

European IT SMEs in India

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Abstract: For large companies, offshore sourcing is rapidly becoming a prerequisite for competing. But for small companies, it is generally assumed that the incremental per-worker savings associated with offshore sourcing are likely to be outweighed by the cost and risk of establishing an offshore operation. Nonetheless we found four European SMEs that have not only succeeded offshore, but gained access to new opportunities and markets that they believe would not have been available to them otherwise.

1 Introduction

While large companies and multinational corporations tend to dominate the headlines, it is actually small and medium sized enterprises (SMEs) that dominate most developed economies. This is particularly true in Europe, where the average company employs only 6 people, compared to 10 in Japan and 19 in the US.¹

In Europe as elsewhere, SMEs generally have a number of inherent advantages and disadvantages compared to larger firms and multinationals. The advantages tend to include faster, more streamlined decision-making processes, less bureaucracy, lower fixed costs, and more agility in responding to new customer needs and changes in the business climate. These advantages make SMEs particularly suited to innovation and new product development, particularly when it comes to technology and software.

¹ SMEs in focus: Main results from the 2002 Observatory of European SMEs

But the disadvantages faced by SMEs include limited working capital and resources, more difficulty in attracting and retaining talented workers, and higher transaction costs. SMEs also tend to be young, specialized companies, which means they lack the scale and scope of larger firms. A small number of managers leaves SMEs with a lack of collective experience as well as a limited “bench” to draw from for new initiatives. Many SMEs are also suppliers to much larger multinationals, which often translates to a lack of bargaining power.

These disadvantages all seem especially pronounced as larger firms begin to organize around offshore to cut their costs, increase speed and enhance flexibility. By doing so large firms gain some of the characteristic advantages of smaller companies. Large companies typically use smaller, specialized companies as suppliers, because the small company can typically provide a product or service at a lower cost than the large company can procure internally. But if large firms can use an offshore strategy to regain some of these small firm advantages, small suppliers are no longer as attractive. As the offshore model takes hold for larger firms, will European SMEs be left in the dust?

It is hard not to notice that offshore procurement and sourcing of IT and BPO services has moved from a cutting-edge business trend into the mainstream. The value proposition for the center-based onshore-offshore model is compelling: JPMorgan estimates that the cost per head offshore is 30-35% below its equivalent in the US or Europe.² Indian IT-services firms like Infosys, Wipro, and TCS have become formidable competitors with growth, profitability, and market capitalizations that are the envy of the industry. The Economist contends that a new geography for the IT industry emerging in India as they see the emphasis of the global IT industry shifting from innovation to execution.³ Ask any executive – the competitive dynamics of the technology industry are changing rapidly and fundamentally. GE CEO Jeff Immelt recently pointed out that competition from places like China and India has evolved to include highly competitive, low cost engineering graduates, and companies like GE must take advantage of this trend in order to remain competitive.⁴ It is therefore no surprise that Goldman Sachs recently asserted that having an offshore capability is a critical imperative if firms want to survive.⁵

As detailed in the exhibit below, companies can secure highly qualified engineers and managers at substantially lower cost in India. For junior software engineers the savings may approach 90%.

² “Cap Gemini Ernst & Young: Defying Gravity?” JPMorgan Equity Research, 1 September 2003

³ “The new geography of the IT industry,” The Economist, 17 July 2003

⁴ GE 2003 Annual Report, p.2

⁵ “From Inflection Point to Stall Point,” Goldman Sachs, 8 July 2002

Employee category and level / Approximate annual compensation bandwidth	India (in Euros)	Europe (in Euros)	India as a % of Europe
Junior software engineer (0-2 years experience) ...	3,500 ~ 4,500	25,000 ~ 35,000	10 ~ 15
Systems analyst (2-4 years experience)	7,000 ~ 9,000	40,000 ~ 50,000	15 ~ 20
Senior systems analyst (4-6 years experience)	11,000 ~ 14,000	55,000 ~ 70,000	15 ~ 25
Technical architect	18,000 ~ 24,000	55,000 ~ 80,000	22 ~ 32
Project leader (6-10 years experience)	18,500 ~ 24,000	70,000 ~ 85,000	22 ~ 35
Project manager (10+ years experience)	28,000 ~ 40,000	100,000 ~ 120,000	23 ~ 35
Head of development center	40,000 ~ 80,000	120,000 ~ 130,000	35 ~ 60

Note:

1. Exchange rate Euro:RS = 55:1
2. Social security benefits, healthcare, and unemployment insurance not included. The cost of these benefits is significantly lower in India to both employer and employee
3. The Indian compensation levels represents total target compensation. At a typical Indian offshore company about 40% of the compensation will be variable. In Europe, the variable component is significantly lower

Source: Company information and Value Leadership Group analysis

Exhibit 1: Typical compensation levels in India vs. Europe

The enormous opportunity for savings offshore, while important in itself, can lead companies and managers to pursue strategies that focus only on labor savings and arbitrage opportunities. But the only way to gain real competitive advantage through offshore strategy is through holistic changes to a company's operating model, and as the four cases in this paper show, realizing even a part of the potential savings is a substantial challenge.

But it is surprising that so much recent offshore activity simply involves cutting costs by moving work to countries with lower overall costs than in the US and Western Europe. Any competitive advantage to be had through cost-cutting is bound to be short lived; any cost savings that can be easily attained can be even more easily imitated by competitors. The real, long-term gain to be had from offshore strategy is not simply from cutting costs, but from using the unique combinations of other strengths and assets to be found in low-cost locations like India to build a sustainable competitive advantage.

But leveraging the offshore model for competitive advantage is a daunting challenge, involving significant risks. These risks may involve operational issues, intellectual property, distraction from core activities, and alienation of the "home" workforce to name just a few. Implementing an offshore strategy also requires substantial upfront investment in infrastructure and people, as well as process and organization redesign. And as several of the cases in this paper will show, leveraging offshore strategy for competitive advantage also requires more than just incremental changes. To succeed, companies must reinvent themselves by making fundamental changes to their business models and operations.

Establishing an offshore “captive center,” or wholly-owned, dedicated facility, would seem to be even more expensive and risky than working with a local partner, and the cost per transaction for small firms would seem to be even higher than with offshore outsourcing. From a European perspective, a captive center would therefore only appear to be an option for the largest firms. A case in point is General Electric, which has operated GE Capital International Services (GECIS) in India since 1997, and opened the John F. Welch Research and Development Center – GE's second largest – in Bangalore in 2000. GE's operations in India employ over 20,000 knowledge workers. Particularly during the past decade GE has leveraged the offshore advantage in India in virtually every way imaginable, and maintains a portfolio of captive facilities as well as equity-based partnerships and strategic non-equity alliances with a range of Indian service firms.

But GE's competitive advantage in India stems not only from low labor costs but also from the way its Indian operations are leveraged throughout the organization. The company has fundamentally rebuilt internal processes to leverage GECIS as a shared resource worldwide, and to seamlessly integrate R&D activities with those in the United States and elsewhere.

Facing the competitive muscle of GE, multinationals around the world are following GE's lead or making plans to do so. A day doesn't pass without another major firm announcing plans to relocate a significant number of jobs to India. The Indian “help wanted” pages are full of European and US firms seeking to fill hundreds of new positions in IT and BPO services. It is no surprise therefore that IDC expects offshore volumes to double to \$16 billion in 2004 and jump to \$40 billion by 2007.⁶ Forrester estimates that more than 3.4 million American jobs will move offshore by 2015.⁷

2 Are European SMEs at a disadvantage?

For large companies, offshore sourcing is rapidly becoming a prerequisite for competing. The case is clear: by going offshore, large firms can lower their costs, enhance their agility, and provide customers with richer and more compelling value propositions. As more and more large firms implement successful offshore strategies, they will regain many of the advantages traditionally enjoyed only by smaller firms - and SMEs will be harder pressed than ever to keep up.

⁶ NASSCOM (http://www.nasscom.org/artdisplay.asp?cat_id=342)

⁷ “Forrester Revises Loss Estimates To Overseas Jobs,” Wall Street Journal, 17 May 2004, Page A8

This is big news because 99% of enterprises in Europe have less than 50 employees, let alone IT workers.⁸ EU studies indicate that high-tech SMEs already face significant challenges in financing as well as attracting and retaining qualified workers compared to larger competitors.⁹ Among other activities these firms are involved in software development, chip design, and biotech – in short just the sort of work that large companies are starting to move to low-cost countries like India, where schools like the Indian Institutes of Technology train local engineers to world-class standards. Furthermore European technology firms, large and small, often compete with American firms for the same business - and American technology firms of all sizes are deploying offshore strategies much more rapidly than their European counterparts.

Should European SMEs become less competitive as a result of offshore sourcing by larger firms, the implications will be dramatic: SMEs are the driving force behind both economic growth and employment in Europe. While the European Union has a number of initiatives to address the traditional needs of the SME sector, the offshore paradigm is triggering a new set of disruptive competitive forces likely to change the rules of the game entirely.

For small companies, it is generally assumed that the incremental per-worker savings associated with offshore sourcing are likely to be outweighed by the cost and risk of establishing an offshore operation. Furthermore, European SMEs typically lack the management bandwidth to effectively source services from distant countries many time zones away. Language and cultural barriers present additional obstacles for many continental European SMEs.

If higher transaction costs, limited economies of scale, and management obstacles prevent European SMEs from reaping the full advantages of offshore sourcing, are they eventually doomed to fail against larger competitors that are already benefitting from a successful offshore strategy? If not, how are they confronting the challenge?

We set out to explore these questions and visited the executives of four European SMEs with substantial operations in India. The firms come from across Western Europe – Belgium, France, Germany, and Sweden – and a number of different sectors of the technology market. They employ between 30 and 800 people, and two of the firms are publicly traded. Despite their different sizes, locations, and sectors, what these firms have in common is that they are on the vanguard of exploiting offshore strategy for competitive advantage.

What we found was more than surprising. Not only did these SMEs succeed offshore, once they had managed the challenges and obstacles to getting started they found themselves better off than before. Moreover, by going offshore, each of the SMEs gained access to new opportunities and markets that they believe would not have been available otherwise. And the smallest of the four firms discussed in this paper believes that it would have gone out of business years ago had it not expanded offshore.

⁸ SMEs in focus: Main results from the 2002 Observatory of European SMEs

⁹ 2002 Observatory of European SMEs: High-tech SMEs in Europe

3 From cost advantage to competitive advantage

The cost advantage of offshore locations like India, at least for large organizations, is undeniable. While figures vary on the actual savings firms can expect from their offshore operations, a number of studies show that the total cost of developing software in India can be as little as 25% of the price of a similar project based in the United States. As many projects require a combination of onshore and offshore workers the associated savings tend to be lower but still substantial. Nonetheless one of the most surprising discoveries we made is that for the four companies profiled the lower cost of labor in India played little or no role in the initial decision to move offshore.

We surveyed ten information technology SMEs from across Europe with offshore operations, and conducted extensive interviews with four that have operations in India: DeDuCo, a Belgian CRM software product company; Telelogic, a Swedish provider of development tools for advanced systems and software development; Case Consult and Valtech, respectively German and French medium-sized IT consultancies with offices around the world. For these companies the lower cost of labor in India was not only just one of a number of advantages they gained from their offshore operations: in every cases it played little or no role in their initial decision to move offshore.

The four companies we met with all developed their offshore strategy before 2000, when the IT landscape was very different from today. Both the US and Europe had a widespread shortage of IT workers in the wake of the explosive growth of the Internet, dot coms, and Y2K-related issues. "Many of our best programmers were leaving to take jobs in the banking industry," remembers Carl Dujardin, co-founder and managing director of xsysys technologies, DeDuCo's captive development center in Bangalore. "Moving our development to India was a bet-the-company decision. If we hadn't done it we would have gone out of business - we simply couldn't retain developers in Belgium." The ensuing war for talent made it particularly difficult for SMEs to attract and keep talented programmers. As a direct result, three of the four companies we spoke to began looking offshore for the workers they needed, and eventually found them in India.

Telelogic produces software development tools and initially entered India to gain access to the growing market for their products among Indian software developers. But what all four cases have in common is that potential for cost savings did not play a strategic role in the initial decision to go to India.

Case Consult moved into India to gain an advantage once only enjoyed by its largest rivals: scalability. As a result the company routinely takes on projects that are unusually large for its size, and counts among its clients a growing number of firms they would be unable to serve without their offshore presence.

Valtech moved to India not only to gain a flexible, scalable workforce for IT projects around the world, but also to build a development center that would also act as a hub to unite its widely dispersed organization. Underscoring the significance of the offshore location, Valtech's CEO even believes that before long the Indian office will become the company's de facto headquarters.

By pursuing an offshore strategy, each of these four companies was able to escape many of the restrictions and limitations of doing business in Europe and find entirely new sources of competitive advantage that are only partially derived from cost savings.

The IT market is more competitive and far less forgiving today than just a few years ago, and many companies - large and small - that did not manage the transition to the post-dot com world have gone out of business. But if limited economies of scale prevent SMEs from reaping the full benefit of cost savings, then why are these four companies all thriving, and why are they still in India?

4 Enormous pool of skilled workers

In our increasingly knowledge and information driven economy, access to qualified talent is an increasingly important factor input of our future prosperity and competitiveness. According to the ten SMEs we surveyed, one of the most significant arguments for offshore sourcing – and one of the most important criteria for choosing a location – is the size, flexibility, and quality of the labor pool. And it is for these reasons – at least as much as cost – that India is emerging as a world leader in offshore sourcing.

The sheer number of engineering graduates who enter the IT industry in India each year – over 150,000 in 2002 according to a NASSCOM/KPMG study¹⁰ – makes it relatively easy for companies of all sizes to rapidly recruit workers and build development teams in response to client demand, even for tasks requiring highly specialized training and experience. The Indian Institutes of Technology are considered to be among the best sources of engineering talent in the world, and they represent only a small part of a very large and high-quality higher education system.

“India produces a large number of engineers and always has,” explains Sidharth Malik, managing director of Telelogic India. “About 15 years ago analysts saw that demand for certain technical skills was already exceeding supply. As a result a lot of private courses for specific technologies came up. So in India the mapping of the technical requirement to the talent has been met.”

Furthermore Bangalore has become a hotspot for talent simply as a result of the sheer number of major international technology firms that have established development centers in the city. This combination of factors makes it relatively easy to attract and retain top talent in almost any technology domain, on short notice and in large numbers. India’s proposition of value for money, top talent, and tremendous flexibility is not going unnoticed to European SMEs who have exhausted their alternatives in Europe.

¹⁰ “Strengthening the human resource foundation of the Indian IT enabled services/IT industry,” Report by KPMG Advisory Services Private Limited in association with NASSCOM under the aegis of the Department of IT, Ministry of Information Technology and Communications, Government of India, 2004, p. 67

Despite the dot com crash and upsurge in European unemployment since 2000, the underlying structural issues in the European labor market have not been addressed. Europe is simply not producing enough engineers with the right skills.

“One of India's key resources is its second-rung universities,” explains Rohan Joshi, president of Valtech India. “As in many other developing countries, many graduates of the first-rung universities go on to work or study in the US or Western Europe. But India also has about 75,000 technology graduates from second-rung universities every year. Even if 10% of them go abroad you still have a pool of 60,000 to recruit from.”

The size of the workforce in India also offers companies a chance to scale more easily than elsewhere. According to Rohan, “You never have to turn down a new project because you can always find the workers here.”

5 Overcoming challenges

Despite widespread fluency in English, India has significant cultural differences to Europe, and we found that some of these differences manifested themselves as concrete obstacles to offshore work. All of the companies we spoke to specifically mentioned the tendency of Indian workers to overcommit (i.e. say “yes” to every request) as a significant cultural issue. We saw several examples of missed deadlines and project failures that the company attributed to this trait.

Unlike in most Western countries, salaries and income tend to be public information in India, and this fact alone can create salary pressure for companies operating in India. Jens Borchers of Case Consult also points out, “Never expect that a secret agreement you share with one employee will stay a secret – he or she will tell the first person in the hall after leaving your office.”

Of course cultural differences go both ways, and Borchers indicates that “many Indians are uncomfortable with the bluntness of Germans.” Furthermore since Indians in the IT industry deal only with foreign customers, they tend to have substantially more experience dealing with a wide variety of people and cultures than many Europeans do. And while many European companies face an uphill struggle to transition from a business model based on customer proximity to the Global Delivery Model, most Indian companies have never worked any other way.

Language is an issue for some European firms, particularly smaller ones - and in such cases Eastern Europe – and Latin America in the case of Spain and Portugal – represent viable alternatives to India for certain activities.

Case Consult's highly process-driven approach goes some way to addressing both cultural and language issues. "Everybody here has to understand English documents and must be able to express technical facts in English," explains Jens Borchers. "We do not require fluent spoken English, since there is nearly no direct conversation on the phone between our offices in Germany and India – as a matter of company policy all communication between onshore and offshore teams must be in writing. Only the management people have one scheduled weekly chat on the phone, which is also used to discuss some more informal issues." Even so Borchers points out that much of the internal email traffic between the company's Indian and German offices is for clarification purposes.

The time difference between India and Western Europe averages four hours, but this was not seen as a major concern. Two firms specifically cited the time difference as an advantage.

DeDuCo explained that problems identified in Europe late in the day can often be solved the next morning in India, before the European office opens. But since much of the day overlaps, engineers in Belgium and India can also collaborate in real time during normal working hours.

One of Telelogic's engineering facilities is 12 hours away in California, which means that like many US-based software firms it can operate with an around-the-clock development and testing cycle. As Telelogic CTO Ingemar Ljungdahl points out, "with development in California and testing in India, we can now turn around new features in the project in 24 hours."

Carl Dujardin also notes that many of these challenges are easier to overcome in India because of the attitude of the workers. "People in Belgium are less eager and less optimistic compared to India. In India people are actively looking for opportunities and you can feel their enthusiasm."

6 IT SMEs in India: four cases

We met with four European SMEs in the software industry, ranging in size from less than 50 (DeDuCo) to over 800 (Valtech) employees. Each company had its own reasons for expanding offshore, faced different obstacles and came up with different solutions - but in the end all four were successful and demonstrate how European SMEs can develop and implement successful offshore strategies.

Even more important, these four cases show that even small companies can look beyond the cost advantages of an offshore workforce and leverage the significant strategic potential of an offshore capability into real competitive advantages.

6.1 DeDuCo

DeDuCo is a Customer Relationship Management (CRM) software product company with 14 employees in Kortrijk, Belgium and 30 in Bangalore (xsysys). The company was originally founded in 1986 by brothers Carl and Tom Dujardin. DeDuCo started out by selling “clone” PCs to business customers, but as the first laptops emerged in the late 1980s, they shifted their focus to offer complete CRM solutions. This approach requires a dedicated software development team, which they started building in Belgium in 1988, and eventually numbered about 30.

A shortage of skilled programmers began to emerge around 1994. Within a very short time, 18 people – about 60% of DeDuCo’s total development team – had left for better-paying jobs in banking and other industries. “Our company had reached a crisis point,” remembers Carl Dujardin. “Our efforts to recruit more engineers in Belgium through advertising were an expensive failure. It was a dead end – if we didn’t do something drastic we would go out of business.”

In December 1995, the founders attended an event in Brussels sponsored by India’s National Association of Software and Service Companies (NASSCOM), and were introduced to a number of Indian outsourcing firms. A short time later they started working with a major Indian IT services firm, and although there was little trouble initially in building a team with the right skill set, retaining the workers was another matter.

“The outsourcing firm couldn’t stabilize the team, and within a year we had decided to move into India on our own,” says Carl. Initially the company hired a local manager and oversaw operations from Belgium, but following a number of challenging managerial and cultural issues with the new team, Carl and his wife took the decision to move to Bangalore to head the operation there directly.

Early on, working in India came with a number of unique challenges that have largely disappeared in recent years. Dialup Internet connections were slow and unreliable; international phone service was almost unavailable, even from airports; and simple cultural differences caused a great deal of friction with the remaining workers in Belgium, even leading some of them to sabotage the fledgling operation in India.

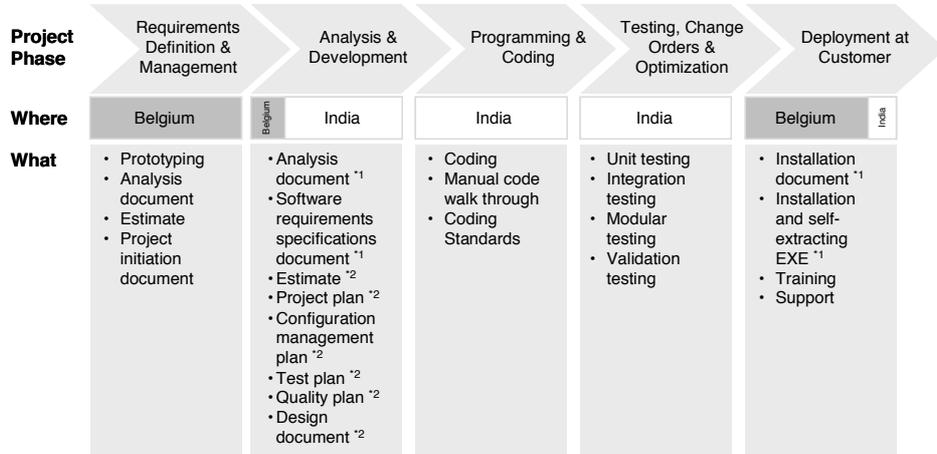
Carl counts the positive attitude of workers in India as just as important as their skills and number. “Part of the reason for this is material - in countries like Belgium, what is there to strive for if you already have a house, a car, and so on? For most people in India the sky is the limit. Indians who work hard can achieve in one year more than their parents ever dreamed of. Belgium is like a freight train on a track - people in India are a lot more flexible.”

Despite the risks it entailed, going to India gave Carl Dujardin the chance to virtually rebuild the company from scratch – and once the initial obstacles were overcome, the cost advantages left him not only with bigger profits, but also better cashflow and a more solid balance sheet. In other words, rather than just increasing the bottom line, the lower cost of doing business offshore turned a small, stable European software developer into an international growth business. The recent name change from DeDuCo Software Systems India to xsysys technologies is part of the current plan to increase the company's workforce tenfold to 300 and begin to offer IT services, as well as expand to reach the US market. None of this would have been possible if the company had simply stayed in Belgium.

The picture for xsysys in 2004 seems almost a different world from 1996. The Belgian and Indian offices are seamlessly integrated via a VPN, and international phone service is widely available and inexpensive. Furthermore a significant number of expatriate Indians are returning from working and studying in the US and Europe, a trend which helps to increase the overall level of professionalism as well as mitigate cultural differences.

Carl contends that in some ways India in 2004 is beginning to resemble Belgium in 1996, “and we’re losing some people to big companies.” But the lower operating costs in India mean that the company is better prepared to offer competitive salaries, and the xsysys brand also has an impact with the workforce in Bangalore that it probably wouldn’t carry at home.

DeDuCo's global product development value chain, outlined in the chart below, leverages the relative strengths of developers in Belgium and India to minimize costs and time to market. The development methodology they use is standard for the software industry – what’s different is where each of the steps in the development process takes place, and how they fit together.



Notes:

*1: Performed in India, reviewed and approved in Belgium.

*2: Performed 100% in India.

Exhibit 2: DeDuCo's global product development value chain

DeDuCo's value chain has also created innovative process capabilities that xsysys can now leverage in IT services. The activities, process steps, and capabilities are performed where they create the most value for the company and its customers. DeDuCo's new global delivery model is a key enabler of the firm's regained competitiveness and improved financial health.

The early stages of DeDuCo's product development - Requirements Definition and Analysis - have remained in Belgium, as the engineers there have direct experience with customers and understand their needs better. But low-level design, coding, and testing have all been successfully transferred to India. Once functional requirements have been translated into technical requirements, the coding and testing work is relatively straightforward and self-contained. Only when the new product is deployed at the customer is the Belgian team's involvement required again.

6.2 Telelogic

Telelogic, based in Malmö, Sweden, is a provider tools for advanced system and software development. The company originated as a unit of Swedish Telecom firm Telia, and originally developed tools for analysis & design and testing of embedded software for telecom switches and other devices.

In 1998 the unit was spun off into an independent company, and later acquired two more firms – QSS (UK) and Continuous (USA). As a result of these acquisitions, Telelogic now offers a complete solution automating the entire process for developing advanced software. The company currently has 40 offices in 28 countries and about 650 employees worldwide, with software development labs in the UK and California as well as Malmö. Telelogic was listed on the Stockholm stock exchange in March 1999.

As Telelogic makes tools for software developers, they originally entered the Indian market to sell their products there. Telelogic India started in April 2001 with two employees, and currently has a staff strength of 65 people divided into three groups: Sales and Marketing, Inside Sales for the US, and the Global Support Center.

Sales and Marketing provides pre-sales support, mentoring, consulting and training for the sub-continental market, including India, Sri Lanka, and to a lesser extent Pakistan.

Inside Sales works the night shift in India and calls qualified potential customers in the US. The group simply identifies prospects and passes the information on to the sales force. One of the advantages of doing this work from India is that it optimizes the use of office space.

The Global Support Center, created in late 2002, provides phone- and email-based support for customers worldwide, and on-site support for customers in India. 40% of the capacity worldwide for the GSC is in India, and all future expansion is currently targeted for India. Under current plans, India will have 50% of global capacity for the GSC by the end of 2004.

“We originally came to India simply to tap the market,” explains Sidharth Malik, Managing Director of Telelogic India. “But in the process we found there were other things here we could leverage for our operations in Europe and the US.”

The biggest market segment in India would appear to be with the outsourcing giants like Infosys and Wipro, but as Sidharth points out these companies have to use whatever development tools their clients use. “So they'll sometimes use our tools, but they won't standardize on them.”

But things are changing: Sidharth continues that smaller outsourcing firms, those with less than 500 people, need differentiators. “Smaller outsourcing firms can gain significant competitive advantage by using Telelogic tools, which make it easier for them to implement and manage development processes. Our tools help them deliver significant value to customer in terms of productivity, quality and time to market. As these companies grow rapidly, scalable solutions from Telelogic will help them manage the change better.”

“If an new outsourcing firm is already standardized on the same development tool as their target clientele, they enter the game with a significant advantage.”

Taking care of the Indian operations of US and European multinationals represents another important activity of Telelogic India. “One of our customers with a development here in India had a problem with a new product release, three days before the ship date. They told us they would have lost \$2.5M if the release had been delayed by the two to three days it would have taken to fix the problem via one of their support options in the US. But because of our support center we were able to send people on site to fix the problem in time.”

This experience has helped Telelogic make a departure from viewing India as simply a cheaper source of workers for the Global Support Center; the Indian team gives Telelogic a specific competitive advantage when serving multinational clients that also have critical operations in India. “As a result of our Indian Global Support Center we get more satisfied customers – and additional revenue – here in India as well as in Europe and the US.”

6.3 Valtech

Based in Paris, Valtech is a \$100M company that develops and implements advanced IT solutions for corporate clients in Europe, the US, and Asia. Valtech was founded in 1993 and has since grown primarily by acquisition. The company currently has about 800 employees worldwide and its clients include the likes of BMW, JPMorgan Chase and Vodafone.

Valtech Offshore, based in Bangalore, India, was created in 2003 following the creation of a joint venture with Indian offshore provider iVega. The iVega venture follows a 2001 partnership with Hexaware in Chennai (since terminated), and is expected to allow Valtech's presence in India to grow to 300 workers by the end of 2004.

Valtech developed their offshore strategy over a period of more than two years. During this time the CEO of Valtech made a number of trips to India that formed the foundation of a strategy exploration and development process. This was a time of active learning and listening for Valtech, and an opportunity to ask basic questions and make some early mistakes.

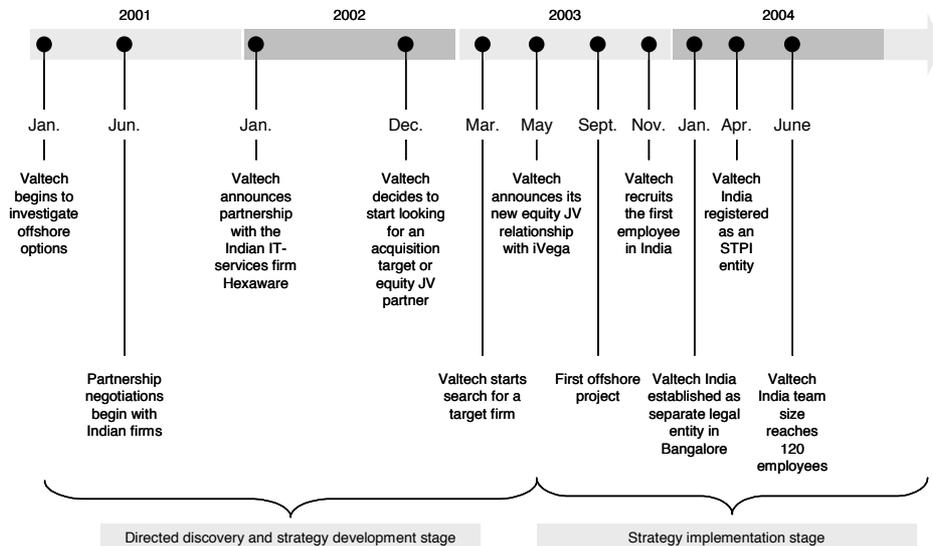


Exhibit 3: Valtech's offshore strategy timeline

As the timeline shows, once the fundamental strategic direction was set, Valtech's offshore operation was able to set up and grow quickly – and the rapid pace continues today.

But the Valtech CEO Jean-Yves Hardy also understood that the company's offshore strategy needed to achieve more than simply cutting labor costs. The global delivery model represents an innovation in process and organization design, and embracing this new way of doing business would require transformational changes to Valtech's operating and business model. Hardy believes that having an effective offshore capability is critical to the future success of Valtech as a whole: the new offshore capability will allow Valtech to break out of the small company trap, and reach a new growth and profitability trajectory that could not be achieved with Valtech's old business model.

As Hardy puts it, the initial reason for going to India was to centralize development. "We are an international organization with a flat structure - we wanted to do more implementation and maintenance following new engagements. But we discovered that none of the locations we already had was as good as setting up something from scratch. Our initial idea was not to go offshore, but to centralize development in a world class location. It's not the traditional cost-cutting story."

“If we didn't have India we would be niche players. We'd have to be the best at Java integration architecture, have the best programmers with the best CVs - we'd just be time and materials consultants with a high-end profile. There's a market for that, but it's not scalable. We are a small listed company, so we have a growth plan that analysts can cover and understand. Niches get you a profit but you stay small and don't exist any more for the stock market. India allows us to compete directly with the largest IT consultancies in the world.”

The biggest challenge Valtech faced at first was the change in the company's focus that would be needed to get the most out of their offshore strategy. Specifically the company would have to move away from the work it had specialized in during the dot com era, such as content management and portal development, and move towards the “back end” of Internet business. As a result Valtech could transition from time-and-materials consulting to maintenance and services.

European IT services firms are said to be entering a consolidation phase, in part due to increasing competition from offshore service providers. Valtech's offshore strategy – and the potential positive impact this strategy may have on the company's valuation – gives Valtech the opportunity to benefit from future consolidation instead of becoming an acquisition target.

Hardy also argues that “the days of consulting with a pen and notebook are gone. In operational consulting you have to come in with a solution or people don't take you seriously any more.” Multinational IT consulting firm can afford to take this expectation of prepackaged solutions in stride, and dedicate internal development teams to the effort, but smaller firms such as Valtech cannot.

“We want to leverage offshore for competitive advantage. It's easy to cut costs with administration, business process outsourcing, and so on. The second level is in performing strategic activities at lower cost than the competition,” in Valtech's case by developing prepackaged solutions offshore.

“All of our units are still fairly independent due to our inorganic growth,” says Rohan Joshi, president of Valtech Offshore in Bangalore. “But there are some obvious opportunities for cross-border cooperation. For example our biggest customer in Britain is T-Mobile, and in Germany it's Vodafone. Valtech's Worldwide Delivery Center (WDC) in Bangalore will become the glue that holds the company together – we're getting into global strategies for services we can offer the customer.”



Exhibit 4: Valtech's onsite-offshore delivery model

Valtech's WDC uses what it calls an onsite-offshore delivery model to serve customers in all of its markets. An onsite Valtech team works with the customer to assess strategy, define requirements, establish project plans and monitor progress, while the bulk of the work thereafter takes place offshore - with a single point of contact between project managers and developers.

“We believe that we need to have in front of the customers people with the same culture who hide all the differences with India,” according to Hardy. “Large Indian IT services firms essentially have Indian people everywhere in the world. But we believe that every company has its own type of people, and the way to be global is to add people in different places together.”

While this approach comes at a somewhat higher cost than a “pure offshore” delivery model, it minimizes the risk to the client while at the same time allowing Valtech to leverage its resources in India worldwide. The opportunities are also apparent for cross-border collaboration between Valtech offices in, say, Britain and Germany, because the technical work can be assigned to a single dedicated team in Bangalore while the appropriate local Valtech offices handle client-facing issues.

But Hardy argues that the greatest competitive advantage Valtech derives from its presence in India is scalability. The relative ease of rapidly finding and hiring large numbers of skilled workers in India compared to Europe gives Valtech a great degree of credibility when competing for large contracts. Many customers already know that simply by virtue of having an established presence in India, companies like Valtech can take on far larger projects than would be possible if their operations were restricted to Europe. As a result Valtech has recently been shortlisted for large contracts with European and American multinationals, alongside competitors more than ten times their size. And many of the new opportunities include maintenance and other activities that provide a smooth revenue stream.

6.4 Case Consult

Case Consult is a privately held IT services firm based in Wiesbaden, Germany. The company was founded in 1988 and has about 200 workers worldwide, more than half of which are in India.

Case Consult's first contact with India came about in 1992. The company was contacted by a German bank for a major database migration initiative. The bank had already spent several months on the project with a major multinational IT consulting firm, with unsatisfactory results. As a result they were more than willing to take a chance on a newcomer, even though the project was far larger than anything Case Consult had undertaken to date.

In order to find a solution Case Consult visited a firm in Oakland, California that had successfully undertaken a similar database migration. They were surprised at the global nature of the project: the project leader happened to be Chinese, and much of the heavy lifting was being done by Tata Consulting Services (TCS) in Mumbai - and this was at a time when the most efficient way to send data and code to and from India was by courier, on magnetic tape.

Case Consult's initial interest in this early offshore project stemmed only from the fact that TCS and its client in Oakland were using the same data conversion tool that Case Consult wanted to use with the bank's database. "We'd never heard of India before," recalls Jens Borchers, Case Consult's technical director, "but at this point we asked ourselves if our project couldn't be done globally as well." The company decided to subcontract TCS for the database migration, and a few months later had established the first direct satellite connection between Germany and India - specifically for the project - which became TCS's largest project in Europe.

"At the time, we weren't even aware of the potential cost savings in India," remembers Borchers. "As a result, the project was very profitable - for TCS." The database migration project was successful, and Case Consult, TCS, and the German bank soon started on a followup project.

Borchers also saw early on the impact of high employee turnover in India. “The second project did not go nearly as well as the first,” according to Borchers, “because many of the best people at TCS left the company as soon as the first project was complete.”

While Case Consult's early projects were not all resounding successes, from very early on they gave the company crucial insights into the advantages India has to offer as well as the potential pitfalls of doing business there. Case Consult opened their own office in Thiruvananthapuram in January 1995 with 10 people, making them the first German company to develop software in India. The office has since expanded to 120.

Borchers remembers that most of the problems the company faced getting started were infrastructure issues. While India's less-than-dependable power grid means that backup generators and UPS systems are simply part of everyday life, getting a suitable system installed and working can be a formidable challenge for a small company.

But the backup power supply represented only one in a series of unexpected expenses for Case Consult. One of the first challenges the company faced was getting workers to and from the office. “We ended up setting up our own public transportation system for the employees,” recalls Borchers, “and today we own three buses for this purpose.” Even some mundane items like office furniture have proven far more expensive than expected.

But as time went on Case Consult's insights and experience in India have translated into significant wins for the company and its customers. One recently completed project involved a programming language conversion of several hundred programs for an Austrian financial organization. As Borchers describes it, “this project was completed in less than 18 months, a duration that other competitors of significantly larger size – and one which was even already a supplier to the client – had assessed as ‘totally impossible.’” Despite the fact that this was the first project of this size and the first undertaken using outsourcing, the project was successfully completed within budget and within schedule. “This project would never have been possible without the Indian teams,” contends Borchers.

“We achieve about a 20% cost savings by being in India, but our clients expect this anyway.” The real keys to competing, argues Borchers, are flexibility and scalability. “Even when we were much smaller, we competed directly with large and established IT consultancies. Our presence in India allows us to scale easily for large projects, and makes it affordable for us to maintain a bench to absorb fluctuations in demand.”

7 Strategy regeneration – offshore

Each of the four companies found a way to leverage their offshore activities for competitive advantage. The companies did not go to India simply to cut costs, but to make a fundamental change in the way they do business. After taking the initial risks in India, each company used the new opportunities found there to regenerate their core strategy and create new value.

Of the four companies DeDuCo perhaps took the most straightforward approach. Due to the company's small size they had the most to lose by “staying the course” with an outdated strategy, and consequently the most to gain from leveraging their investment offshore.

As long as DeDuCo remained in Belgium, its only competitive advantages were its thorough understanding of the European market for CRM software and experience in developing CRM software - but the company's history has shown that these advantages were only just big enough to have kept the company in business.

Expansion in India allowed DeDuCo to pursue an entirely new strategy and enter the market for IT services, and this new strategic option was enabled by two competitive advantages that were a direct result of the company's foray into India: the much-improved financial situation that resulted from lower costs in India combined with a revenue stream from Europe, and the in-depth understanding they built over time about how to recruit and retain a skilled workforce.

By taking the business to India, Carl demonstrated strategic leadership. He recognized that incremental changes to DeDuCo's cost structure would not be sufficient to save the company. It was clear to Carl that the core capabilities and resources of his company had been so severely diminished that he could not wait for the market conditions to improve in his favor. His radical step of rebuilding the company from scratch in Bangalore created a unique opportunity to reinvent his company: he realized every entrepreneur's dream of being able to start over again.

Once Carl had succeeded in putting DeDuCo on more solid footing, as well as transforming its financials, Carl realized that he could pursue new strategic opportunities by leveraging Bangalore's unique locational advantages. This insight is what led to the creation of xsysys, an IT-services firm with ambitions of entering the US market. The entry into the global market for IT services was directly enabled by the move to Bangalore; it simply would not have been possible had he remained in Belgium.

When Telelogic set up its Global Support Center, which provides phone and email-based support to Telelogic customers around the world, it located 40% of the workforce in India to take advantage of the ready availability of talented, inexpensive software engineers. The company's customers are software developers from around the world, and many of these companies have been expanding in India for the same reasons. Telelogic's competitive advantage in India emerged when the company realized that their Global Support Center could also provide onsite support to multinationals with software development operations in India, which has led directly and indirectly to new revenue opportunities for the company both in India and abroad.

Valtech is the largest of the four companies we explored and perhaps also the one with the most diversified offshore strategy. As an IT service provider, it was keen to enter India to gain the cost advantages of the country's workforce. But sooner or later every company in IT services will either have significant operations offshore, or be driven out of business by those firms that do. So it's not easy for a firm like Valtech to leverage the cost advantage into a competitive advantage.

Instead, Valtech's new strategic direction is enabled by scalability - the company can leverage the size of India's workforce and the ease of hiring there to compete head-to-head on large contracts with much bigger rivals. This growth strategy is driven in part by the fact that Valtech is a public company - the new opportunities the company gains by having a strong presence in India are in part reflected directly in the company's stock price, which in turn can be used to fund Valtech's further expansion and pursue a variety of new strategic options. As Hardy puts it, "I can be an entrepreneur again. We can afford to take risks again."

Case Consult, while much smaller than Valtech and privately held, has also been able to benefit from the strategic options enabled by scalability in India - like Valtech they can undertake much larger projects than their size would allow if they were restricted, like many of their competitors, to operating in Europe. As a very early entrant in India, Case Consult also derives substantial competitive advantage from the depth and scope of their experience there. The company is able to reduce employee turnover in part by operating from Thiruvananthapuram rather than Bangalore, and Case Consult's substantial experience in India helps it make the offshore component of project work transparent, and often invisible, to its customers.

By having a presence in India, European SMEs can regain and exploit the inherent competitive advantages one would expect from a well-run SME: value for money, agility, and responsiveness. And all four companies are moving beyond cost-cutting and process optimization, and using their presence in India to develop entirely new strategic options.