Offshore outsourcing in India: is this the way forward?

Offshore outsourcing is a phenomenon that first began in the 1990s in India when Cobol programmers were recruited to help companies prepare for Y2K. Since then, the market for outsourcing in India has grown at an immense rate – NASSCOM estimates that India's export revenues from IT services will grow from $6.1 billion in 2001 to $50 billion by 2008. These are no longer mere 'sweatshops' of programmers, but a vast number of highly-skilled IT professionals who are able to offer higher value services such as business process re-engineering. A small number of Indian companies such as Infosys have even begun competing directly with US and European companies – the 'Big 5' consulting firms should be worried. Offshore outsourcing is a means of reducing costs for hosted service providers, but there are a number of issues to watch out for.

Abundant and highly-qualified personnel

Along with the usual pros for moving to an outsourcing model, such as cost effectiveness and allowing organisations to focus on its core competencies, offshore outsourcing also offers a number of added advantages. One is the large number of highly-skilled IT personnel that are available in some developing countries – the IT skills shortage affecting the majority of the western world has made it difficult for all types of companies to attract the requisite number (and standard) of IT staff at an affordable cost. By looking at developing countries such as India, companies have a larger pool of IT personnel to choose from.

Cheap and efficient labour

The original driver for the growth of offshore outsourcing was the low salary cost of IT personnel. A typical American engineer charges $75 per hour; engineers in India charge just over $25 per hour for the same job of equal (or better) quality. This should worry US employees, whose typical demands include not only a six-figure salary, but also additional employee benefits such as a pension and company car. This means outsourcers with US staff only will find it difficult to outbid competitors that do employ an offshore model. Indian teams can offer lower costs and more available skills to staff projects with bigger teams of dedicated programmers in order to bring time to delivery down to a minimum. In addition, round-the-clock development could be carried out if part of the team was in the US and the rest was in India.

Infosys

Founded in 1981, Infosys Technologies (Nasdaq: INFY) provides consulting and IT services to clients globally. With more than 11,000 employees worldwide, the company's headquarters are in India's 'Silicon Valley' in Bangalore, with offices in

Argentina, Australia, Belgium, Canada, France, Germany, Hong Kong, India, Japan, the Netherlands, Singapore, Sweden, Switzerland, the UK, the United Arab Emirates and the US. For the fiscal year ending 31 March 2002, revenues reached $545 million compared to $413 million in 2001. Despite the economic slowdown, Infosys is seeing its profits increase in 2002 – net income rose to $164 million in 2002 compared to $131 million in 2001. The company targets the major vertical industries – engineering, financial services, healthcare, technology, manufacturing, retail and distribution, telecoms, transportation and utilities and energy. It wins new business through a direct salesforce that contacts prospects, responds to requests for proposals and negotiates new contracts. Approximately 70% of its employees serve the North American market, with 3,000 based in the US and Canada. Five hundred employees are based in Europe and 250 are based in Asia-Pacific.

Key services offered

Infosys provides consulting and IT services. Core to the company's strategy and profit margin is an extensive offshore infrastructure based outside the US (mainly India) to provide managed software solutions to clients worldwide. The company offers a broad range of services, including business consulting, systems integration, application development, product engineering, custom software development, maintenance and re-engineering. In addition, Infosys offers dedicated offshore development centres (OSDCs) for selected clients. Lastly, Infosys develops and licenses a number of software products including CRM and accounting.

Global delivery model

Of Infosys' 10,000 employees worldwide, approximately 8,000 are located in India; the remainder being located in the US and Europe. Infosys' internal information systems, remote infrastructure & network management, global HR management and finance are all located in India, as well as most of the management and executive leadership team. Two hundred sales and marketing employees are based in their respective regions with a further 500 consultants, technology architects and product managers.

As the majority of the workforce is based in India, the company is able to offer higher efficiency, at a lower cost, to its customers. Infosys delivers its services cheaper than many competitors, while still providing round-the-clock support and development from staff based in its clients' countries or regions.

The pitfalls of offshore outsourcing

The Infosys example seems to suggest that offshore outsourcing, with some local support, is the way to go for service providers. However, this model is not 'all singing and dancing' – there are a number of pitfalls.

Companies that are not used to offshore outsourcing management will need to take into account potential issues and problems associated with differences in language, culture, politics, regulations and work practices, which could hinder collaboration

efforts and thus increase risk. For example, the Indian government fully supports its IT services industry, creating organisations such as NASSCOM (the National Association of Software and Service Companies) to help fuel growth. It also encourages its citizens to go to the US and *vice versa*. The Russian government, on the other hand, wants to keep its IT resource in the country, and also imposes restrictions on imports and exports of IT technology.

Moreover, the salaries for software engineers in India are rising rapidly (faster than the US even), at approximately 25–30% per annum. At this rate, organisations using the offshore outsourcing model will not be able to sustain their lower prices, therefore risking erosion of their key differentiator. This rate of growth is not likely to continue, but companies will still need to monitor their staff costs carefully.

Look to other countries

There is also the issue of geographical proximity – some customers will want to be close to their IT service provider team should the need arise. To this end, Russia has begun to catch up rapidly with India as another country suitable for offshore outsourcing, with the added advantage that it is geographically closer to the West (in this case, Europe) than India. Russian firms have even begun to undercut Indian firms to provide cheaper talent.

What does this mean for hosted service providers?

Hosted service providers should consider utilising the growing supply of IT resources abroad – if they don't, they could risk losing market share. However, it is critical that service providers are sensitive to Indian culture, politics, working practices and regulations. They should pay close attention to the salary levels of engineers, otherwise there will be the risk of costs slowly rising and therefore margins decreasing over time, thus losing a cost differentiator. Service providers also need to ensure there is a representative in close geographic proximity to customers in order to help alleviate customer concerns.

It is also worth considering other up and coming countries such as Russia, which despite lacking the 20 years of IT experience India has gained, have an increasing number of highly-skilled technical staff at the ready. Providers can also spread the risk of their investments and outsource in Russia as well as India.

By outsourcing an element of your offering offshore, you may be able to:

- reduce costs, which will translate into lower prices for your customers, which in turn has the potential to drive demand. Customers may begin looking for some element of your solution to be outsourced abroad as a means of ensuring prices are as low as possible
- reduce overall delivery time. With employees in different areas of the world, round-the-clock development and support will be possible
- have a large pool of available IT resource. The lack of skilled IT professionals in the West will no longer be an issue.