an International Trade Organization in the 1940s. The GATT which provided a format for a further several rounds of negotiations. Till 1994 this was the forum for negotiating lower customs duty rates and reducing other trade barriers. These multilateral negotiations are known as “trade rounds”. Since GATT’s creation in 1947–48 eight rounds of trade negotiations took place including the Uruguay round. This happened to be the last round, in the eighties of the last Century. The Uruguay Round was the longest GATT series of negotiations which took place from 1986 to 1994.
Between 1947 and 1985, world trade in goods increased by almost nine times. Despite this, certain problems in world trade surfaced. They related mainly to exemption of agricultural products and textiles from GATT disciplines, protectionist measures like antidumping duties, voluntary export restraints, and countervailing duties, concern regarding protection of intellectual property, and growing importance of trade in services. GATT had no rules regarding trade in services. It was therefore realized that major review and modernization of GATT was very essential. Thus, a new regulatory organization, the World Trade Organization (WTO) came into existence. The WTO was designed to provide a common institutional framework for the conduct of trade relations amongst its members relating to the Multilateral and Plurilateral Agreements arising from the Uruguay Round. The central role of the WTO has been to pursue an assured, effective market access worldwide for traders, investors, and inventors.

The expanding role of services in trade over the years, led to the inclusion of the 'General Agreement of Trade in Services' (GATS) in the Uruguay Round of the WTO meeting. However, GATS entered into force on 1st January 1995. GATS were introduced to do for services, the same that GATT did for commodity trade. This multilaterally agreed legal framework for international trade in services provides a system of predictable and enforceable conditions ("binding commitments") for services trade, applying to all Members of WTO. It is pertinent to point out that the phenomenal growth of the IT-ITES/BPO sector in the Indian Economy has its roots in GATS.

The GATS establishes the 'Most Favored Nation' (MFN-equalization of treatment) principle for trade in services. This is meant to benefit countries which have otherwise been discriminated against in trade. Further, the members are obliged to offer MFN status and provide access to their markets to other countries who are service providers. This ensures transparency to all service providers from countries bound by GATS. The GATS helps not only in increasing the trade in services tremendously, it also helps in tracking trade flows in international services through appropriate definitions and categories that trade activities can fall into. However, the MFN rules may conflict with other objectives such as regional economic integration (e.g., in the North American Free Trade Agreement (NAFTA) or the European Union). Customs
Unions are permitted as exceptions to MFN. Large scale growth of customs union after establishment of WTO may be seen as conflicting with the MFN principle and the principle may also be violated as part of ‘anti-dumping’ retaliation.

Traditionally, trade in merchandise has always been easier vis-à-vis trade in services, by virtue of being ‘tangible’. However, the increasing role of telecommunications and internet services has been acknowledged in the WTO as reasons for reducing barriers in international trade in services. The GATS includes schedules of specific commitments, which show the services sector and modes of supply in which foreign services and/or suppliers will be permitted and under which conditions they may be permitted. The modes of supply are extremely relevant for the analysis of growth of ITES/BPO sector in India. Members can undertake commitments using WTO’s Services Sectoral Classification list which in turn are identified by corresponding codes of the Central Product Classification (CPC). The GATS defines four modes of supply, i.e. transactions of services across borders. ITES/BPO falls under the Mode 1 transaction, called Cross border supply, where both the supplier and the consumer of the service remain in their home territories but the services cross the border. Deliberations on improvement in the definitions and concepts of various transactions of services are ongoing. It is also observed that hard data on global outsourcing is not easily available. While WTO identifies the central classification of products; the relevant data can be obtained from the Balance of Payments statistics published by IMF. As Outsourcing directly impacts exports and imports data of a country, greater clarity is needed in understanding these classifications.

With reference to the BPO activities, out of the IMF data, Service Sector related data alone is of relevance. Service Sector is broadly classified by IMF into three categories, namely Transport, Travel and Other Services.

Outsourcing falls under the category of ‘Other Services’ which again consists of nine sub classes. Of these, the two categories i.e., ‘Computer and Information’ and ‘Other Business Services’ together include most part of IT and ITES/BPO. They include:

- ‘Computer and Information services’ comprises hardware consultancy, software implementation and data processing.
'Other Business Services' comprises accounting, management consultancy, call centres and other back office operations.

The aggregate of these two heads gives the data on India’s and other countries export revenue from Outsourcing.

Trends in export revenue under different categories reveals that IT services and BPO services can be identified as the most dynamic areas of service trade, world over since the early 90's. There does exist a doubt as to whether it is justifiable to separate different types of services under the category of 'customer interactive services' or 'back office services' under the BPO head, which is part of the category 'other business services'. This is because, often, in running a Call Centre, many services need to be clubbed in reality and hence cannot be separated. Although, not entirely all encompassing, the IMF Balance of Payments statistics classification of BPO services under the category of 'Other Business services' is as close as one can get to the perfect identification as of now.

With inclusions of services under several heads, it has been possible for trade in services to progress systematically and outsourcing businesses in India in particular to leverage the conducive liberalized environment and global opportunities. Thus, the international acceptance of 'trade in services' has catalyzed the birth of the BPO Sector which has also brought India in the forefront of a Service led growth phase.

4.4 Birth of the BPO Industry

It was during the early 90's that the introduction of the Internet led Corporate experts to realize that anything that can be done on a desk can actually be wired outside and done at a cheaper cost. Although, the internet was one of the main factors responsible for the Outsourcing Sector’s birth in India and other countries, the real applicability caught on with Prof. C.K.Prahalad’s Core Competency Theory catching the attention of huge MNC's in the US and other parts of the world.9

The crux of this theory is:

The simple lesson for an Organisation is –

'Identify your core competencies, focus on them and get out of everything else.'
The BPO Industry owes its roots in India to just a few global companies. The first international firm to start its operations in India was Texas Instruments in 1985. Others are General Electricals (GE), American Express, British Airways and Swissair. The mantra was – ‘to leverage the low cost Indian talent to deliver services and cut down on cost of transactions’. This included mainly services like account enquiry, credit card processing, airlines reservations and cancellations and other such services.

Infact, back in the US, the need to outsource was becoming dire for the survival of several Companies. As the internet’s outreach grew, several Venture Capitalists came up with ingenious ideas to put the internet to optimum use. So much so, that in this early stage of offshoring when dotcom addresses started growing, people thought that buyers and sellers would only interact through mails and the service providers would manage it all through the internet. (For eg: If it cost a Bank $2.5 to process a transaction, while the same came down to $1 with the ATM, it came down to as low as 35 cents when outsourced to India)

However, the business had just begun and the bubble of the Dotcom boom soon ended in the Dotcom bust.

**The Dotcom bust:**

Companies which imagined that they could convert e-mails or dotcom sites into revenue ran out of business. All this coincided with the economic slowdown in the US that was accentuated by the 9/11 incident. Companies struggling to survive in the US were forced to look for cost cutting measures to survive. The option of outsourcing most noncore services to low cost delivery Centres in India turned out to be the best bet and thus the fledgling BPO Industry which used to be known as IT Enabled Services began its take off to a growth path that has awed the entire world since. India soon came to be known as the ‘Back office of the world’.

**The Process of Outsourcing:**

Processes in any Organization could be Core and non-core which in turn could be both critical and non-critical. Organizations initially found convenient to outsource noncore non-critical processes. Looking into its success outsourcing extended to noncore critical processes and thus core non-critical leaving only core critical
processes for the organization. The organization then minimized the focus to gain greater comparative advantage through specialization in a core process so that it would ultimately carve a 'niche' for itself in that business.

Thus there are:

i) Core-critical processes

ii) Core non-critical processes

iii) Noncore-critical processes

iv) Noncore-non critical processes.

In order to save time and costs, Companies started Outsourcing some of their processes. The Companies

- First the Noncore non-critical processes started getting outsourced.
- Slowly even the Noncore-critical processes started moving out.
- As telecommunications, internet services or IT services started improving, it became extremely easy to transfer data across nations. Thus, even Core but non-critical processes started getting Outsourced. Outsourcing through Call Centres/Contact Centres can be seen in Annexure 1. Finally, it was found that the only processes that could not be or should not be outsourced were the 'Core-critical processes'. All others were best outsourced. In short, Companies globally were getting into the practice of making only what they were best at making. It made business sense to outsource practically everything else. In is worth noting that this practice has been in conformity with the contentions of some of the International Trade Theories discussed in Chapter 2 of the present study.

This is also explained in Exhibit 4.1 where it is evident that the non core process of an Organization which is outsourced becomes the Core process of the Service provider.

Which processes to outsource and which to provide in-house, is a matter of each Organizations discretion and there is no water tight distinction. The entire business of outsourcing initiated with the IT companies. Due to their experience in IT Outsourcing (ITO), some companies took keen interest in entering the field of BPO.
Initially in the late 90’s the BPO Industry was led by the Captive players such as GE, American Express, Dell, HSBC, Standard Chartered, and American Online & Hewlett Packard. However, soon Indian third-party vendors started by bidding voice –based work from the Captives. Spectra mind and Daksh were the pioneers among the Indian players. They were followed by prominent IT Companies like Infosys and Satyam floating their BPO wings, Progeon and Nipuna. Several activities are outsourced and the BPO Sector itself has expanded into a number Vertical, providing a number services. This is discussed in a separate section.

Between 2001 and 2007, the path of growth of BPO’s has been mind boggling. From a handful of BPO units initially, the number rose to more than 400 in less than five years. However since then there have been certain critical differences between the Captive Units vis-à-vis the Third Party BPO’s. Both have had their typical advantages and disadvantages. While one had the edge in terms of experience in process engineering the other had the advantage of access to a greater man power resource to pick from. Initially, the Third Party focused predominantly on the Domestic markets . With time this changed and as of today both Captive Units as well as Third Parties; cater to the needs of both International markets as well as Domestic markets particularly from the Airlines, Telecom and the Retail Sector. Now
additionally, there are also the hybrid models that have come into existence such as the Joint Ventures and the Build-Operate-Transfer (BOT) models. These are becoming increasingly profitable in some cases as against the conventional models.

For a better understanding of the BPO Sector, it is necessary to be familiar with the jargon that is typically used in the BPO Sector which is provided in detail in Annexure 2.

The BPO Sector has grown to include several processes and activities. A following section deals with this and briefly explains how BPO Companies function.

SECTION - II

4.5 CLASSIFICATION OF BPO SERVICES

Broad categories in the Indian market:

Processes that are outsourced can be classified on the basis of vertical services specific to certain activities as well as service lines that are known as horizontals. The processes that are typical to a particular vertical include are similar but maybe quite different from that of another Vertical. For eg: Insurance claims are different from hotel reservations and ticketing. This belongs to three different verticals. Across the globe, Banking, Financial services and Insurance (BFSI) and Healthcare have been leading in outsourcing vertical based services. Domain knowledge is very essential. As we move up the value-chain in the Vertical services, Organisations becomes more ‘niche’ and need highly specialized employees. Thus as one moves up the value chain, BPO activities evolve into knowledge based work or analytical work and get identified as KPO services.

Whereas, the horizontal services are a range of services that are common across several Industries. These are typically ‘back office processes’ wherein the outsourcer does not enjoy any comparative advantage. Such services are found to exist across Verticals and require certain basic skill sets among the employees rather than specialized domain knowledge. A detailed discussion of the Vertical classification is provided below.
1) **VERTICALS:**

A Vertical is a group of similar businesses which engage in trade based on specific and specialized needs.

Based on the Nasscom classification, the activities of the Industry are divided into various verticals, which is shown in Exhibit 4.2.

**EXHIBIT 4.2: VERTICAL CLASSIFICATION**

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Vertical Classification

- Banking / Finance
- Manufacturing
- Insurance
- Telecom
- Health Care
- Media and Entertainment
- Retail
- Transport / Airlines
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1. **Banking/Finance** This is one segment of the Service Sector which has found outsourcing of its services very profitable. This is mainly because; the nature of work in BFSI is quite repetitive and requires only brief training. As the operations involve transfer of a lot of data, these are easily done through the computer and the internet. BFSI related work involves innumerable transactions and hence ‘transaction processing’ becomes an important part of BPOs work for this segment. Under this category, the following processes are commonly outsourced:

   o Net banking processes including payments, account status verification and other transactions.
   o Loan transaction including application processing, delivery and collection
   o Credit card services including Application processing, bill generation, collection of payments, credit card loans, marketing of products linked to
credit card. Apart from all these, one of the most popular Credit card service outsourced is 'customer care'.

- Mortgage processing is also an important Financial Sector service outsourced.

2. **Insurance**: Common processes outsourced in the Insurance Vertical are:
- Application form processing
- Policy administration
- Claims processing
- Medical Insurance / mediclaim
- Settlements
- Apart from these functions there are several other processes related to foreign exchange, NRI banking, banking transfers etc in this Vertical. As these are treated as 'core and critical', they are usually done in-house.

3. **Healthcare & Life-sciences**: Healthcare is provided by Hospitals, private Doctors and medical shops. Between these three, all the needs of any patient in any corner of the world are taken care of. The Insurance Companies also play an important role here, particularly in the Western countries. For instance when a person falls sick in the USA, a lot of personal and medical details of the person have to be exchanged between the patient's Insurance Company, the Hospital and the Pharmacy before the treatment actually starts. This has created various processes such as Medical transcription, medical billing, and medical coding, forms processing and so on. Medical history and other details of the patient would have to be stored in documents. As medical Insurance has been very common in the US and other advanced countries, Doctors have always had to take utmost precaution in treating. Even a minor mistake could cost the Doctors and the Insurance Companies heavily. Moreover there is strict Government regulation on these matters.\(^{11}\)

4. **Retail**: The Retail Sector is one of the fastest growing sectors in the world and particularly in economies like India, China and the Philippines etc. Multi National Corporations from all the Developed countries have entered into retail business. The main attraction is the growth in purchasing power and hence in demand. The Retail sector includes outlets for apparels, departmental stores, malls and all the new stores that cater to consumer needs directly. The 'pick and choose' approach is followed here. The retail sector has plenty of back office operations which include supply chain
management, procurement, administration, financial services, advertisement etc. Apart from this, customer service plays a very important role in this sector. Retail chains like McDonalds, Marks & Spencer, Wal-Mart etc. outsource these back office operations to low cost estimations like India and China. In India, domestic chains like Subhiksha, Reliance etc. have entered the retail market. The growth of these retail chains and competition between them is becoming increasingly evident in their approach to woo customers. In this Vertical too, outsourcing has been followed as a profitable business strategy.

On similar lines of the activities mentioned above, several other Verticals exist as shown in Exhibit 4.2.

2) **HORIZONTAL CLASSIFICATION OF OUTSOURCED PROCESSES:**

A horizontal classification refers to categories of services that maybe used in all Industries or Verticals and not any specific one.

BPO services started initially with outsourcing of medical transcription work and customer care in various areas of work. Slowly the types and number of processes being outsourced expanded to cover a wide range of services. The classification can be understood horizontally too.

The major services that BPOs offer are represented in Exhibit 4.3:

**EXHIBIT 4.3: HORIZONTAL CLASSIFICATION OF BPO**

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Horizontal Classification

- Customer Interaction service
- Back office Transaction Processes
- IT Support / Software Operations
- Knowledge Services
- HR Services
- Finance / Accounting Services
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Typically any service that is outsourced usually falls into one of these categories. This list may widen to include still more services as the BPO Sector is growing. New service providers enter the market to offer new services and thus the list expands.

Let us take a closer look at these service categories.

Major services that is outsourced:

1) Customer Interaction Service – This is done through Call Centres or Contact Centres. These may be voice based or web based (non-voice). It includes Customer Service, Customer help desk, telemarketing, customer feedback etc. The typical examples are attending to customer questions related to bank account, credit card or product information.

2) Back office Transaction Processes – Most Organizations have a number of processes that are carried on without direct interaction with customers. These broadly fall under the category of 'back office operations'. Such transactions include data entry, processing applications and other non voice customer related operations. This relates to cases such as credit card application, loan applications etc.

3) IT/Software Operations – There are some IT applications that are widely used by various Industries. The process of implementing such applications includes customizing, training and maintenance which are often outsourced to Service providers.

4) Finance and Accounting Services - These processes are common to almost all Organizations. They include financial accounting, general ledger, balance sheet accounts payable and receivable, loan administration etc. These are also non-voice services.

5) HR Services - This includes several processes relating to Human Resource Management starting from Recruitment till the Exit formalities. This covers training, Payroll services, Employee Benefits Management, etc. HR Services have been popular in the Outsourcing business.
6) **Knowledge Process** – When the Outsourcing activity becomes high end requiring very specialized skills and is analytical in nature, it takes the form of Knowledge Process Outsourcing.

Apart from the above categories mentioned, there are several processes such as Procurement, Transport Management, Inventory Management and other Logistic Services that are also gaining popularity among BPOs.

This is a brief classification of BPO activities. For a more detailed coverage of activities, see Annexure 5.

Further, Exhibit 4.4 gives a snapshot of the entire gamut of Verticals and Horizontals to clarify that almost all the service lines may exist in each of the Verticals. Moreover, as the nature of the processes become complex, BPO work takes the form of Knowledge Process Outsourcing or KPO. The BPO Sector is found to be in the practice of coining and using new terms such as HRO for Human Resource Outsourcing, RPO for Recruitment Process Outsourcing, and LPO for Legal Process Outsourcing and so on. As the BPO Sector itself is in the path of maturity, this classification is more by way of common practice rather than any legal distinctions.

**EXHIBIT 4.4: CLASSIFICATION OF BPO ACTIVITIES - A SNAPSHOT**
Having seen what processes are outsourced, the section presents a discussion on the Ownership patterns prevalent in the Outsourcing business.

4.6 OWNERSHIP MODELS IN OUTSOURCING:

The term ‘outsourcing’ is often used as a synonym for ‘offshoring’. However a closer look at the two terms indicates a difference which cannot be ignored. While the former is a movement of work from one Organization to another, the latter refers to movement of work within the same Organization, but from one Country to its Unit/Branch in another Country.

There are no ‘off the shelf solutions’ which are readymade for any Organization which wishes to adopt outsourcing as an ideal business option for staying in competition. It differs from case to case. There are a few classic outsourcing models that can typically be adopted according to one’s requirement. These may also be seen as Ownership models because essentially depending on the model, the ownership differs. Infact, the choice of model requires an analysis across five dimensions.

Strategic impact – The question a Company may ask is – will the outsourced process be critical to our business in the future?

Financial Impact – Will outsourcing amount to significantly lowering our costs?

Business impact– Will outsourcing help us deliver our services better and hence penetrate newer markets?

Business risk – Will outsourcing hurt our brand? Is the vendor operating from a place with high geopolitical risks?

Feasibility – Do the vendors have necessary experience and scales? Or do we need ongoing capital to maintain the required set of skills and knowledge in-house?

Based on the answers an Organisation arrives at after high level managerial deliberations and consultations with experts in the field, decisions are taken about the model of outsourcing. There are wide variations in verticals, products, processes, client profile and risks in the business. Depending on how critical the processes in question for outsourcing are, choices are made with respect to what, when and how
to outsource. Here it needs to be noted that the models have been changing and evolving since the Industry as a whole has been maturing globally. There are no watertight compartments in the models and neither does the concept of ‘best’ or ‘ideal’ model fit in within the given context.

This brings to light the different Ownership Models that exist in case of Outsourcing Companies. The most common one’s are:

1. Captive Model

2. Third Party Service Provider

3. Build-Operate-Transfer (BOT) and Joint Venture

While off late there is one more Model referred to as Build-Operate-Transfer or BOT model, the most prevalent one’s are Captive and Third party.¹²

1) CAPTIVE MODEL:

A Company, usually a MNC or any Company from a Developed country that decides to set up its Office in another Country which is necessarily a low cost Country in terms of labour but does so without losing the major control of its operations will opt for outsourcing using the Captive Model. This model can also be viewed as ‘offshore in sourcing’ as it is outside the country where the Company’s parent company is but the work is not ‘outsourced’. In this case, the Organization tries to leverage the benefits of lower costs but blends it with its own technical expertise, client base and superior Management practices.

Captive Units can be set up as:

Branch Office—with limited benefits

100% subsidiary—with plenty of sops particularly in case of opening this in EPZ / STPIs.

Acquiring an existing Company – Incase of acquiring an Indian Company, the RBI needs to be informed.
The main plus points of this Model are:

**Data security** – Highly sensitive and confidential data pertaining to the Offshoring Company or its clients stays with the Parent Company.

**Direct control** – The Parent Company’s C-level employees find it safer to function, as the major control over the Managerial decisions lies with them.

**Better rapport** – Between employees in the Country of origin and the Country where the work is offshored / outsourced, there is greater rapport as all are employees of the Parent Company, no matter which is their location of work.

**Cost benefit** – As the accounts of the two locations are merged, the Parent Company directly benefits from the cost advantage of outsourcing and this gets reflected in the Company’s profits.

**Superior Management practices** – From the perspective of the Outsourcing Country or the low cost destination, the Captive Unit automatically brings home management practices that have evolved to suit Global standards. This has a very positive impact on the domestic management system which is forced to improve so as to survive in a competitive environment.

However, the minus points of this Model are:

**Survival of major players**- While MNC’s with a global existence and a big name can attract the best of talents from the available man power, lesser known Companies would find it a struggle to make their presence felt in the labour market, particularly if their target is the highly skilled work force that graduates out of the premier Institutes of a country like India.

**‘Hire and Fire’ not welcome** – In a country like India which has seen liberalization only recently, the work force does not react well to a Hire & Fire Policy due to the deep rooted mind set of rather rigid Exit Policies for several decades. This makes it expensive for the Captive Unit to run all processes in case of lower demand or lesser business.
Economies of Scale – Due to certain pre-determined standards of Office space or work environment, unless there is enough business, substantial economies of scale cannot be recovered.

Higher Training costs – The cost of training the work force in the Outsourcing Country to suit global customers and specific processes is very high both in terms of time and money. In case of BPO work as against pure IT work, particularly where Voice based activities are involved, the vernacular influence can make it very time taking to flag off operations.

Cultural differences – There are several lags in blending of the work cultures of employees of the same Company but from two different Countries. These gaps may give rise to teething trouble in the initial years of the Captive Units setting up.

Legal hurdles – There are likely to be legal issues for any Foreign Company opening shop in another country. These maybe related to sanctions, licenses or infrastructure.

2) THIRD PARTY MODEL:

These are also called Third Party Service Provider or TPSP. Here the entire ownership is with a Company, usually from a low cost destination. This Service provider is also called a Vendor and is outsourced work to by Companies who want to limit themselves to their core competencies. Outsourcing non core activities to a TPSP is seen as a very rewarding exercise as the TPSP view this work as their core competency. The TPSP in turn work systematically to attain highest standards of service provision, so as to retail their customers. As against the Captive model, in case of TPSP, the accessibility to resources by virtue of their being domestic in nature is very high. Thus there is an intrinsic edge over the Captive model in this form of ownership.

However, the clients do face very high costs in initially migrating processes from one country to the offshore Third party vendor and slowly stabilizing them. The process of migration itself is so complex that there is a need for a team of experts in processes along with process managers. Infact the entire process may take anything from six months to a year. The Indian IT Industry had already proven itself to have ‘process migration’ as one of its key value propositions. The BPO Industry has also had to
function on similar lines. As the clients expect very high perfection in service delivery, there are Service Level Agreements or SLA’s that have to be met by the Service provider. Incase a TPSP fails in keeping up to the SLA’s, it could mean charges, penalties, litigation and even loss of business. For instance, in the case of the Customer Services horizontals, in the voice based call centres, a simple telephonic complaint from a customer could amount to serious damages to the TPSP’s reputation and business. The greatest challenge that the TPSP faces is delivering the three important stages of process migration, i.e. planning, executing and stabilizing.

1) Planning – starts with identifying the goal, the process to specialize in, the metrics to meet, the business requirements, the feasibility study and the risk mitigation analysis.

2) Execution- involves the actual act of preparing a transition plan, implementing it, documentation of terms, SLAs, legal commitments and kick starting the project on a pilot basis with plans to stabilize as soon as things shape up. It is seen that, this is the stage where the TPSP’s face maximum hurdles in India. The glaring gaps between planning and execution are highlighted by pitfalls such as availability of employable manpower, infrastructural bottlenecks and competition from the existing experienced players, mostly the Captive units.

3) Stabilizing – Once work moves in as planned, the ground is ready for a complete roll out. The TPSP then moves ahead with plans to stabilize, expand and carve a niche in the specific domain or process, within the given limitations it functions in.

The nature of the processes migration is not just a single function but entire processes. This could be across verticals and across functions. Across verticals could mean a medical insurance policy follow up or a high end complex research analysis process. Across Horizontals could mean Voice based call centre activities such as Customer relationship service or Marketing services.

Either way, the delivery has to be near perfect with no scope for errors. However, the high end services undoubtedly pose greater risks to the TPSP as the stakes are higher. As the systems and regulatory bodies in one country are very different from those of another country, the employees at a Third Party BPO need very specific process
training. Thus the setting up of a Third Party BPO involves consultations with experts in the field, as well as appointment of people with domain knowledge and above all expertise in setting up facilities, recruitment of staff, training of staff, technical skills and operational skills.

The main advantages of the Third Party model are:

**Cost effective** – From the view point of a client, outsourcing work to a Third party can be the most cost effective solution and can help solve several other problems. The TP has much more effective access to resources at lower costs as it deals at the domestic level.

**Process expertise** – The TPSP usually deals with multiple clients for similar processes and hence acquires expertise in delivering services. Best practices are developed and migrated across the Organisation to improve quality and reduce cost. With Certifications like Six Sigma and other quality certifications, services have reached a level of near perfection. This offers the client maximum leverage which would otherwise not be possible due to its preoccupation with its core competency area. This is particularly true of back-office services such as accounting, payroll management, IT support, insurance follow ups and the like.

**Flexibility in choice of Vendors:** The client also has the choice of surveying the market to pick up the best TPSP and hence minimize the risks in the business. This advantage is nonexistent in case of the Captive model and many Companies are forced to continue with less than optimal efficiencies.

**Flexibility to scale operations:** Operations can be scaled up as also scaled down by the client merely because it is the lookout of the Vendor to manage the show. The sensitive task of laying off or recruiting amass is all at once transferred from the client to the Third Party vendor. In case of expansion, this is also made possible due to access to several Service providers.

**Retaining decision making through metrics:** Although, the Clients may not have complete control over the operations, there is a substantial control on the Third party through SLA’s and other quality based metrics. This gets manifested in the fee
structure and ensures complete solutions. In a competitive environment the Third parties are subtly and at times directly forced to perform or perish.

**Global standards in competition:** As this model has been maturing, Third parties have been striving to attain not just high standards of services domestically, but also globally. Other low cost countries that catch up in the business force TPSP’s of every country to be conscious of the reality, that no business deal is permanent. This has a very positive impact on improving performance standards offered by any single destination. This in turn, slowly trickles down into the other Domestic Industries, who may also be clients of the TPSP. There are forward, backward and even horizontal linkages that help in raising the quality of life in a less developed economy. Eg: In India, typically the use of Professional Call Centre services by the Public sector such as the Railways is a leap ahead in this direction.

The minus points of the Third Party Model:

**Availability of manpower:** While facilities can be built overnight, plug and play offices can be hired in short notice, network and IT support can also be organized, manpower with the appropriate skills have been a serious issue. Though India is a labour surplus economy, manpower which is readily employable, is not easily available. Though the IT Industry could access employees through campus recruitment from Technical schools, the case of the BPO industry is a little different. The range of services is so vast from Medical transcription to CSR and at the high end research/market analytics, that there are no readymade solutions to recruitment. The mismatch between the current Education system and the needs of this fast growing Industry poses a serious pitfall.

**Attracting the right talent:** It was initially an uphill task for the TPSP’s to make their offers comparable enough to those of the Captive BPO’s so as to attract talented manpower. The Captive model has the distinct attraction of plush office environment, a work class work culture, frequent stress buster picnics, a warm and lively atmosphere in addition to the advantage of being associated with a MNC with a global name. (American Express, Accenture, American Online, GE which is now a TPSP and so on). The most talented manpower, particularly when there are Campus recruitment drives tend to opt for the Captive BPO’s. However, things are slowly
changing on all fronts. The packages offered by TPSP’s have started keeping pace with their counterpart and also very many infrastructure related and work culture related changes have started being imbibed even in the TPSPs. This is narrowing the gap between the two models.

**Role of Training:** This brings in the relevance of training of staff, which is next to indispensable in the BPO Industry. The role of training in any Industry can never be undermined. However, two reasons make it even more important in the BPO Industry. One is the newness of this Industry. Two, the range of services it covers, which are so wide, that, it is quite unimaginable to think of an appropriate Institutional support, which maybe a part of the curriculum. Each service has a unique set of requirements and still further, each Client may have a unique set of requirements. Thus, the cost of training does play a significant role in the commercial aspect of this business.

**Thin margins:** The burgeoning growth of number of BPO’s in the country has forced Companies to make their fees /prices reduce to very competitive levels. This is also the result of competition with the established Captive BPO’s which have altered their models recently and now started competing for domestic clients as well. Even though, the TPSPs have access to cheaper resources, there is always the need to peg up prices just to retain their resources, particularly experienced manpower who may swept away by major players and MNC’s. Thus, the TPSP’s at the very outset have to begin business with rather thin margins, until they are able to create a space for themselves and justify more suitable terms.

**Sustaining long payback periods:** TPSP’s most often are not financially strong enough to sustain long payback periods, which is not the case with the Captive model. In case of the Captive model, the financial implications of delays in payments or any other financial bottlenecks are overcome with support from the Parent company in another country, which is often a large MNC. However this convenience is absent in case of TPSPs and there are cases where a weak Domestic Company is acquired by a Captive.

**Data Security:** Unlike the Captive model, one of the serious constraints is Data security. Personal information and confidential data of clients is something that needs complete privacy. Increasingly Service providers are getting globally accepted
Certifications such as ISO 17990 / ISO 27001, SSE-CMM and the like. However, there have been instances of breach of security and data leakages which have also caused criminal cases of funds misappropriation. Even a single such instance can shake the trust of several clients and cause loss of business to the Company, TPSPs in general and the economy as a whole.

**Attrition:** Attrition has undoubtedly been a major threat to the IT / ITES Industry or any other Industry for that matter. The attrition in the BPO Industry is anything from 15 – 80%. However these are mostly guesstimates, as the methodology is not uniform. This affects the TPSP’s in particular because they face the challenge of retaining their employees from the tempting, lucrative pay hikes offered by rivals, particularly the Captives BPOs. Across verticals, the packages in the TPSPs are lower than that offered by the Captives. Further, it is an unfortunate truth that the practice of ‘poaching’ is quite rampant in the IT/ITES Industries and those least resilient to this are the TPSPs.

**Pay hike:** While attrition is checked to a large extent by revisions in remuneration packages, the extent of hikes in TPSPs are often directly and indirectly influenced by the existing market trends in an effort to retain qualified, trained and experienced staff. The strength of any Service Industry lies in their human resource. Thus pay revision is an inevitable consequence of any Industry suffering from attrition. However, with already low profit margins, these pay hikes can be very pressurizing for a TPSP.

Notwithstanding the weaknesses of the TPSPs in the BPO space, there have been a lot of deliberations as to which of these ownership models will make a better option for the Outsourcing Company. In the late 1990’s and the turn of the Century, Captive BPO’s dominated the market with more than 60 % ownership. In more recent times, TPSP’s have grown to be almost equal in numbers. In the view of Phaneesh Murthy, CEO, iGATE, the GE sale of GECIS to a TPSP to become Genpact a TPSP has changed stake holder’s perception of the Third Parties. It has benefited the cause of the TPSPs and now Global Companies are questioning whether there really exists a need to establish a Captive Centre in a low cost destination, when TPSP’s serve equally well if not better.
The present scenario reveals a position where both the Captive and Third Party BPO's are sharing the market almost equally. Both have their pros and cons. Which way the trend will swing is a matter that only time can tell. It is also seen that other forms of ownership such as Venture Capital and BOT are also gaining ground for their respective uniqueness of advantages. However, the major portion of the BPO market will still be either Captive or Independent Third party.

3) ALTERNATE MODELS: JOINT VENTURE AND BUILD-OPERATE-TRANSFER/BOT:

The Third ownership model is a Joint Venture, and Build-operate and transfer or BOT model. This model is a mix between the earlier two, wherein the advantages of both are blended.

In case of the Joint Venture model, the client who outsources identifies a Vendor in a low cost destination and enters into a partnership with the Vendor on an equity participation agreement. The Vendor's availability of funds and its search for business are taken care of to a large extent. While the Client abroad is assured of a regular, reliable location to outsource work to and also assured of profits for the funds invested, the Vendor is assured of source of capital and also of regular flow of work. This is often found to be a win-win situation.

However, in practice, there are certain pros and cons that one cannot ignore. The other alternate model where the two earlier models, Captive and Third Party are mixed is the BOT or Build Operate and Transfer model. Here a Third Party Service Provider usually builds an entire centre keeping in mind a specific client. All processes are developed according to the client's requirement. Later the ownership of the Centre is transferred to the client and the Third party centre becomes entirely captive. At times the agreement between the two parties is made for a fixed tenure after completion of which period; the TPSP would have built the Centre, operated the Centre and is now ready to transfer the same. Once transferred, the operations and staff are so streamlined, that it becomes very easy for the Client to run it independently.
The distinct advantages of both the JV and the BOT model are:

**Shared risks** - Risks are shared throughout the business deal. The Client is guaranteed of dedicated services from the Vendor. While the vendor focuses on satisfying a single client and does not have to worry about long payback periods. It also does not compete with other service providers for pricing margins, as the tie up or partnership arrangement is prefixed in clear terms.

**Ease of start-up:** In both cases, as the entire responsibility of starting the Centre lies with a Third party Service Provider, it is much easier to start the Centre. Infact better access to resources makes it more cost efficient than the case of a MNC or a client setting up the Centre from scratch.

**Data Privacy:** In case of the BOT model, data privacy is well protected, particularly because the local Centre focuses on only one client and also intends to pass on the entire ownership once business stabilizes. The same is not necessarily true in the case of the Joint Venture.

**Cost efficiency:** As the BOT model and the Joint venture, for all practical purposes, function just like a TPSP, they have much better access to the all the local resources. This helps them get inputs at most competitive prices and thus make business very cost efficient.

However, the negatives are:

**Control is not total:** In the other two models, the control lies entirely in the hands of either the foreign Company or entirely with the TPSP. In the case of both BOT and Joint venture, since it is blended model, the decisions are often joint and there is a possibility of clash of roles. This can be avoided with accurate documentation of terms and conditions between the parties. However, when each party works within a certain limited sphere of operation and has to be conscious of avoiding entering into the others terrain, the control of decisions are constricted and performance cannot be free flowing. This may have its impact on various metrics in the operations.

**Transfer of ownership is tedious:** The transition from a TPSP to a complete Captive Centre is an elaborate process involving several legal issues. The legal framework under which the earlier model existed would be based on the country in which the
TPSP exists. Once the transition is implemented, the Company is bound by the legal framework of the country that the Captive Centre comes from. Further, the employees also need to streamline their functioning to suit a global work environment, once the transition takes place.

**Data theft:** So long as the model is that of BOT, there is very minimal fear of data theft, as the entire Centre is sold to the Captive Centre. However, in case of Joint Venture, since both the models of ownership coexist, there is always an element of risk regarding client details, process details, and confidential personal details such as medical history of a patient and so on. It cannot be ignored however that in any service related to the internet and information technology Industry, irrespective of the ownership model, the risk of data theft is a bottleneck that needs to be addressed independently and seriously.

**IDEAL MODEL:**

Which of these Ownership models is ideal, is a very relative and transitory decision? The Industry itself has exhibited a changing trend in the Ownership pattern since inception. Initially, Captives such as GE and British Airways were predominant. However, over the years TPSPs have had a mushroom growth. Major players like Wipro, HCL, Infosys and other veterans in the IT Industry have opened their BPO arm and given the Captives a run for their money. Infact this has even lead to a situation in which the Captives have been forced to reconsider whether it is really worthwhile to set up a Captive unit in another Country or simply engage a TPSP for their requirement. It is seen that many Captives are turning towards the TPSPs, for Mergers and Acquisitions.

An alternate model in the form of BOT and Joint Venture have also come into existence and have gained acceptance by virtue of being a via media between a pure Captive and a pure TPSP. The option of skipping all the strain of starting a Centre from scratch in an unfamiliar country and also later taking up the business when it is stable is seen as a great alternative as against the earlier options. This is seen in case of the BOT model.

Similarly, functioning in partnership where the major risks of the business are divided is also a practical solution to many outsourcing related issues. While decisions are
...substantially retained with the Captive Company, the work is shared in a very practically efficient manner.

Which of the models is the best fit, cannot be ascertained easily. However the recent study by A.T. Kearney –Global Services Location Index 2007 reveals that the most popular model among Companies that have shown phenomenal benefit from outsourcing or who have been very successful in outsourcing operate the 'global delivery model'. They choose a range of Vendors from different advantageous destinations and distribute the processes depending on the skill specialization. The number of service providers is usually large enough for no single one to have a monopoly. It is also ensured that the number of Service providers is not so large that it becomes unmanageable. The Centres are decided, keeping in mind variables such as cost efficiency, availability of skill sets in manpower, infrastructural support, and scalability and so on. This model allows tasks to move between Centres and this makes it an ideal model. The Outsourcing Company keeps experimenting with tasks till it arrives at the best mix in terms of quality and cost. It hence protects the Company which outsources from changes in the market conditions, pricing policies, political upheavals and shortage of manpower in any vendors Centre. The operations can be scaled up or shifted as and when required. Companies that evolve an Optimal Global footprint are actually able to sustain success even in the long term.

4.7 A CONSOLIDATION IN THE INDUSTRY THROUGH MERGERS AND ACQUISITIONS:

A very interesting development in the BPO Industry during this period was the case of consolidation between the Captives and the Third Parties. The lead was taken by HCL Technologies in 2002 when it bought over a medium sized BPO Unit Apollo Contact Centres, of Belfast, Ireland. Soon, several other mergers took place between the following Companies:

In 2002 – Essay Group & Aegis Communications, US

2002- Datamatics Technologies & Corpay Solutions, Detroit, US

2003 – Tracmail & Web help, Toronto, Canada
2003 – Godrej Group & Upstream, US


2003- Essar & Aegis Communication Corp, Texas, US

2004 - IndeComm Global Services & Simpata Group, San Francisco, US.

2004- Hinduja TMT & Source One Communications, New Jersey, US

2004- ICICI One Source & Accounts Solutions Group (ASG), New York, US

2006- Transworks & Minac, US

2008- PE Fund Nalanda India & WNS Global Solutions

Interestingly all these were cases of Indian BPO Companies taking over a small or medium sized US Company. This trend has been referred to as ‘Reverse Migration of BPO’. The main purpose of such take over’s was for Indian Companies to boost their Industrial expertise, geographic reach and customer base.

Consolidation of Captive BPO Units was a trend in the early part of the decade with a landmark deal of $ 500 mn in 2004 when the Global Giant GE sold a 60 % stake in its Captive GECIS (GE Capital International Services) to Oak Capital & Atlantic Partners. GECIS became Genpact, a Third party Company, setting the trend for other Captives to change ownership into Third Party with a bang.

Simultaneously, there were also several Mergers & Acquisitions of Indian Third Party BPO’s with larger MNC’s. Smaller Companies were often forced to capitalize their net worth by selling their shares to MNCs at high market prices. One such record deal was that of IBM acquiring Daksh eServices of Gurgaon at $160 mn. Some other deals that followed were:

In 2004 – ICICI OneSource acquiring First Ring, Bangalore.

– Aditya Birla Group bought over Transworks, Mumbai.

– Scandent (Singapore based) acquired Cambridge Integrated Services, Bangalore
2005- Spheris (US) acquired Health scribe

2005 - Intelenet Global acquired Sparsh (51% stake)


These M & A deals are based on the principles of ‘benefiting from economies of scale’ and ‘a wider customer net’ playing at their root. This further strengthened the trend towards better long term health of the BPO Industry and supports the hypothesis that ‘the expansion of the BPO Sector in India will lead to greater income and employment’.

The BPO Industry has attained such a high degree of competitiveness globally, within a short span. In fact identifying Vendors on the basis of their performance is a major challenge in itself for the client Companies in present times. There are several yardsticks and metrics on which one service provider can prove its one-upmanship on the other. However, the strength of superiority in a globally competitive market can be authenticated with the established of different Certifications. There are several Certifications that validate the Quality and Security levels of an Organization. Most of these are typically acceptable to an Industry based on its needs. There are several Quality Certifications and Security Certifications in the BPO Sector that are valued and widely recognized globally.14

SECTION - III

4.8 GROWTH OF THE BPO INDUSTRY IN INDIA

All data of the BPO Sector is taken from various Nasscom Reports as these are considered most authentic globally, including the WTO.

The Indian BPO Sector is a part of the Indian IT Sector. The Indian Information Technology Sector is divided into three parts:

1) IT Services and software: This accounts for the greatest portion of the revenue. This sub sector includes software itself, software-related services like IT consulting and services for the maintenance and improvement of IT products such as staff training, support and research and development.
2) IT-Enabled Services and Business Process Outsourcing (BPO): This comprises the second subsector and includes services that do not directly offer services related to provision or maintenance of IT products. Instead, this category includes services which rely on IT products to deliver their value. This includes typically, work ‘outsourced’ from other parts of the world. These involve customer support, technical assistance, human resource information provision or accounting, financial services such as market analysis, equity research and fund management. There are also technical services like content development, medical diagnostics, legal transcription and animation.

3) Hardware: This sub sector which used to be the most important earlier is now growing slower than before.

MACRO ECONOMIC PERSPECTIVE

REVENUES AND GROWTH:
The revenue generated by the BPO Industry is recorded under the head ITES-BPO and is shown as part of the revenue of the IT-ITES Sector. The Figure 4.1a represents data taken for a period from 1999-2000 to 2005-2006 which reveals a consistent growth in the revenue of the ITES-BPO Sector. The revenues earned in the entire IT-ITES Sector are both from exports as well as domestic services. In the early years i.e. 1999-2000, there was no domestic market for outsourcing services. Even the export earnings were insignificant with just a handful of BPO Units mostly Captives. However, as seen earlier in this Chapter, with the dire need to curtail costs, outsourcing grew in leaps and bounds from the Developed countries, US in particular to India. With this the revenues from export of ITES-BPO Services grew at an average compound annual growth rate of 51% to reach a total of USD 13.5 mn in 2005-2006. Infact, the services outsourced to Domestic Companies has grown even faster at 55% than the services that are offered to foreign clients at 48% during the period mentioned. It is worth noting that while the contribution of revenues from the ITES-BPO sector is lowest among all segments of export and domestic revenue from both pure IT and ITES-BPO Sector; it is growing faster than all the segments such as Software services, Engineering and R & D etc. This commendable performance has been noticed world over and given India the reputation of being one of the worlds’ best outsourcing destinations. This is represented diagrammatically below in Figure
4.1a. The Figure 4.1b also shows explicitly, how the ITES-BPO Sector is way ahead of the overall export and domestic earnings of the entire IT-ITES Sector for the period taken into consideration.

SHARE IN GDP

One of the indicators of the growing relevance of the IT-BPO Industry in India is seen from the growing share of this Sector in India’s GDP, this can be seen from Table 4.2 and Figure 4.2. This Sector is one of the few Sectors that has shown a continues increase in its share in the GDP since 1998 without even a single year of exception. An increase from 1.2% by about five times to 5.2% in 2007 is among the fastest growth in share of GDP observed from any Sector since India’s Independence. Here, the IT and BPO Sectors are clubbed, as individual share in GDP is rather small.

GROWTH IN EMPLOYMENT

The BPO sector has generated employment at the rate of 31% between 2003 and 2008 reaching a figure of more than 0.7 million from a meager 0.18 million, which can be seen in Figure 4.3. While this growth has been mainly in the metros with the spread of outsourcing companies to the smaller cities, where more human resource can be accessed, there is a potential for spread of employment to a larger extent. Apart from direct employment NASSCOM has estimated a generation of more than 2.5 times the direct employment in an indirect way. As this is likely to be in the unorganized activities such as, securities services, drivers, janitors, etc., the potential of employment generation of the BPO sector can have far reaching implications. Thus the figures shown above support the hypothesis that “The expansion of BPO sector has increased income and employment in India”.

SHARE OF INDIA IN GLOBAL OUTSOURCING IN IT AND BPO

The share of global outsourcing to India has shown an increase both in case of IT and BPO Services in case of Figure 4.4. However, the growth in case of the world outsourcing in BPO services to India has grown faster than the case of IT Services. India’s share in global outsourcing has shown a minor increase from 62 % to 65 % between 2001 and 2006. Whereas in case of BPO Services, India’s share in global outsourcing has gone up from 39 % to 45% in the same period. While outsourcing of
BPO Services to India is still way behind the IT services, the trend shows the chances of the former reaching close to the latters share in the global market.

**BREAK UP OF THE BPO SECTOR BY VERTICALS**

Figure 4.5 shows that among all the services outsourced to India, a majority belong to just four areas, Banking, Financial services and Insurance, better referred to as BFSI, Hi-Tech/Telecom, Manufacturing and Retail services. There is a small increase in their role from 78.5% in 2006 to 82.5% in 2007. The other areas worth noting, where work is outsourced to India are Airlines and Transport, Healthcare, Construction, Media and entertainment. There are several new activities that are being outsourced to India with every passing year. Of all, the single largest area where Indian talent is identified to reduce costs substantially is the BFSI Sector.

**THE INDIAN BPO SECTOR EVOLVING OVER THE YEARS.**

The Outsourcing Sector as a whole has matured over the last decade or so, particularly in India and has entered into the third stage of maturity.

Presently, the Sector comprises Companies which are among the Fortune 500 Companies and whose clients are also among the global giants. The focus of the business has shifted from cost to ‘processes and quality’. Operating models of excellence have emerged and the Sector has witnessed very effective consolidation.

Exhibit 4.6 below traces graphically how the BPO Sector has matured over the years. The maturity curve shows that the BPO Sector has now reached a stage of ‘emerging rapid growth’ is poised to become a mature Sector. The maturity of this Sector has lead to the following:

- Increased buyer options- Clients outsourcing services to India have expanded beyond the US and UK to include more than 25 countries from across the globe. A similar trend was seen even in the case of export of goods post Independence when the components of India’s exports basket expanded to include even engineering goods apart from basic agricultural goods. This trend is expected to move in a direction wherein outsourcing expands even further not just internationally but the domestic also increases as the use of IT spreads.
Improvement in provider capability with adoption of better tools and models. – As the Sector expands, the number of Service providers has been on the rise. As numbers increase, the element of competition between them has intensified and lead to several performance models and use of certifications of quality/security to prove their worth.

Broad delivery footprint – In India, BPO has spread to more than 30 cities. While the Tier 1 cities are the preferred one, the growth of cities like Mysore and Chandigarh into BPO hubs is not a matter of chance. There is scope for a lot more expansion to smaller cities and towns too. The necessary steps are on from various quarters and it is expected that the results would be seen soon in the form of expansion in income and employment in the entire country.

4.9 CONCLUSIONS

This Chapter has thrown light on the practical side of the BPO Sector and its growth in India. It has traced the roots of Outsourcing, particularly from a Policy angle and also drawn a descriptive picture of this Sector.

The last Section has brought to light the fact that notwithstanding discussions and deliberations on the utility or otherwise of Outsourcing as a business, this Sector has expanded over the last decade and carved a niche for itself globally. The trends seen in terms of the growing exports of ITES/BPO Services from India, increasing revenue, growing employment, and expanding service lines all are indicative that this trend is likely to continue in the future too. In any case, the macroeconomic position of the BPO Sector supports the hypothesis that the expansion of BPO has led to the growth of income and employment in India.

This brings to light certain further issues. Due to several reasons, India has made a mark for itself in the Global Outsourcing business since its inception. The BPO Sector itself is evolving and becoming more mature. However, at this juncture, the appears a need to check if this Sector is really doing as well as it seems to be doing. The question that arises is, will continue to be a leader in this business? The Chapters that follow present an analytical coverage of some of the challenges that the Indian BPO Sector faces at present.
## TABLE 4.1: REVENUES AND CAGR OF INDIAN IT/ITES-BPO SECTOR

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>INR / USD</td>
<td>43.3</td>
<td>45.6</td>
<td>48.0</td>
<td>48.3</td>
<td>45.5</td>
<td>45.3</td>
<td>44.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indian IT - ITES Revenue Total</td>
<td>8.3</td>
<td>12.1</td>
<td>13.4</td>
<td>16.1</td>
<td>21.7</td>
<td>28.4</td>
<td>36.3</td>
<td>48.1</td>
<td>24.56</td>
</tr>
<tr>
<td>Export Revenues - Total</td>
<td>4.0</td>
<td>6.2</td>
<td>7.6</td>
<td>9.8</td>
<td>13.4</td>
<td>18.2</td>
<td>23.9</td>
<td>31.9</td>
<td>29.63</td>
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<tr>
<td>- Software Products</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.6</td>
<td>0.8</td>
<td>0.9</td>
<td>1.1</td>
<td></td>
<td>24</td>
</tr>
<tr>
<td>- IT Services</td>
<td>3.1</td>
<td>5.0</td>
<td>5.8</td>
<td>5.5</td>
<td>7.3</td>
<td>10.0</td>
<td>13.2</td>
<td>18.0</td>
<td>24.59</td>
</tr>
<tr>
<td>- ITES / BPO</td>
<td>0.6</td>
<td>0.9</td>
<td>1.5</td>
<td>2.5</td>
<td>3.1</td>
<td>4.6</td>
<td>6.3</td>
<td>8.4</td>
<td>39.08</td>
</tr>
<tr>
<td>- Hardware</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.3</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>10.75</td>
</tr>
<tr>
<td>Domestic Revenue Total</td>
<td>4.3</td>
<td>5.9</td>
<td>5.8</td>
<td>6.3</td>
<td>8.3</td>
<td>10.2</td>
<td>12.4</td>
<td>16.2</td>
<td>18.03</td>
</tr>
<tr>
<td>- Software Products</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.5</td>
<td>0.7</td>
<td>0.9</td>
<td>1.6</td>
<td>18.9</td>
</tr>
<tr>
<td>- IT Services</td>
<td>1.5</td>
<td>2.0</td>
<td>2.1</td>
<td>2.4</td>
<td>3.1</td>
<td>3.5</td>
<td>4.3</td>
<td>5.5</td>
<td>17.63</td>
</tr>
<tr>
<td>- ITES / BPO</td>
<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.3</td>
<td>0.6</td>
<td>0.9</td>
<td>1.1</td>
<td>40.85</td>
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<tr>
<td>- Hardware</td>
<td>2.4</td>
<td>3.4</td>
<td>3.2</td>
<td>3.3</td>
<td>4.4</td>
<td>5.4</td>
<td>6.4</td>
<td>8.0</td>
<td>16.24</td>
</tr>
<tr>
<td>Total ITES/BPO Revenue</td>
<td>8.6</td>
<td>10.0</td>
<td>10.1</td>
<td>10.9</td>
<td>13.2</td>
<td>17.2</td>
<td>24.2</td>
<td>28.7</td>
<td>31.24</td>
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</table>

Source: Compiled from Nasscom reports.

Figures between 1999-00 to 2005-06 from Nasscom Strategic Review 2006 (2006 figures are estimated figures)

Figures for 2006-07 are from Nasscom Strategic Review 2008.
FIGURE 4.1 a: REVENUES AND CAGR OF IT/ITES-BPO

Figure 4.1 b: COMPOUNDED ANNUAL GROWTH RATE (CAGR) % 1999-00 TO 2006-07
TABLE 4.2: SHARE OF IT-BPO IN GDP:

<table>
<thead>
<tr>
<th>YEAR</th>
<th>FY98</th>
<th>FY99</th>
<th>FY00</th>
<th>FY01</th>
<th>FY02</th>
<th>FY03</th>
<th>FY04</th>
<th>FY05</th>
<th>FY06</th>
<th>FY07</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT-BPO AS A % OF GDP</td>
<td>1.2</td>
<td>1.4</td>
<td>1.8</td>
<td>2.6</td>
<td>2.8</td>
<td>3.2</td>
<td>3.6</td>
<td>4.1</td>
<td>4.7</td>
<td>5.2</td>
</tr>
</tbody>
</table>

Source: Nasscom Strategic Review 2007

FIGURE 4.2: SHARE OF IT - BPO IN GDP

FIGURE 4.3: EMPLOYMENT IN INDIAN BPO

Employee Growth (5 years CAGR): 31 per cent

Source: Nasscom – Everest India BPO Study
FIGURE 4.4: INDIA’S SHARE IN GLOBAL IT/BPO OUTSOURCING

SHARE OF GLOBAL IT OFFSHORING

<table>
<thead>
<tr>
<th>Year</th>
<th>Others</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>38</td>
<td>62</td>
</tr>
<tr>
<td>2006</td>
<td>35</td>
<td>65</td>
</tr>
</tbody>
</table>

SHARE OF GLOBAL BPO OFFSHORING

<table>
<thead>
<tr>
<th>Year</th>
<th>Others</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>61</td>
<td>39</td>
</tr>
<tr>
<td>2006</td>
<td>55</td>
<td>45</td>
</tr>
</tbody>
</table>

Source: Nasscom Strategic Review 2006

FIGURE 4.5: SECTOR-WISE BREAK UP OF INDIAN IT/BPO

FY 2006

- BFSI: 20%
- Hi-Tech / Telecom: 13%
- Manufacturing: 8%
- Retail: 8%
- Media, Publishing & Entertainment: 4%
- Construction & Utilities: 4%
- Healthcare: 3%
- Airlines & Transportation: 4%
- Others: 3%

FY 2007

- BFSI: 40%
- Hi-Tech / Telecom: 19%
- Manufacturing: 15%
- Retail: 3%
- Media, Publishing & Entertainment: 3%
- Construction & Utilities: 5%
- Healthcare: 8%
- Airlines & Transportation: 3%
- Others: 3%

Source: Nasscom Strategic Review 2007
EXHIBIT 4.6: THE INDIAN BPO SECTOR's EVOLVING OVER THE YEARS

Key characteristics
- Rapid maturity of BPO providers - global majors, diversified vendors, specialised BPO vendors and captives
- Establishment of operating models and standards in select areas
- Substantial M&A activity
- Establishment of operating models and standards in select areas
- Emergence of third-party vendors
- Emergence of a small number of third-party vendors
- Setup of captives by select large global players
- Emergence of India as a feasible offshore destination
- Set up of VC-funded third party vendors; entry of Indian ITO players into BPO market
- Increased adoption by a large number of buyers
- Increased focus on processes and quality by providers

Market value creation

Source: Nasscom-Everest Report 2008
END NOTE


2 The time zone difference between countries makes outsourcing even more advantageous at times. For instance, if some process is sent at the end of the day to India from US, the completed work reaches the US by the next morning, when they just start the day.


4 See T.N.Srinivasan 2005

5 See (i) Telecom Asia (Feb 2007) Sufia Tippu, 'India bandwidth market set boom: government moves to open up resale market, setting the stage for international competition and price reductions. (ii) Also see Business line (July 28, 2005) Thomas K. Thomas. 'Indian firms set to dominate global bandwidth business' (iii) See www.vsnl.in or www.tatacommunications.com for a detailed understanding of the privatization of VSNL in 2002

6 Debroy Bibek, 2000 Ed. 'Beyond the Uruguay Round: The India Perspective on GATT'

7 See Annexure - 4 for World Trade Organisation - Services Sectoral Classification list.

8 Infact most of the studies on Outsourcing revolved around the conceptual aspect of exports of services, 'particularly other business services'.

9 The idea of differentiating between core and noncore processes got initiated soon after Hamel and Prahalad brought out their paper. See Gary Hamel and C.K. Prahalad 1990.

10 See Chapter 3. Voleti and Ramchandra have made a similar reference. This was similar to the fall of the Medical Transcription business which practically killed itself by inter-industry price cutting as quoted by an Industry insider.

11 One such regulation is that of HIPAA or The Health Insurance Portability & Accountability Act of 1996. The Act provides guidelines on transactions, privacy and security related to patients. The medical community, Insurance Companies, BPOs engaged in the Healthcare Vertical and all associated entities are liable to comply by HIPAA. It enforces stringent quality and security standards on the stakeholders. For more, see Kulkarni, Sarita, 2005, Pgs 83-89.

12 See Mark Kobayashi-Hillary-2005

13 See www.bpoindia.org/vc/m-n-a.shtml - 41k -

14 See Annexure 3 for a detailed list of certifications pertaining to the IT/BPO Sector.