

PRACTIONER TRACK PAPERS

CASE STUDIES ON REPCOL AND IORAM: AUSTRALIAN COMPANIES THAT ARE CREATING SHAREHOLDER VALUE THROUGH GLOBALLY DISTRIBUTED WORK

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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 management decision-making.

The under-participation of Australian firms in Globally Distributed Work (GDW) to Indian service providers appears surprising given Australia's full employment and aging population. Sixteen years of unbroken expansion of the Australian economy have created skills shortages that can be addressed by GDW, and Australia and India share many common characteristics that should facilitate mutually beneficial partnerships in GDW. Managers in Australian firms require a research-based framework to accelerate decision-making and adoption of Globally Distributed Work. The authors are endeavouring to use case studies to develop a decision-making framework that will assist Australian firms to make effective investments in GDW

Repol and Indian Ocean Rim Asset Management (IORAM) provide two examples of Australian firms that are creating value for shareholders through successful implementation of Globally Distributed Work. Repcol has leveraged GDW through a major investment in Bangalore. Effective management of GDW has enabled Repcol to grow from a small, privately owned Australian company into a global provider of financial services that is now listed on the Australian Stock Exchange. IORAM provides another 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. Case studies of Repcol and IORAM provide insights for Australian mid-sized firms and organizations considering GDW. Both IORAM and Repcol appear to have utilized GDW in a manner that could be described as "transformational".

Key words:

Globally Distributed Work (GDW), Business Process Outsourcing (BPO), Offshoring, Offshore BPO to India, IT practices of Australian Small and Medium Enterprises (SME)

1. INTRODUCTION

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. While North America accounted for 68% of the Indian IT-BPO export market and the UK 15% in FY 2006, Australia accounts for only 1.5% and that is up from 0.8% in the previous 3 financial years (Nasscom, 2007). One possible explanation for these lower rates of participation is that offshore outsourcing by Australian firms is an under-researched area with little in the way of theory or models to guide management decision-making.

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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.

3.1. Business Processing Outsourcing Industry Structure in India

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 IORAM and Repcol 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.

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, financial 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”)

airport). Repcol had set up their own captive operation but the MD had a close working relationship with an Indian Singaporean whose family came from the Bangalore region whom he appointed as GM of the Bangalore operation and he was able to understand and handle local customs, regulations, national government restrictions, and web of contacts. By 2007 they have expanded the Indian operation to their own building and now have 400 staff in Bangalore with 70-80 staff in Australia. Their business includes collecting on their own consumer debt 'assets' plus doing fee-for-service debt collection for other companies. Their debt-collection process includes inbound and outbound calls, a team approach, and opportunity for promotion. Repcol claims to adopt a professional, constructive approach to debt collection via collaborative problem solving. Calls utilise a VOIP service provided by a major telco and their processes incorporate various software including CRM, searching/tracing database queries, and whitepages.

They operate on two shifts (10.30 am - 6.30 pm, 6.30 pm – 2.30 am), staff are bussed door-to-door, provided with meals, and are trained in-house. All staff have completed degrees (usually Business/Commerce) and some have Masters, about 50% are female, and they are paid at a Total Employment Cost (TEC) that is about 25% of the comparable Australian TEC.

Repcol sees India as a strategic initiative, not just cost reduction, providing opportunity for growth into other markets not possible from Australia and with staff numbers not possible in Australia. Offshore outsourcing to Bangalore was the only way that Repcol could achieve their business plan objective to increase scale and scope of its operations because they could not obtain sufficient skilled Australian staff – debt collection is not seen as a desirable career choice in Australia whereas working for an international company is attractive to Bangalore staff. Repcol reports greater than 60% labour cost saving for complex, value adding activity conducted in India and deducting costs associated with establishing in Bangalore and on-going overheads for co-ordination and management this still generates a 40% cost reduction overall. Staff in Bangalore are well qualified (e.g. MBAs), highly motivated, and some already have multinational company experience. Most Indian staff had never spoken to Australians before and they had to be taught to handle the relationship with the clients in a very different power relationship to most other call centre operations. Staff turnover was 32.5% for 2006 whereas in other Indian centres it reportedly varies from 60 to 130% while in Australia the rate is about 25%. The Managing Director of Repcol has strong cultural awareness but still has had some problems dealing with staff and management issues.

Repcol provides a case study on the business benefits of offshore business process outsourcing. Offshore BPO has enabled Repcol to grow revenue and profit five-fold in a five-year period from 2001 to 2006. Important success factors appear to be that senior management at Repcol has embraced the concept of transformational outsourcing, has been immersed in key cultural factors and has mastered the skills required to co-ordinate offshore BPO. In terms of the model of CEO behaviour described by Feeny et al. (2003), the Managing Director of Repcol has demonstrated that he is a "believer" in offshore and Repcol's success with offshore BPO appears to be based on more than just arbitraging lower labour costs in Bangalore.

5. MANAGEMENT AND DECISION-MAKING ISSUES FOR AUSTRALIAN FIRMS ENGAGING IN BPO TO INDIAN SERVICE PROVIDERS.

Case study research indicates that business drivers for Australian firms engaging in BPO to Indian service providers will include:

- Infusion of new skills, energy, knowledge and best practices
- Cost reduction through labour cost arbitrage
- Simplification of the value chain of the firm or organization, without adverse impact on customer service, brand image and reputation
- Increased project capacity and reduced turnaround time on projects through simultaneous task processing

With labour and skill shortages impacting on the Australian economy, the opportunity to inject new skills through BPO would appear to represent a significant business opportunity, especially in the areas of Knowledge Services.

In the area of Knowledge Services, Australian small and medium enterprises (SME) appear to have lower average labour and operating costs than their counterparts in (for example) North America and the United Kingdom. Nevertheless, the authors' research indicates that Indian BPO service providers can still deliver to Australian firms cost

In a BPO practice established through an “arms length” contract, key risk factors appear to be the potential difficulties in capturing and leveraging knowledge and intellectual capital, and the significant overheads associated with searching for, engaging and contract with, and then managing the performance of offshore BPO suppliers. Quoting research on US companies engaged in globally distributed work, Rottman and Lacity (2006) report that firms micromanage their offshore suppliers to a much greater degree than they manage their domestic suppliers. And such micromanagement significantly increases transaction cost, reported to be up to 50% of contract value in some offshore projects compared to 5% to 10% for domestically outsourced projects (Rottman and Lacity 2006)

In a captive BPO operation, high rates of staff turnover (“attrition”) appears to be a key risk to be managed, and there is evidence that establishing a sustainable local management model can also be a risk factor (Wreford 2006). Difficulties associated with local management models arise from cultural differences between Australian and Indian work places, especially those related to the area of power distance.

The “Equity Research Hub” established by IORAM 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. To address the risks associated with staff turnover and consequent loss of knowledge potential, 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 remuneration strategy for analysts in India will assist in achieving the objective of low staff turnover.

5.3 Contribution of the Bangalore Ecosystem - Choices Regarding Location

In developing its “captive” operation, Repcol first conducted systematic research into both engagement options and also preferred locations. In January 2003, a team from Repcol visited Chennai, Hyderabad, Mumbai and Bangalore and met with providers of Call Centre solutions, BPO service providers and operators of technology parks (Wreford 2006).

Having satisfied themselves that the capabilities and infrastructure available in India could meet Repcol’s requirements, within a month the team recommended to the Repcol Board of Directors that a presence be established in Bangalore.

Repcol relocated a senior manager to Bangalore to supervise the construction of the facility which was operational within four months. The strength of the Bangalore “ecosystem” in terms of ITES-BPO, which have been widely documented (for example Freidman 2006), were also recognized by Repcol senior management.

In addition, for Australian companies such as Repcol and IORAM, Bangalore offers relatively easy access to and from the Australian west coast, political stability and a temperate climate that is attractive to Australian companies and executives. In establishing a “captive” operation, Repcol found that real estate costs in Bangalore were less expensive than in Mumbai and Gurgaon (Wreford 2006). Other favourable considerations were the breadth and depth of connections between Bangalore and Karnataka State and Australia; these links include business, academic and cricket. There is also a “critical mass” of Australian businesses with a presence in Bangalore and this was a factor in influencing IORAM’s choice of location.

Nasscom (2007) has identified five factors which need to be strengthened in order to maintain the competitive advantage that India currently enjoys in ITES-BPO. The five factors include:

- Augmenting talent supply
- Creating world-class infrastructure
- Strengthening information security
- Enhancing operational effectiveness
- Providing regulatory support

The experience of the authors suggests that talent supply, information security and operational excellence are factors in which Bangalore continues to occupy a strong position. However, infrastructure in the form of the airport and intra-city urban transport is an increasingly problematic factor that has the potential in the future to undermine the competitive advantage of the Bangalore “ecosystem”.

the case studies are intended to add to the literature on this currently under-researched area.

Future research will track the evolution of both cases' BPO model through longitudinal case studies. 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 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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