

# Venture Capital – Opportunities in BPO Sector

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## **Abstract**

*The IT services sector and the BPO sector has seen a year-on-year decline and it does not appear to change any time soon give the uncertainty in the united states. IT services had attracted 10 investments in 2007, which declined to five deals in 2008, and the BPO saw 17 deals in 2007, which dipped to six in 2008. At present in BPO sector opportunities may be less but profitable, because of positive strengths of the country. This paper analyses the strengths and weakness of the country and some positive corners to venture capital in BPO sector at present scenario.*

## **Venture Capital**

Starting and growing a business always require a capital. There are number of alternative methods to fund growth. These include the proprietor's own capital, arranging debt finance or seeking an equity partner, as in the case with private equity and venture capital. Venture capital is a means of equity financing for rapidly growing private companies. With Venture Capital financing, the venture capitalist acquires an agreed proportion of the equity of the company in return for the funding. Venture capital firms invest funds on a professional basis, often focusing on a limited sector of specialization e.g. IT, Infrastructure, Health/Life Sciences etc. The goal of venture capital is to build companies so that the shares become liquid through IPO or Acquisition and provide a rate of return to the investors in the form of cash or shares that is consist with the level of risk taken.

## **Types of Venture Capital Financing**

The venture capital industry has increasingly distinguished between the financing needs of companies at different stages of corporate development. Thus, while companies at each stage may have financing needs which are not fully satisfied by traditional financing institutional. Venture capital intermediaries generally specialize in one or more of types of venture capital financing. This can be categorized as follows

1. Early stage financing for seed capital, setting up new business
2. Later stage financing for expansion, replacement
3. Special situation

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## Opportunities

China, India, Israel and Canada are primary target countries for venture capitalist all over the world Primary locations where investors would like to expand investment focus

**Table 1**  
**Target Countries For Venture Capital**

Country	Percentage
China	34%
India	24%
Canada	11%
UK and Ireland	9%
Israel	6%
Australia, New Zealand, other Asia, South Korea	4%
Other Europe	7%
Others	5%

Source: Indian Venture Capital Association

### Primary reasons, venture investors are expanding globally

Among the primary reasons venture capitalists around the world are interested in investing globally is to take advantage of higher quality deal flow. Other motivators include access to quality entrepreneurs, diversification of industry and geographic risk and access to foreign markets.

**Table 2**  
**Driving forces for venture capital**

Factors	Canada	China	India	Israel	UK & Ireland
High quality deal flow	21%	18%	10%	70%	17%
Access to quality entrepreneurs	21%	4%	13%	20%	11%
Emergence of entrepreneurial environment	21%	42%	42%	0%	22%
Diversification of industry and geographic risk	0%	6%	10%	0%	22%
Access to foreign markets	0%	21%	13%	10%	11%
Low cost locations	29%	6%	10%	0%	0%
Extensive competition for deal flow in our local market	8%	3%	4%	0%	17%

Source: Indian Venture Capital Association

## **Emerging Markets – India**

A growing middle class, early success stories of venture backed companies and solid innovation pipeline are several of the factors driving acceleration in India

An important part of India's acceleration is the growing amount of capital available for investment and the increasing number of investment professionals. The number of investment firms increased almost fourfold in the last two years.

There is likely to be a major shift in India taking place in the coming years. An innovation of new technology is always done in collaboration with early adopters. As the country continues to open up, Indian enterprises will rely on technology as a key differentiator to compete globally. The rapidly increasing salaries in India will also force the country to rely more heavily on technology to increase productivity.

An expert committee on technology innovations and venture capital provided a policy paper to the government of India planning commission in Delhi July 2006 with very clear recommendations for the government's 11<sup>th</sup> Five-year plan. If adopted the recommendations would lead to an increased flow of venture capital funds for commercialization of technology ventures.

### **India – A BPO Destination**

New technology, global competition and changing markets have led to rapid transformation taking place in the global outsourcing market with the emergence of number of global giants and new entrants. Today, India is the world's off shoring capital with phenomenal growth potential.

The abundant skilled manpower has made India a target destination for multinationals to back end their operations in India. India ranks high in areas such as qualifications, capabilities, quality of work, linguistic capabilities and work ethics and thus is ahead of competitors such as China, Philippines, Ireland, Australia, Canada etc., Indian companies have unique capabilities and systems to set measure and monitor quality targets.

In specific BPO categories, Indian centers have achieved higher productivity levels. For example, the number of transactions per hour for back office processing, then their western counter parts. Also India is able to offer a 24 X 7 service and reduction in turnaround times by leveraging time zone differences. Many state governments in India are offering incentives and infrastructure for outsourcing activities

### **Cost Competitive**

India is the leading outsourcing destination. The Indian BPO industry accounts for half of the global business in this arena and NASSCOM has predicted that the industry will chart a growth rate of 40 percent over the next fiscal year

### **(a) Cost advantage**

Indian IT players have in fact already made great strides in the ITES/BPO market, what began as an activity. That was confined to MNCs that set up captive ITES (Information Technology Enabled Services) facilities in the country, India today has a large base of third party ITES/BPO companies that are bagging prestigious remote services projects from leading global organizations.

Global corporations are generating cost savings in the range of 40-60 per cent depending on the process off shored. Manpower costs in India are 70-80 per cent less than UK and US.

The real estate costs and General and Administrative expenses are low in comparison with developed countries, yielding additional cost savings to customers.

Salaries for Indian professionals are lower when compared with pay scales in the US. The average monthly salary in India is \$400-700 compared to \$2700-2800 in the US

### **(b) Growth in pool of knowledge professionals**

Besides cost and abundance knowledge professional, a host of factors make India a front-runner in attracting BPO business. Indian companies offer 20 per cent higher productivity in comparison to other competing countries like Philippines, Canada and Australia. In terms of quality of services offered, India ranks 30 per cent higher than any other region

About 100000 engineering graduate from India every year. Many of these engineers are employed with different forms of BPO organizations for troubleshooting and providing technical support.

## **India – Strengths and Weaknesses**

### **(A) Strengths**

- Solid history in software development
- English proficiency
- Government support
- Cost advantage
- Strong tertiary education
- Process quality focus
- Skilled work force
- Expertise in new technologies

- Entrepreneurship
- Reasonable technical innovations
- Reverse brain drain
- Existing long term relationships

**(b) Weaknesses**

- Positioning and Brand management
- Infrastructure
- Cultural differences
- Sales and Marketing
- Business Process experience
- Poor globalization skills

**(c) Opportunities**

- Creation of Global brands
- BPO and Call Center Offerings
- Expansion of existing relationships
- Indian domestic market growth

**(d) Threats**

- Internal competition for resources
- Over-promise/Under-deliver
- Rising labor costs
- Competition from other countries
- Corruption / piracy / trust
- Political and religious instability

**Key Highlights of Indian ITES-BPO sector performance<sup>1</sup>**

- a) Indian ITES-BPO exports (including hardware exports) reached USD 40.9 billion in FY2008 as against USD 31.8 billion in FY2007, a growth of 28 percent.
- b) Indian IT-BPO grew by 33 per cent in FY2008 to reach USD 64 billion in aggregate revenue, thus revalidating its strong fundamentals, despite concerns of a slowing US economy and supply constraints. Of this, the software and services segment accounted for USD 52 billion, growing by 28 per cent (currency – adjusted) over FY2007.

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<sup>1</sup> NASSCOM

- c) Domestic IT market (including hardware) reached 23.1 billion in FY2008 as against USD 16.2 billion in FY2007, a growth of 44 percent in FY2008. Software and services spending supported by increasing adoption, grew by over 41 percent during the year.
- d) The industry's vertical market segment exposure was well diversified across several mature and emerging sectors. Banking, Financial Services and Insurance (BFSI) remained the largest vertical market for Indian IT-BPO exports, followed by High technology and Telecom. These sectors together accounted for nearly 60 per cent of the Indian IT-BPO exports in FY2007. Manufacturing, Retail, Media, Healthcare, Airlines and Transportation, and Utilities were the other key segments.
- e) Indian IT-BPO is on track to reach USD 60 billion in exports and USD 73-75 billion in overall software and services revenues by 2010. FY09 software and services growth forecast 20-23% (USD).

## **Information Security Environment in India<sup>2</sup>**

### **NASSCOM's Security Initiatives**

NASSCOM has taken a holistic view of Information Security through its 'Trusted Sourcing' Initiative to strengthen the regulatory framework and further improve India's attractiveness as an outsourcing destination. This multi-pronged initiative is targeted at employees, organizations, enforcement agencies and policy amendment, through a '4E Framework' - Engagement, Education, Enactment and Enforcement.

Most Indian companies that are aiming to go global will require certifying their ability to maintain proper security levels when scouting for international clients. Information security is no more a mere legal requirement but it is fast becoming a factor for companies to compete on and grow businesses. A "secure and reliable" environment—defined by strong copyright, IT and cyber laws—is an imperative for the growth and future success of the ITES BPO industries.

### **Security Environment in India**

Indian companies are known for their quality deliverables. International certifications like ISO 9000 and CMM went a long way in establishing this reputation. Likewise following international standards in information security is also helping Indian companies build credibility among customers. While most Indian BPO firms are recognized for high quality processes and services, information security practices need to be constantly reviewed and updated according to the rapidly changing environment. Customer data demands special focus.

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<sup>2</sup> NASSCOM

### **Currently, the information security environment in India is:**

- Indian companies have robust security practices comparable to those followed by western companies. Indian companies primarily comply with ISO 27001 – a global standard that covers all domains of security.
- Companies sign Service Level Agreements (SLA), which have very strict confidentiality and security clauses built into them at the network and data level. Such SLAs also cover all relevant laws that the companies want its offshore providers to comply with and actions that can be taken in case of breaches.
- Laws such as the IT Act 2000, Indian Copyright Act, Indian Penal Code Act and the Indian Contract Act, 1972 provide adequate safeguards to companies off shoring work to US and UK
- Most of the BPO companies providing services to UK clients ensure compliance with UK Data Protection Act 1998 (DPA) through contractual agreements.
- Companies dealing with US clients require compliance depending upon the industry served. E.g. Healthcare requires compliance with HIPAA, Financial services require compliance with GLBA. To ensure compliance with such laws, Indian vendors follow security practices as specified by clients such as security awareness trainings, access control, data encryption and obfuscation, non-disclosure agreements, screening of employees, penetration testing etc. Further, clients conduct periodic audits to ensure compliance.
- Many companies in India are undergoing/have undergone SAS 70 Audit. SAS-70 assignments helps service companies operating from India to implement and improve internal controls, ensure minimal disruptions to business from clients' auditors, and is potent marketing tool in the face of increasing competition.

### ***Factors to be consider while investing in BPO sector***

Given that investing in BPOs can yield a genuine returns, the key areas in which an investment must carry out due diligence are

- Attrition
- Global delivery model
- Critical mass
- Information privacy and security
- Operational excellence

### **Attrition**

The BPO sector is facing an unprecedented boom witnessing a hiring growth rate of more than 40% per year. The industry is expected to employ around 1.1 million people by 2008 and has been battling the complex problem of growing manpower attrition.

The main reasons for attrition is

- Restricted career operations
- Stressful work
- Inexperienced middle and frontline management
- Undefined policies

It is important for a venture capital investing in an outsourcing company to have knowledge of how the investee is positioning itself to tackle this problem. It would be wise for venture capital and private equity investors to carry out a strong due diligence on the core HR competencies in the management team.

### **Global delivery model**

Outsourcing is a global phenomenon and if venture capitalists want then BPO companies to grow into top tier group and yield attractive return on exits, then the investee firm must figure a global delivery game plan and its business model. In the current economic scenario serving large and complex organizations with global markets, it is essential for a BPO company to be able to function effectively across the globe. The delivery model must be capable of offering quality service both onshore and offshore.

### **Critical mass**

It is essential for BPO partners, with participation from clients as required, to clearly understand infrastructure capability required, build requisite levels of redundancy and plan for disaster recovery and business continuity

- Appropriate infrastructure
- Business continuity planning
- Plan for disaster recovery
- Quality standards and control technologies
- Security softwares and hardwares

### **Information privacy**

Brand is extremely important to every company. The enhancement of brand and protection of reputation is essential to how investors look at the company. What are the measures taken by the company to secure the information thoroughly inspected before investing.\

### **Operational excellence**

In this dynamic business environment operational excellence in managerial and operational business practices is essential for its sustainability. Despite having the right infrastructure in terms of premises, communication, hardware and software resources and HR competencies



the success of an outsourcing finally depends on the approach of the investee to interact with and meet customer expectations. His focus on operation excellence will lead to customer satisfaction, and ultimately create wealth for its shareholders.

## **Conclusion**

Uncertainty in US may be cause for decline in the Venture Capital investments in the IT services. Apart from the decline of the share of IT services and BPO sector in the overall investment pie, there has been a decline in actual numbers too. IT services had attracted 10 investments in 2007, which declined to five deals in 2008, and BPO sector saw 17 deals in 2007, which dipped to six in 2008. The IT services sector and the BPO Sector has seen a year-on-year decline and it does not appear change any time soon given the uncertainty in the United States. But BPO industry certainly represents huge opportunity to create wealth. From a fundamentals viewpoint, the drivers for global sourcing are likely to remain strong in the near future. Most environmental factors affecting global sourcing also look favorable despite concerns of a possible economic slowdown. Nature of short-term cutbacks in US technology spends are unlikely to impact global sourcing negatively, in fact could even boost its growth. Worldwide adoption of outsourcing, another key influencing factor, is also expected to grow rapidly over the next five years. The boom in the Indian outsourcing industry, particularly BPO sector may well be over. Overall thus, global sourcing of services seems well placed to continue expanding its share of worldwide IT-BPO spending. It is important for an investor to look for the various factors discussed in this paper and scan the environment related to the industry before investing in a new or existing outsourcing company.

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