Topic Name: NLI & Competiveness of Indian IT industry

Table of Contents

1 Executive Summary

The Indian IT industry juggernaut has been chugging away at an impressive growth rate over the last two decades. It institutionalized the pioneering Global Delivery Model (GDM) and then enhanced the same to a level of maturity that allowed non-Indian MNC players to leverage this framework to chart their India growth story. While decades of consistent performance and strong corporate governance have helped build a strong credibility for the Indian IT industry, its growth rate is being seriously challenged by both established players and new entrants. The strong differentiations of GDM, Process Maturity (CMMi, Lean, Six Sigma etc.) and to an extent Labour Arbitrage seem to be running out of steam. The Indian marketplace has transformed significantly over the last 5 years to pose a set of unique challenges to the Indian IT Leadership. Some of the key ones include - deployability of graduates, escalating staff compensation, inflation, currency fluctuation and protectionism as a fall-out of the 2008 economic recession.

As the cliché goes, when the going gets tough, the tough gets going. The visionaries among the Indian IT industry community stood up to this challenge by proposing a model that allows de-coupling of revenue growth with proportional labour input. Such a framework is typically called Non Linear Model (NLM) by industry practitioners. In this model, revenue generation is more a function of usage and business or innovation value delivered as opposed to input (i.e. resources). NLM typically leverage alternate pricing models that belong to two broad categories: a) output based; b) outcome based. Morgan Stanley research report of March 2010, indicate that the first model is characterized by "gain sharing" philosophy with clients, the other model is based on "risk reward". Extending their argument, the report believes that

NLM is expected to help companies improve rate realization per employee and drive higher profitability. As a practitioner, it is important to reiterate that NLM assures clients of higher predictability and quality of services while leveraging elements of value based pricing.

Having appreciated the potential of NLM, let us understand its current level of maturity. The top tier Indian IT service providers have made rapid strides towards adopting and enhancing this model. While some have chosen the product or platform route, others have started delivering services. It needs to be mentioned that most of these companies are still in their infancy of developing a holistic Non-Linear Model that not only addresses their internal objectives but helps clients in their transformation programs. Consequently, true non-linear revenue for top tier Indian IT companies is still a small portion of their total revenue.

The document takes a close look at this NLM journey and attempts to explain how interested companies can adopt and implement this framework at a fast clip. It is expected that a practitioner's perspective will help address the typical issues and challenges in traversing the NLM path that is relatively new and filled with promises. Leveraging the NLM framework will surely enable the Indian IT companies to gain competitive advantage and further consolidate their position in the global marketplace.

2 The NLM Journey

2.1 Non-Linear Models: Overview

The Non Linear Model journey can be looked as an evolution from the traditional "Project Management Triangle" constraints of <u>Scope</u>, <u>Time</u>, and <u>Cost</u> along with <u>Quality</u> to a three dimensional focus of Tomorrow's Organization that speaks to <u>Client</u>, <u>Employee</u> and <u>Shareholders</u> (i.e. Organization). NLM based business initiatives are aligned to either reduce client's Total Cost of Operations (TCO) via several Operational Transformation programs or enhance business processes in the client value chain through Business Transformation engagements. It might be noteworthy to mention that the some of the benefits accrued to the service providers include increased revenues and higher profitability.

Indian IT service providers can potentially leverage three tracks of initiating NLM based business initiatives. They include:

1. Services: This can be achieved by providing a specific set of services leveraging a framework of tools and processes along with modern infrastructure. Examples include FlexDelivery based Outsourcing services provided by Wipro

2. Platform: This calls for developing process centric solutions on a technology platform of choice of the service provider. Examples include Infosys' Source-to-Pay (S2P) or Wipro's Loan Origination solutions to serve their respective clients

3. Product: This calls for incubating one or several products aligned to certain industry segments addressing an end-to-end process in the value chain. Examples include BaNCS from TCS and Finacle from Infosys providing core banking solutions

2.2 NLM Vehicles

Let us examine the different vehicles leveraged by service providers to deliver business or innovation value to its clients via NLM.

1. FlexDelivery: It is an innovative multi-tenanted delivery model that enables specified set of services to be accomplished in a consistent and predictable manner through its state-of-the-art infrastructure and a cohesive set of tools and processes leveraging industry best practices while ensure clients' IP and data are completely secured. It is characterized by delivering services for a pre-defined scope based on process standardization and leveraging a shared pool of experts, tools and infrastructure. This model is based on the principles of economies of scale. Examples include Wipro's Operational Transformation services for its marquee clients in the SAP and Oracle EBS businesses.

2. Platform BPO: It is a comprehensive offering to address specific business processes of clients by leveraging Consulting, Infrastructure, Technology and BPO capabilities of a service provider. Examples include Wipro's .Net based Loan Origination and Infosys' SAP based Source-to-Pay solutions

3. Productized services: Such solutions address either a niche area or a sub-industry business process or the intersection of technologies and are characterized by their

ability to meet multiple client needs. They harness the deep domain, product and industry expertise of the service provider along with its savvy sales and marketing skills to provide these services at a competitive price point. Examples include Wipro's smartUtil or IBM's Smart Metering solutions. The former is a template-based SAP solution addressing Utility retail business processes specifically customer care and billing.

2.3 NLM Commercial Models

With increased maturity in the IT consulting world, both clients and service providers seem to be appreciating the benefits of alternate commercial models such as Output-based and Outcome-based. We aim to examine these two models in terms of its current adoption and challenges.

1. Output-based model- A resource-based commercial model is counterproductive to a win-win partnership that clients seek to build with select service providers. The latter is less incentivized to continuously improve performance over a period of time and consequently its client relationship typically gets impacted. However, NLM enables service providers to evolve their IT consulting offerings in a utility based model. Some of these firms have adopted an output based pricing model that charges services rendered to clients in a "pay-per-use" mode. A few examples include:

   o Service related: Fees charged based on number of tickets solved or number of users served or number of enhancements delivered

- o <u>Solution related</u>: Rate card based pricing based on Volume of Spend Data processed or Number of Pay Cheques processed

Some of the typical challenges faced in this model include:

i. Its success depends on a certain level of maturity within the client organization including a degree of transparency between both partners – client and service provider

ii. It falls short to address dynamic client environments

iii. The cornerstone of this model is based on reliable baseline data of the client IT landscape. Additionally, it calls for defined boundary conditions to ensure the model is a win-win for both parties. Both aspects have challenges and are evolving at this point in time

2. <u>Outcome-based model</u> – A far more radical alternate pricing model is outcome-based. Its philosophy is based on a "gain-sharing" model wherein both the client and service provider share the risks and rewards. This allows for true partnerships to foster between the concerned parties. Examples include the Wipro-Aircel deal that is structured to generate Wipro's revenue based on Aircel's success on pre-defined metrics.

Some of the typical challenges faced in this model include:

i. Needs extremely high degree of maturity across clients and service providers

ii.   Some service providers believe that there are a number of variables that impact the outcome, hence the risks are too high to engage in this commercial model

iii.   Evolve a framework that enables both service providers and clients to measure outcomes at different points to ensure that vendor pay-outs can be planned appropriately

To conclude, it must be mentioned that the current alternate pricing models are dominated by the output-based model; while many service providers claim that they are leveraging outcome-based model. The future growth and success of Indian IT industry is largely dependent on creating strong differentiations via channels such as outcome based model.

3   NLM: Implementation Plan

3.1   NLM: How to get started

This document attempts to define a NLM framework that will potentially help leadership teams embrace and implement the Services led Non-Linear model in their respective organizations. The framework is outlined as below:

1. Define the NLM goals – Clarity of goals is an absolute must

2. Identify the team – Pick the best team

3. Build and Empower the team – The team should be enabled to execute the Grand Design

4. Build awareness – Ensure every member of the organization is aware of this initiative. Repeat this process

5. Ensure Top Leadership commitment and buy-in – Half-measures rarely work; the top leadership need to sign-off on the goals and required support to make this happen

6. Identify the pilot program – Start small. Be selective in picking a representative program from the portfolio; neither too simple nor complex

7. Execute the program – Run this pilot program as well as your best client engagement

8. Schedule a program de-brief – We rarely have all the answers to all our questions. Be prepared to learn; unlearn from this pilot program. Re-visit and finalize the framework

9. Roll-out the NLM framework – Launch the NLM wave and baby-sit the identified programs to ensure 100% success

While detailing out this framework, this document will highlight the significance of Organization Structure and Systems, Talent Management and Change Management in making NLM a success story from a Services stand-point.

3.2 NLM: How to execute

Experience suggests that for an organization wide initiative to be successful, the goal post cannot keep shifting. It is also important to note that NLM needs to address the three key constituents of the services industry: Client, Employee and Shareholder (i.e. Organization). More often than not, such initiative becomes inward focused, more specifically catering to just one constituent – the Shareholder/ Organization. Hence, the NLM execution plan needs to holistic.

Let us examine the success of the FlexDelivery Model led Services based NLM at Wipro.

Forrester's March 2010 report on "Maximizing Innovation from ERP Service Providers" mentions that leading firms operating in the Non-Linear Model, such as Wipro with its FlexDelivery approach, balance shared and dedicated resources and also empower clients to name competitors with whom they would not want to share resources or IP. Wipro's FlexDelivery Centers (FDCs) are helping its marquee global clients realize their Operational Transformation goals across multiple platforms. The Forrester report further argues that such services that can be shared across multiple clients to help service providers manage market demands of higher service quality at highly competitive price points. It goes on to say that, "Systems integrators (SIs) often maintain these multi-client shared services at lower, more commoditized service layers — where resources can be easily shared and interchanged across

clients. But now SIs are leveraging shared service models across higher levels of domain expertise, such as FI/CO skillks in SAP. This allows clients to benefit from economies of scale and also allows greater efficiency in training of resources because they will not be limited to experience from one account".

Below are the key focus areas of the NLM execution plan:

1. Client Perspective:

   i. Voice of Customer: Involve key client representatives in ensuring that this initiative is well conceived and is geared towards providing value in the mid to long term horizon.

   ii. Evolve a strategy that facilitates building solutions for clients' end-customers. Such solutions should help in faster time to market, enhance outreach including new markets, Sustainability and Green objectives.

2. Employee Perspective:

   i. Ambiguity and Lack of communication can kill the best of initiatives. As a critical part of the eco-system, it is essential that they understand the objectives of such a program. Potentially, they can be leveraged to infuse fresh and innovative ideas to make this program a success at the ground level.

   ii. Employees need to appreciate the significance of this initiative w.r.t their skill enhancement and career progression. How will their lives change for the better?

This question needs to be addressed in the best possible manner and with a fair degree of honesty and transparency.

3. Shareholder/ Organization:

    i. Leaders need to view this initiative as one of the biggest Change Management programs executed in the history of Indian IT industry. The mindset shift from an ODC (Offshore Delivery Center) based model to a FDC one is not easy. As much as our penchant for drawing lessons from the Manufacturing Industry, it is foolhardy to assume that the nature of the workforce across Manufacturing and IT is the same. While the former is predominantly, an "order taker", the latter at least believes in "thinking and executing". Added to this complexity is the burgeoning population of a younger workforce that is far more mobile and connected. This calls for a significant change in Talent Management – hiring, training, and mentoring leading to building leaders of Tomorrow.

    ii. Given the proliferation of new models such as NLM, the bastions of traditional Organization structures or Competency needs are being challenged. The organization of tomorrow will seek to implement a flat structure that incubates multi-discipline talent and leadership that is geared towards the future needs.

4 NLM: Challenges and Results

4.1 NLM: Client Perspective – Challenges and Results

The Voice of Customer for a NLM based Services led business initiative suggests the following key challenges:

1. Perceived lack of transparency

2. Prioritization of work between clients (Time, Quality, Cost)

3. Perceived lack of personalized attention

4. Security/ Regulatory issues

5. Uncertainty in the volume of work

Having said that, clients leveraging NLM often share their satisfaction at the following results:

1. Enhanced predictability and quality of services

2. Variability of pricing structure

3. Deeper understanding of client business processes and estate allows partner to be engaged in Transformational initiatives

4.2 NLM: Service Provider Perspective – Challenges and Results

The challenges emanating from the Voice of Service Providers for a NLM based Services led business initiative need to be considered along the following dimensions:

1. Internal Challenges:

    i.   Change Management – Perception of losing "control"; Adoption of tools and processes

    ii. Differences in the rhythm of running ODC based engagements and FDC based ones

    iii. Commensurate Compensation

2. External Challenges:

    i.   Security/ Regulatory concerns

    ii. Client mindset of "touch and feel"; struggling to get away from resource centric mode

Notwithstanding, the above challenges, service providers seem bullish on the results achieved so far. Some of them include:

1. Enhanced SLA compliance and process compliance via strong adoption of ITIL V3 framework and associated processes/ tools

2. Significantly enriched learning environment for consultants

3. Improved productivity of consultants

4. Re-usability and/ or Extensibility across platforms

The Forrester report mentioned in the earlier section also states that, "Attrition and talent retention is a top concern for SIs, and the recovering economy and positive outlook for 2010 mean greater risk of attrition, particularly in key geographies like India where talent retention has been a significant concern. Furthermore, with significant numbers of first-year "freshers" joining the workforce, fast training and ramp up is crucial to maximizing the overall value

pyramid. Leading SIs are building models that expose junior hires to multiple projects and types of work to maximize their ramp-up, either through shared services models, like Wipro's FlexDelivery approach".

Hence, it can be said that NLM is akin a budding prospect; it still needs significant "work" with the required dedication and focus to ensure that it delivers on its potential.

5 NLM: Success Metrics

5.1 Client Perspective

As one of the most important stakeholders of NLM, client related success metrics are key to the adoption and evolution of this model. Below are some of the key metrics:

i. Improvement in CSAT (Customer Satisfaction) rating or NPS index (Net Promoter Score)

ii. Improvement in – a) On-time/ lower resolution time; b) On-time/ faster delivery time and productivity

5.2 Employee Perspective

How is NLM impacting employees? This million-dollar question begs serious answers and hence critical to examine a few key metrics:

i. Increase in number of functional and technical trainings

ii. Increase in number of cross-skilled/ multi-skilled employees

iii. Improvement in ESAT (Employee Satisfaction) score

5.3 Organization Perspective

Typically, an organization might consider three categories to define NLM related metrics. They include:

a. Innovation:

i. Increase in number of knowledge artifacts

ii. Increase in number of IPs created

b. Growth:

 i.   Improvement in deal win-ratio leveraging NLM vis-à-vis traditional model

 ii. Increase in revenue linked to NLM vis-à-vis traditional model

 iii. Increase in NLM revenue with a pre-defined agreed OM

c. Operations:

 i.   Improvement in EBITA per person

 ii. Ability to scale EBITA

6 NLM – Looking Ahead

6.1 NLM – Crystal Gazing

NLM has evolved over the last decade from a theory to proof-of-concept to fairly successful execution model. Has it fulfilled its promise and potential? Guess, most Indian IT industry leaders would concur that the envelope is yet to be pushed. Most of the top players have "experimented" NLM in large "Labs"; results are encouraging. Yet a combination of client and service provider maturity levels result in abysmally slow progress. Below is a depiction of the evolution of NLM through the author's lenses.

Key assumptions considered in developing the chart above include:

- Client profiles include Fortune 1000 organizations

- Chart depicts both service offerings and delivery models

Based on my understanding, the following steps should help in providing an impetus to NLM and consequently enhancing the Indian IT success story:

1. Focus and Funds for NLM based initiatives

2. Greater transparency between clients, employees and shareholders (i.e. organization)

3. Execution excellence of the "Lab" work and its ability to scale such success stories

7 Bibliography

Key references include:

1. www.wipro.com
2. www.infosys.com
3. www.tcs.com
4. www.ibm.com
5. www.gartner.com
6. www.forrester.com
7. www.nasscom.in
8. www.morganstanley.com