

Indian Ocean Rim Asset Management: A Case Study in Offshore Business Process Outsourcing to India

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Abstract:

The past decade has seen explosive growth in offshore Business Process Outsourcing (BPO) to India by US and European firms. However, Australian firms have been slower to take advantage of this trend. Offshore outsourcing by Australian firms is an under-researched area with little in the way of theory or models to guide decision-making. Exploratory case study research on Indian Ocean Rim Asset Management (IOR Asset Management) provides an example of an Australian boutique fund manager that is utilizing a “captive” Business Processing operation in Bangalore to drive higher returns from investment in listed Australian small capitalization stocks. If IOR Asset Management can make a success of their Bangalore operation, it may provide insights for Australian firms and organizations considering offshore BPO.

Key words: Analysis, Asset Management, Money Management, Financial Analysis, Financial Modeling, Financial Forecasting, Business Process Outsourcing (BPO), Offshoring, Offshore BPO to India, IT practices of Australian Small and Medium Enterprises (SME)

1. INTRODUCTION

Indian Ocean Rim Asset Management (IOR Asset Management) is an Australian boutique fund manager that is utilizing a “captive” Business Processing operation in Bangalore to drive a new vision for out-performance¹ through high conviction investment in listed Australian small capitalization stocks. IOR Asset Management is utilizing an offshore Business Process Outsourcing (BPO) model to move small cap equity analysis from a “cottage industry” to an industrial strength business model. In their search for undiscovered value in Australian small caps, IOR Asset Management aims to apply BPO to their back office operation in Bangalore to develop and update financial models for the large number (approximately 1,600) of Australian listed companies that are to be found outside the ASX 200 (i.e. the largest 200 listed Australian companies). Exploratory case study research has been conducted on the approach that IOR Asset Management is adopting, with a view to developing a theoretical framework that can support decision making by Australian firms considering offshore BPO to either wholly owned subsidiaries or service providers located in India.

The principals in IOR Asset Management have a track record of previous funds management success in Australia at TD Waterhouse, QBE, Westpac, Macquarie Bank and Fat Prophets, and are leveraging the deep talent pool available in India to supply the research “muscle” that will allow all stocks outside the ASX 200 to be modeled for the first time. IOR Asset Management is bringing “process and science” to an under researched sector and thereby maximizing its information advantage. With the weight of money continuing to flow into Australian superannuation funds it is likely that trustees looking for alternative asset classes will increasingly turn to value investors and boutique fund managers in order to maintain high investment returns. Through the model pioneered by IOR Asset Management, the retirement savings of many ordinary Australians stand to benefit from offshore BPO.

¹ “Out-performance” is a term used in the Funds Management industry to denote achieving an investment return that is higher than an Index benchmark, such as the ASX 200, which is an index calculated on the share price movement of the largest 200 companies listed on the Australian Stock Exchange (ASX).

Traditionally, offshore BPO has been driven by lower cost labour arbitrage. With favourable demographics, salary costs about 25%-30% of the Australian equivalent and a well educated, English speaking workforce sharing a similar legal and commercial framework for business, cities like Bangalore continue to offer ample opportunity for labour arbitrage. But the IOR Asset Management BPO model looks at far more than labour costs. It recognizes that the Australian small cap sector has historically been under-researched, and that analysts are time poor with too many companies to follow up. Inevitably, most analysts have focused on the largest Australian listed companies and the smaller end of the market has been ignored. IOR Asset Management will use its Bangalore operation to conduct desktop research, to develop and update financial models and to research all 1,600 companies outside the ASX 200 – an Australian first. Staff based in Australia will generate the investment ideas, conduct the company visits and make the investment decisions and no longer be “slaves to their spreadsheet financial models”.

2. BUSINESS PROCESS OUTSOURCING: LITERATURE REVIEW

Business Process Outsourcing (BPO) is defined as handing over to a third party responsibility for performing certain business processes that are required for an organisation to carry out its mission. Outsourcing as a phenomenon is neither new nor should it be seen as restricted to IT (Dibbern et al, 2004). In the past fifteen years, academic research on Information Technology Outsourcing (ITO) has evolved rapidly (Dibbern et al., 2004, Willcocks et al., 2006). However, published research into both offshore IT Outsourcing and Business Process Outsourcing is limited, particularly on Australian organisations.

Apart from IT outsourcing (ITO), another common form is business process outsourcing (BPO) of various “back office” functions, which can include human resources, finance and accounting, processing of insurance and credit transactions, procurement, and IT services (Grant 2005, Davies 2004, Feeny, Willcocks and Lacity, 2003, 2005). Common to many of these “back office” processes that are regarded as suitable for BPO is that they are IT-intensive. In defining BPO, some writers view ITO as a subset of BPO (Willcocks et al, 2005, Robinson and Kalakota, 2004), so for the purposes of this research, BPO is defined as the outsourcing of any knowledge-intensive business process, including ITO.

“Offshoring” originally referred to a business decision to employ workers in another country to do the work once done by locals. It is a global expression of “outsourcing” as companies in western countries increasingly consider outsourcing business processes that do not contribute to competitive advantage, or are not regarded as a fundamental part of their value chain (Grant 2005, Davies 2004). Increasingly the “Offshoring” model is moving up the value chain – to more core business functions - as businesses become more confident and knowledgeable and India becomes more capable at providing skilled, competent and motivated labour (Bhargava & Bhatia, 2005) .

According to Davies (2004), over half of the UK FTSE 100 companies now contract some portion of their IT or business processes to outside organizations, a position that is also replicated to an even greater degree with the Fortune 1000 companies in the USA (Friedman 2006). Davies (2004) cites a survey by India’s National Association of Software and Services Companies (NASSCOM) that 70% of US Chief Information Officers spent at least 15 percent of their budgets on outsourcing to India in 2002.

A key business driver for offshore outsourcing is the ability to arbitrage lower cost, skilled labour in countries such as India (Grant 2005, Davies 2004). Other reasons cited by Davies (2004) and Khan et al. (2003) include:

- focus on core competencies
- cycle time reduction in both processes and projects (which deliver market entry advantage)
- using time zones to advantage
- access to special expertise not easily obtained in the home country
- access to a pool of highly skilled professionals
- relieving resource constraints

IOR Asset Management cite an additional reason not originally foreseen, that of the “enthusiasm and optimism” of Indian staff – which adds to motivation, so critical to optimal productivity. As noted by Drew Wilson:

“Our Indian office is a delight to work in – it’s a 100% cynicism-free work place. – and the power of this environment on productivity and quality should not be underestimated.”

There appears little doubt that India currently dominates as the country that is the destination for most offshore business process outsourcing (Carmel and Agarwal 2002, Davies 2004, Grant 2005, Friedman 2006). In a widely cited paper entitled “Maturation of Offshore Sourcing of Information Technology Work”, Carmel and Agarwal (2002) conclude that India dominates offshore IT outsourcing because of the following advantages:

- low-cost skilled labour
- high quality work processes
- large supply of skilled professionals
- English-speaking workforce
- ITO industry structure in India
- effective support from both Union and State Governments
- scalability (management skills in India are reported to be superior to other ITO destinations such as Russia or China)

The research by Carmel and Agarwal (2002) is highly US-centric. Taking an Australian perspective, Wreford (2006) adds that the Indian legal system and commercial framework is compatible with Australian firms’ expectations and notes also the ease of access for Australian firms to Indian BPO service providers.

For Australian companies, offshore outsourcing of business processes to service providers in India is a controversial practice. On the one hand, there is evidence that successful management of BPO to Indian service providers can have a transformational impact on the growth prospects and performance of Australian firms (Wreford, 2006). On the other hand, BPO by Australian firms to Indian service providers is claimed to result in the transfer of Australian jobs overseas (Grant 2005).

2.1. Development of the Business Process Outsourcing Industry in India

India has been recognized for almost two decades as a source of expertise and capability in Information Technology Outsourcing. Business Process Outsourcing draws upon similar skills and capabilities from the deep Indian talent pool of highly qualified, well-trained, IT-literate, English-speaking professionals.

Most BPO occurs within the borders of the customer’s country of origin, as managers of enterprises define and focus on core competencies while looking to gain efficiencies by outsourcing support activities to specialist providers. Extending BPO across borders represented a logical progression as countries like Eire initially and India more recently have become key hubs for offshoring of business processes. BPO as a large-scale industry in India is less than 10 years old.

The genesis of the BPO industry in India appears to have been decisions in the mid-90’s by global multinationals such as McKinsey, American Express, British Airways and GE to utilize India as a centre for their “back office” processes. From 1995 onwards, American Express (Amex) established a significant BPO operation in India at its Global Infrastructure Operation at Gurgaon just outside the capital Delhi.

British Airways (BA) was also an early participant in both IT and Business Process Outsourcing in India, commencing in 1996. Building upon its decades-long presence and substantial operational experience in India, BA steadily increased its involvement in both IT outsourcing and BPO from 1997 onwards. BA outsourced IT activity to NIIT Technologies through “arm’s length contracts” and conducted BPO through a captive operation in Mumbai (Eddington 2006, Marshall, 2005). Initially, the offshore IT outsourcing by BA had three objectives:

- Augment UK-based IT development teams with skilled Indian resources
- Reduce the costs of major software development projects
- Address staffing shortages resulting from a lack of programmers with skills in the legacy airline software protocol Transaction Processing Facility (TPF)

BA was able to leverage the training and education capabilities within the NIIT Group to increase rapidly the pool of IT and BPO professionals in India with in-depth understanding of the airline business and of the specific requirements of BA. With India 4.5 hours ahead of UK time, BA was also able to hand problems off from UK at the close of business and receive a solution back from India at the start of the next business day (Eddington 2006).

Two business drivers for offshore BPO were the strong growth in the US economy in the late 90's which, together with demographic trends, meant that firms such as GE Capital had difficulty finding enough skilled workers to perform back office transaction processing, and the potential for significant reductions in operating costs through labour arbitrage. These trends are considered by some analysts to have generated critical mass in the BPO industry in India from 1997 onwards when GE Financial Assurance decided to shift their back office operations to GE Capital International Services (GECIS), based in Gurgaon near Delhi in India. In 1998, GECIS had 800 employees and revenues of \$4 million USD. The numbers increased to 5,000 and \$85 million in 2000 and 17,500 and \$426 million in 2004, by which time GECIS was handling insurance, finance and accounting, treasury management and document and content management for most of the 35 businesses making up the global operations of the GE conglomerate (Sengupta et al., 2004).

When it commenced business operations as GECIS, the company was a "captive" operation of GE (a wholly-owned subsidiary of GE and providing BPO services only to the parent company). On 31 December 2004, GECIS concluded a transaction that saw GE sell 60% of its equity to General Atlantic Partners and Oak Hill Capital Partners. Subsequently, Wachovia Bank acquired from GE an equity stake of 7% in Genpact when it signed a seven-year BPO contract (Singh, 2006).

Now Genpact employs 20,000 people in six countries, it services over 80 customers through 16 operating centres. The core of its operations continue to be in India where Genpact employs 17,500 people across the cities of Gurgaon, Bangalore, Mumbai-Pune, Kolkata, Hyderabad and Jaipur. The company also plans to expand in second tier Indian cities, and reflecting the growth potential of the global BPO industry, Genpact plans to open a 1,000-seat Call Centre and BPO facility every four months, and expects this rate of expansion to continue for the next five years. With revenues growing at 25%-28% per annum, Genpact plans to hire an additional 8,000-10,000 staff per annum (The Economic Times India, 19 April 2006).

Friedman argues that it was the demand for skilled programming staff to address potential software problems associated with the handling of the transition to "Year 2000" (Y2K) in computer code that created opportunity and generated critical mass (Friedman 2006). According to "Jerry" Rao, foundation CEO of Mphasis, quoted in Friedman (2006):

"The Indian IT industry got its footprint across the globe because of Y2K. Y2K became our engine of growth, our engine of being known around the world. We never looked back after Y2K."

Nandan Nilekani, CEO of Infosys, points to the vast expansion in optical fibre capacity and consequent reduction in telecommunications costs as also providing a foundation for offshore BPO (Friedman 2006).

"[Broadband connectivity around the world] created a platform where intellectual work, intellectual capital, could be delivered from anywhere. It could be disaggregated, delivered, distributed, produced, and put back together again – and this gave a whole new degree of freedom to the way we do work, especially work of an intellectual nature. And what you are seeing in Bangalore today is really a culmination of all these things coming together". (Nilekani, quoted in Friedman 2006).

International consulting firm McKinsey initiated a project in 1995 led by Anil Kumar (Bhargava & Bhatia 2006) to exploit reductions in global telecommunications rates that would create opportunities for "remote business services" whereby providers in locations such as China and India could work for customers located in economies such as the US, UK and Australia. This led McKinsey to establish a Knowledge Centre in Delhi whereby staff and researchers would develop models and analyse trends for McKinsey consultants worldwide.

Having seen at first hand the value creation potential of BPO, McKinsey consultants and GECIS alumni were quick to spread the gospel of BPO (Business Week, 2006). Neeraj Bhargava left McKinsey to play a major role in the development of WNS Global Services, now the second largest BPO service provider in India. Started as a “captive” transaction processing centre for British Airways, WNS Global made the transition to a third-party BPO provider when Warburg Pincus, a leading global private equity firm took a majority stake in 2002 with Bhargava as group CEO. Head of Knowledge Services at WNS is Amit Bhatia who conceived, co-founded and led the McKinsey Knowledge Centre in Delhi (Bhargava & Bhatia 2006, Business Week 2006).

The alumni of GECIS and McKinsey share a number of common characteristics. They view outsourcing as a tool to increase growth and efficiency and not just as a pure cost savings exercise. Firms founded and led by the alumni have attracted top performers in management ranks, have acquired global scale and are comfortable with multiple cultures and languages.

Just as the BPO industry has grown at a phenomenal rate, so have Indian operators increased in sophistication. Indian BPO brands, such as Genpact, WNS Global Services, Wipro BPO, Infosys, NIIT Technologies, and MphasyS are becoming major global players. They have experienced and highly qualified management with strong track records, and have received benefits from investments by major US and global private equity firms. Both Genpact and WNS Global services have made a common journey from “captive” operation based in India for a global multinational company (MNC), to a globalizing service provider with operations in multiple jurisdictions, to a third-party service provider with the introduction of private equity and a consequent “sell down” by the original parent MNC (Shukla, 2006).

Table 1 below summarises the major BPO service providers, and provides some indication of the scale and scope of the BPO industry in India.

Table 1: Major BPO Service Providers Headquartered in India

Company	Revenue (USD)	Employees	Major Clients
Genpact	\$493 million	20,000	GE, GSK, Wachovia, Linde, Nissan, Air Canada
WNS Global Services	\$224 million	9,000	British Airways, Air Canada
Wipro BPO	\$200 million	14,000	Amex, Dell, GSK
HCL BPO	\$156 million	11,200	Deutsche Bank, British Telecom
IBM Daksh	\$120 million	15,000	Lloyds TSB, Barclays, Allstate

Source: India Today International, 8 May 2006

2.2. Business Processing Outsourcing Industry Structure in India

According to Bhargava (2005), the BPO industry in India generated around \$5 billion USD in revenue and employed 400,000 people in 2005. The industry creates 5-10 times more jobs in areas such as Transportation, Construction, Catering, Telecommunications, Accommodation, etc. Because BPO jobs are high paying by Indian standards, the industry also drives domestic economic activity in retail, financial services, hotels, restaurants, and real estate. New townships like Gurgaon near Delhi have arisen because of the BPO phenomenon, and 50% of new commercial real estate occupied in India in the last 3 years has been taken up by BPO companies. Bhargava (2005) reported that the BPO industry adds 1%-2% per annum to India’s economic growth. It also seems clear that the BPO growth story appears far from over. According to estimates contained in a joint report prepared by McKinsey and the Indian National Association for Software and Service Companies (NASSCOM), India’s IT software and BPO services exports will generate revenues of \$50 billion USD by 2008 (McKinsey 2004).

Within the BPO industry, various sub-classifications are utilized based on the nature of the activities provided and services performed. BPO activities are often classified as either “voice processing” or “data processing” (sometimes also called “transaction processing”). Voice processing typically refers to some form of Call Centre operation, which can be in-bound calls (for example, activating your Amex card or redeeming frequent flyer points), or outbound calling (for example, to sell mobile or long distance telecommunications services, or credit collection). Within the sub-classification of “transaction services”, industry analysts such as Bhargava and Bhatia (2006) define a category of “Knowledge Services”, which is BPO performed by people with specialized skills and knowledge and advanced degrees. The Knowledge Services sector of BPO includes activities such as business research, product development, and investment analysis of various types.

The BPO activities of IOR Asset Management fall into the category of Knowledge Services, and Bhargava and Bhatia (2006) report that there are 12,000 knowledge professionals engaged in delivering these types of services from India. Hence, it represents the elite “tip of the iceberg” of the BPO industry.

For firms located in Europe, Australia or North America that make the decision to outsource business processes to service providers located in India, there are a variety of ownership and relationship structures that are possible with Indian service providers (Ramachandran and Voleti, 2004). A fundamental decision is whether to establish a “captive” operation in India (i.e. wholly owned subsidiary) or to enter into some form of contracting relationship with an established Indian service provider. According to Ramachandran and Voleti (2004), key factors that should be considered include:

- Direct costs of establishing operations in India, and possibility of economies of scale
- Long-term assessment of India as a low-cost operating centre with a deep pool of high quality staff
- Cost-benefit analysis of “owning” versus “renting”
- Possible loss of control over their transactions and confidentiality and security of their data if an “arms length” contractor handles them
- Brand implications of perceived loss of control or drop in quality
- Robustness of existing systems and procedures

The principals of IOR Asset Management have considered these factors and taken the decision to establish a “captive” operation, because of a strong preference to maintain control over their transactions and security of their key data and intellectual property. They also felt that systems and processes must be robust in order for offshore BPO to succeed, irrespective of whether a “captive” or “arms length” model is adopted. The “Equity Research Hub” in Bangalore is staffed with equity analysts who individually hand craft financial models on each small cap company in Australia. The industry and company specific knowledge required by staff to do this is Intellectual Property and needs to be retained, so low staff turnover is a key metric. Importantly this labor pool is then capable of being the nucleus that drives successful Indian funds management products into the local market and longer term additional funds management products around the globe. To this end, IOR Asset Management has implemented a reward structure that effectively makes all Indian staff financial stakeholders in the business. By aligning staff bonus structures with client outcomes, this almost unheard of remuneration strategy (in India) will assist in achieving the objective of low staff turnover.

2.3 Existing BPO Models in the Equities and Fund Management Sectors

The Knowledge Services sub-category of the BPO industry in India already provides a number of successful models for the analytical and synthesis research capabilities that IOR Asset Management is developing via its “captive” operation in Bangalore which has grown to 12 full time staff (August 2006) since Indian company incorporation in June 2006 and Australian company incorporation in March 2006. Interestingly India (at 12 expanding to 20 by year end) already swamps Australia in terms of staff numbers (at 2 moving to 4). Culturally IOR Asset Management acts as if the Sydney and Bangalore office are one and the same aided by world class telecommunications infrastructure and leadership determined to mesh the best of both cultures and global best practice.

Based in Chennai, Irevna is a third party BPO service provider that focuses its activities on equity research and analysis that guides the investment decisions of Asset Management institutions, equity research firms and investment banks worldwide. Irevna has demonstrated the capability to implement complex and intricately designed financial models for US clients at a higher level of quality than in-house teams (The Economic Times of India, 19 April 2006). For another US client, Irevna has been able to develop new models to cover all companies in the S&P 500 Index, much faster than could be accomplished by in-house staff. Furthermore, Irevna ensures that new information is loaded into financial models immediately, providing updated company valuations.

In Bangalore itself, the giant Fidelity Fund already has 1,000 staff engaged in back office processing and administration, and also has analysts engaged in equity research in support of its global funds management operations. Fidelity has also used its Bangalore presence to establish various India Funds, aimed at both retail investors in India and also wholesale superannuation, pension and 401k funds in other jurisdictions such as UK, USA and Australia.

As an investment destination, India offers some compelling advantages, including rapidly expanding middle class, growing participation by retail investors, exponential investment in infrastructure and GDP predicted to grow at 8%-10% on a sustainable basis. In addition, India has an expanding group of world-class entrepreneurs and managers. The investment fundamentals appear to be very strong in India. Having a Bangalore presence would appear to provide IOR Asset Management with a compelling opportunity to complement its Australian Smaller Companies Fund by establishing its own India investment fund.

2.4 Participation by Australian Companies in Offshore BPO to Indian Service Providers

To date, there has been limited academic research published on the nature and extent of offshore BPO by Australian firms. Grant (2005) reports that offshoring by Australian firms commenced in 1989 with ANZ Bank's decision to open a software development and maintenance facility in Bangalore, and that momentum has grown significantly in the past two to three years. Australian companies engaged in the industry sectors of Information and Communications Technologies (ICT), banking and insurance appear to be the most actively engaged in offshore BPO to Indian service providers.

Utilising mainly newspaper published articles as primary sources, Grant (2005) reports that Telstra is Australia's most prolific offshoring company, having announced four major offshoring decisions. Offshore BPO activity by other Australian firms has accelerated in the past 2-3 years with Hutchison Telecommunications, Optus, Axa, Repcol, NAB, Westpac and Hewlett Packard providing examples of Australian firms either engaging Indian service providers or developing "captive" BPO operations in India (Grant 2005).

ANZ now employs over 500 staff at its software development and maintenance operation in Bangalore (Grant 2005). Repcol Ltd, the subject of ongoing case study research by the authors, has established a "captive" operation in Bangalore that now employs 500 staff. Headquartered in Perth, Western Australia and listed on the Australian Stock Exchange, Repcol provides financial services to a global client base. Pursuing an ambitious growth strategy and facing staff and skills shortages in its Australian "home" market, Repcol commenced BPO to India in 2003. The decision by Repcol to adopt an offshore BPO model has enabled the company to grow revenue and profit five-fold in the period from 2001-2006, and to dramatically increase market capitalization and total returns to shareholders. Repcol appears to provide a case study in transformational BPO (Lindner 2003).

3. RESEARCH METHODOLOGY AND DATA COLLECTION

The data utilized in this case study of Indian Ocean Rim Asset Management (IOR Asset Management) was gathered through interviews conducted with IOR Asset Management staff and the principals of the firm, David Shearwood and Drew Wilson, in Bangalore, India and Sydney, Australia, together with a review of company documentation and formal presentation material.

Bangalore interviews were conducted in person while those in Sydney were done via telephone. Interviews were between one and two hours in duration, and a semi-structured interview format was followed. Questions were provided in advance to participants via e-mail, and the interviews often departed from the prepared format because unstructured or spontaneous observations and anecdotes from participants were followed up and discussed. Interviews were recorded and transcribed into summary format, and a copy of the written notes was provided to participants for confirmation of accuracy. In the course of reviewing notes, the principals of IOR Asset Management provided a number of additional observations that improved the overall level of understanding and accuracy.

For Australian enterprises, offshore outsourcing of business processes is a new, largely unresearched area that is putting great pressure on Australian managers. To date, very little research evidence has been accumulated on offshore outsourcing, and on identifying the key factors that can contribute to the success or otherwise of Business Process Outsourcing (BPO) by Australian firms. The aim of the Research Project is to establish a framework for providing advice and guidance to Australian managers considering offshore BPO to Indian service providers.

The methodology being used in the research involves an initial exploratory field survey, followed by in-depth case studies of Australian firms engaged in offshore BPO and their Indian service providers. Initial theoretical frameworks developed from the case study findings will be validated by a survey and quantitative analysis of data collected from a larger sample of Australian firms engaged in offshore BPO. The case study method appears well suited to the current situation where there has been little published research into offshore BPO by Australian firms. As pointed out by Borman (2006) the case study method is well established in information systems research, especially where research and theory are at a formative stage and a phenomenon is not well understood.

The information gathered in this research will be of significant importance to both Australian firms and their managers that are considering or participating in offshore outsourcing, and also to Government policy makers and academic staff involved in business and information systems management.

4. DESCRIPTION OF BPO MODEL FOR IOR ASSET MANAGEMENT

Indian Ocean Rim Asset Management commenced operation in March 2006 with a view to developing a new business as a boutique funds manager that would focus on establishing an Australian Smaller Companies Fund. The principals, David Shearwood and Drew Wilson, were already familiar with an offshore Business Process Outsourcing model as a result of a previous successful investment that they had made in an Australian small cap stock (Repol Limited) that had succeeded in establishing an operation in Bangalore.

With an established track record in identifying value by bringing process and science to under researched market sectors, the principals of IOR Asset Management view offshore BPO not simply as an opportunity for cost reduction, but primarily as a means to achieve faster reaction times by analyzing more companies and more ideas. The basic value proposition behind IOR Asset Management is that Australian Portfolio Managers will be supported by equity analysts based in Bangalore to focus on overlooked market sectors, with a view to finding undiscovered value within the Australian small caps, ultimately leading to out-performance and increased Funds under Management.

For IOR Asset Management, BPO provides an opportunity to do something unique in Australia – so it is not about cost reductions. The competitive advantage derived then allows a globally scaleable and repeatable business model to be exploited.

The straight labour cost arbitrage argument for offshore BPO to India is that suitably skilled equity analysts can be recruited in Bangalore for about 25% of the personnel costs associated with an Australian analyst. Of course, this is not the whole story, as the costs of coordinating activities of equity analysts conducting research and modelling from Bangalore must be factored into the equation. The Australian principals of IOR Asset Management each plan to spend about 15% of their time in Bangalore driving and developing the business, and during the recruitment and establishment phase, more than 50% of their time has been

spent in India. The bottom line is this: if the principals are required to spend more than 15% of their time physically present in the Indian office, then the business model is flawed. Strong local management, effective use of technology and frequent 'virtual' contact will be the keys in remotely managing the Bangalore operation.

Other costs of coordination include travel, management time, accommodation and telecommunications. Generally, these costs are not onerous for Australian companies considering BPO to service providers located in Bangalore. Travel links are excellent, and high-performance broadband telecommunications connections are available at reasonable cost.

A common metric for equity analysis is that a senior and experienced analyst in Australia can track about 50 stocks (doing ideas generation, financially modeling and company visits). With experienced and highly competent equity analysts able to be hired in Bangalore for an Australian dollar Total Employment Cost equivalent of \$15,000 to \$45,000, clearly it is possible for IOR Asset Management to have a larger team of analysts in Bangalore covering more stocks (as these analysts are primarily focused on financial modeling alone).

According to David Shearwood:

“Historically, the Australian small cap sector has been under-researched because analysts are time poor with too many companies to follow up. Experienced Australian analysts become slaves to financial model maintenance rather than being able to get out and investigate smaller companies, talking to management, searching for value.”

IOR Asset Management equity analysts based in Bangalore perform financial analysis of Australian small cap stocks, including the following tasks:

Electronic upload of financial data from annual reports and ASX stock market releases provides a base financial model for each company. This allows Indian equity analysts to focus on value added tasks such as:

- The creation of financial models in MS Excel to forecast key company metrics, including Price Earnings Ratio, Earnings Per Share, Net Profit After Tax, etc.
- The tailoring of these financial models to provide ready manipulation of key value drivers and “what if” scenario analysis based upon Investment Manager feedback from company visits in Australia.
- Identification of any Sustainable and Responsible Investment (SRI) issues
- Monitor stock for updates and changes (e.g. new information, quarterly and half yearly earnings reports) and keep all models up to date
- Respond to requests for reports and analysis on Australian companies being tracked via database of models
- The mining of the models database using “Quant” investment strategies in order to identify potential value investment opportunities (done via 28 stock “screens”)

Equity analysts employed by IOR Asset Management in Bangalore generally have an MBA and a first degree in a quantitative discipline (such as Engineering, Accounting, Commerce, Science, Biochemistry), and some have post-graduate Finance qualifications (for example, Actuarial). Typically, they will have a background as a financial equities analyst for a stock broker, mutual fund, investment bank or company, and some have experience of the US market. Analysts are organized around market sectors such as Oil & Gas, Pharmaceuticals, Financial Services, IT and Engineering. Within IOR Asset Management Bangalore, career progression is generally from analyst to senior analysts/team leader (covering multiple sectors), with the ultimate possibility of progressing to portfolio manager and then fund manager.

While IOR Asset Management sees that the relatively deep pool of experienced and qualified equity analysts is the major part of the model, also important is the Internet and broadband telecommunications

technology that now allows for collaboration, communication and control in ways not previously possible. Experience with offshore BPO also demonstrates that the activity has the effect of forcing improvements in process design and control, leading to higher quality outcomes. Hence, IOR Asset Management aims to transform small cap equity analysis from a “cottage industry” to an industrial strength process that can be replicated. As part of this transformation, it aims to increase the number of stocks that can be analysed in detail and to shorten the cycle time associated with successful small cap stock selection. In addition, IOR Asset Management aims to increase the frequency with which new ideas can be generated, and also aims to free up senior, experienced investment professionals in Australia to be out visiting companies and talking with management of these companies. The principals believe that better research will result in better returns.

4.1 Challenges Facing IOR Asset Management in Establishing Equities Research BPO in Bangalore:

Likely challenges for IOR Asset Management will be similar to those facing the broader industry in India. The success of the offshore BPO model is likely to mean that costs will escalate dramatically in the so-called Tier One BPO cities in India (which include Mumbai, Bangalore, Chennai, Pune, Delhi (Gurgaon) and Hyderabad). The BPO industry in India is faced with growth-related infrastructure bottlenecks, high rates of staff turnover (30% p.a.), rising salaries and soaring real estate prices in the key locations for BPO activity.

For IOR Asset Management, recruitment and retention of skilled quantitative analysts is likely to be the most significant challenge. There will also be subtle cultural issues to be managed, including training Bangalore staff to become familiar with the Australian business and investment environment. Given the significant training investment that IOR Asset Management is making in its staff in Bangalore, a high rate of staff turnover is a risk in terms of possible delay in the execution of the business model and dilution in IOR Asset Management’s intellectual property. The firm is addressing these risks by offering staff a share in the performance fees generated by its Funds. This approach of treating Indian BPO staff as full partners in the success of the firm is relatively new in an industry that is still less than 10 years old

However, research into IOR Asset Management has demonstrated that Bangalore continues to enjoy significant location advantages over other possible BPO sites in India. Bangalore continues to demonstrate advantages in terms of world class educational institutions, a deep pool of talented and highly motivated staff, and the presence of a cluster of sophisticated and successful BPO firms. Located in southern India, Bangalore is relatively accessible via airline connections with the major Australian cities. It is regarded by Australian managers as a convivial destination for re-location. Bangalore enjoys a temperate climate, is less adversely impacted by the monsoon (which can cause Mumbai to shutdown due to flooding) and poverty is less evident.

5. CONCLUSIONS, LIMITATIONS AND FUTURE RESEARCH

IOR Asset Management is pioneering new business models for the Australian Funds Management industry. Adapting a proven offshore Business Process Outsourcing model to high conviction, value selection of Australian small cap stocks is innovative, but it is not high risk. Wall Street firms such as Morgan Stanley, Citibank and Merrill Lynch have proven that the outsourcing of some parts of the equity analysis process to Indian service providers works, and leads to value creation. Now IOR Asset Management is bringing that enhanced capability within the reach of Australian funds.

The principals of IOR Asset Management have demonstrated a deep commitment to establishing a successful “captive” operation in Bangalore. They have spent considerable amounts of time in Bangalore and have immersed themselves in the local BPO industry and culture. A tentative conclusion from the IOR Asset Management case study is that the level of commitment by senior management is a critical success factor for Australian companies seeking to obtain business benefits from offshore BPO.

There are barriers to entry with this offshore BPO model for equity analysis. Through a successful prior investment in an Australian small cap (Repcol) that had adopted offshore BPO, IOR Asset Management had acquired familiarity with the issues and challenges associated with establishing a Bangalore presence.

According to David Shearwood:

“We identified during our due diligence phase with Repcol Limited that IOR Asset Management would benefit from on-the-ground expertise in Bangalore, and chose to seek Repcol as a shareholder in order to access Repcol’s established facilities in Bangalore (such as office space, HR, IT) and also benefit from their abundant knowledge of local culture. This has accelerated the growth of IOR Asset Management and we proudly proclaim increased “cultural intelligence” as a result.”

As a consequence of the commitment demonstrated by IOR Asset Management principals, they are gaining first-hand experience in the challenges of executing their innovative business model, with recruitment, training and retention of analysts in Bangalore emerging as an essential prerequisite for success. With the Indian economy set to become the world’s fourth largest within a decade and with a number of well managed Indian companies emerging as major global players, IOR Asset Management is also well positioned to offer Australian investors some exposure to the Indian growth juggernaut.

A limitation in this research is that it is focused on one Australian firm that is operating one particular BPO model (i.e. “captive” operation) in one location, Bangalore. In addition, it is confined to one industry sector and is based primarily on qualitative data. Furthermore, the data has been gathered over a relatively limited time span of just over six months. However, published case studies on the participation of Australian firms in offshore BPO are scarce, and the case study on IOR Asset Management is intended to add to the literature on this currently under-researched area.

Future research will track the evolution of IOR Asset Management’s BPO model through a longitudinal case study. Other case studies that are currently underway will gather data across a broader range of Australian and multinational firms that participate in offshore BPO to service providers located in India. Data is being collected on a wider range of industry sectors, and on several different BPO models, which will enable cross-case comparisons between IOR Asset Management’s activities and results obtained from a range of case studies.

Following an exploratory field survey phase, the in-depth case studies will be constructed on a sample of Australian and multinational firms, together with Indian service providers. The data collected will be used to develop a model that will assist Australian managers to make decisions about whether their organizations should participate in offshore BPO, and to maximize the benefits to Australian firms and the Australian economy from the global BPO phenomenon.

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Kevan Penter has over 20 years management experience in Information and Communications Technology in Australia, USA, Europe, Middle East and Asia. He has held executive roles in Telstra and Western Power and was CEO of a broadband telecommunications start-up company. Currently he is conducting research aimed at identifying the key factors and managerial practices that can contribute to the success or otherwise of business process outsourcing by Australian firms to service providers located in India.

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