
Mumbai

INDIA'S OFFSHORE INDUSTRY:
A DISRUPTOR GETTING DISRUPTED

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BACKGROUND

Over the last 30 years, India has put itself on the international business map by offering and scaling low-cost, low-end IT services to global enterprises. Immediately after 2000, "India Inc." emerged as a disruptor, creating an alternate sourcing and delivery model by reducing "back-office" costs and taking tactical jobs offshore. These jobs are now prone to disruption, with most involving routine functions that are candidates for automation and new technologies, such as robotic process automation ("RPA"), chat bots and self-repairing code, which largely negates the value proposition of cheap labor from a low-cost destination that India Inc. has sold the Western world for three decades.

HISTORICAL CONTEXT

The economy of India, much as the country itself, has undergone vast changes over the last three decades, one of which is becoming a huge, diluted talent pool of IT-related engineers. The seats offered in engineering colleges today are nearly 27X what they were in the 1990s[1], as India churned out engineers to fulfill the rapid demand of tactical jobs from developed markets moving offshore. This had significant impact on workforce quality while scaling talent pool. In any professional service business, you cannot attract top-quality clients and jobs without the best talent, but you can't attract and retain top talent without those top-quality jobs.

1 http://www.livemint.com/Opinion/QFJhOYAE9YrNyW01wuRWjI/Postreform-India-produced-too-many-unemployable-engineers.html

This dilution of workforce quality also created a gap in the mindset of the IT professionals in India, as most people were trained to execute processes, not to develop cutting-edge products. As a result, India's offshore model hasn't produced an Apple, Google or Facebook over the course of the last 30 years. Recently, there has been a surge in startups, which are either replicas or geographic variants of existing products – still, no real innovation or scale is notable from these efforts. This is not meant to overlook the occasional sparks of brilliance that emerge from startups in India, but to replicate them is not an institutional capability.

India's offshoring companies, and its business media, have tried to brand Bangalore as the "Silicon Valley" of India, which is dubious. Silicon Valley has built its brand on innovation, scale and forward-thinking, while incorporating an entire ecosystem that fosters continuous innovation. Academia, angel investors, venture capitalists, banks, entrepreneurs and local and state governments are all integral parts of this ecosystem.

Silicon Valley is built on original thinking and implementation, not executing customers' routine workloads in a back office – there is a big difference in these two mindsets – and a constantly innovating product ecosystem tends to disrupt incumbents and perpetuate itself over time.

THE EVOLUTION OF INDIA INC.

In the years that ensued, the volume and scale of India's offshore centers drove size-related goals, such as "the race to X number of employees" or "the race to $X billion in sales", which was how competitors measured themselves against each other. Professionals measured their own career growth in terms of how many people they managed, and other misguided measures of success that prevailed. It was predominantly about quantity, be it clients, jobs, people or valuation, with quality of process and innovation being afterthoughts at best.

India Inc. sporadically made attempts to recognize and address its quality problem and move up the value chain by trying to mimic higher-end and higher-margin management consulting models. Nearly all of them essentially failed, some more visibly than others, with "failure" defined as lack of business scale, dearth of quality talent, brand association with low-end work and inherent cultural antibodies. Some companies did generate meaningful revenue, but ended up playing at the low end of the value chain in their space.

The current focus for India Inc. is an attempt at going digital, with large offshore System Integrators and BPO providers running to create their own AI platforms. Only time will tell if they succeed, and if so, to what extent. In our experience working with these businesses and conducting due diligence on relevant operating models, we believe such hopes are mostly unfounded and these attempts will likely encounter a fate similar to their management consulting efforts.

> "Transformation in thinking around research and innovation should initiate from schools and graduates should be better equipped to support the industry needs."

There are several impractical solutions being discussed or attempted by traditional Indian offshore companies. A few select examples include:

1. **TAKING ON THE BIG DIGITAL PLAYERS**: This is the most impractical of all. For example, many have tried to compete with large public Cloud Service providers in the infrastructure space, but no one has come close to competing with these giants. Even network and storage product innovators who were market leaders earlier, gave up and moved on. Given these results, we would not wager bets on India Inc. being able to compete well in these areas.

2. **ACQUIRING DIGITAL CAPABILITY**: As we all know, digital is not a single thing, hence a company must acquire a few different aspects across the stack and value chain. Buying an asset is one thing, but creating value out of it is quite another. Integrating new business models is one of the hardest things to do; many serial acquirers have not mastered the art, science and complexity behind integrating digital assets. Given the esoteric (and rich) valuations, challenges to integration and cultural considerations, this path is an uphill battle.

3. **MEDIA AND PR SPIN**: Executives at several of these companies have taken the PR route to create the impression they have been developing digital capabilities, such as AI and RPA. Many do not want to provide breakdowns of digital revenue, while others have a definitional problem, as we'll discuss shortly.

4. **RETOOLING THE WORKFORCE**: Retooled people who have executed processes and sold efficiency solutions to clients for years are not likely to be ideal candidates for building high-end solutions or selling expertise to clients.

   Only a fraction of the incumbent workforce will transition successfully. Many of these companies also lack the leadership skills to orchestrate a complete business model transformation.

We base these assertions on having worked on and conducted several dozen due diligence reports and assessments of companies with traditional offshore business models. We have also observed many traditional offshore providers claiming that 15-20% or more of their revenue comes from digital services. Their definition of "digital" is often questionable. Some examples include running tools and scripts to migrate from traditional enterprise resource management ("ERP") to SaaS-based ERP, managing and monitoring software-defined wide-area networks, implementing RPA for automation, etc. One might argue that these are digital services but, once again, they reside at the low-end of the value chain and are not likely to make a full pivot.

Digital, in its true sense, is not about selling efficiency to a client, but is about selling expertise – and therein lies the daunting challenge for India's gigantic offshoring machine, which has sold efficiency for decades.

MULTIPLE HEADWINDS

The headwinds faced by India's IT industry are non-trivial. We have identified ten factors which will accelerate disruption of the model.

	Headwind	Impact
1	Cloud Natives	Most smaller, growing companies today are doing everything in the cloud, and almost all new capabilities added are cloud-sourced. We see more enterprise-grade companies starting to go "asset lean" and in five years' time, this will be the standard posture of the stack and operating model. Their needs are going to evolve differently from the labor-intensive services of today, where everything will be subscription-based and not capex intensive. Any professional services support will be analytical and high value-add compared to the traditional services offered by India's offshore companies today.
2	Economic Buyer Shift	India Inc. companies have traditionally worked with decision makers within the Chief Information Officer's organization. With digital, there has been a shift in the buying pattern; it is estimated that about 15-25% of spend is driven from the Chief Marketing Officer's office. Defining, articulating and selling solutions in the Chief Marketing Officer territory requires a shift in thinking, approach, sales and go-to-market planning. While it is achievable, this is not an easy pivot for companies that have sold lower-end services centered on cost efficiencies for three decades.
3	The New Stack	The new enterprise, or even small business stack, of the future will be public/private cloud, software-defined networks, software-defined storage, server-less computing, containerized applications with the majority, if not all, running in the cloud. There will be limited opportunities to deploy armies of offshore resources to integrate or maintain. Orchestration in the cloud is the new paradigm, eliminating several thousand maintenance jobs as companies embrace the new stack.
4	Lower-end of the Value Chain	Focus on low-end services of the value chain, inability to innovate and the advent of automation presents a threat to core services of India's offshore players. Retooling and upskilling of work is required to capture the new service market that will be created due to automation jobs. While those companies are promoting media hype regarding retooling, there are very few from the workforce who will cross that line. Our experiences have revealed that it is impractical to counter these headwinds with mass workforce retooling of the existing talent pool.
5	Digital Revenue Definition	Digital revenue breaks the linearity between revenue and headcount – the entire economic logic of offshore companies was built on headcount-based utilization models. Inability to accurately define digital revenue and identify more digital services will have an impact on the volume and margin of services offered by existing Indian companies.
6	Robotic Process Automation	With the advent and maturity of RPA and its rapid adoption by enterprises, back offices are becoming automated on a global scale (e.g. systems supporting finance, HR, etc.) making India's offshore jobs an easy target. Various industry reports cite that approximately 60-70% of the existing jobs in this space could be eliminated.[2,3] While some higher-end jobs could be created due to automation, they may go to destinations where high-end skills are available.
7	Innovation Quotient	Over the past few decades, India Inc. has lapsed into a period of innovative dormancy which has now slowed its economic momentum. In 2015, there were 4,227 patents granted in India, which is a gauge of a nation's innovation strength, compared to 326,000 for the United States[4], demonstrating a huge magnitude of difference in innovation.
8	Infrastructure in the Cloud	With more IT infrastructure moving to the cloud, there is a fundamental shift in organizations' IT missions. The traditional support and maintenance mindset is being replaced by a strategic and software-centric vision. IT professionals today need to think in a product-forward way instead of merely enabling processes that require frequent changes.
9	H1 B Regulations	The U.S. remains the most favored destination for offshore service providers. The strengthening of visa regulations presents challenges in execution, given that a lot of digital services will be high-touch and client-facing. Increased dependency of onshore resources impacts the cost of execution, negating the labor arbitrage and reducing margins further.
10	Brexit Referendum	Europe and the UK contribute approximately 30% of the total revenue to the Indian outsourcing sector[5]. Many Indian outsourcing companies have their European Union headquarters in the UK and use the country as a gateway to European business. The Brexit referendum and subsequent business uncertainties, including currency fluctuations and policy changes, will have a major impact on India Inc.

2 https://www.mckinsey.com/business-functions/digital-mckinsey/our-insights/where-machines-could-replace-humans-and-where-they-cant-yet

3 https://www.bloomberg.com/graphics/2017-jobs-automation-risk/

4 http://www.moneycontrol.com/gestepahead/innovation-and-leadership/article/raising-indias-innovation-quotient-4444461-99.html

5 https://qz.com/india/716157/indias-146-billion-it-industry-has-no-idea-what-will-happen-to-its-european-business-now/

POSSIBLE WAYS INDIA INC. CAN REDEEM ITSELF

India Inc. should focus on non-traditional fronts, in addition to traditional areas to redeem itself from the impact of these headwinds. While some are achievable near-term, most require long-term strategic planning to bring about cultural transformation. Below are some thoughts on how India Inc. could reinvent itself:

Transform Marketing and Sales: The shift in economic buyers within client organizations (more Chief Marketing/ Digital/Technology Officers compared to traditional Chief Information/ Technology Officers) mandate transformation of marketing and sales capabilities within India Inc. companies. The ability to articulate outcome-based value instead of technology execution and cost focused pitches is required to generate interest in sales and marketing discussions (e.g., revenue enablement of $X million compared to cost reduction of X%).

Redefine Value Proposition: Leadership of India Inc. companies should become trusted partners to CxOs and should be able to guide them with strategic initiatives like digital transformation. They should be able to have conversations around 'what to do' and 'why do it' rather than 'how to do it' (e.g., enable spend analytics with single view of spend by vendor, location and service, etc.).

Reinvent Revenue Model: Compared to existing revenue models that are based on headcount and project execution, outcome-based and risk-reward based models are increasingly favored. Companies should transform their revenue models to break the headcount and project-based linearity to prepare for the digital era (e.g., fee based on X% of savings for operational transactions like order-to-cash, travel and expenses, etc.).

Foster Intelligent Automation: Intelligent automation and robotic process automation will continue to flourish, disrupting existing commercial outsourcing models and drive down costs considerably. Robotic automation will become more intelligent with added cognitive features and context awareness. Investments in these areas will result in supplier margin expansion with enhanced productivity.

Enhance Digital Product Development: Established players should focus on enhancing digital product development capabilities through small-to-medium size product acquisitions, acqui-hires and/or hiring top talent from established Western firms and startups. They should also build alliances to rapidly increase access to these capabilities and be part of an ecosystem to reduce time-to-market on new product developments.

Empower Digital Product Portfolios: Enable autonomous governance to digital product portfolios through spin-offs, organizing into divisions or sub-brands. Define separate key performance indicators and metrics for measuring success based on the depth of expertise and product innovation achieved.

Enhance Engineering Talent Pool: Redefine and standardize engineering school's curriculum to focus on research-intensive teaching rather than textbook-based methods. Transformation in thinking around research and innovation should initiate from schools and graduates should be better equipped to support industry needs.

CONCLUSION

While some India Inc. companies will have a place in the IT ecosystem, many more will not – they will be unable to adopt prevailing business models and won't have compelling value propositions for clients. Furthermore, these organizations have not utilized divestitures to optimize their portfolio of products and services, such as large IT infrastructure providers divesting their services businesses to focus on core products.

On a positive note, we have now seen more entrepreneurs emerge from India than ever before, which is starkly different from a conventional mindset of routine back office-type processing. Whether it can develop enough entrepreneurial talent to innovate on a large scale remains to be seen. We hope that some of these sparks of brilliance emerging from India can light many candles and eventually become an institutional capability.

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