

Business process outsourcing (BPO) in India: Success and challenges

- Dr. Jacob Kurien

1. INTRODUCTION

Economic integration of global markets has prompted businesses to be more agile and competitive so as to penetrate foreign markets and establish a market niche. The 'buzz-word' in the world of business is 'cost-efficiency' and the most compelling reason for outsourcing is to reduce or control operating costs. Global corporate giants are increasingly moving to India, a nation considered to be a safe destination and provider of high quality services in outsourced operations. Business Process Outsourcing (B.P.O.) has today become a strategic choice and a viable option for achieving cost-effectiveness.

Global Business Policy Council, FDI confidence index (October 2004) has ranked India as the third most attractive FDI location (up from sixth place in 2003). This is the country's highest ranking, just behind the U.S. India has also emerged as a major R&D hub. According to the report, manufacturing and communication services are the most bullish enterprises in India, ranking it the second most attractive market globally.

With an average annual GDP growth rate of around 7 percent, India is one of the world's most promising and fastest growing economies. The nation has emerged as one of the leading BPO destination of the world.

2. THE ECONOMICS OF OUTSOURCING

The seed for outsourcing was planted by Adam Smith (1776) when he spoke of the virtues of the division of labor. In his "Wealth of Nations" he illustrates the example of an individual performing a specific task, which eventually raises the productivity and total production. Hence, the application of Smith's idea of outsourcing or contracting out could be viewed as a measure of total factor productivity across firms and across countries.

There are broadly three economic principles (theories) that are primarily related to the issue of outsourcing. The first is the contractual framework proposed by Ronald Coase (1937), which took its roots from his paper "The Nature of the Firm". The core of the contractual principle is that market prices are not the sole factor for determining whether a firm should produce goods and services on its own or outsource the job. Coase points to significant "transaction costs" that guide decisions about whether or not a firm will seek an outside supplier or service provider.

The second economic principle that has a strong influence on the decision to outsource or not is the comparative (opportunity) cost advantage principle and gains of specialization (labor and capital). Every business owner or manager is driven by the goal of profit maximization, which would involve minimizing costs. Hence, by restructuring the supply and production chain and focusing on the core business allows the manager to accomplish this goal.

Thirdly, gains from scale or scope economies and the market structure where the firm operates does influence the decision on outsourcing. Also, it is possible that by integrating (vertical and horizontal) the gains to the business firms outweighs the cost savings derived from outsourcing that particular activity.

3. THE BPO MARKET: AN HISTORICAL PREVIEW

Being an essential part of today's global economy, outsourcing has been occurring for decades. Back in the early years of U.S. history, the making of America's covered wagon covers and clipper ships' sails was a job outsourced to workers in Scotland, with raw material imported from India. England's textile industry became so efficient in the 1830's that eventually Indian manufacturers could not compete, and the work was outsourced to England.

More recently, in the U.S. in the 1970's, it was common for computer companies to outsource their payrolls to outside service providers for processing. This had continued into the 1980's where accounting services, payroll, billing and word processing became outsourced job.

The outsourcing history of India is one of phenomenal growth in a very short span of time. Since the onset of globalization in India during the early 1990's, successive Indian governments have pursued programs of economic reform committed to liberalization and privatization. Economic liberalization of 1991 did open a new era for the Indian economy, although the seed for the emerging market economy was planted

in the 1980's. Up until 1991, India's policy-makers followed economic policies that were detrimental for open trade but rather favorable towards state controlled inefficient industries and public utilities. It was later, due to a balance of payment crisis, that policy-makers began the process of liberalizing the economy. As of 1999, the Indian telecom sector was under direct governmental control and the state owned units enjoyed a monopoly in the market. In 1994, the government announced a policy under which the telecom sector was liberalized and private participation was encouraged. The New Telecom Policy of 1999 brought further changes with the introduction of IP telephony and thus ended the state monopoly on international calling facilities. Although the IT industry in India has existed since the early 1980's, it was the early and mid 1990s that saw the emergence of outsourcing and one of the first outsourced services was medical transcription. Outsourcing of business processes like data processing, billing, and customer support began towards the end of the 1990's when MNCs established wholly owned subsidiaries, which catered to the process off-shoring requirements of their parent companies. Some of the earliest entrants into the Indian market were American Express, GE Capital and British Airways. The BPO industry is a relatively young and vibrant sector in India and has been in existence for over 6 years. India, which was once a closed and over-regulated economy, is today at the threshold of sustaining and deepening an ongoing process of economic growth.

4. THE INDIAN BPO MARKET: PROGRESS AND TRENDS

India has been consolidating its position as a world leader in Information Technology (IT) Services. According to the National Association of Software and Services Companies (NASSCOM), the Indian software industry is expected to raise its export revenues by 35 percent during 2004-05 to U.S. \$17.3 billion. The financial Services sector including banks, insurance companies and securities firms account for the largest share of India's software and IT services exports at 37 percent during 2003-04, followed by the telecommunication and the manufacturing sectors. The Information Technology Enabled Services - Business Process Outsourcing (ITES - BPO) segment generated revenue of U.S. \$3.9 billion in 2003-04 and is expected to grow by 44.4 percent during 2004-05. In the Business Process Outsourcing (BPO) segment, India has maintained its lead as the best outsourcing destination, particularly for the U.S. and European companies. India accounted for 3.4 percent of global IT spending in 2003-04 (RBI bulletin, March 2005).

As regards IT enabled services; India renders two thirds of all off shored services worldwide. Indian companies have also made rapid strides in securing shares in the world markets for communication and management services.

In 2003-04, Indian ITES-BPO progressed into the third phase of industrial evolution - highlighted by a greater degree of depth, specialization and competition. Players in the Indian ITES-BPO industry are broadly classified into captive units and independent third-party services providers. Captive units continue to dominate the segment, accounting for over 65 percent of the value of work off-shored to the country.

In recent years, India has undergone structural transformation whereby services have assumed a dominant position in the production structure and as a key motivator of growth. Income from financial assets, information technology and advances in communication technology is rapidly catching up with merchandise exports as the principal foreign exchange earners for the country. According to the IMF's Balance of Payments Statistics Yearbook (2002), India is ranked 18th among the world's leading exporters of services, with a share of 1.3 percent in world exports, moving up from the 27th position in 1990 when its share was 0.6 percent. The sustained buoyancy in invisible earnings has provided the impetus for embarking on a phased but widening liberalization of the exchange and payments regime. Since 1995, international trade in services has moved into center-stage in India's trade policy negotiations.

According to a study conducted in the year 2002 by NASSCOM-McKinsey, the global market size estimate of BPO was U.S. \$ 127 billion in 2001 and is expected to grow to U.S. \$234 billion in 2005 and projected to be U.S. 310 billion in 2008. The percentage of total BPO market off-shored to leading countries for offshore outsourcing (India, Philippines, China, Mexico, Ireland, Poland, Australia, Hong Kong, Russia and New Zealand), which was 5% in 2001, will rise to 15% in 2005 and 20% in 2008.

The worldwide ITES-BPO spending by segment of different categories of BPO services in 2001 was U.S. \$712,145 million and is projected to increase to U.S. \$ 1,198,908 million in 2006.

5. RECENT MACROECONOMIC DEVELOPMENT'S IN INDIA

The Indian economy recorded a strong growth performance during 2003-04 and has entered the fiscal year 2004-05 on an optimistic note. Based on assumptions of a normal monsoon (IMD forecast) the Reserve Bank of India (RBI) in its Annual Policy Statement for the year 2004-05 (May 2004) has projected a real GDP growth rate of 6.5 - 7.0 per cent (Table 1). Number of other institutions has also projected growth rates close to this rate (Table 2). In FY2005, industry is predicted to grow at a lower rate of 6.7 percent and services sector growth is estimated at 7.7 percent. A slowdown in industrial growth in FY2005 is attributed to cost-smoothing behavior of firms to tide over anticipated cost escalation (NCAER-New Delhi). Although upbeat about capacity utilization, firms are not very optimistic about demand conditions.

Inflation is forecast to decline to 4.2 percent in FY2005 and then to 3 percent and 3.5 percent in the following 2 years.

Expansion in investment - especially in infrastructure - holds the key to sustaining high growth over the long run. The investment rate increased to 26.3 percent of GDP in FY2003 and is estimated to have increased to 26.5 percent in FY2004. However, the current rate of infrastructure investment at 3.5 percent of GDP is way below the 8.0 percent of GDP target for FY2005 made by the Expert Group on the Commercialization of Infrastructure projects (Government of India - Ministry of Finance - October 1994).

Services Sector, the main source of growth for the economy, sustained its momentum during the first quarter of FY2004. This is mainly led by the Trade, Hotels, Transport and communication's sectors.

6. POTENTIAL FOR BUSINESS INVESTMENT IN INDIA

India along with China dominates the top two positions for most positive investor outlook, likely first-time investments and most preferred offshore investment locations for business processing functions and IT services. India is the fastest growing world's business process and IT service provider, as well as R&D investments with long-term market potential. The more attractive attributes India provides as incentives to foreign investors are, i) highly-educated work force, ii) management talents, iii) rule of law, iv) transparency, v) cultural affinity and vi) favorable regulatory environment. The most important attribute is that India is a secular democratic country and the present United Progressive Alliance Government under the leadership of Prime Minister Dr. Manmohan Singh is committed to enhance the image of the country as a leading FDI destination. The government has recently amended the Patent Act (1970) and the new amendment (2004) allows for the introduction of product patents and exclusive marketing rights under certain conditions in the area of chemical - including Pharmaceuticals and food.

Currently India offers a strong value proposition as the ITES-BPO services hub because of the following advantages.

1. Scalability - the ability to scale and retain talent for running successful BPO business
2. Access to abundant skill pool of cheap labor and English speaking manpower with high quality of work capabilities and ethics
3. Sustained cost advantage on technology and management costs. Net savings is valued to be in the 30% - 40% band
4. Enhanced business quality and productivity
5. Lower absenteeism
6. Proven leader in BPO services with India expected to emerge as the largest BPO service provider in Asia in FY 2005. (Ref: Board of Investment, July)
7. Stable financial sector and active capital market
8. Global competitiveness report (2003-04) has ranked India 41st of 102 countries in term of the restrictiveness of foreign ownership.
9. Shift towards high-value services

The report of the National Intelligence Councils' 2020 Project; Mapping the Global Future (Dec. 2004) reiterates the irreversible nature of globalization but cautions the likelihood of the process to be less westernized. It foresees China and India as new major global players who are likely to transform the geopolitical landscape. The forecast indicate that competitive pressures will force companies based in the advanced economies to "outsource" many blue and white-collar jobs.

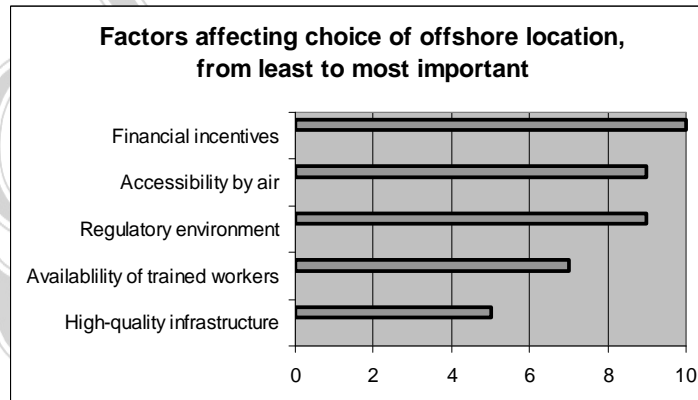
The report concludes that India has surpassed beyond what the Indians refer to as the 2-3 percent "Hindu growth rate" and could emerge as the world's fastest-growing economy as we move towards 2020. The potential high growth areas for BPO are geared towards higher value customer care services such as data analytics and

business intelligence as well as legal transcription support to lawyers. This new breed for high-end knowledge based BPO - knowledge process out sourcing (KPO) - such as related to pharmaceuticals and biotechnology, design and development, animation and graphics besides financial process outsourcing (FPO), are already witnessing explosive growth.

7. ISSUES AND CHALLENGES BEFORE THE BPO SECTOR IN INDIA

It is clearly suggested from an economic perspective, as well as inferences from past performance results, that outsourcing does provide overall economic gains. India has certainly been a beneficiary, locally and globally. Indian I-T companies have been moving up in the value chain into I-T consulting and system integration, hardware support, installation and processing services, besides emerging areas such as biotechnology, healthcare, telecommunication, legal, retail and government services. The grey areas that need to be fixed and improved are infrastructure, transportation, financial services and the legal and regulatory environment (Kushua-2004, Singh-2004). The McKinsey (2002) survey of client companies reiterates the need for improving these vital segments of the Indian economy so as to enhance capital investment in the BPO industry. The other areas of concern are on issues dealing with consumer privacy and cyber security involving sensitive medical and financial information.

Source: 2002 McKinsey Survey of 30 executives at companies using outsourced labor in India.



On the social and cultural aspects, the emerging concerns are issues related to the redistribution of economic gains and pressure on wages. It is observed that the benefits are not widely dispersed throughout states and regions of the country. At the industry level, growth in turnover rates currently stands to be an inevitable aspect of the industry. The high attrition rate and job-hopping in the BPO sector has a direct impact in terms of recruitment and training cost (Williams, 2004). India has one of the lowest retention rates in the world (A.T. Kearney Inc, 2004). Other matters of concern are; employee burnout due to job stress, parental pressure, identity problems and cross - culture backlash. A case study of Coles Myer- one of Australia's largest company- on off-shoring customer call center to India (Nash et al, 2005) highlight the issue about Indian workers losing their cultural heritage. The above-mentioned issues can hinder the effectiveness and efficiency of the Indian BPO industry. Hence, Addressing these critical issue's are vital for the future stability and sustainability of the BPO industry in India.

8. CONCLUDING REMARKS

The Primary objective of this paper is to assess the performance and growth potential of the Indian BPO industry in the light of globalization of the world economies. Globalization has helped improve living standards and promoted cultural diversity and global integration. Nonetheless, on the flip side, rapid social and cultural transition, due to influence of western culture and values, has also generated anxiety and disdain among certain religious and conservative members of the Indian society. An in-depth study on the social and cultural dimensions of outsourcing will help provide an answer to whether the apprehensions laid down are myth or reality.

BIBLIOGRAPHY

Asian Development Bank "Asian Development Outlook - South Asia", 2005.

"Global Business Policy Council", FDI Confidence Index, Vol. VII, 2004.

International Chambers of Commerce, "Standing up for the Global Economy",

June, 2004.

Kushua, C.V., "Indian Economy in the next five years: key issues and challenges, 2005-2009",

Applied Econometrics and International Development, Vol. IV (4), 2004.

McKinsey Global Institute, "Global Insight", 2005.

Nash, Holland and Pyanan, "Turning the tables on off- shoring", Monash Business Review, Vol., I, 2005.

National Association of Software and Service Company's, "Strategic Review",2005.

National Intelligence Council, "Report of the National Intelligence Council's 2020 Project",2004.

Panagariya, A, "India in the 1980's and 1990's: A Triumph of Reforms", IMF Working Paper, 2004.

Reserve Bank of India "Reserve Bank of India Bulletin- March",2005.

Singh, N. "Information Technology and India's Economic Development", India's Emerging

Economy, (Ed) Kaushik Basu, 2004.