

# From Cost Arbitrage to Expertise: The Third Wave in Outsourcing

The author is Chairman and CEO of Polaris Software Lab

That a company can save 30 percent to 50 percent on software development and maintenance costs by outsourcing to India is a proposition understood well enough; so much so that it hardly deserves repetition. 20 years after the initial breach in the dam of resistance made by pioneering Indian companies like Tata Consultancy Services, outsourcing has become a flood; NASSCOM and McKinsey speak airily of software exports from India reaching \$100 billion, then a trillion, and eventually, one can say, the sky!

But it may be worthwhile to pause and ask: Can this really happen? Has it ever happened in the history of the world? Can cost arbitrage really drive an industry's complete dislocation? And if these calculations are really correct, and the model of growth really linear, how long will it be before every literate man, woman and child in India becomes a computer programmer?

There are two historical forces we must keep in mind when we contemplate these scenarios:

1. labor-intensive industries sooner or later develop ways to become less labor-intensive.
2. cost arbitrage itself is not sustainable in the long run because costs in India will rise to become comparable to costs abroad.

Credible studies of the BPO industry, for instance, warn us that, since wages are rising 15 percent a year in India, the cost advantage enjoyed by Indian companies will shrink to almost nothing by 2015. BPO is, of course, the ultimate

non-linear cost-arbitrage industry, and we in the software services segment must learn to get our early-warning signals from that vertical.

The Second Wave of Outsourcing saw a continuation of the cost arbitrage logic, with BPO and IT getting combined in an integrated offering to customers. It was a way to expand the market, in some sense, horizontally, by offering services related to IT, rather than IT alone.

We believe the Third Wave of Outsourcing, of which we have already seen the first few ripples, will bring about a qualitative change in the nature of services offered by Indian companies, and the quality of the interaction they have with customers. There are only a few ways to get out of the trap of excessive reliance on cost arbitrage, viz.

1. create a brand so strong that cost no longer becomes the key.
2. drive costs down by moving work to China, that is, chase cost economies across the globe
3. 'move up the value chain' so that it is no longer 'bodies' we offer but something more.

There is no doubt that Indian IT companies will try all of them, but what is the 'something more' that we can offer? It is the economics of expertise, and we believe it will fuel the third wave of outsourcing. But what is this 'expertise' that we are talking about and what is it for? How does it benefit the customer?

Software is now so critical to the world's business that it can no longer be considered a supporting or enabling

Arun Jain



technology. The Software 2005 conference held in California had large users of IT telling the industry that software is no longer something 'cool', so bugs cannot be tolerated. Software fuels the modern economy, nothing less. This insight can be seen, as through a prism, in a number of different ways.

1. The way business and IT are getting intertwined today
2. What IT really has to deliver - that is, the new meaning of quality in IT services
3. The kinds of solutions customers now want.

### 1. IT and Business intertwined: 'Financial Technology'

In the world of banking and financial services, 'financial technology' itself is an emerging form. Technology is no more the bit player in a support role, but an enabler that can shape the business. Illustrations of this abound in the industry today: the way web interfaces can allow a bank's customer to surf across the bank's channels, for instance, or the way securities can be stripped, combined and modified to create new securities-clearly shows how IT can itself directly transform the financial services landscape. When management gurus speak of customers co-creating products jointly with product companies, it is evident that only technology can make such dreams a reality.

What does this mean for IT companies? Clearly, it is not enough to understand IT, or even how IT can support a given industry. The companies must be experts in understanding the subtleties of the customer's business, and perceive how technology can change its dynamics. This calls for expertise in the customer's domain, in technology, and most, importantly, in the way the two interact-which we call the space of 'financial technology'.

**Economics of expertise will fuel the Third Wave of Outsourcing.**

### 2. Quality of Service - 'Bugs' and Defects

It has long been understood by gurus like Fred Brooks that the most pernicious defects in software come, not from the way the software is written, but from the way the software system is visualized or conceptualized. It is almost humanly impossible to depict a software system in any conventional diagrammatic representation, for it is too complex, too organic, too dependent on how it is used in the first place. To conceptualize the software system correctly, in a way that the customer himself conceptualizes it requires the IT company to be able to think and feel like the customer. If IT providers are to deliver the 'bug-free' software customers want, they must have enough expertise to understand a software system which is too complex to explain or depict in diagrams and process flow charts alone. This will take an 'outside-in' view of technology that begins with the customers' business and ends with the IT, not the other way around.

### 3. The kinds of solutions customers want

In the first two waves of outsourcing, customers simply took a large part of the activities they were already doing, and moved them to India. In the third wave, we see banks, for instance, looking for ways to offer new products to their customers, or to launch whole new business lines, without disrupting their existing business. What they need is not a monolithic product such as the ones they can get from the ERP players or from the large banking product companies, for these would require them to rip out their existing platforms - the operation may be successful but the patient would be dead!

If a bank is to 'change while it runs', it needs a solution provider who understands banking so well that it can protect the existing busi-

ness of the customer even while adding to it and enhancing it. The level of domain knowledge, specifically banking knowledge that the solutions provider must bring to the table is several notches higher than in conventional outsourcing. It is not merely a matter of degree-we believe it is a difference of kind. The ability to talk to business managers of a bank, not IT managers alone, in their own language, the experience of having seen other banks working around the world, and the ability to predict and control the change effort required-these are completely unprecedented levels of expertise.

### Polaris and Economics of Expertise

It is in this context that the 'economics of expertise' Polaris offers must be understood. Expertise comes from focus on a given industry (BFSI), working hard to understand its details. An investment in building products and components that embody world-class banking processes is also primary. It is this investment that Polaris has made over the past 5 years. It enables us to provide the right solutions for the customer. The latest step in this journey has been the creation of a dedicated Investment Banking solutions centre in Hyderabad - The Capital, the first of its kind in the world.

Our two decades of experience with Citibank, in developing the widest possible range of applications, from support to mission-critical, has taught us the processes of a world-class bank. No other Indian IT company has had the benefit of this hard schooling. Over the past few years, Polaris has worked with 6 of the top 10 investment banks on Wall Street, 4 of the 7 top banks in London, and 3 of the top 5 Australian banks. The expertise Polaris has developed from this experience is the basis of our new way of competing.