

CRISIL YOUNG THOUGHT LEADER SERIES 2005

Challenges for Indian Companies in the Financial Services KPO Business

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EXECUTIVE SUMMARY

KPO (Knowledge Process Outsourcing) implies outsourcing of knowledge intensive business processes that require specialized domain expertise. Unlike BPO (Business Process Outsourcing), which follows pre defined and structured processes that can be performed by virtually anybody, these processes demand advanced analytical and specialized skill of knowledge workers who have specific domain proficiency. Therefore, outsourcing of knowledge processes face more challenges than BPO.

This research paper focuses on the challenges facing the Indian financial services KPO companies. The usual list of challenges of any offshore activity like political, infrastructure, legal issues still exist. But the advent of KPO will bring along a few additional challenges unique to the industry. Using the Internal and External Environment Scanning Model, the key challenges that have been selected are:

- **Internal Challenge:** Recruiting and Retaining the Right Talent
- **Customer Challenge:** Demand for Quality, Data Security and Compliance
- **Competitor Challenge:** Other Countries and Global KPOs Operating in India
- **Industry Challenge:** Information Infrastructure and Branding

In the future, the ingredients of a successful KPO business would be recruiting and training the right professionals, developing domain expertise, creating value for clients by offering highly differentiated services, providing dependable quality over time and building credibility alongside competing countries. To achieve these, many steps need to be taken at the strategic and operational level by both the government and the individual KPO. Also, it is suggested that a dedicated body promote India's expertise in the KPO domain and help create a formidable brand in the international financial services market.

1. INTRODUCTION

1.1 Financial Services KPO Business in India

The evolution of the Indian Business Process Outsourcing (BPO) sector has given birth to a new trend in the global outsourcing scene: KPO or Knowledge Process Outsourcing. In BPO, clients provide the business process requirements and the outsourcing service provider in India follows the needs of the client. KPO is significantly higher on the value chain and involves processes that demand advanced information search, analytical, interpretation and technical skills as well as some judgment and decision making. For example, Financial Services KPO usually deals with areas such as insurance underwriting, fund management, risk assessment and actuarial analytics, debt collection and recovery, equity research, financial data mining, corporate & market research. Cost savings, operational efficiencies, access to a highly talented workforce and improved quality are the major drivers behind knowledge process outsourcing to India.

The term KPO is often misleading. Unlike a BPO which deals with low end, predefined processes, knowledge creation and codification cannot be turned into a process and subsequently outsourced. In the case of knowledge, there is never a pre-defined process or a structured, rules-based manner to reach a conclusion or solve a problem. Instead the term KPO can be interpreted to mean outsourcing of knowledge intensive business processes that require specialized domain expertise.

A few of the prominent Indian players in the financial services KPO domain are OfficeTiger, Smart Analyst, The Smart Cube. In addition to these, a number of MNC KPOs such as EvaluateServe, GE Capital as well as captive arms of global firms such as JP Morgan, HSBC, Reuters, Fidelity, Morgan Stanley and Citigroup also operate in India.

1.2 Objectives

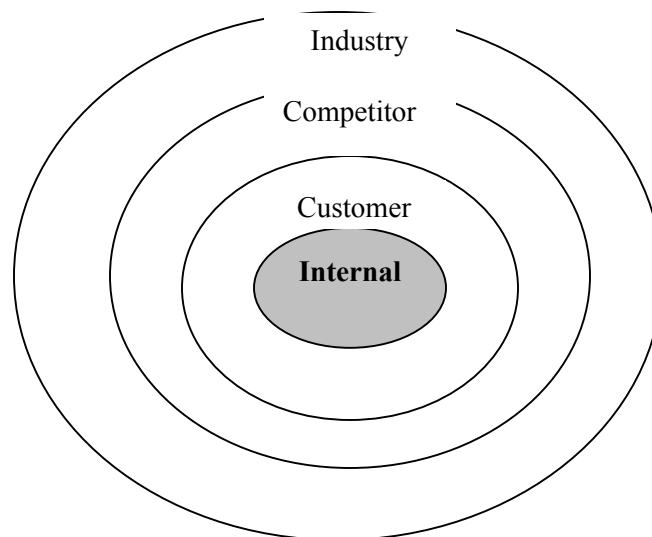
The three fundamental objectives of the research paper are:

- To identify the key challenges faced by Indian financial services KPOs companies
- To identify the factors behind each challenge
- A possible strategic and operational action plan that can ease the way ahead

1.3 The Approach Adopted to Identify Key Challenges

The Scanning Model was adopted to select the significant challenges in each layer. This bottom up approach was used to achieve a precise isolation of the factors of concern in each layer starting from the level of the individual company to the level of the industry.

The Internal and External Scanning Model



2. INTERNAL CHALLENGE

Recruiting and Retaining the Right Talent

KPO services in India are set to touch the \$17 billion mark by 2010 (CII). To grab a sizable market share in the KPO sector, Indian companies will need to recruit a significant number of highly qualified employees with very strong academic backgrounds. Unlike a BPO where fluency in English is all you need to get in, the work in financial services KPO requires expertise in specific domains such as financial analysis and equity research. Access to a large, high-quality skill pool is a precondition for successful KPO operations. But the requisite skill pool is not easy to get. Reasons being:

- **High competition for access to a limited superior - quality pool** - Few of the graduates and MBAs India produces every year actually possess the high quality and functional competency that is essential in a knowledge intensive project - primarily due to ineffective government monitoring of the quality of colleges
- **Successful players attract better people** - Global MNCs like Evalueserve and GE manage to attract better talent than Indian players in the financial KPO domain because of better brand name and pay
- **High attrition rates** – This occurs as a result of poaching by competitors and frequent job hopping by young employees looking for better job opportunities
- **Lack of domain expertise** - Graduates in India may not be aware of the client's business environment E.g. US system of accounting (US GAAP)
- **Incorrect perception of the KPO profession as low grade** – Qualified professionals mistake a KPO job to involve low level work and a 24x7 pressure environment similar to that of a BPO and refrain from undertaking it

3. CUSTOMER CHALLENGES

3.1 Demand for Quality

In BPOs, there is a pre-defined way to solve a problem which the employees can be trained to learn. Clients have an OLA (Operation Level Agreement) or SLA (Service Level Agreement) with the Outsourcing Company where both parties decide on certain metrics for quality adherence – for example, a customer service call pick up time should be less than ten seconds. In contrast, KPOs require keen understanding of how a client works and what his exact needs are for each assignment. No pre-defined process can be created and replicated each time there is an assignment since every project is unique. As a result of this, *defining an ideal metrics to measure the quality of work can be quite a difficult task*. For example, an analyst may target twenty factors of importance for a market research study whereas another analyst may shortlist just five. The client may be pleased with the preciseness of the latter though the number of factors seem inadequate compared to the former. Thus, the difficulty lies in accurately determining whether you met client expectations or not. Ultimately, the client in a KPO will not look at dollar figures but will be mainly concerned with quality of services. That is where Indian companies may fail.

3.2 Concern over Data Security and Client Confidentiality

In an opinion poll Conducted by NASSCOM and the Information Technology Association of America (ITAA) in 2004, greater than 75 percent of respondents agreed that offering sophisticated information security provisions and practices provide a competitive advantage because security has become a critical selling point. According to

Ernst & Young's 2004 Global Information Security Survey, companies have identified major viruses, spam and employee misconduct as the key concerns in India.

The data and information a KPO business works with is extremely sensitive. Clients such as banks, insurance companies and corporations trust KPO providers with company financial data, treasury and cash management functions and investment portfolio decisions. Thus, KPOs are privy to information not otherwise public knowledge.

Thus, *clients often hesitate to offshore research and processing of sensitive financial data and information involving strategic decisions*. A big challenge is to convince clients that their confidential data will be treated with extreme caution and will not fall into the hands of unscrupulous or unauthorized individuals. Thus, the fundamental and near-term challenge facing Indian companies is to provide the necessary security and data protection while working on client data. To keep up with the increasing demand from clients to maintain information security, KPOs will need to balance the escalating costs of maintaining global security standards while staying competitive in a cost-driven market.

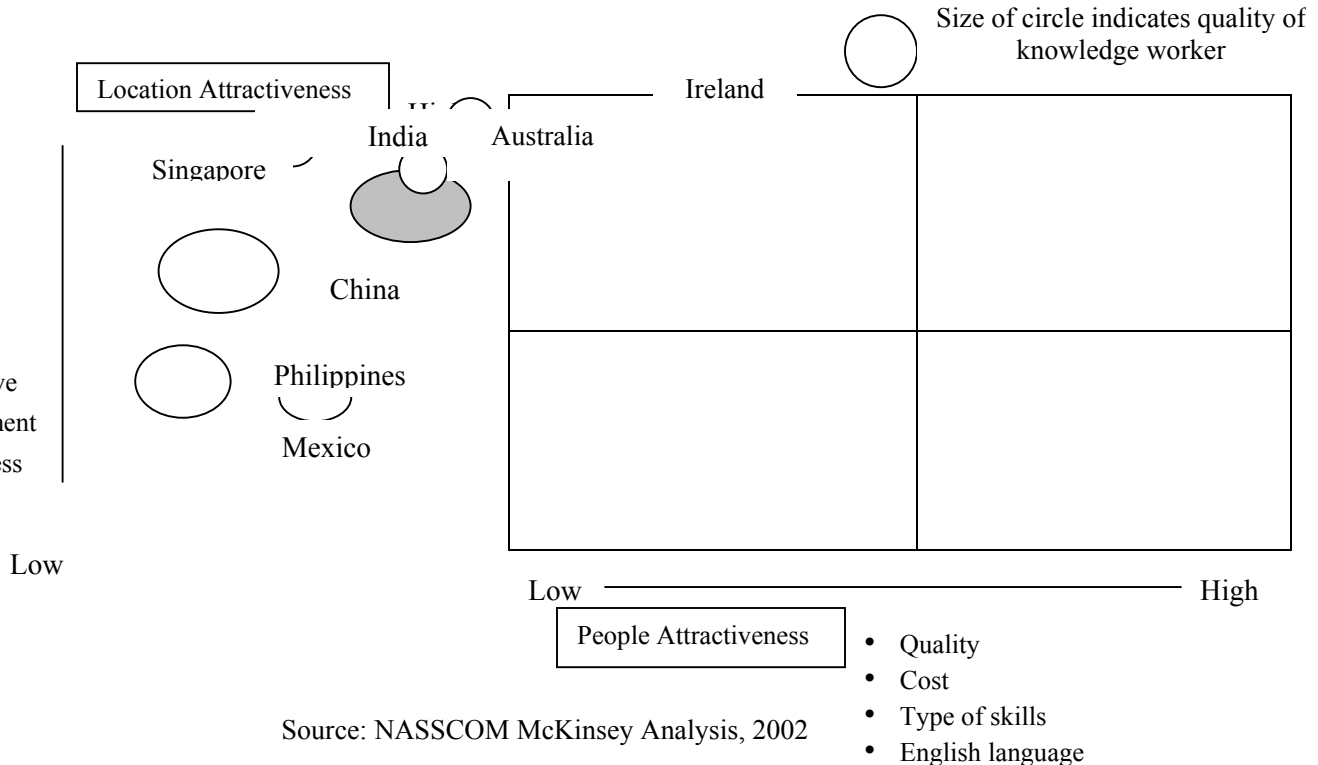
3.3 Compliance and Corporate Governance

With legislations such as Sarbanes-Oxley (which requires companies' executives to provide personal assurances as to the completeness and accuracy of the financial figures they publish), companies that outsource finance functions are facing increasing business risk. A greater emphasis on governance and greater direct control of finance processes is acting as a barrier in the way of a decision to outsource finance functions. The client concern is that *outsourcing might lead to a loss of control, which might in turn lead to a weakening of corporate governance and subsequent breaches of compliance with regulatory requirements*.

4. COMPETITOR CHALLENGES

4.1 Competition from Other Countries

Countries such as China, Philippines, Mexico, and Ireland are fast emerging as alternative KPO Services destinations. Although, according to McKinsey analysis, India is comfortably placed in the Location /People attractive metrics, other countries like China are fast catching up. A *positive foreign investment climate, favourable government policies and an educated, yet low cost workforce* are encouraging foreign financial firms to offshore their KPO needs to these countries.



4.2 Competition from Global KPO Units Operating in India

Thus far, MNCs like GE and Evalueserve, with their huge resources and large scale have been doing well in India. Many of the financial number crunching for firms like Fidelity, Reuters and are also done by captive units in India. These firms take *advantage of the low cost Indian knowledge worker, simultaneously leveraging their specific domain expertise, huge scales of operation and higher employee remuneration.*

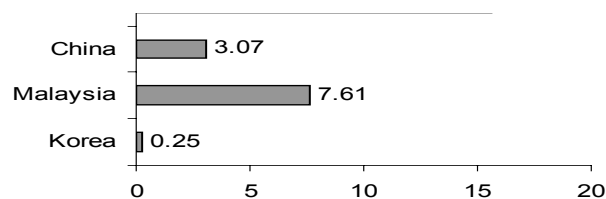
5. INDUSTRY CHALLENGES

5.1 Information Infrastructure

KPOs need 24/7 Internet connection to collect data, perform secondary research and transmit data back and forth, either nationally or internationally. According to the Telecom Regulatory Authority of India (TRAI), internet bandwidth prices account for almost 40 per cent of a KPO's total costs, thus being a critical differentiator between its success and failure. Although, major reforms have been undertaken by the government to spur the growth of IT infrastructure, there are a few significant roadblocks, such as:

- **India's high international bandwidth prices** - Leased line is the most preferred mode of internet connectivity due to its permanent "Always on" connectivity, reliability and speed. Unfortunately, India's international bandwidth prices are the highest in the world, the main reason being market control by an oligopoly of few players such as VSNL, Reliance, Bharti. In contrast, in highly competitive Western and East Asian markets (e.g. 14 in Korea and 32 in Germany and U.S.), a large number of players force prices down and keep bandwidth charges minimal.

Price per 100 Kbps of data per month US\$, April 2004



Source: Telecom regulatory Authority of India

- **High entry fee for Internet Service providers (ISP) who provide Virtual Private Network services (VPN)** – which is a viable alternative to leased line connectivity. The entry fee for the cash strapped ISPs is around Rs. 10 crore for an all-India license, apart from an annual revenue-share license fee of 8 per cent.

5.2 Low Cost -Low Quality Image

India's unique positioning as a low cost, low down the value chain service provider in the form of its BPO operations has turned out to be a double edged sword – It is a cash cow for Indian firms but when it comes to the choice of processes outsourced to India, Indians cannot seem to shed their '*Cost Effective Service Provider*' image. Foreign companies also worry about the quality of work that a low wage country like India can deliver. Thus, more and more foreign companies contemplating outsourcing to India consider outsourcing only the non trivial back office operations in order to cut costs. Simply because, they do not know any better.

Thus, organizations are finding it increasingly difficult to migrate from their cost effective standardized service offerings (which are low in the value chain and also earn lower margins) to a more differentiated financial service offering (which can command a premium by virtue of the intellectual value add and knowledge of industry). This is also the roadblock existing BPO companies may face as they try to scale up their operations and move higher up the value chain to offer KPO services.

6. THE WAY AHEAD

India may start to lose its low-cost advantage in future. Low-end services may move to even cheaper destinations. For India to stay ahead in the global outsourcing market it will have to develop its indigenous KPO industry and maintain its leading edge. Few ways of overcoming the several challenges ahead of the financial service KPO industry would be:

Steps at the Operational Level

- **Skill Upgrade** - More focus on training, constructive feedback, appropriate coaching, mentoring and building domain expertise
- **Staff Retention** - Identifying right career paths for their professionals - the central theme being nurturing professionals, not poaching
- **Better Security** - Need to invest heavily to adopt and enforce best practices in information and data security - Measures may include biometric security, and employee background checks
- **Better Control Mechanisms** - Organize methodical status reporting for outsourced processes, ensure continuous evolution of the control structure, and review of the defined contract specifications, in order to maintain quality of KPO deliverables
- **Improve SLAs (Service level Agreements) to Improve Quality** - Need to utilize comprehensive, continuously updated service level agreements to quantify and effectively measure the quality of services provided. Outsourced processes should be better defined and documented – leading to greater clarity

Steps at the Strategic Level –

- **Attract Better Quality Professionals By**
 - **Involving Government to Enlarge the Pool** - Keeping in view the tremendous need for academically qualified personnel in the KPO sector, the Indian education system needs to be given a major face-lift. The government needs to invest more in education, allow more private sector participation and monitor the quality of colleges more diligently.
 - **Creating More Awareness About the Nature of Work KPO Involves –**
There is a need to create awareness that KPO is different from BPO and involves high end knowledge intensive work.
- **Bring in More Capital By**
 - **Entering into Partnerships with Big Financial Service Organizations –**
This step can help in two ways - provide much needed cash to Indian financial services KPO's and also impart the requisite domain expertise
 - **Getting more Venture Capital –** Another viable option to gather funds for cash strapped Indian KPO units
- **Form an Effective Industry Association to**
 - **Lobby with the Government to bring on**
 - Better regulations in the form of more stringent IT acts
 - Better enforcement of laws by creating regional regulatory bodies to help in diligent monitoring

- Improving the information infrastructure by taking adequate steps to reduce prevailing bandwidth prices. Ref (1)

- **Build Brand India** – There is a need to lobby for and increase the value of ‘Brand India’ as a potential high end financial services outsourcing destination. Selling KPO services abroad and helping it scale up to a global size would require significant branding efforts in the medium-term.
- **Collaborate with Institutes like Carnegie Melon or Other Financial Services Accreditation Organizations** – In order to develop process or quality standards for the KPO industry, similar to the creation of CMM standards for the software industry. This would not only help KPOs gain credibility with their clients but also fight multinationals entering this domain.

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