Non-linear models
Driving the next phase of growth for the Indian IT Industry
The Indian IT industry has entered the post-adolescent stage now. Since its birth in late ’70s and 80’s, it has seen birth of a sibling (BPO) in 90’s. It has seen two inflection points, Y2K and DotCom, which propelled its growth and then has seen atleast two economic shocks during DotCom bust and 2009 meltdown - making him a “man” out of adversity.

However, now it is facing major challenges and opportunities. The tax holiday has ended, MAT on SEZs have made them irrelevant, competition from other “offshore” countries is increasing and multinationals like IBM and Accenture have cracked the Indian model. The labor arbitrage can not sustain for more than 10-12 years.

The industry needs to reinvent itself. It needs to define a compelling new business model. The industry needs to dramatically change revenue per employee equation, thus bringing “non-linearity.” Can it do it? In order for it to succeed, many factors will have to fall in place. The ecosystem involving the government, trade bodies and academia is missing maturity and involvement of two critical components - (1) Consultants / Advisers (strategy, accountants, lawyers) and (2) VC/PE community. When they all work in tandem with the industry, the transformation will come.

Pradeep Udhas
Partner and Head
IT - BPO Sector
KPMG in India

“Indian IT industry has to change its business model whereby it can create more value to its customers by facilitating business process transformation, using technology innovations. Indian companies can no longer sit back and expect to do low-end work as what they have been told to do by their customers as in the past. This paradigm shift would require IT companies to acquire in-depth understanding of their customers’ business and consulting skills to advocate and facilitate business process changes. Vertical domain specialization within their hitherto technology horizontal operation will be a key requirement going forward”

VK Mathews
Chairman - India IT Summit 2012 &
Executive Chairman - The IBS Group
Our thanks to these leaders for their insights

Mr. N. Chandrasekaran  
CEO & MD,  
TCS

Mr. Bhaskar Pramanik  
Chairman,  
Microsoft India

Mr. Vineet Nayar  
Vice Chairman & CEO,  
HCL Technologies

Mr. C. P. Gurnani  
CEO,  
Mahindra Satyam

Mr. Harsh Manglik  
Former Chairman NASSCOM, and Former Chairman and Geography Managing Director of Accenture-India

Mr. N.V. ‘Tiger’ Tyagarajan  
President and CEO,  
Genpact
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**Glossary**
The Indian IT-BPO industry today stands at an inflection point in its evolution. While, the industry expanded from a mere USD 8 billion in 2000 to USD 88 billion in 2010, contributing significantly to India’s economic progress over the last decade, business leaders now agree that the next decade will be substantially different from the previous one, in which new business models will emerge to deal with a rapidly changing marketplace and customer needs. Thus, while remarkable progress has been exhibited by the Indian IT-BPO industry in the past, the future brings increasing complexity.

The industry has had its share of turbulent times; it has grappled with adverse protectionist policies, visa regulations, falling discretionary spends and slower scale of adoption in newer markets. Market conditions have become tougher due to heightened competition among vendors, emergence of other low-cost destinations and increasing maturity of clients now demanding more accountability. Technological disruption is shaking up the vendor landscape, where players are racing against time to respond to change. Domestic regulatory environment comprising of issues of taxation, transfer pricing and lax IP Protection laws are further adding to woes of the industry. But the most important challenge of all is perhaps the employee conundrum. With rising attrition, wage inflation and non-availability of skilled employable talent pool, companies are wondering what their strategy should be in an industry which has traditionally been highly people-dependent.

**IT-BPO Industry Challenges**

- **Geopolitical** - Protectionist policies, new visa policies, falling discretionary spends, emerging markets not compensating for overall decline
- **Market Conditions** - Increased competition among vendors, low-cost destinations, Client maturity, high-end services eluding Indian players
- **Socio-Technological & Cultural** - Social media, mobility, convergence, disruptive, technologies
- **Regulatory** - Taxation, IP protection
- **Human Resource** - Attrition, wage inflation, huge employee base, employability.

At this critical juncture, firms need to look beyond the conventional linear growth models and turn to innovative non-linear forms of growth.

---

1. NASSCOM Strategic Review
Based on the industry trends, KPMG has identified 7 emerging models increasingly being adopted by companies to accelerate their non-linear growth. They are:

**Non-linear Models**
- Intellectual property
- Cloud computing
- Platform BPOs
- Non-linear pricing models
- Delivery accelerators
- Branding
- Mergers and Acquisitions.

- **Intellectual property** so that companies can monetize their intellectual property portfolios
- **Cloud computing** to use flexibility, scalability and cost benefits made available through the ‘as-a-service’ paradigm
- **Platform BPOs** to use a common business platform for multiple clients & services
- **Non-linear pricing models** linking client expenses to business outcomes or usage instead of headcount and effort spent
- **Delivery accelerators** to deploy reusable tools across multiple customers accelerating set up time and attaining efficiency
- **Branding** to command a premium over competition
- **Mergers and Acquisitions** as means to acquire new ideas, clients, service extension, patents and enter new markets.

Today, there is an urgent need for innovation on multiple fronts – across products, services, delivery models, pricing and branding, a need further accentuated by the recent slowdown. We believe it will be a combination of all these factors that will equip the Indian software industry to stay on top of their game, at an equal footing with global giants and transform India to a technological behemoth from just being the world’s back office.

At this watershed moment in the Indian IT-BPO industry, all important stakeholders in the technology ecosystem comprising service providers, clients, government, industry bodies, academia and consultants will need to work cohesively in order to develop a long-term, holistic growth strategy. The government’s role here is envisioned to be multifold, in creating an environment conducive for innovation, rationalizing tax structures and transfer pricing laws, building robust infrastructure and aiding in domestic growth through e-governance measures. It is the Academia’s imperative to nurture the next generation of talent, by fostering a thinking mindset, offering vocational training for ‘ready to work’ human capital and promoting partnership with the industry to prepare students as they enter the workforce. A more proactive role should be played by private equity funds and venture capitalists by identifying early stage technology start ups and nurturing them through their lifecycle.

Of course, one of the most important stakeholders, the client, will have to shed its inertia and seek transformational deals with service providers, who they should see as strategic business partners. Joint initiatives for new technologies, an open mindset, transparency and calculated risks would help contribute to this end. In that last endeavor, consultants would come into the picture keeping vendors and clients ahead of the curve and help conceptualize new products and markets based on their experience and exposure.

With successful adoption of the seven models of non-linear growth and incorporating them in their strategy, Indian IT majors can emerge as this decade’s leaders in technology, pioneering the next phase of exponential growth.

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2. India IT Services, Primer on Non-Linear Pricing Models and Their Implications, March 2010, Morgan Stanley
Very few industries in modern economic history have replicated the success story of the Indian IT-BPO industry. The industry, which was almost at nascent stage till late 1980s, grew at tremendous pace after early 1990s. The IT exports have grown by 100 times over the last 15 years. The Indian IT industry has witnessed five distinct stages through its evolution. It has faced different circumstances and challenges, and has emerged triumphant at each stage.

**The 1970s: Birth of Indian IT Industry**
The Tata group (in the late 1960’s) has been instrumental in the inception of the IT industry with the establishment of Tata Consultancy Services. As software development could not come to India, Indian programmers were sent to developed countries. Towards the later part of the decade, the government began to realize the potential of Information Technology, and gave the go ahead for setting up the National Informatics Centre (NIC) in 1975.

**The 1980s: Setting up of new IT firms**
As the 1970s gave way to the 1980s, the IT industry experienced a radical transformation. On the domestic front, policy reforms that reduced costs of imported hardware and software caused the Indian software industry to shift from supplying programmers to supplying software programs. Huge cost arbitrage and English language skills were the other two most important competitive advantages which India had in its favour. Government policy also changed to a supportive stance during the 1980s; and a New Computer Policy (NCP-1984) consisting of series of measures to encourage the growth of the IT industry was framed. In 1985, all the software export revenue was exempted from income-tax. Domestic firms shifted from exporting programmers to outsourcing custom software while few others started venturing into product development.

**The 1990s: Booming of India’s IT sector**
The 1990s were the turning point in the story of India’s IT industry. The economic reforms of 1991 reduced tariffs and other taxes that were plaguing the industry. The 1990s also saw the return of IBM to India, which sent a positive signal to other global majors that India’s IT industry, was open for business. Several new Indian IT firms were started during the decade, which also saw TCS, Infosys and Wipro pull ahead of the pack to emerge as the market leaders by the end of the decade. These firms started scaling up increasing their global reach in small but eventful steps in global outsourcing market which was dominated by global IT players.

**2000-2010: Surging ahead – Indian becomes IT behemoth**
The past decade witnessed an explosive growth for the industry. It has surpassed all expectations, and has become a behemoth today. The IT-BPO industry is a significant growth catalyst for the Indian economy and has grown 11 times in the last decade, up from USD 8.2 billion in 2000 to USD 88.1 billion in 2011. IT services continues to be the largest share of all segments followed by the BPO, ER&D segment and the hardware industry.
India’s IT-BPO Industry Journey

- High import tariffs
- Software was not an "industry"

**IT in Enterprise**
- IT viewed as a "support" function
- Computing limited to mainframes
- IT processes not established
- Business focus was to make IT scalable

**Government**
- Government decides to promote indigenous IT industry
- IBM becomes preferred partner, centers most of the domestic market
- Sets up NIC in 1976

**Industry**
- TCS is a major player among domestic firms
- Steps taken to promote IT hardware manufacturers
- End-users such as banks used Indian firms to convert existing applications software into IBM-compatible versions
- Indian companies start sending programmers overseas

**Trade**
- By the end of 1980s, there were 21 firms with annual exports of USD 4 million

**Sources:**
5. Origins and Growth of the Software Industry in India, Rafiq Dossani, Stanford University
6. NIC Website
7. Offshoring Why businesses launch IT operations in India, Sep 2010, Silicon.com
8. "Offshoring Why businesses launch IT operations in India," Sep 2010, Silicon.com
10. NASSCOM Strategic Review 2011
11. "BPOs hunt for recruits among various professionals," Dec 2010, Daily Shiksha

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**Indian IT-BPO Industry**

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports (USD Mn)</th>
</tr>
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<tbody>
<tr>
<td>1979</td>
<td>4</td>
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<td>1989</td>
<td>128</td>
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<tr>
<td>1999</td>
<td>58</td>
</tr>
<tr>
<td>2009</td>
<td>708</td>
</tr>
<tr>
<td>2020</td>
<td>1008</td>
</tr>
</tbody>
</table>

- India opens up in 1981
- Increasing IT output, favorable atmosphere towards outsourcing
- Global Market Opportunity

**IT in Enterprise**
- Automation gains traction
- OIC’s role comes into being
- Business focus was to accelerate time to market with new IT capabilities
- IT processes get defined for different business functions

**Government**
- Government allows Indian firms to operate their own dedicated transmission links

**Industry**
- IBM returns to India in 1982
- Application Development, Maintenance, and Integration projects start moving to India from US clients
- IBM IT majors pick up pace to start pitching for global projects
- Birth of the Indian RPO industry: outsourcing limited to data processing and data entry tasks
- Availability of huge unexploited pool
- Pricing of contracts primarily effort based

**Trade**
- IT exports reach nearly USD 4 billion by the end of the 90s

**IT in Enterprise**
- OIC gains prominence
- Value seen in end-to-end management of IT as a tactical cost-center
- Processes better defined and institutionalized as core vs. non-core processes

**Government**
- 5-Government initiative accelerates
- NASSCOM established
- NASSCOM & LO services opened to competition
- 24x7 Internet telephony, mobile services launched

**Industry**
- Y2K contracts in early 2000’s bring volume to business
- New service lines such as KPO, LPO introduced
- Outsourcing bubble bursts, impacts global IT spending in the early part of the decade
- BPO industry acquires scale, employ over 750,000 people
- MNC IT firms acquire scale in offshore operations: IBM, Accenture lead the pack
- High end application development, analytics, infrastructure management projects outsourced to India
- Indian firms spread their wings to Europe
- Global acquisitions by Indian firms
- Indian industry starts undertaking new advanced level IT services like Business Analytics, ERP, Cloud etc.
- Vendors venturing into providing hosted/co-located environment
- Mix of TAM and fixed price contracts

**Trade**
- IT exports reach nearly USD 60 billion by 2010

**IT in Enterprise**
- Enterprise-wide, borderless strategy becomes a norm
- IT viewed as strategic means to achieve business objectives
- OIC viewed as a business partner
- Standardized processes leading to internal efficiencies

**Government**
- Aims to increase revenues of IT-BPO industry to 320 billion USD by 2020

**Industry**
- Firms move to Tier 3/4 cities to scout for talent and reduce cost
- Indian players undertake high-end strategic tasks for clients such as business consulting and transformation
- Indian players focusing on high-end services such as consulting, business analytics, engineering design services, product innovation, etc.
- Indian majors look at multi-million dollar acquisitions
- Focus on creating R&D capabilities
- Disruptive technologies like Cloud, Virtualization, Social media etc. change the IT landscape
- Industry applies non-linear growth models
- New pricing models like outcome based, pay-as-you-go start emerging

**Trade**
- Govt targets IT-BPO exports of USD 320 billion by 2020

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**Source:** KPMG in India – Oil Summit 2012, Non-linear models is 2012 Analysis
**India’s IT-BPO Industry - Snapshot**

- India’s market share in global sourcing industry – ~55 percent (2010)
- Fastest growing sector among all services in India
- Contribution to GDP – ~6.4 percent (2010)
- Contribution to India’s service sector – ~10 percent (2010)
- Indian IT companies:
  - Presence in ~52 countries
  - 400+ global delivery centers
  - 750 captives
- Employment to ~10.8 Million
  - Direct Employment – ~2.5 M
  - Indirect Employment – ~8.3 M
  - 60,000 foreign nationals
- Domestic IT-BPO sector – INR 1321 Billion, growing at ~16 percent (FY2011)
- IT Services – INR 501 Billion and BPO – INR 127 Billion; both growing at ~17 percent (FY2011)
- Indian Software Product segment – INR 157 Billion

**Employment Breakup**

- Hardware, 12.1 - 14%
- Software Products & ERP, 14.8 - 17%
- BPO, 16.9 - 19%
- IT Services, 44.5 - 55%

Several top Indian IT firms have reached considerable scale and feature in the global lists like Fortune 500, and Forbes 2000. With the domestic market opening up, almost all major global IT-BPO firms have a presence in the Indian market in one form or the other. Indian IT firms have also hit their stride, and have expanded globally across all major geographies, acquiring both clients as well as other companies.

**India’s technology and business services export market - scenarios 2020**

- Global sourcing industry USD billion: 79, 276, 450, 450, 530**
- India share Percent: 51, 45, 40, 50, -57

**2010 and Beyond: Continuing the saga**

Not being content with executing basic application development and maintenance (ADM) projects, Indian IT firms are offering a complete integrated suite clubbing high end services like consulting, Business Intelligence, Infrastructure Management, Product Development etc. Firms were able to withstand the tumultuous period and have emerged stronger than ever. As per NASSCOM India’s IT-BPO sector revenue is likely to reach USD 225 Billion by 2020 due to industry level initiatives countering competition. Further, there exists a significant headroom for growth through innovation which can propel revenues to the tune of USD 300-310 Billion by 2020**. Nevertheless, the decade ahead seems to offer great promise for Indian IT firms, as they seek to overcome their current challenges and tread on to new avenues moving from their traditional linear models to the non-linear growth models.

**Summing up the Journey**

Industry has witnessed a complete transformation from delivering stand-alone hardware, software and services, to moving up the value chain and providing a complete suite of end-to-end integrated offerings coupled with high-end services like consulting in large transformational deals. Disruptive and emerging technologies such as virtualization, cloud computing, social computing etc. have further brought revolution in the IT space. The linkages between processes, infrastructure and software are likely to get tighter and pricing models such as pay-per-use and outcome-based pricing expected to gain more prominence. All these developments are compelling vendors to transform themselves and adapt to the changing ecosystem.
Changing Dynamics of the Businesses

Maintaining the same level of rapid growth as registered in the past decade is going to be a challenge for Indian firms. The current market is characterized by uncertain demand, increasing competitiveness and changing technology landscape.

IT-BPO Industry – Changing Dynamics

To sustain sharp growth registered by vendors, there is a constant impetus on companies to innovate and undergo transformational changes to stay relevant in the market place. Like any other industry during its growth phase, this industry is also going through its share of turbulence.

Geo Political – The Cocooning West
Extreme measures by western economies to prevent jobs from flowing out of their countries to destinations like India are weighing heavily on Indian exports, especially the Indian IT-BPO industry.

Protectionist Policies
The economic crisis resulting in rising jobless claims has once again forced the west to raise anti-outsourcing flags and promote protectionist policies. For example, the recent US Call Center Worker and Consumer Protection Act introduced by some members of US House of representatives seeks to punish the US companies outsourcing their customer calls by denying them federal grants or loans for a span of five years. Operators would need to disclose their location to customers and offer them the option of being serviced by an alternate US call centre. In a separate move last year, the State of Ohio had banned outsourcing in government funded projects.

New Visa Policies
New visa norms are making it more challenging for the industry players to serve their customers in their biggest markets. Last year, US government imposed a steep hike in the visa fees for work permits for the skilled workers to fund the security on Mexico border. This steep hike could potentially make it difficult for some of the IT resources to visit US for work. UK government has also taken few measures making it difficult for companies in UK to hire workers from outside the country.

Source: KPMG in India - CII Summit 2012, Non-linear models 2012 Analysis

15. http://www.thehindu.com/opinion/editorial/article2738977.ece
Alternate markets growth not fast enough North America, UK and Western Europe are the largest markets for outsourcing. On the other hand, the rate of growth in outsourcing has been highest among emerging economies though the base is still relatively small. The lower volume and low scale of IT adoption in emerging markets is not proportional to the contribution made by western countries and has not been able to compensate for the decline in growth from West.

Domestic market emergence While the industry has primarily been export-centric, India’s domestic market is now also gaining traction, the expected size of Domestic market is USD 29 Billion17. The market size of domestic BPO is expected to reach USD 2.47 Billion by 201418. Domestic IT spend is USD 16 Billion19. The Indian software product segment fuelled by replacement of in-house software applications to standardized products from large organizations and innovative start-ups is estimated to be USD 3.5 Billion20. The government (state and centre) annual spend on e-governance is also expected to be USD 4-6 Billion over the next couple of years21. Most of the IT-BPO companies now have an independent vertical for Government22.

Market conditions- High client expectations, low spend The sector where “stock performance” is directly linked with quarterly results, companies are in constant pressure to perform and deliver while facing issues of margin pressure due to rising wages, lower billing rates and forex volatility.

Heighened competition between vendors Limited client spending in a recessionary environment has led to intense competition amongst Indian IT vendors, often leading to undercutting of prices to win a bid. This is leading to pricing pressure as contracts are won based on lowest price bids. This heightened competition is leading to increased cost pressures on the companies as margins get hit.

New low-cost destinations Emergence of low-cost destinations like Philippines, Eastern Europe and Latin America is also adding to already existing competitive environment; as a result, unlike in the past where India was the default destination for outsourcing, the customer today has options, and they are using them. This too is exerting pressure on the Indian players.

Maturing clients- demanding high quality Clients are now way more mature when it comes to outsourcing. They have better controls in place, not just to manage outsourcing but also measure the quality of delivered goods. As a result they have turned more demanding towards the vendors and their expectations are sky high. The cost pressures on them just makes it worse, since their expectations are still high but their spends are not increasing considerably.

Consulting to implementation: The elusive value chain Despite the top Indian players having established their brands globally and having cut edge solutions across certain verticals and functions, boardroom access still eludes most of them. They are still looked upon as vendors instead of partners – as against how the global players are positioned in the marketplace.

Falling discretionary spends The slower than expected and uncertain economic recovery has made companies cautious in making any discretionary investment decisions for the future. This resultant decrease in discretionary spend from clients has impacted the order pipeline of IT companies and delayed contract closures.

Socio-technological & cultural- unthetered access everywhere Social layer which has spread itself atop almost every consumer-related service, is now spreading fast into enterprise space. Adding to this is the new “mCulture” that is defining the lives of next generation of consumers wherein “touch” and “share” is ubiquitous and mobile is the new desktop.

• Global market size for Enterprise Mobility - USD 168.8 Billion by 201523
• Over 840 Million active mobile subscribers24
• 15 million mobile subscribers are added every month25
• Smartphone market share - 15 percent25
• Laptop market growing at the rate of CAGR 50 percent26
• Banking, Manufacturing and Retail are leading the way in applying mobility service to their operations27
• Over 34 million Facebook users and over 13 million Twitter users28

Social- The new ‘uncontrollable’ channel Any web/online presence or an enterprise application tool dealing with customers is incomplete without the social layer today. More companies are now interacting with their customers directly, through various mediums not confined to the traditional channels. While the IT vendors create business tools or various enterprise applications, now they need to think about social interactions right from the inception during conceptualization phase and not relegate it to an after-thought. Whether it is a bank or a retailer or a telecom firm, customer interactions are no more limited to branches or outlets. Consumers are connecting to the companies from anywhere now – whether its desktop, laptops, phones or tablets. They are using the likes of Facebook and Twitter as a medium of expression, and given the extent to which the organizations might be exposed, they can do anything but ignore it.

Mobility in enterprise Workforces are getting mobile at a rate faster than ever before. Desktop/workspace are losing their definition as the new order demands people to be able to work and have complete access from wherever they are. While ‘Blackberry’ and VPN were synonymous with ‘work from home’ anywhere in the past decade, the coming decade will have the employees’ entire office ‘move’ with them giving them the ‘access’ to everything which they had from their workspace in office. The larger challenge will be to provide this not on a single medium like desktop/laptop, but other digital mediums like phones or tablets as the employee might choose. ny web/online presence or an enterprise application tool dealing with customers is incomplete without the social layer today. More companies are now interacting with their customers directly, through various mediums not confine

Mobility in consumer space Past 3-4 years have seen the growing use of ‘Smartphones’ and more recently the ‘Tablets’. The underlying principal to the rapid expansion of these new product types is quite simple – mobility. IT/Technology vendors and clients alike will need to think ‘Mobile up’ design strategy rather than create a solution and then making it mobile enabled.

Communication is changing To get a perspective: The number of social media accounts is 3 times more than the email accounts. Email has seen a 59 percent decrease in usage amongst 12 to 17 year-olds and 12 percent decrease amongst 45 to 54 year-olds29. This implies that ‘instant/Social’ is to communications today to like what ‘email’ was 10 years ago. Adding to this is the existence of multiple platforms unlike single platform in the past decade. The consumers of today want to communicate from...
anywhere through any device or any application. Hence, communication needs to be treated as a platform over which other experiences are built, and not vice versa.

While earlier, the ‘market’ for all the latest in technology used to be the west, thanks to the demographics and the rate of technology adoption in emerging countries like India, the market is now shifting close to home. India is central to the global mobile and internet exports of computer software and IT-IT consulting service. In the last few years, the IT-BPO Sector has not seen the high growth rates experienced by it in the earlier part of the decade.

Further, while the Industry has grown big, a major portion of the industry revenue is concentrated with the top 10 players. Small and Medium Businesses ("SMBs") are large in number, have a low revenue base and they are the ones who constitute the bulk of companies registered under the STPI scheme. The expiry of income-tax benefits under the STPI scheme from 1 April 2011 (i.e. FY 2011-12) would impact the SMB sector in a big way.

SEZ: Imposition of MAT
Minimum Alternate Tax at 18.50 percent (plus applicable surcharge and cess) of book profits has been made applicable to SEZ Units and SEZ Developers vide Finance Act 201125. Although, a Company may claim set off of taxes paid under MAT against taxes payable under normal provisions in future years, it is possible that the set off may not be available in its entirety. In such a scenario, taxes paid under MAT would become a cost for the Company. Further, Dividend Distribution Tax at 15 percent (plus applicable surcharge and cess) has also been made applicable to SEZ Developers26. These developments have adversely impacted the prospective investment in the SEZ scheme.

Intellectual Property (IP) protection
Software industry is currently plagued with weak patent protection and high piracy rates. In order to foster R&D, there is a need for the government to put in place a strong IP protection law (and enforcement). As of today, the IP protection laws in India are tenuous at best. Looking at the ongoing patent disputes across the world, especially in the mobile space (Apple vs. Google, Apple vs. Samsung, Motorola vs. Microsoft etc.) there is a strong need to evaluate whether current IP laws and judicial systems are geared up to handle cases of complex dimensions, should they arise in the future27.

Transfer pricing: Affecting MNCs and Indian players alike
India is an attractive destination for MNC’s to set up and operate their Captive units, R&D and ODC. The conducive tax environment in the form of tax holiday benefits given to IT-BPO industry under the STPI, EOU and SEZ schemes have acted as a catalyst in its growth. However, this has not come without increased scrutiny from the Indian Revenue Authorities (IRA) especially in the area of transfer pricing where there is a steep rise in the transfer pricing adjustments. Key Challenges faced by the IT-BPO companies have been mentioned below.

Indian players
The IRA considers Indian entrepreneur players to be the technology and brand owner. Accordingly, the Indian players are expected to retain higher profits in India and compensate the foreign affiliates at minimal cost plus margin. Another key challenge for the Indian players is that the IRA are increasingly trying to compare prices of software products supplied to domestic parties with exports being made to overseas affiliate company despite there being significant differences in terms of geography, market dynamics, marketing expenses being accounted for in the pricing etc.

Captives centers
The captive centers being ‘low-risk’ and involved in ‘low-end’ functions are typically remunerated by their foreign affiliates between 10 to 15 percent on their cost. However, the IRA have adopted an aggressive approach and expect a return of as high as 25 to 35 percent from the captives by comparing them with full fledged entrepreneurs. Denial of economic adjustments for functions & risk differences and single customer risk are few pain areas for captive centers. Further, in the recent transfer pricing audits the captive centers are looked upon as creating unique intangibles and a portion of the profits earned by the foreign parent at the global level is demanded.

Companies focusing on R&D
The Indian Revenue authorities also claim that the Indian subsidiaries engaged in undertaking contract research and development ("R&D") activities, create intangibles for the foreign parent. The intangibles and the proprietary product so created are commercially exploited by the foreign parent to earn super normal profits while the Indian captive centre is remunerated with a ‘low’ mark-up on its costs. This happens despite the fact that the R&D centre in India does not assume any risk for the work done by them and perform only limited functions.

These multiple regulatory issues are impacting the industry growth potential and would need attention from government so as to give the required boost and support to the industry.

Human resource: Ready to pay but no availability of skills
Attrition and wage inflation
Indian IT-BPO industry is facing challenges in hiring, managing and retaining talent in current environment. Availability of abundant opportunities has led to rapid job switches among professionals leading to high attrition levels. An effect of this is the wage inflation which is adding to margin pressure on firms. To contain attrition, companies have to invest proactively in hiring, training, cross skill development, managing motivation and paying higher salaries to employees. All these measures lead to further cost escalation aggravating margin pressure on the firms.

Huge Employee Base leading to operational complexity
The top Indian companies in the IT-BPO sector have an employee base greater than 100,000 and are hiring in the rage of 40,000 employees to 60,000 employees annually28.

Governance & regulatory- Killing the golden goose
Past couple of years have seen the government rolling out policies that are not favorable for the industry. In addition, the Tax authorities have been very aggressive with respect to imposing tax regulations on the Indian IT players as well as MNCs who have set up captive centers in India. Adding to these is the lack of clarity on agreements with various countries for avoidance of double taxation. Current taxation measures from government authorities need to consider the current market situation, the challenges and needs of the industry. This calls for an open dialogue between the government and the industry representatives which would lead to formulation of favorable policies by mutual consent.

Tax
Upto Financial Year (‘FY’) 2010-11, the Income-tax Act, 1961 (‘the Act’) provided for deduction from profits generated from exports of computer software and IT-IT consulting service. In the last few years, the IT-BPO Sector has not seen the high growth rates experienced by it in the earlier part of the decade.

Further, while the Industry has grown big, a major portion of the industry revenue is concentrated with the top 10 players. Small and Medium Businesses ("SMBs") are large in number, have a low revenue base and they are the ones who constitute the bulk of companies registered under the STPI scheme. The expiry of income-tax benefits under the STPI scheme from 1 April 2011 (i.e. FY 2011-12) would impact the SMB sector in a big way.

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Managing such a massive employee base is becoming a mammoth challenge owing to its operational complexity which leads to increased HR costs.

**Employability**

With a large pool of graduating engineers largely unemployable due to deficiencies in the current system of education, the IT-BPO sector is grappling with the issue of not being able to recruit the ‘right fit’. The wide industry-academia gap is forcing companies to invest heavily in training to convert “qualified” manpower to “billable” resources. Owing to current falling margins and pricing pressure, “investments” to build best of the breed talent are increasingly being viewed as cost amongst companies.

Factors such as wage inflation, skills shortages, rising attrition and operational complexity in managing large pool is making it difficult to source talent in the industry. These challenges are forcing IT-BPO companies to re-calibrate their strategies and shift focus from cost competitiveness to providing increased value in terms of domain expertise and efficiencies to customers. As part of larger strategy to de-risk, thrust is on moving from being “people dependent” to “process dependent”.

Given the many challenges the Indian software faces currently, linear growth i.e. proportional increase in headcount to augment revenue is neither desirable nor a sustainable model.

The impact of linear growth could be gauged from the fact that at the current revenue per employee levels of top Indian vendors, the employee base could double by FY2014 at current growth levels. From the current employee base of ~493,000, the top 4 Indian firms could add another ~430,000 employees over 3 years to reach a total of ~923,000 by FY2014. Managing such a massive base could become a herculean task and might be unsustainable over long-term.

**Revenue per employee (RPE) ratio – Global IT services vs Indian IT services firms**

Over the last 5 years, the aggregate revenues of top pure play global IT services firms have been in the range 2-4 times the aggregate revenues of top Indian IT services firms while the employee base of global majors has been proportionately declining, reaching at 30 percent lower level (2011) than the top Indian firms. Also, on the RPE metric (one of the metrics to measure non-linearity), the RPE of global firms has been ~3-4 times the RPE of Indian counterparts. Over the years, while the revenues of Indian vendors have been growing at a CAGR of 21 percent, the employee headcount has also growing at a slightly lower rate (CAGR ~18 percent) making the RPE metric nearly constant over the years.
It is because of these reasons that companies are eyeing non-linear growth models which can deliver higher revenue per employee value. This would enable these players to stay lean and deliver sustainable growth and profitability. To achieve this, it would require a clear shift from “labor-based service delivery” to “asset-based service delivery”.

Gradually, this is leading to a change in the rules of the game and a transition to non-linear growth model, which is expected to be the next driving force of the industry.
In the next phase of growth, the Indian software industry is attempting to move away from delivering a cost advantage to clients to delivering value for them, by exploring different avenues of non-linearity. While a majority is focusing on creating IP/products and platforms, some are exploring novel pricing mechanisms; few are building efficiencies into how they deliver service using repeatable modules. Though the effect of some effect of some could be disruptive (e.g.: cloud, products, platforms, M&A) and some incremental (CoEs, Delivery Accelerators, Pricing Models, Brand), a move to non-linearity is inevitable.

Based on the practices prevalent in the industry, there are primarily following seven models through which vendors are redefining their services in their endeavor to deliver value to their clients.

Section 2
Non-linear growth model

Non-linear growth model- Redefining business dynamics

In the subsequent sections, we explore each of these models in more detail, identifying trends, current scenario and imperatives for players attempting to use these levers of non-linear growth.

- Intellectual Property
- Cloud Computing
- Platform BPO
- Non-linear Pricing Models
- Delivery Accelerators
- Branding
- Mergers and Acquisitions
Market scenario

The past few years have witnessed modest growth in the Indian software products landscape. Despite previously being relegated to the background by its services counterpart, the Indian software products industry has grown from just over hundred million dollar in the year 2000 to about USD 2 billion in 2011. Further, it is expected to reach 9.5-12 Billion USD by 2015.2

Leading global patent holders

As evidence of the Indian software product growth story, multinationals have opened their R&D centers in India and the country is expected to become a global R&D hub in the near future. But to achieve accelerated growth in the future, India needs to be positioned as a preferred destination for product development globally through joint efforts by the industry bodies and organizations. Some imperative for firms are to set up incubation centers near the target market, create a separate product business and financial model to measure success, and potentially acquire companies with a strong IP-portfolio.

Revenue aggregate Indian software product business

The last three decades has witnessed a gradual shift in perceptions of corporate value being measured from tangible assets to intangibles, such as patents, copyrights, trademarks and industrial design rights. The success of global technology majors can be attributed to the creation, development and monetization of their vast intellectual property portfolios. Notable examples are industry leaders such as IBM, Microsoft, Intel, HP, Apple and Google with IBM topping the list of patent holders worldwide.1

India’s software product industry

- Indian Software Product Industry
  - USD 2 Billion (2011)
  - USD 9.5-12 Billion (2015)
  - Contribution of Indian software companies – 25-30 percent
- Global addressable market for Indian software product companies – USD 290 – 315 Billion
- Domestic Indian market opportunity – USD 3.36 Billion (2011); growing at CAGR of 14 percent
- Surge in VC investment - Investments in technology start-ups expected to grow from USD 2.1 bn to USD 75 bn in next 5 years.


Source: KPMG in India - CII Summit 2012, Non-linear models 2012 Analysis

Leading global patent holders

- IBM
- Apple
- HP
- Microsoft
- Google

Source: KPMG in India - CII Summit 2012, Non-linear models 2012 Analysis

Market scenario

The past few years have witnessed modest growth in the Indian software products landscape. Despite previously being relegated to the background by its services counterpart, the Indian software products industry has grown from just over hundred million dollar in the year 2000 to about USD 2 billion in 2011. Further, it is expected to reach 9.5-12 Billion USD by 2015.

Revenue aggregate Indian software product business

- USD Billion

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>0.1</td>
</tr>
<tr>
<td>2011</td>
<td>2</td>
</tr>
<tr>
<td>2015E</td>
<td>9.5-12</td>
</tr>
</tbody>
</table>

CAGR – 38%

Source: NASSCOM-Zinnov Study, KPMG in India - CII Summit 2012, Non-linear models 2012 Analysis

1. IBM Website, “IBM Shatters US Patent Record; Tops Patent List for 18th Consecutive Year” Jan 10, 2011
The global addressable market for Indian software product companies is expected to reach between USD 290 to 315 Billion by 2015\(^3\). Among the software product categories, Enterprise Resource Management (ERM), BI, storage and security are among the largest segments and are going to be the key priorities, while emerging categories of Mobile applications, online gaming, and search marketing are the fastest growing\(^4\).

In parallel, the domestic market is also rapidly evolving and is tuned to provide exciting opportunities to the software product companies. This is becoming one of the drivers for companies to innovate and provide high value-low cost solutions to the domestic customers.

In India, Companies are working in different realms of IP development. Few companies have developed their own IP in their chosen areas of focus while few others are working in areas of outsourced product development assisting their clients in product development. There are also multinational companies (MNCs) supporting R&D product development through their subsidiaries in India.

Further fueling the growth of product development, a large number of start-ups have ventured in this space focusing on areas of business productivity applications, mobile applications, social media, online gaming etc. Most of these are driven and supported by VC funding, government agencies, angel networks and MNCs.

Of late, large Indian software majors have been developing and acquiring IPs in the areas of banking, financial services and insurance segment which have been widely implemented on global scale. Increased focus on R&D is also pushing up the number of patent applications by top Indian IT firms. Despite all these encouraging developments, the Indian companies have yet to crack the “product” code and be successful in establishing software product businesses like their global software product majors.

**Financial perspective**

Successful companies focusing on IP/products generally demonstrate higher revenue growth with significantly lower employee growth rate. Supporting this, we find the global software product companies also demonstrate higher revenue per employee ratio than the Indian IT-BPO companies. For instance, on an average, leading global product companies operate on revenue per employee at least of 10-20 times the revenue per employee of leading Indian IT services companies\(^5\).
On comparing the revenue and employee growth of the top global product firms with Indian IT services companies, the employee base of global product majors have been relatively constant with the revenue growth. Comparing this with the Indian firms, the employee base has also grown with the growth in revenues suggesting that the revenue growth of global product companies is decoupled with the employee growth which is not the case with leading Indian IT companies.

**Revenue per employee comparison of top 5 Global product companies with top 5 Indian IT companies**

![Graph showing revenue per employee comparison]

*Source: Company Data, KPMG in India - CII Summit 2012, Non-linear models 2012 Analysis; Indian IT Services Companies – TCS, Infosys, Cognizant, Wipro, HCL; Global Software Product Firms – Microsoft, Oracle, SAP, Adobe, Symantec*

**Revenue and employee growth of Global top 5 product companies with top 5 Indian IT companies**

![Graph showing revenue and employee growth]

*Source: Company Data, KPMG in India - CII Summit 2012, Non-linear models 2012 Analysis; Indian IT Services Companies – TCS, Infosys, Cognizant, Wipro, HCL; Global Software Product Firms – Microsoft, Oracle, SAP, Adobe, Symantec*

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**Case Example 1**

A recent study by a British insurance company has shown that men drive an extra 276 miles per year by wandering around aimlessly because they refuse to ask for directions. This comes out to around USD 3,000 in wasted gas over a lifetime! So, the next time you are lost and are too proud to ask for directions, consider investing in a GPS. And helping you in that endeavor is MapmyIndia’s GPS Car Navigator, one among many innovative products offered by the location-based solution provider.

MapmyIndia started out as a free portal that put out Indian mapping data for consumers. It later moved on to partnering with car companies, mobile phone brands and telecom operators who would be interested in offering mapping data to their customers, but found it hard to convince these original equipment manufacturers to invest in maps as a value-added service. Then, taking a leap of faith, the company launched its own GPS navigator in 2007 and saw a tremendous response to the product. In 2009, the company raised an additional USD 9 million from Qualcomm Ventures to scale up. Today, the company is considered a preferred business partner for car, mobile and telecom companies in India.

MapmyIndia registered a growth rate of a whopping 600 percent in the past 3 years or so. The company has brought on board clients like Samsung, Motorola and Hyundai and currently has over 500 corporate clients across 60 cities. MapmyIndia stands out in the market amongst its competitors in being able to offer consumers the entire range of consumer navigation products and services on real time and expects to expand internationally in coming years.

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Sources:
1. www.aolnews.com
2. www.thesmartceo.in
3. www.Moneycontrol.com
Case Example 2

Competing head on with the major Cloud players is Tata Consultancy Services’s IT-as-a-Service offering iON. It is an IP based first-of-its-kind fully integrated information technology solution for Small and Medium Business (SMB). iON addresses the entire spectrum of an SMBs technology needs ranging from business solutions like HR, finance, inventory, sophisticated domain-based ERP solutions as well as basic applications like email, document management and website services1.

“Our cloud-based solutions are an attractive proposition for SMBs as they do not have to buy hardware or network (TCS provides that on a pay-as-you-use basis),” explains Venguswamy Ramaswamy, global head of the SMB vertical at TCS. “Tech obsolescence also becomes a thing of the past because every three years we replenish the technology we have provided them.”

TCS has big plans for iON and the IT major hopes to turn it into a billion dollar business by 2015. It is targeting over 1,000 SMB customers across the country by end of FY12, with plans to launch it globally in coming years2.

Source:
1. Company website www.tata.com
2. articles.economictimes.indiatimes.com

Key imperatives for Intellectual property

Take the innovation nearer to the market

Spin Off Product Business as a separate Company

Keep a separate financial model to gauge success

Acquire Companies for Ideas & Patents; not just extension & expansion

Create the innovation ecosystem - encourage smaller firms

Source: KPMG in India - CII Summit 2012, Non-linear models 2012 Analysis

Key imperatives

Given the huge transformation that will be required for Indian firms to cross the ‘Product’ barrier in a systemic fashion, it will need involvement not only from players but also the other ecosystem entities consisting of government institutions, industry bodies and academia.

A few imperatives that will be decisive in this journey have been outlined below; but while we do the same, we need to take into cognizance the following facts:

- Most Indian IT players have traditionally been pure service providers
- The growth of Indian IT sector was driven by demand for skilled labor at lower cost, which is the reason for the current linear model in place.

With this background, Indian players have performed exceptionally well, but the drivers that have helped them reach here cannot carry them through the next curve.

Take the innovation closer to the market

Likelihood of innovation is much higher when the germination/incubation of ideas take place nearer to the market where it is expected to be consumed. For example, most tech breakthroughs happen in Silicon Valley and most electronic breakthroughs happen in Japan/South East Asia which are also early adopters and huge consumers of technology and electronics respectively. There are countries that have developed ecosystem for fostering innovation. While India slowly tries to find its niche in the innovation space, it is a good idea for the current set of medium to large IT players to set up incubation centers in the geographies where they are most likely to be fed with the right set of talent and ideas. An example could be an IT player selling software services predominantly setting up an independent subsidiary in Silicon Valley, which for all practical purposes works as an independent company and focuses on certain areas in the market. The operating model should allow it to raise VC funding, partner with R&D labs of leading universities in the US, acquire startups and so on. Once the company makes headway in terms of IP, Patents, Products etc., the benefits of the same can be leveraged by parent company to strengthen its brand, product offering and customer reach.

Spin off product business as a separate company

The mindset and operating model to run a Product Company differs significantly from that of a service company. While some Indian Players have successfully developed products out of their software offerings, most players wanting to set foot in this space are struggling.

Organizations that are serious about entering the product business should spin off their product division as a loosely held subsidiary. It should be able to operate independently without the pressure of quarterly results and such. Similar to the previous point, the company should be able to acquire other companies, get its own funding in whatever way is most conducive for its R&D and growth and should be able to monetize it independent of its parent company. Once the unit is mature, which would typically take many years, the parent company can take a call on either keeping it separate or merging it back with the parent unit.
Keep a separate financial model to gauge success

Products have a relatively longer incubation period compared to services. Also, post-launch, the probability of product being a success is uncertain. The financial metrics defined and tracked for product business in order to measure its success would differ with those defined for services business. It is due to these reasons that a firms need to have a separate financial model to gauge success of product business.

Acquire companies for ideas & patents; not just extension & expansion

Most large companies have successfully ventured into nascent products and technologies through the acquisition route. A simple look at their string of acquisitions will give an idea of the reasons behind the decision, which typically fall into the following brackets:

- Ideas (Google acquisition of Android/YouTube/Whitley, Apple acquisition of Siri/Lala/Proximity, Microsoft’s acquisition of Hotmail/Visio)
- Patents (Google acquisition of Motorola, MS/Apple acquisition of Nortel’s Patents, Qualcomm acquisition of Atheros, SAP’s acquisition of BusinessObjects)
- Market-geo/customer base (Microsoft Acquisition of Skype)
- Talent (HCL acquisition of Axon group)
- Brand (Lenovo retaining the brand ‘Thinkpad’ post acquisition, SBC retaining AT&T name post merger)
- Service Extension (SAP’s acquisition of SuccessFactors to enhance its Cloud offering; KPMG’s acquisition of EquaTerra).

Given that M&A has been one of the driving forces of I/P-led growth for global majors, this is an area which Indian Players aggressively need to pursue.

It is not that Indian companies haven’t been on an acquisition spree, but if we look at the reason for M&A, most of it have been for service extension, geo expansion or talent, while very few acquisitions have been for ideas or Patents.

Given that M&A has been one of the driving forces of I/P-led growth for global majors, this is one means that Indian Players will need to aggressively explore; and while acquiring companies for next-gen ideas (e.g. silicon valley start-ups) or patents might require the Indian players to move out of their traditional character, it is something that needs to be done.

Create the innovation ecosystem – encourage smaller firms

The startups have a critical role to play in building the innovation ecosystem owing to their entrepreneurial mindset. They would need to develop mindsets like their counterparts in Silicon Valley. The key priorities for them would be to:

- Focus on product development and R&D
- Keep sales & marketing and customer acquisition costs under check
- Focus on emerging categories of technology such as mobile applications, online gaming etc., which are unchartered territory in order to ride the next wave of growth
- Seek capital and guidance from VC/PE funds
- Leverage incubation centers and industry bodies providing mentorship.

Mr. N. Chandrasekaran
CEO & MD,
TCS

Views on the significance of adoption of Non-Linear Models in India.

“Our ability to sustain growth in the long-term is dependent on creating new models and businesses in addition to building on our strengths in services. In this context, non-linear business models are very important to drive additional growth for the industry. Not only will it help to diversify our revenue mix but more importantly spur the creation of intellectual property across the industry value chain in terms of introducing new products, platforms and hybrid models to the market.”

Views on the innovative models prevalent in the industry (products/services/business models) and the imperative for the industry to undertake innovation at multiple levels given the market realities

“The pace of innovation being set in many countries around the world is increasing and Indian IT needs to accelerate its participation in the innovation journey. While our track record in service innovation is excellent, we need to ratchet our ability to introduce and scale up new business models which are based on innovations in platforms and solution sets. Emerging technologies and high bandwidth are making new service delivery models possible and Indian IT must rise to the forefront in accelerating the adoption of these innovative growth models among enterprises and their customers.”

Trends in the industry today, what is working and what is not. Also, TCS’s current initiatives for non-linear growth

“Companies are investing in all facets of this new paradigm. It is too early to call the
the winners as adoption and scale will take time yet and not all industries are proceeding at the same pace. At TCS, we have three clear defined strategies to focus on non-linear growth. These are as follows:

- **Products:** TCS is already a global leader in the arena of software products for the financial services covering the entire industry spectrum from market intermediaries to retail banking and insurance. We will continue to explore new opportunities in multiple industries.

- **Platforms:** TCS has been investing in building horizontal and vertical process platforms for some time. These multi-tenant, pay-per-use platforms provide an efficient and effective way to deliver services to customers across a wide range of industries. One notable success in this regard has been TCS life and pension platform, Diligenta. TCS has scaled in the UK with more than 5 million life insurance policies under administration. This clearly shows the potential of these platforms to deliver quality to end customers.

- **iON:** iON is TCS’ unique cloud-based comprehensive IT offering for the Indian Small and Medium enterprise market. Using latest technologies, iON provides SMEs with a total IT solution for all their relevant business needs on a fee basis. It has gained traction in the 9 months since its launch and has garnered over 200 customers.

Initiatives that the government needs to take in order to support innovation, in turn facilitating non-linear growth in the industry

“The government is taking multiple initiatives to spur innovation like funding a National Knowledge broadband network among 450 universities to increase collaboration. The initiative to connect all Gram Panchayats will also provide the last mile connectivity to offer virtual citizen service windows across all villages. Many of the pilot programs in areas from financial inclusion to healthcare and education have shown the potential of platforms to deliver effective solutions at the base of the pyramid. Now we need a coordinated approach to scale up these initiatives and build sustainable business models.”
Cloud computing

Executive summary

The Cloud is perhaps the most talked about technological phenomenon in recent times, in its promise of flexibility, scalability and cost benefits made available through the ‘as-a-service’ paradigm. Industry research firms estimate double digit growths of Cloud spend over next several years. But despite the few success stories, at present, most Indian IT companies are engaged in third-party implementations and cloud migration services; which would still come under the traditional outsourcing models. Such third-party cloud-based process implementations could be numerous though paltry in revenues and would provide only linear growth.

The ability to cater to multiple customers through a single delivery platform makes Cloud an attractive investment for service providers in the long term. Cloud, being an IP-driven business, companies would need to evaluate their appetite for risk and investments. Indian firms need to examine fitment and focus on building expertise in one cloud delivery model which can be extended to other service models. Also, companies need to focus on building the right partnerships evaluating their strengths and market potential.

Cloud Computing is a phenomenon that has stirred up interest and investments in many parts of the world. The promise of the Cloud lies in its flexibility, scalability and cost benefits made available through the ‘as-a-service’ paradigm. For any offering to be termed as a Cloud it should have the following characteristics:

Characteristics of Cloud

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>On-Demand Self-Service</th>
<th>Internet Accessibility</th>
<th>Pooled Resources</th>
<th>Elastic Capacity</th>
<th>Usage-Based Billing</th>
</tr>
</thead>
</table>

Source: KPMG’s The Cloud: Changing the Business Ecosystem, 2011

Further, the Cloud is defined in terms of three Service models and four deployment models as depicted below:

Cloud Service Models and Deployment Models

<table>
<thead>
<tr>
<th>Cloud Service Models</th>
<th>Cloud Deployment Models</th>
</tr>
</thead>
<tbody>
<tr>
<td>Software as a Service</td>
<td>Private</td>
</tr>
<tr>
<td>Business operations over a network</td>
<td>Operated for a single organization</td>
</tr>
<tr>
<td>“SaaS”</td>
<td>Community</td>
</tr>
<tr>
<td>Platform as a Service</td>
<td>Shared by several organizations, supporting a specific community</td>
</tr>
<tr>
<td>Deploy customer-created applications to a Cloud</td>
<td>Public</td>
</tr>
<tr>
<td>“PaaS”</td>
<td>Available to the general public or large industry group, served by an organization selling Cloud services</td>
</tr>
<tr>
<td>Infrastructure as a Service</td>
<td>Hybrid</td>
</tr>
<tr>
<td>Rent processing, storage, network, other computing resources</td>
<td>Two or more Clouds that remain unique but are bound by technology that enables data and application portability</td>
</tr>
</tbody>
</table>

“aaS”

Source: KPMG’s The Cloud: Changing the Business Ecosystem, 2011
Among the major global players in SaaS are Salesforce.com, Intuit, Cisco Webex, NetSuite, SuccessFactors, and RightNow. PaaS model consists of three categories - Raw Compute Platforms like Amazon Web services; Web Application PaaS like Google App Engine; Business Application PaaS like Force.com.7

Market Scenario
Industry research firms including Gartner, IDC and Forrester estimate the Cloud to grow at a double digit CAGR for the next several years. According to the forecasts, 13 percent of the incremental IT budgets would be utilized for Cloud computing. Within cloud computing, SaaS will continue to dominate spending on cloud computing.8

Cloud Computing
- Cloud Computing contribution to reach 3.8 percent of Global IT Spending (2014) from 1.4 percent (2008)
- Public cloud services are expected to grow at an annualized rate of 27 percent from USD 15 billion in 2010 to nearly USD 160 billion by 2020
- In the private cloud space, market is expecting to reach USD 16 billion by 2020 from current USD 8 billion with a CAGR of 8 percent.
- SaaS would comprise majority of these growing from USD 13 billion in 2010 to USD 133 in 2020 with a CAGR of 26 percent.
- Global addressable market for Indian software product companies – USD 290 – 315 Billion.

SaaS is also the most mature and largest among all three service models. With its value proposition of low risk, no capex and usage-based pricing model, it has managed to rapidly penetrate the market. PaaS is still nascent, evolving and highly competitive. IaaS has the highest growth of 67 percent among all the three models.9

The recent USD3.4 billion agreement for SAP to buy SuccessFactors10 and Oracle’s USD 1.4 billion acquisition of RightNow11, indicate that large firms are recognizing growth potential in this space. These recent acquisitions may be the start of urgent consolidation in the cloud computing marketplace as big players attempt to create scale and meet customer needs with diverse applications.

While small start-up firms dominate the SaaS landscape in India providing attractive cost propositions, large firms are also investing in SaaS solutions to be able to cater to new market segments. For example, TCS has invested in building iON platform providing business applications over cloud to small and medium business enterprises in India.12 Small and mid-sized players have also plunged in SaaS and players like Zoho.com, HRMantra, Impel, iWeb, Kallos, have launched their applications in CRM, Payroll, Enterprise resource management, SRM and host of other areas.13

The PaaS revolution is being led by small enterprises with customized PaaS applications in India. An example is Bangalore based Wolf Frameworks, which has built a cloud-based Census Information Management System (CIMS) for SEDS, a NGO based in Anantapur District in Andhra Pradesh, which is also India’s second most drought-prone area. The NGO has used

<table>
<thead>
<tr>
<th>Leading Cloud Players</th>
<th>SaaS</th>
<th>PaaS</th>
<th>IaaS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salesforce.com</td>
<td>Google</td>
<td>Dell</td>
<td></td>
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<tr>
<td>SAP</td>
<td>Amazon</td>
<td>HP</td>
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<td>Gmail</td>
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<tr>
<td>IBM</td>
<td>Amazon</td>
<td>Microsoft</td>
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<tr>
<td>Windows</td>
<td>Dropbox</td>
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</tbody>
</table>

Source: KPMG in India - CII Summit 2012, Non-linear models 2012 Analysis

<table>
<thead>
<tr>
<th>Public Cloud Market</th>
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<tbody>
<tr>
<td>Forrester Experts Public Cloud (SaaS/PaaS/IaaS) to Reach Nearly USD 160 Billion by 2020</td>
</tr>
<tr>
<td><img src="public_cloud_market.png" alt="" /></td>
</tr>
</tbody>
</table>

Source: Forrester Research

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12. TCS company website
13. Company website

© 2012 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
the PaaS platform to transform the lives of more than 40,000 members living below the poverty line. The National Stock Exchange has used AppPoint’s software BizApp Studio, to develop a compliancy management solution. Among the large players, Wipro has leveraged OrangeScape’s PaaS platform to build a complete custom ERP system for a large government organization14.

**Indian Success Stories**

- **Wipro** – Leveraged OrangeScape’s PaaS platform to build a complete custom ERP system for a large government organization
- **NSE** – Used AppPoint’s software BizApp Studio, to develop a compliancy management solution
- **Wolf Frameworks** – Built a cloud based Census Information Management System (CIMS)
- **TCS –iON** platform for SMBs
- **Other small and mid-sized players - Zoho.com, HRMantra, Impel, iWeb, Kailos.**

Despite few success stories, at present, majority of Indian IT companies are engaged in third-party implementation of process solutions for clients on their cloud (e.g. enabling a business process solution on the client’s cloud) or are helping implement cloud migration services. Such third-party cloud-based process implementations could be numerous though modest in revenues. These are still traditional outsourcing models that would provide linear growth.

**Financial Perspective**

The ability to cater to multiple customers through a single delivery platform makes Cloud an attractive investment for the service providers in the long term. With an increase in customer base, the fixed cost incurred in creating and delivering services gets recovered and results in higher margins over long term. Being a volume driven business, cost benefits are realized with surge in volume of customers and customers achieving scale once the fixed upfront investments are recovered. The economies of scale are derived from amortization benefits of administrative and run time costs across multiple customers. On infrastructure front, costs benefits of investments made are realized with scale. For example, a 100,000 server data center would have 80 percent lower TCO/server vs. a 1000 server data center15.

On profitability, though the long terms revenue opportunity look promising for service providers, margins are depressed, in the initial phases. The prime reasons are relatively high sales and marketing cost, high customer acquisition costs, slow customer acquisition and customer churn. However, after the initial years of investment lasting between 1 to 3 years, margins are likely to be phenomenal once revenue crosses a threshold. An example is Salesforce.com which has current gross margins of over 80 percent16. Given the customer stickiness and the annuity of predictable subscription services, long terms benefits are enormous.

**Case Example**

“Over the next three years, you will see cloud offerings really mature in terms of features and functions, and become feature rich, overtaking desktop offerings in many areas. As feature parity is reached, market adoption will explode. Just as mobile phones overtook wired phones in terms of features, functions and of course usage over the past 10 years, cloud software will overtake installed software over the next 10. The reason in both cases is the sheer speed of technology evolution.” 1 says Sridhar Vembu, CEO of Zoho Corp, the company behind the Zoho suite of online applications. Zoho’s growth has been spectacular in the past few years; at logger heads with industry giants Google and Microsoft for a share of the Web-based software pie, the company has managed to carve out a loyal customer base, by plugging the gaps in the offerings of industry leaders.

Zoho is a leading provider of on-line business applications and a pioneer of cloud-based offerings in India. The company has built a customer relationship and business process app on the cloud using open source platforms such as Apache and offered it free of cost initially; the product soon went viral. Its office suites now cost USD 300 a year, against USD 600 that a large vendor charges2. Its office suite of productivity and collaboration tools called ZOHO.com competes with Microsoft’s and Google’s offerings, including word processor, spreadsheet, presentation, and CRM tools, where it competes with Salesforce.com. The suite has over 3 million users around the world. ZOHO also has a tool for IT administrators to manage networks, called ManageEngine which has over 40,000 customers, and is the company’s biggest revenue earner3.

Source: JP Morgan, India IT Services, 15 December 2010

**Source:**

1. Interview with Sridhar Vembu by Jeremy Caplan on Wall Street Journal’s Digits blog, published 26th July, 2010
2. The Cloud of Opportunities, Businessworld, published 12th January, 2011
3. Zoho brothers on cloud 9, published on Times of India online version, 12th January, 2011

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Key imperatives for cloud computing

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Get into right partnerships

Address data and security issues beforehand

Key imperatives

The Indian IT industry has been playing a catch-up role in terms of leading the technological breakthrough. Cloud has for the first time in history of IT-BPO industry, offered an opportunity for the Indian players to take a giant leap in the global playing field and emerge as leaders. Cloud is going to disrupt the current landscape impacting both - players as well as customers. Firms either have the option of following “wait and watch” or “lead and define” approach in shaping up the future landscape.

Get the market right; Cloud is not a commodity

Developing cloud based IP assets would need substantial investments owing to its large gestation period. Because of these attributes of Cloud, the following questions, however basic, assume significant importance, and should be answered by every Indian Player today:

- Should we do Cloud?
- Which part of the Cloud can be our strongest play? Which other parts should we invest on developing – if any?
- What will be our target market?
- What will be our unique offerings?

Once the organizations are clear on what they want to pursue, they need to ensure that all the success factors for cloud are taken into consideration. A few imperatives for moving into any component of cloud are mentioned below.

Venturing into the right service model

Amazon, Salesforce and Google are the world leaders and Gold Standards in Cloud today[11] – in terms of coverage of Cloud components as well as impact on businesses worldwide. They have been game changers in the truest sense; disrupting industries, businesses and consumer demands alike – which is an imperative for any company to stay ahead of the game.

However, this does not mean that every single player that enters the cloud business needs to spread its scope across all Cloud components. Owing to their past track record of being successful at software development, standardization and domain expertise, Indian players can explore and invest in areas of SaaS. This expertise, once gained, could be extended to PaaS and IaaS service models. A brief point of view on each Cloud component and their fit with Indian players is provided below:

SaaS – Develop domain and functional expertise

We believe most companies would venture in SaaS model of Cloud leveraging their previously gained expertise in domain and business functions. For firms aiming to venture into SaaS model, gaining niche expertise in a specific domain or business function is most important; and given the history and experience Indian players could become potential leaders in this space.

PaaS – ‘Influence’ necessary to take off

To succeed in PaaS, firms need to have an ‘influence’ that can drive businesses to adopt their platforms and vendors to build for it. Basis of this influence could be various

- Captive clients (Google Apps)
- Unique value proposition (Amazon – reliable and affordable IaaS combined with a flexible PaaS)
- Unique offering (Salesforce).

On drawing parallels with global firms, most firms including the ones mentioned above ventured into this space after attaining leadership and a position of influence in another Cloud component. A recent example is SAP’s acquisition of SuccessFactors. Combination of the captive client base of SAP and the robust platform of success factors will inevitably lead SAP to succeed in the enterprise PaaS space.

IaaS – Capital intensive; high volume, low margin business

IaaS is capital intensive due to investments made in setting up underlying infrastructure. Since, it is a high volume, low margin business, gaining scale is critical. We believe owing to large investments required, IaaS would be dominated by few large players globally and in due course will be relegated to the background as a non-value adding component of cloud - similar to what cables are to telecom – dark fibres are an example. The real Cloud play will happen in the space of SaaS and PaaS.

Some Indian players have software products that have a fairly large client base, and some of these products form a core component of their client’s business (Banks, Retailers, Hospitals etc.). These firms are best placed to venture in PaaS, since their captive base will attract other vendors to develop on their platform and once the offerings are rich in features, will in turn attract more clients.

18. Company website

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Get into right partnerships
Indian players will need to form their strategy for the Cloud components they want to venture into and the kind of services they want to provide. This also implies that whichever component the firms decides not to pursue will need to be fulfilled with partnerships. It is important to choose the right partners, since for a Cloud offering, every single component of the service is key to success, and while the firms will have a control over what they are providing themselves, they will need to ensure that their partners are reliable and do not turn into a point of failure. For the providers of SaaS and PaaS, the right partnerships are crucial.

For SaaS players, key considerations for partnering with PaaS players are
- Large client base
- flexible development environment

For PaaS players, key considerations for partnering with SaaS players are
- Application or Services that enhance the value of the Platform
- Standardized and Configurable Offerings that can be customized to suit a large number of clients Key consideration for partnering with IaaS players is reliability and uptime.

For SaaS and PaaS players, key consideration for partnering with IaaS players is reliability and uptime.

Address Data and Security Issues beforehand
This is a core imperative that the Indian players, or for that matter any player will need to address once they move into Cloud business. Clients are worried about data security, and not wrongly so. One misstep and the entire cloud strategy of a player can get derailed. Hence it is very important for IT vendors to have a comprehensive, fool proof solution at hand while they approach clients with their Cloud based offerings.

Indian players, as they slowly move into Cloud services will need to make investments to ensure that any client will be absolutely comfortable with the solution being offered. Investments to ensure data security in the cloud could be huge at least in the initial stages, but this is something that’s not an option – it is necessity of the new business model.

Mr. Bhaskar Pramanik
Chairman, Microsoft India

Thoughts around building a non linear model in the IT-BPO industry...
The success of the Indian IT sector, pegged on the global delivery model, is well known and documented. The time has come to look at how the IT-BPO industry can adopt nonlinear models to enable it to grow and remain profitable and competitive especially with other nations.

Possible Areas for Non-Linear Model
A stronger focus on Product development as distinct from the traditional application development and maintenance, outsourcing model. Building application and technology products and taking them to market globally is now a lot easier than before especially using cloud based technologies and a pay for use business model.

Even in the App Development area using the latest generation of software tools can bring about considerable developer productivity, allow reuse of code and create frameworks which can considerably reduce time to deploy and associated costs. You can now create applications once, using the latest tools on the cloud and then decide whether you will deploy on the cloud or on premise. No need to rewrite the code.

Lowered costs by using cloud technologies at development and in deployment saving on capital costs, creating multi tenanted applications and serving many customers globally. Cloud also allows for a different business model where you can charge by user or any other metrics (outcomes).
Platform BPOs

Executive summary
Extending their current BPO service portfolio, Indian outsourcers are gradually moving to Platform BPO solutions - which involves bundling of technology, consulting and BPO. This is a shift from the erstwhile labour dependent delivery model to a largely transaction and process-centric delivery model. Software providers are offering an entire suite of services over a common business platform that gives them the ability to easily scale up, optimizing costs and improving process performance for clients. Indian IT vendors are working at different levels offering services under different models. Inherent benefits of this model like cost savings with short deployment time and no upfront capital investment for clients makes it ideal especially for clients not willing to make CAPEX investments and appeals largely to mid and small-sized businesses. But despite costs savings for the client, vendors need to consider that the break-even period for platforms is significantly longer because of the initial set up costs and upfront expenses before their clients adopt the platform. Some of the key priorities for companies offering platform BPO would be the need to facilitate easy process of migration, offer attractive pricing mechanisms, transfer platform benefits across multiple clients and leverage cloud for platform delivery.

With traditional modes of service offering in Business Process Outsourcing (BPO) slowly turning into commoditized services, Indian outsourcers are taking another look at how they deliver BPO services to clients. Moving away from a predominantly voice based, low margin offerings, more and more clients are asking for standardized business processes with a fully “integrated platform” that also includes a standard software offering, not just the people and process expertise.

Platform BPO is defined as an integrated BPO solution that involves bundling of technology, consulting and BPO – a shift from people - centric to process-centric delivery model. A Platform BPO vendor provides the whole breadth of services the client needs ranging from software licensing, hosting, implementation and support. The buyer is required to only pay a monthly fee based on usage which is also known as the pay-as-you-use model.

Market Scenario
Traditionally, Indian outsourcers have built their BPO value proposition on labor arbitrage but that is rapidly changing. Rather than working in silos, software providers are offering an entire suite of services with a common software platform that gives them a more scalable solution with ability to optimize costs and improve process performance for clients. Major segments that exist in the platform BPO space today are Finance & Accounting, Business Intelligence and Analytics, Human Resources Outsourcing and Procurement Outsourcing.

Operators are using several ways of including platform BPO strategy in their business plan. In the most basic format, vendors are building their own add-ons to optimize existing platform BPO solutions. In the high-volume offerings like HR and procure-to-pay, vendors have gone to package leaders Oracle and SAP to negotiate favorable terms around supplier offerings. Firms are also creating their own industry-specific software packages from ground up. Finally, software firms are adopting the inorganic route to acquire vendors with proprietary platforms and captive clientele.

Buyer preferences with respect to standardization of outsourced business processes

Platform BPO – Major Segments
- Finance and Accounting – AP, AR, Cash Management, Billing, Invoicing
- HR Outsourcing – Recruitment, Payroll, Talent Management, Compensation, Workforce Management
- Analytics – Sales, Customer records, cross-sell, Customer churn
- Procurement Outsourcing – Vendor Management, Inventory Management, Contract Management, Payment Processing, MDM
Indian IT vendors are working at different levels in these four models. TCS, for example, signed a ten-year USD 1.2 billion deal with the Nielsen Company in 2007 to deliver outsourced finance, accounting and HR services on proprietary platforms built by the company. Infosys has developed platforms in HR, procurement and media & entertainment. Some of its products are Newspaper-in-a-box (NiABox), HR outsourcing (Hire-to-retain) and Shopping Trip 360 (retail analytic solution) respectively. One of the biggest BPO platform play for Infosys was its acquisition of McCamish Systems (a platform-based insurance processing solution provider) in FY1019. Accenture has its internally developed “pharma-in-a-box” offering20.

Indian Success Stories
- TCS signed a 10-year USD 1.2 Billion deal with Nielsen company in 2007 to deliver outsourced F&A, HR services on proprietary platforms
- Infosys has developed platforms in HR, procurement and media & entertainment like Newspaper-in-a-box (NiABox), Shopping Trip 360 (retail analytic solution).


With the advent of Cloud, the next wave of BPO is being considered to be Business Process-as-a-Service (BPaaS) which is in other words is delivering platform BPO over cloud and is expected to be a gamechanger in coming years. BPO delivered as BPaaS includes the benefits of Infrastructure as a Service (IaaS), Platform as a Service (PaaS), SaaS as well as the traditional benefits of outsourcing such as process expertise and labor arbitrage. This is better than the platform BPO proposition considering the fact that companies are increasingly finding it difficult to secure the capital required for major platform implementations and other IT initiatives. Thus cost reduction and flexibility would be key drivers to move into BPaaS to deliver BPO services.

Financial perspective
The platform BPO form of service delivery moves away from being people-centric to being platform-centric, thus breaking the linear link between revenue growth and headcount. It allows service providers to de-linearize growth through standardization and large-scale productivity payoffs. In addition, having the Platform BPO model in its service portfolio, it offers more credibility to the capability of the BPO service provider, in terms of domain and process expertise, essential in today’s competitive marketplace.

Incorporating platform BPO into their IT strategy will cut costs for clients by an additional 20 percent to 30 percent on top of the 15 percent to 20 percent savings of a traditional BPO solution21. A significant immediate and sustained cost savings that can be deployed in a short period with no upfront capital investment for clients makes it ideal for clients not willing to invest in CAPEX, especially for small and medium business segments. For a vendor to be able to offer platform BPO, significant upfront investments need to be made in setting up data centers, license costs for third-party software, hiring talent etc.

Owing to greater proportion of fixed costs, the degree of operating leverage is higher in these standardized platform solutions. Hence, a minimum threshold is required to register profits. It is estimated that the break-even period for platforms is significantly larger (atleast 18 months) due to high initial set up costs22.

However, once the initial investments have been made and services launched, the cost of maintaining platform keeps reducing as more and more customers are added to the platform. Large customer base also drives further standardization of processes across multiple clients, reengineering of processes for efficiencies and technology improvements; further reducing the cost of supporting the platform.

Platform BPO – Vendor Strategy

<table>
<thead>
<tr>
<th>Vendor Strategy</th>
<th>Create their own industry-specific software packages on third-party platforms</th>
<th>Adopt inorganic route to acquire vendors with proprietary platforms and captive clientele</th>
</tr>
</thead>
</table>

In other words, is delivering platform BPO over cloud and is expected to be a gamechanger.

Case Example

When it comes to platform BPO, pure play BPO companies are competing as equals with IT services firms. In fact, a few of them like Genpact and WNS are ahead of a BPO subsidiaries of IT majors.

"More and more customers are going in for platform BPO though they do need some push initially. Most of them start with some process initially and then transfer other processes as well," says CTO of Genpact, SV Ramania. The company is also investing in BPaaS, where it believes there would be significant traction in the medium term. "BPaaS will force people to standardize their processes. Infrastructure and software become more of a choice that allows buyers to leverage the right ecosystem. I think that is a huge shift that changes the landscape and is fundamental to how this will play out." Says Shantanu Ghosh, how this will play out23.

Genpact is also pursuing the inorganic route to strengthen its BPO offerings. The BPO major acquired 100 per cent stake in High Performance Partners (HPP), a US-based company developing software platforms for the mortgage industry in 2011. Genpact will leverage HPP’s Quantum software platform to support its Mortgage Business Process as a Service (BPaaS) offering. The Quantum platform helps originators and lenders to automate and streamline major elements of the loan origination process, resulting in a shorter loan life-cycle and a more transparent mortgage asset.

Source:
1. Company websites
3. www.outsourcing-center.com, Published 1st February, 2011
4. Times of India online version, published on 10th October, 2011

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22. Accenture company website
Key Imperatives for Platform BPOs

Ensure ease of migration for Customers

Ensure long-term contracts

Develop industry specific process platform

Leverage Cloud to offer BPaaS

Key imperatives

In a bid for BPO firms to deliver more value to client, some of them have extended their portfolio to include platform BPO. Process standardization, stable technology platform, transaction pricing model coupled with right talent mix are the critical success factors for vendors venturing into this space. In addition, some key imperatives for vendors are as follows:

Ensure ease of migration for Customers

Platform BPOs should require minimum effort to migrate from client’s platform to vendor’s platform. This should be achieved through best in class scalable and highly standardized technology to support majority of client’s requirements without customization. Vendors should ensure enhanced level of data security and business-continuity planning. Standardization and uniformity in processes across business verticals and locations for the customer will be essential. Building solution accelerators may help in this process. Secondly, a phased approach to migration is advisable. The service provider can start with BPO support to develop an understanding of client’s processes and then move on to migration. Finally, as the vendor needs to ensure seamless integration across geographies, a strong alliance/vendor management is needed for standardized delivery.

Ensure long-term contracts

The one-time cost in platform BPOs is usually high as it bundles the initial setup cost, data migration cost and in many cases infrastructure. To offset this, the supplier and vendor can enter into a long term contract so that the supplier can amortize it over the deal period and the client realizes productivity gains over the lifetime of the contract. Outcome/output based pricing can be explored mutually as beneficial to clients and vendors. While some clients might want to enter into short term contracts in order to ‘proof test’ the model, it is not advisable for the Indian players to succumb to the immediate revenue pressures and go ahead with it. It might be better to be patient till the client is more comfortable with the solution and is ready to enter into a long term contract.

Develop industry specific process platform

With more and more software vendors going the platform BPO way, it is essential that service providers invest in building industry specific process platforms or IP led expertise that showcase significant process improvements. They should also make an effort to communicate the same through a concerted branding exercise. Firms can either play on their historically strong vertical offerings or choose to move into uncluttered space. In addition, this should translate into higher capability to scale and ability to use the same platform for multiple clients.

Leverage Cloud to offer BPaaS

The BPaaS model allows vendors to spread their investments across multiple customers and customers share financial benefits by reducing operating costs, thereby cutting capital expenditures. BPaaS can be offered as a fully integrated suite of services as well as stand-alone offerings, depending on a client’s needs. A flexible pay-per-use pricing is inherent in this model as is standardization available from externally sourced infrastructure, platform, and software across many clients.

Mr. Vineet Nayar
Vice Chairman & CEO, HCL Technologies

Views on future of Indian services companies ...

Indian services companies will continue on the services model moving up the value chain – higher value services and with more complex (non linear) commercial / pricing models i.e. transaction based pricing, revenue sharing, outcome based pricing etc. The challenge in front of Indian companies is to find the adjacencies that they can enter...

Services demand for India will stay since Indian companies will continue to move up the value chain preserving the overall “value proposition”. This coupled with nonlinear pricing will sustain the model...

On talent pool...

Skill pool and ecosystem in India is very much lagging the west e.g. Silicon valley and it may not be realistic to expect Indian companies to step up and compete on the product innovation front...

On HCL’s current initiatives ...

HCL is developing 14 products with Cisco and will not charge any fees – they will get a percentage of the revenues

Prognosis for the industry ...

There will be restructuring which will result in margin dilution. Some VCs may be farmed out by large companies...
Non-linear Growth Model – Driving Profitability, Bolstering the Indian IT Industry

Non-linear pricing models

Executive summary
The current economic climate has compelled customers to reevaluate their existing and new contracts with service providers, who, are moving to high-value, complex service offerings like consulting, system integration, which demands a different pricing paradigm. Indian IT companies have been pricing based on Time and Material (T&M) and Fixed Price (FP) models, which are linked to headcount and effort spent. Non-linear pricing models on the other hand, link clients’ expenses to their business outcomes or usage. Billing is no longer based on effort and revenues are linked with productivity ensuring vendors share productivity gains with clients. This is fast emerging as a win-win proposition for both the client and the service provider as both parties share the risk.

Non-linear pricing models result in higher revenue productivity per employee and improved margins for companies.

Analysts estimates a margin gain of ~1 percent for every ~5 percent move to non-linear revenues owing to their better margins compared to traditional services\(^2\). But in order to better leverage the different pricing models available, companies need to increase its level of adoption in application outsourcing services – which form a majority of their current revenues. Success in non-linear pricing management depends on the ability to isolate and measure business drivers or KPIs. Also, non-linear pricing models can be perfected only with sufficient data points and experience which can act as a guiding factor to decide on key KPIs and outcomes. This will mandate building of comprehensive baseline repositories. Lastly, a “Consultative” front end will need to be created engaging with key stakeholders at various levels to gather business insights, obtain buy in and drive change that will ultimately deliver business results.

Linear and non-linear pricing models

<table>
<thead>
<tr>
<th>Contract Type</th>
<th>Linear Pricing Model</th>
<th>Non-Linear Pricing Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billing</td>
<td>Time &amp; Material Fixed Price</td>
<td>Business Outcome Linked Pricing</td>
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<tr>
<td></td>
<td>Effort based</td>
<td>Productivity</td>
</tr>
</tbody>
</table>

Benefits of Non-Linear Pricing
Higher revenue productivity per employee Improved vendor margins

Source: KPMG in India – CII Summit 2012, Non-linear models 2012 Analysis

Market scenario
It is estimated that most Indian firms currently garner less than 10 percent of their revenues via the new pricing models\(^2\), but intend to multiply that in the next couple of years, given its immense non-linear potential.

Outcome based models cover service offerings like products, consulting, infrastructure management and customization. IBM has used outcome-based model in various deals, including the end-to-end IT operations management deal with Vodafone wherein IBM’s revenue was linked to the commercial performance of Vodafone\(^4\). TCS used similar pricing contracts in its BPO deal with Pearl Insurance in UK and again in the USD 250 million IT infrastructure management deal with Tata Teleservices in 2005\(^5\).

Non-linear pricing models

<table>
<thead>
<tr>
<th>Non-linear Pricing Models</th>
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<tbody>
<tr>
<td>Outcome-based</td>
</tr>
<tr>
<td>Usage-based</td>
</tr>
<tr>
<td>License fee-based</td>
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</tbody>
</table>

Source: KPMG in India – CII Summit 2012, Non-linear models 2012 Analysis

Traditionally, Indian IT companies have been pricing based on Time and Material (T&M) and Fixed Price (FP) models, a model linked to employee strength. Non-linear revenue models on the other hand, link clients’ expenses to their business outcomes or usage.

Report on India IT Services by Morgan Stanley, published on 23rd March, 2010
\(^2\) LiveMint.com and Wall Street Journal
\(^3\) TCS changes rules of outsourcing game: Published in Economic Times, 28th September, 2006

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Platform-based services that employ the usage-based pricing model have arguably seen the highest level of adoption across the industry. All major Indian companies are either focusing on acquisitions that offer scalable reusable platforms or convert their traditional offerings into a platform. Wipro and HCL Tech appear to have a higher number of acquired platforms while TCS and Infosys have so far focused on developing a majority of their offerings in-house. Wipro also offers testing services under both usage-based and outcome-based pricing models.

In license fee based models, the universal banking products developed by Infosys (Finacle), TCS (BaNCS) and Oracle financial services and software (Flexcube) qualify.

Financial perspective
Non-linear pricing models result in higher revenue productivity per employee and thus, improved margins for companies. As billing is no longer based on effort and revenues are linked with productivity ensuring vendors share productivity gains with clients, it is a win-win situation for both the parties.

Assuming that non-linear initiatives generate a higher EBIT margin of ~50 percent compared to traditional services, large Indian IT players can potentially achieve a margin gain of ~1 percent for every ~5 percent of top line earned from non-linear pricing.

Key imperatives
Pricing management is a significant profitability and positioning lever that Indian companies have not focused on enough in the past but would need to focus on, going forward. Companies need to treat pricing management as a discipline itself that requires senior management attention on an ongoing basis. It may be worthwhile for companies to enhance price setting and governance mechanisms before embarking on the non-linear based pricing models. Estimation models and assumptions used therein also need to be made robust to ensure that it is truly a win-win proposition.

Isolate key performance indicators (KPIs)
Success in non-linear pricing management will depend on the ability to isolate and measure business drivers or KPIs, which is by far the greatest challenge of non-linear pricing model, especially in outcome based pricing. Since this step requires a serious commitment from the client, this needs to be a collaborative process, with a joint task force to formulate tasks which can come under the umbrella of non-linear pricing and set up a measurement process accordingly. It is essential though that the firm moves away from their erstwhile selling proposition of total cost of ownership (TCO) optimization to a more tangible gain sharing understanding with client to achieve any significant gains in terms of non-linearity.

Build a baseline repository
Since non linear pricing is a relatively recent phenomenon; Indian IT firms are at a back foot with respect to historical points of reference when embarking on a new deal. Non-linear pricing models can be perfected only with sufficient data points and experience which can act as a guiding factor to decide on key KPIs and outcomes. Dedicated investment in building a baseline KPI database and senior management teams which can steer the initiative can drive strong execution in outcome based pricing deals. This would also be a step towards creating frequent repeatable model elements.

Creating a “consultative” front end
Consulting skills will be required in engaging with client stakeholders at various levels to gather business insights, obtain buy in and drive change that will ultimately deliver business results. In addition, these skills would be leveraged at all stages of engagement, right from the project conceptualization stage through execution involving creating of metrics scorecard, governance, tracking and monitoring. Hence it is imperative that companies explaining outcome-based pricing , invest in a “consultative” front end to manage these engagements. This will ensure that both the parties are able to leverage the benefits of this model, leading to a more mature and strategic relationship between the customer and service provider.
Mr. C. P. Gurnani  
CEO,  
Mahindra Satyam

Views on the innovative models prevalent in the industry...  
Interestingly, Indian IT companies are already on the unbeaten path and embracing innovation. Some models that have worked wonders in the IT-BPO sector are:

- Automotive initiatives where leading service providers are leveraging their technological competency to automate back office operations
- Evolution of new business models - “Platform based service” and “Business Process as a Service” - to cater to dynamic needs of buyers will play a significant role in imminent future.

Views on Innovation in the IT-BPO Sector in India...  
In short, innovation is "a dramatic game changer exemplified by improved margins, reduced risk, delighting customers, and introducing new capabilities. Sometimes we confuse productivity improvements with innovation and that is something we need to be careful about."

On Non-linear growth: trends in the industry today...  
Software-as-a-service (SaaS) is the trend that has the potential to alter IT industry landscape along with Cloud which is provided 'as a service' to external customers using Internet technologies. Deep specialization into sub vertical processes will be an imperative for commercial success in the new arena of alternative services delivery.

On company’s current initiatives for non-linear growth...  
The formula for future success which "Mahindra Satyam is closely following - microverticalized solutions, which will indeed lead to market fragmentation. This fragmentation will spawn vendor-led innovation, increased choice to the buyer and differentiated value in prebuilt solutions leading to a win–win situation for customers."

Initiatives that the government needs to take...  
While the Government is going to the grass root level to provide basic education, the time is now to provide the youth with knowledge which will that will enhance their skill sets and enable to apply for specialized jobs. The need of the hour is also to foster a culture of innovation in colleges and encourage and assist in all possible ways, path breaking thoughts and ideas, especially in the areas of energy, science, utilities and finance. This can be done in various ways like Grants, Fund Generation, Awareness Drives and Curriculum Based programs.
Delivery accelerators

Executive summary

Of late, companies have started leveraging CoEs to develop reusable tools which could be used across multiple customers accelerating deployment time and attaining efficiency. One of the outcomes of these CoEs are the solution accelerators which are essentially pre-built software that help in lowering TCO and offer greater flexibility in customization. Almost all Indian IT majors have invested in building these tools and have had some successful implementations too. These tools bring in reusability and hence, reduce the total cost and effort required for implementation, adding non-linear effect. In order to achieve non-linearity, companies would need to invest in building CoEs, assembling knowledge management practices and hiring the requisite talent mix to support these. The productivity benefits could go a long way in differentiating players from competition.

Companies are adopting means to accelerate their deployment process in projects and attain cost efficiencies. Of late, companies are investing in Centers of Excellence to develop reusable assets like solution accelerators, software tools, templates, business process, etc. Solution accelerators are one of the incremental ways which global and Indian companies have been using to attain higher efficiency and easy replication.

These are essentially pre-developed software products that help accelerate implementation of business solutions for clients. A typical solution accelerator could contain readily deployable process frameworks, templates, tools and partial code modules. These could be industry focused, technology focused or could span across both.

These pre-built software help in bringing down the total cost of ownership through reduced time to market and lower deployment efforts ensuring reusability. As per definition by Forrester, 30 to 70 percent of code could be reused while using solution accelerators across engagements. Solution accelerators also offer greater flexibility when it comes to customization as they can be reconfigured based on the nature of a client’s business processes. When compared to products, they are more agile as they are only partially finished unlike products. Apart from bringing productivity gains, they also de-risk the implementations by making outcomes predictable.

Categories of solution accelerators

Select Categories of Solution Accelerators

<table>
<thead>
<tr>
<th>Readily deployable process frameworks</th>
<th>Pre-built templates</th>
<th>Software tools</th>
<th>Partial code modules</th>
<th>Business application components</th>
</tr>
</thead>
</table>

Source: KPMG in India - CII Summit 2012, Non-linear models 2012 Analysis

Solution accelerators

- **Industry focused** – Automates business processes specific to an industry/domain
- **Technology focused** - Automates business processes specific to a particular technology implementation or a service line
- **Industry and technology focused** - Automates implementation of processes in solution implementation

Market scenario

IT majors are investing significant resources to develop technology labs or Center of Excellence (CoE) whose sole directive is to build software/solution frameworks, accelerators and create IP. Some of the CoEs also work on a ‘Lab on hire’ concept for clients which designs solutions, offer consultation on make/buy decisions for platforms and also, serve as a Simulation & Testing Lab for projects. As an example, the TCS Automotive Center of Excellence (CoE) serves clients by leveraging the firm’s automotive domain knowledge and pre-built business models and solution accelerators. Wipro’s high-tech ‘Lab on Hire’ services can help organizations optimize IT investments and reduce costs involved in testing services management like tools purchase and managing licenses.

Of late, several Indian IT companies have built solution accelerators and benefited from them. Amongst the larger ones, TCS has a solution accelerator portfolio spanning industry verticals such as the ‘Due Diligence Cube’ for its manufacturing clients and the ‘Retail Accelerator Solution’ for the automotive segment. Similarly, peer Infosys offers the ‘Manufacturing Collaboration Accelerators’ for the manufacturing segment, and ‘Test Automation Accelerator (ITAA)’ as well as ‘Cloud Strategy and Consulting Accelerators’ for the various sectors it serves.
Software major, IBM, has committed significant investment towards building such software at its Global Business Solutions Centre in Bangalore30. Small and mid cap IT companies are focusing more on domain specific solution accelerators. For example, Persistent Systems has developed a solution accelerator for rapid integration of Skype video calling on embedded devices such as connected TVs, IP set top boxes, mobile internet devices, media phones and more31. NIIT Technologies has worked on an airport portal solution accelerator that addresses the needs of the airport portals32.

Smallers firms are sticking to their domain expertise; for example Sonata Software recently established a dedicated CoE for mobility, with a dual focus on supporting ISVs and enterprises.

**Financial Perspective**

As per Forrester more than a dozen solution accelerators save an average of 25 to 30 percent of time in a project implementation cycle for a client as they are meant for multi-client implementations33.

**Case Example**

Among the top Indian software firms, TCS is at the forefront of creating technology and engineering solution accelerators for leading global IT product and platform companies1. According to the company management, “Austere investments in quality assurance and software testing space, including solution accelerators and frameworks created by the Company’s in-house R&D team, are paying handsome dividends.” TCS claims that well-proven components can typically generate cost savings of 30-40 percent through reuse. The business excellence program at TCS has developed over 750 solution accelerators/ productivity components across the three areas: (a) technology services; (b) business processes; and (c) vertical domain. This has enabled TCS to be aggressive while pitching for large projects, by highlighting its cost competitiveness2.

Some of the key solution accelerators which TCS has developed are3:

- **TCS SOLAR Framework** is a service oriented framework to strategize and deliver Business Intelligence & Performance Management solutions for clients

- **TCS Code Generator Framework** (TCS MasterCraft) provides an integrated environment along a product or application development life-cycle. By significant re-use of code, it speeds up new application development, legacy system integration, and/or making enhancements.

**Key Imperatives**

Though the Indian software industry has reached some degree of maturity, yet, it has not reached the levels of standardization as achieved in other traditional industries such as manufacturing and automotive. Most of these industries have achieved higher efficiency and reaped productivity gains through extensive standardization, replication and reusability. A key driver for this is the extensive investment made in creating reusable tools, templates, business processes to be used for all customers bringing highest level of automation. A Center of Excellence (CoE) is one of the channels which can help create these tools & technologies of standardization for IT companies.

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32. http://www.google.co.in/url?sa=t&rct=j&q=niit percent20solution percent20accelerator percent20aerospace&source=web&cd=1&ved=0CCYQFjAA&url=http percent3A percent2F percent2Fwww.niit-tech.com percent2Fimages percent2Ffiles percent2F21FAAAS.pdf&ei=xsoC4T4xB03oUyACzqYQDw&usg=AFQjCNGfZlWfFp0D5hKGlub9Pl5nOG4tHg
**Vertical and horizontal solution accelerators**

<table>
<thead>
<tr>
<th>VERTICALS</th>
<th>HORIZONTALS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>Supply Chain</td>
</tr>
<tr>
<td></td>
<td>• Business Process Templates</td>
</tr>
<tr>
<td></td>
<td>• Software Tools, Code, libraries</td>
</tr>
<tr>
<td></td>
<td>• Best Practices</td>
</tr>
<tr>
<td>BFSI</td>
<td>• Business Process Templates</td>
</tr>
<tr>
<td></td>
<td>• Software Tools, Code, libraries</td>
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<td></td>
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<td>• Software Tools, Code, libraries</td>
</tr>
<tr>
<td></td>
<td>• Best Practices</td>
</tr>
</tbody>
</table>

**Source:** KPMG in India - CII Summit 2012, Non-linear models 2012 Analysis

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**Invest in CoEs for creating assets**

Indian firms need to make significant investments in creating CoEs which can help them create assets bringing standardization. These could be software tools, templates, business process maps, etc. which are relevant for a particular type of customer under specific business conditions. To achieve the real benefits of standardization, companies need to invest in creating comprehensive reusable assets for all types of customers and for all conditions. Initially, these could be created only for major focus areas but could be expanded to all areas. Once these reusable assets are in place, there would be incremental efforts spent in modifying and improving it.

**Focus on internal awareness**

Often, it is found that companies have created tools but are not able to monetize it since the delivery teams and client management teams are not aware of its existence and benefits. Companies would need to ensure that once the tools are developed, the beneficiaries within the organizations are aware and are able to leverage them. Also, support and feedback mechanism needs to be in place so that these tools can be improved/modified as per the changes in business environment.

**Set the knowledge management tools in place**

To make it more effective and leverage the true benefits, it is critical that there is constant flow of information and knowledge between CoE and business. Knowledge management plays a crucial role in this. Companies need to invest in KM so as to allow the business to leverage the benefits of these accelerators.

**Hiring the right talent**

Apart from investments, companies need to hire the right talent sets with a right mix of domain/industry experts and process experts. These teams would differ from the regular pool of technical resources involved in delivery and would have significant technical and domain expertise with some R&D mindset.

IT services vendors who are focused on leveraging the benefits of standardization can differentiate their service quality and this will go a long way in offering better services to customers thus improving their bottom lines.
Branding

Executive summary
A higher brand perception can enable service providers to charge a premium for a similar category of services offered by its competition. While global technology firms have been largely agile in the branding game, their Indian counterparts have been lagging behind. A strong brand identity in terms of showcasing critical elements that clients look for may enable providers to increase their brand perception, augment profitability and ultimately contribute in their non linear growth strategy. Some of the components to build a strong brand would include highlighting technology/domain strengths, offering a symbiotic partnership proposition, articulating key differentiators vs. peers and delivering on the brand promise.

All else being equal, what makes one company command a pricing premium over another? Why are clients willing to pay a hefty price for precisely the same set of services that a vendor provides merely because they perceive a different and better value proposition? The answer is simple. A strong brand can make all the difference to a company’s growth trajectory. Brands add value to a basic product or service by enabling the product or service to command a higher price, or higher market share than an unbranded equivalent. The term Brand equity is used to describe both the value of the brand and the brand’s component values. Its value may be monetary, an increase in a rate of return or any number of softer market research measures such as awareness or consideration.

Branding in the global technology outsourcing market works at different levels of projected competence. To understand this better, we have categorized the brand projections of service providers in six levels:

- **Outsourcers**, who have mastered the ability to replicate commoditized tasks
- **System Integrators**, experts in bringing together component subsystems and making them work seamlessly
- **Technology Advisors**, experts who understand the finer nuances and limitations of the technology being implemented
- **Business Advisors** with a complete understanding of the business objectives and industry practices that are essential for a planned technology initiative
- **Business Technology Advisors**, who combine the best of both of the above by being experts in pertinent aspects related to both business and technology
- **All-in-Alls**, who are the one stop shop for all needs, providing sound advice on all areas of the projects, and accountable for the business outcome and ultimate success of the project. They are considered partners rather than just service vendors. This level of perception usually ensures that a technology provider reaps maximum benefits with minimum effort.

Market scenario
Cost benefits associated with outsourcing to India have ceased to be the exclusive domain of home grown India technology providers. Leading global technology brands have now established their offshore development centers in Indian cities and offer services that customers perceive as superior at comparable costs. Their Indian competitors are now realizing that they can no longer continue to under-invest in their brands, both financially and in terms of management attention.

“They have been caught napping. It may require a rethink of their positioning and customer value propositions to avoid potential risk,” says a BrandFinance report on India’s Most Valuable Brands.

It ranked TCS fourth among the top 50 brands. Wipro and Infosys slumped one position each to ninth and 15th place respectively.

As the world of IT services undergoes a radical transformation, brand perception will play a huge role in deciding the pecking order of those who survive the race for dominance in the industry. Forrester estimates how the world of IT service providers would change by then end of this decade.
Financial Perspective

An example of how a global technology firm used a strong branding initiative to gain competitive advantage over its peers will help signify how branding should be inherent to a company’s non-linear growth strategy.

Accenture: Rebranding and Repositioning

The year 1989 was a watershed year for Andersen Consulting when the consulting practice of the accounting firm Arthur Andersen separated to form an independent business unit. For close to ten years after the split, an estimated USD 7 billion was spent in building the Andersen Consulting brand. But therein came another blow. In arbitration against Andersen Worldwide and Arthur Andersen, Andersen Consulting was granted its independence in August of 2000, but as part of the ruling, the license to use the Andersen Consulting name was to expire December 31, 2000.

To deal with the new development, Andersen Consulting started to develop a new positioning that would formalize its position as a leader in the new economy. To distinguish Andersen Consulting from its competition, the firm developed a positioning platform that captured the company’s vision and strategy—positioning Accenture as a bridge builder helping companies close the gap from the old economy to the new. It also positioned the company as one who helped companies transform trends into business opportunities using its deep global knowledge, its unique vantage point and its breadth and depth of resources and relationships. This change in business strategy was realized through extensive market research with senior executives coupled with input from a team of brand experts. As Joe Forehand, Managing Partner of CEO of Andersen Consulting, explained in a press release: ‘We are a very different organization today than we were when we formed Andersen Consulting back in 1989, so adopting a new name and brand identity is a logical next step in our growth strategy."

To carry out the global rebranding and repositioning initiative, Andersen Consulting supplemented its annual USD 75 million marketing & communications budget with an additional USD 100 million. To create interest around the effort, it tapped the advertising agency Young & Rubicam to develop a teaser advertising campaign in support of the rebranding and repositioning effort. Following the specified launch schedule, Andersen Consulting announced its new name on October 26, 2000. Managing Partner and CEO, Joe Forehand commented on the new name at the time of the announcement: ‘Accenture expresses what we have become as an organization as well as what we hope to be—a network of businesses that transcends the boundaries of traditional consulting and brings innovations that dramatically improve the way the world works and lives."

Today, Accenture commands a market cap of USD 35 Billion and is a respected consulting firm across the world. It is the second most admired company in the world after IBM and constantly tops the perception charts. Despite having a similar operating model for service delivery as its Indian counterparts, the consulting and technology giant charges a significant pricing premium over its Indian peers which, according to some industry experts, are almost 20 percent higher than the existing rates. It would seem that the company’s extensive branding effort over the years has borne rich dividends.

Source: Forrester Research, Inc.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Name</th>
<th>2010 revenue (USD billions)</th>
<th>Estimated Top 10 service providers, 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>IBM</td>
<td>USD 55.0</td>
<td>1. IBM</td>
</tr>
<tr>
<td>2</td>
<td>Accenture</td>
<td>USD 23.2</td>
<td>2. Accenture</td>
</tr>
<tr>
<td>3</td>
<td>HP/EDS</td>
<td>USD 21.5</td>
<td>3. Infrastructure consolidation</td>
</tr>
<tr>
<td>4</td>
<td>CSC</td>
<td>USD 16.7</td>
<td>4. European consolidation</td>
</tr>
<tr>
<td>5</td>
<td>Fujitsu</td>
<td>USD 14.0</td>
<td>5. Consolidation of Japanese players</td>
</tr>
<tr>
<td>6</td>
<td>T-Systems</td>
<td>USD 11.4</td>
<td>6. Product vendor wildcard</td>
</tr>
<tr>
<td>7</td>
<td>NTT Data</td>
<td>USD 10.5</td>
<td>7. Telecom wildcard/consolidation</td>
</tr>
<tr>
<td>8</td>
<td>Xerox/ACS</td>
<td>USD 9.7</td>
<td>8. salesforce.com</td>
</tr>
<tr>
<td>9</td>
<td>Capgemini</td>
<td>USD 8.7</td>
<td>9. TCS/Infosys</td>
</tr>
<tr>
<td>10</td>
<td>Atos Origin</td>
<td>USD 7.0</td>
<td>10. Product development roll-up</td>
</tr>
</tbody>
</table>

Note: Rankings and revenues are estimates.
**Perception Value Top 10 Winners**

<table>
<thead>
<tr>
<th>Company</th>
<th>New Media</th>
<th>Social Media</th>
<th>Twitter</th>
<th>Total</th>
<th>USD Change</th>
<th>^PV/IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blackberry</td>
<td>USD 3,692</td>
<td>USD 19,392</td>
<td>USD 962</td>
<td>USD 24,046</td>
<td>USD 48,002</td>
<td>70.3 percent</td>
</tr>
<tr>
<td>Accenture</td>
<td>USD 2,338</td>
<td>USD 2,971</td>
<td>USD 83</td>
<td>USD 5,393</td>
<td>USD 3,241</td>
<td>35.7 percent</td>
</tr>
<tr>
<td>Hermes</td>
<td>USD 1,130</td>
<td>USD 4,588</td>
<td>USD 120</td>
<td>USD 5,838</td>
<td>USD 4,299</td>
<td>33.0 percent</td>
</tr>
<tr>
<td>Philips</td>
<td>USD 1,173</td>
<td>USD 6,665</td>
<td>USD 217</td>
<td>USD 8,055</td>
<td>USD 4,490</td>
<td>32.3 percent</td>
</tr>
<tr>
<td>Colgate-Palmolive</td>
<td>USD 3,059</td>
<td>USD 930</td>
<td>USD 37</td>
<td>USD 4,025</td>
<td>USD 2,500</td>
<td>30.9 percent</td>
</tr>
<tr>
<td>3M</td>
<td>USD 1,535</td>
<td>USD 4,750</td>
<td>USD 158</td>
<td>USD 6,443</td>
<td>USD 3,956</td>
<td>26.4 percent</td>
</tr>
<tr>
<td>Danone</td>
<td>USD 1,734</td>
<td>USD 396</td>
<td>USD 14</td>
<td>USD 2,144</td>
<td>USD 1,118</td>
<td>25.8 percent</td>
</tr>
<tr>
<td>Goldman Sachs</td>
<td>USD 13,549</td>
<td>USD 2,967</td>
<td>USD 52</td>
<td>USD 16,568</td>
<td>USD 14,199</td>
<td>24.9 percent</td>
</tr>
<tr>
<td>Audi</td>
<td>USD 4,254</td>
<td>USD 8,606</td>
<td>USD 471</td>
<td>USD 13,331</td>
<td>USD 7,477</td>
<td>24.1 percent</td>
</tr>
<tr>
<td>Ikea</td>
<td>USD 3,871</td>
<td>USD 884</td>
<td>USD 236</td>
<td>USD 4,991</td>
<td>USD 2,764</td>
<td>21.5 percent</td>
</tr>
</tbody>
</table>

Source: General Sentiment, Inc. 2010

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**Case example**

The most watched soccer game in American television history, the FIFA World Cup 2010 finals between Spain and Netherlands attracted over 700 million viewers worldwide, beating the 600 million that caught the opening ceremony at the 2008 Beijing Olympics. 16.8 million Spaniards and 8.5 million Dutch - 91 percent of the TV audience in their respective countries\(^1\), watched the game as did some 24.3 million Viewers in the US\(^2\).

This global sporting event was an unlikely benefactor to Mahindra Satyam going through a hard time in terms of client perception because of the recent accounting scandal and economic downturn. Mahindra Satyam tied up with FIFA, for which it managed the IT services and application development program in return of getting prominent visibility during the sporting event. The company’s logo appeared across the side boards alongside some of the best brands in the world at the ongoing FIFA World Cup 2010 in South Africa. This brand recognition helped Mahindra Satyam bag several large clients from the sporting segment, a key win being the multi-million dollar deal with Aspire Zone Foundation in Qatar, one of the leading sports institutes in the world in March 2011\(^3\).

Source:
1. Reuters article, July 13, 2010
2. Huffington Post, July 12, 2010
3. Financielexpress.com, March 16, 2011

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**Key imperative for branding**

- Develop a comprehensive, integrated brand strategy
- Right positioning- Don’t confuse the market
- Showcase the right strengths
- Deliver on the brand promise

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**Key imperatives**

A comprehensive, integrated brand strategy is vital to ensure success in the marketplace. Developing a brand strategy requires following few key steps:

- Identify and understand the target market segment
- Articulate key components of the brand in-house
- Test and enhance brand values with the target market
- Communicate clearly and consistently across the right media formats
- Delivering on the brand promise

While designing a potent branding exercise, the following factors need to be kept in mind:

**Right positioning- Don’t confuse the market**

Customers have long considered labour arbitrage as the key selling point for Indian IT majors. Only in recent years have Indian vendors tried to change this perception by attempting to move up the value chain and establishing themselves as premium players. Notwithstanding their best attempts to position themselves differently, Indian software providers still undercut on price if the client so demands. This dilutes the very intent of the high value brand they are trying to create.

**Showcase the right strengths**

It was only in the late 90’s that IBM ventured into the software and solutions space. In 2004, the global technology major...
major transformed from being a software solutions to a premium solution delivery provider via acquisitions (Trigo, Alphablox, Cyanea, Venetica, Maersk Data, Systemcorp) that strengthened their portfolio in high end services\textsuperscript{42}. When recession hit economies around the world, IBM chose to go ahead with its ‘Smarter Planet’ campaign and in 2010 its brand value surged 30 percent over the previous year to USD 86 billion\textsuperscript{41}.

IBM has built its brand equity by putting a disciplined brand system in place over the years and showcasing its strengths and key differentiators at various stages of its existence. Thus, it is crucial in the branding process that companies continue to actively identify pockets of expertise that they can showcase to clients and command a premium from them. In addition, building an all round competence and projecting the promise of a one-stop-shop to meet all client requirements, right from conceptualization to procuring and deploying the services at competitive prices is key to commanding a strong brand. An added benefit is demonstrating an organization culture of innovation.

Delivering on the brand promise
Instead of focusing on building the perfect brand, companies should focus on developing a solid business model that delivers on the brand promises and brand values. The idea should not be how much to spend but how well you define and deliver the service and how effectively you communicate the value proposition. Branding is effective only when it is perceived to offer a real benefit for its audience and a demonstrable point of difference\textsuperscript{42}.

40. IBM sticks to premium branding strategy through downturn by The Economic Times, published on 30th June, 2009
41. Local IT firms lag on branding quotient published by DNA Money on 24th March, 2011
42. www.gantrygroup.com

Mr. Harsh Manglik
Former Chairman NASSCOM, and Former Chairman and Geography Managing Director of Accenture-India

“The future offers neither guarantees nor entitlements … only possibilities. Individuals organizations are a key a part of the system to realize the potential, but not the only ones. Governments too have a critical role through sound and consistent policies that contribute toward creating an attractive and stable environment for investment and commitments of resources, where global alternatives exist.”

Innovation in the IT-BPO/ITeS Sector in India Views on the innovative models prevalent in the industry (products/services/business models) and the imperative for the industry to undertake innovation at multiple levels given the market realities

A spirit of constant innovation is fundamental for sustained growth and business competitiveness not just in IT-BPO/ITeS but in all areas of enterprise. But it is even more important in IT-BPO/ITeS because the industry got its start based on leveraging the favorable cost differential that India provided. The recognition and capture of that potential was innovative but that is no longer enough. All the dimensions of business lend themselves to innovation, including the basic value proposition, delivery system, approach to talent, and business model.

Since customers take a global view and have global alternatives, the role of governments is important as well since it is critically important to have policies that are sound and stable, advanced infrastructure and nurturing of human capital. The nations and regions where these are done well become attractive for investments and as long term “bets” by customers. “Surprises” and lack of consistency undermine the overall attractiveness.

Non-linear growth: Trends in the industry today, what is working and what is not. Also, your company’s current initiatives for non-linear growth
The operating environment globally is ever evolving and is always associated with emerging opportunities but also threats. Non linear, or dramatic, growth cannot be attained by maintaining the status quo. The idea of a race provides a good metaphor where one is either getting ahead or getting behind. Innovation, across all dimensions of the environment …. by both businesses and governments … provides the potential means for developing competitive differentiation, and through it the basis for pulling ahead and dynamically maintaining the lead.

The emergence of “Cloud Computing”, business propositions where analytics are embedded, and innovative structuring of career propositions to attract and retain the best talent, are examples of innovations that different organizations are following to sharpen and strengthen their competitive positions with the idea that these would help create non-linear growth for them.

Government: Initiatives that the government needs to take in order to support innovation, in turn facilitating non-linear growth in the industry
At its heart, successful Innovation is about people who are curious, imaginative, confident and have well developed faculties for critical thinking and working together with open minds. These capabilities evolve over time through developmental experiences, starting from childhood and go well into adulthood. Therefore educational philosophy plays a critical role, in addition to the culture of organizations where people work.

The role of government becomes critical because for much of India it is essentially the shaper and driver of educational policy, at all levels. Governments can give a powerful boost to a national culture of Innovation through a thoughtful development of the educational approach and by ensuring that the educational policies and implementation develop rather than stifle the potential for innovation. Innovation does not work well in authoritarian and hierarchical environments. Nor is it nurtured when uniformity and conformity dominate. Diversity of exposure and understanding are very important.
The last decade has seen a steady growth in M&A activities of IT-BPO companies driven by huge growth opportunities present in both domestic & global market. M&A has been one of the key strategies adopted by companies globally for acquiring both scale and depth in business. Globally, M&A and PE investments are directly linked to the state of the economy. As a result, 2008 and 2009 witnessed a significant decline in global M&A activity as world economies slowed due to the recession and shrinking investment funds. M&A deal values declined and investors & sellers adopted a wait-and-watch approach. However, the last 2 years have seen a global revival leading to an uptick in M&A activity. The cash flow pressure for the companies has lead to consolidation of the small and mid-sized firms for sustenance in the extremely competitive industry.

The current economic conditions are conducive for consolidation as small and mid-sized players are struggling for sustenance. Indian companies have started to look at inorganic route for non-linear growth. Global companies have always been ahead and spearheaded M&A route for innovation and strengthening product/IP business. Indian companies have been reactive in this area unlike the global software majors. Indian companies need to take risks and make bolder acquisitions in unexplored but promising areas. Focusing on integration post acquisition is another critical lever for success. Also, companies need to keep a long term view and evaluate the benefits of acquisition. If need be, companies may also need to take the bold step of hiving off the acquired business unit if synergies have not been realized after a sufficient amount of time.

**Executive summary**

M&A has been a strategic growth engine for firms since last couple of years. The current economic conditions are conducive for consolidation as small and mid-sized players are struggling for sustenance. Indian companies have started to look at inorganic route for non-linear growth. Global companies have always been ahead and spearheaded M&A route for innovation and strengthening product/IP business. Indian companies have been reactive in this area unlike the global software majors. Indian companies need to take risks and make bolder acquisitions in unexplored but promising areas. Focusing on integration post acquisition is another critical lever for success. Also, companies need to keep a long term view and evaluate the benefits of acquisition. If need be, companies may also need to take the bold step of hiving off the acquired business unit if synergies have not been realized after a sufficient amount of time.

**Factors fueling growth of M&A in India**

- **Alignment with Market opportunities**
- **Conducive Policies**
- **Top line growth**
- **Market expansion**
- **Disruptive technologies**
- **"Seat at the table" for large deals**
- **Global downturn**
- **Portfolio expansion**

**Market Scenario**

The story of the evolution of M&A deals in India

Traditionally the Indian IT-BPO companies have acquired companies for scale, geography, headcount addition, domain expertise and to leverage or set up Global Delivery Model. However they have seldom looked beyond their core business model. It is only in the last 2 years that companies have started taking the inorganic route to target non-linear growth. A number of Indian IT firms in spite of the significant cash balances on their balance sheets were conservative and risk averse which has put them way behind the global counterparts. In India the numbers of deals for non-linear growth were relatively few. Below are some of the deals with non-linear growth intent:

- **TCS – FNS acquisition:** TCS’s acquisition of Sydney-based Financial Network Services (FNS), an Australian core banking solutions company, led to the evolution of what is today known as ‘TCS BaNCS’ product.
- **WNS’s – BizAps acquisition:** WNS acquisition of Business Applications Associates (BizAps), a provider of SAP solutions to optimize ERP functionality for finance and accounting processes, strengthened its position in platform-based services.
- **Aditi Technologies – Cumulux acquisition:** Aditi Tech., a software product and application development services provider, acquired Seattle-based cloud-computing start-up Cumulux to gain capabilities around Cloud and move to non-linear model.
Evolution roadmap for M&A’s in India

Global scenario
Global companies have always been ahead in envisaging the future trends in technology on the basis of which they strengthen their product/service offerings, accelerate innovation, obtain critical mass, meet customer demand more rapidly, and leverage partnership opportunities. The approach is also reflected in the M&A strategy for global companies. Based on the trends in the M&A space we can segment past/current acquisitions into three categories: Market acceleration, Market expansion, and New market entry.

In the Global M&A scenario, companies are now focusing on:
- IP and technology assets
- Enterprise Mobility
- ERP Platforms
- Niche Capabilities
- Capturing the complete Value Chain.

Global M&A Scenario (FY11)
- Converging trend including security, social media, mobility and cloud computing driving M&A
- Mix of big and small strategic deals as companies make small acquisitions and weave them together to address strategic goals.
- Multiple deals by to enhance competitiveness and build capabilities, for example Google in the last 2 years did 50+ acquisitions around social networking, mobile video, mobile advertising & payment technologies.
- For rapid technology innovation many large companies acquired small companies and R&D units.

Source: Gartner Symposium, KPMG in India - CII Summit 2012, Non-linear models 2012 Analysis
Below are the indicative M&As in Indian & global markets over the last decade. The nature of M&As indicate that while there is a lag in some of the scenarios in the way M&A has evolved and matured in the Indian and global markets, some areas are totally unexplored. The Indian companies are reactive unlike their global counterparts which define the trends, bear the risk, transform the business model and transition the customer mindset.

### Global and Indian M&A Trends

#### GLOBAL

- **2006-08**
  - Oracle - Hyperion & Siebel
  - Google - Double click & YouTube
  - SAP - Business Objects
  - Cisco - Nixx
  - IBM - Cognos

- **2009-11**
  - Google - AdMob & Slide.com
  - Oracle - Sun
  - IBM - DemandTec
  - SAP - SuccessFactor
  - Microsoft - Venga

#### INDIA

- **2006-08**
  - HCL - Axiom
  - WNS - Avista BPO
  - TCS - UI Solutions
  - EDS - Naphis
  - Wipro - Infocrossing

- **2009-11**
  - iGate - Patni
  - Cognizant - Headstrong
  - Sero - Intelnet
  - GridEye - Dimension One
  - Tech Mahindra - Satyam

### Evolution of Global M&A deals

The diagram illustrates the phases of M&A deals:

- **Strengthening Phase**
  - Acquisition of Related products/services
  - Addition of Brands and new features in the existing profile

- **Expansion Phase**
  - Adding new service capabilities
  - Acquiring Technology assets
  - Focus on enterprise application capabilities

- **Diversification Phase**
  - IP Led Acquisition
  - Acquiring niche technologies
  - Set up new business models through acquisitions
  - Acquisition of cross platform application

- **Innovation Phase**
  - Acquisition in Cloud Computing
  - Acquisitions in Internet space
  - Complete portfolio of software, hardware, application and services
Financial Perspective

Google – Android

Google acquired a small software start-up – Android – in August 2005 for an estimated USD 50 Million\(^5\). The acquisition helped Google gain talent including co-founder Andy Rubin, who had previously also started mobile-device maker company - Danger Inc.\(^6\). In no time, Google Android started witnessing a significant surge in demand with activation rate growing at a staggering rate. The company is now activating 700,000 devices per day, translating into 255.5 million Android devices annually. At this rate, it is expected to outturn Apple by 2013 which is selling nearly 260 million iOS devices\(^7\).

As a result company’s revenues from Android have been increasing at a considerable pace. A small start-up which remained dormant for some time even after its acquisition by Google in 2005, contributed nearly USD 1 billion to company’s revenues in 2010\(^8\). It now contributes USD 2.5 billion a year though mobile advertising & services, growing 2.5 times in the last 12 months\(^9\).

HCL – Axon

HCL acquired Axon in December 2008 for USD 658 million\(^10\). The acquisition was aimed at blending the SAP practice of target with existing capabilities of acquirer and come up with productised solutions for large transformational engagements. Company’s revenues from Enterprise Applications stream before the acquisition of Axon stood at USD 180.6 million in FY 2007 and USD 206.5 million in FY 2008, accounting for 13 percent and 11 percent of company’s revenues respectively. The acquisition was able to help the company expand its revenues from this stream to reach USD 718.0 million in 2011 accounting for 21.3 percent of company’s revenues\(^11\).

TCS BaNCS

TCS acquired Financial Network Services (FNS), an Australian core banking solutions vendor in 2005 for approximately USD 26 million\(^12\). Post acquisition, TCS integrated it with its Financial Solutions portfolio, a company’s arm dedicated to provide application solutions to financial institutions globally. TCS BaNCS, its portfolio of banking solutions, has been deployed across 240 companies in over 80 countries\(^13\).

The company’s revenues from Banking, Financial Services and Insurance (BFSI) vertical has grown from INR 2,796.8 crores in 2005 to INR 16,527.3 crores in 2011. As a percentage of total revenues, the sector currently contributes 44.28 percent of the company’s total revenues as against 34.48 percent in 2005\(^14\).

Case Example

From modest beginnings as a small services firm in the late 80’s, Rolta India has built upon a steady stream of acquisitions to become a world leader in the GIS, CAD/CAM space in a little over two decades. In response to the market’s changing needs and to fuel growth, Rolta has acquired companies with world-class IPRs, in addition to pure technologies, which have enabled Rolta to move up the value-chain and offer cutting-edge solutions to customers world-wide. Forbes Global has ranked Rolta amongst the “Best 200 under a Billion” four times in six years while the company was included by Standard & Poor on their 2008 Global Challengers List.

Through its intelligent extension of expertise and knowledge acquired in one business, Rolta has successfully launched new businesses. Rolta’s acquisition strategy is clear and focused. It acquires companies, business divisions or technologies – that are at the cutting-edge, synergistic with its lines of businesses, have an established track record, give it access to new markets, are culturally compatible and enable it to move up the value chain. In line with this, Rolta has acquired many companies like Orion in Canada, TUSC, Piocon and OneGIS in the US. While Orion brought in enterprise wide GIS integration technology, TUSC has been an industry-leader in providing assessment and implementation for mission-critical IT and business systems. Piocon brought in high-level BI solutions for engineering and OneGIS brought consulting, development and systems integration capabilities.

With each of these acquisitions, Rolta added another piece of the GIS/CAD/CAM pie of its product portfolio. These acquisitions have not only brought in critical technology, in the form of source code, design & software, but also added rich domain knowledge, consultants, project expertise, credentials, references and customers. Leveraging this expanding pool of its IPR, Rolta has also successfully launched various innovative solutions for its markets, by offering differentiated solutions at the high-end of the value chain, encompassing enterprise-level decision support systems for selected vertical segments. Rolta has developed flagship solutions frameworks that provide deep application integration and insightful business intelligence across an enterprise. These include, Rolta Geospatial Fusion in the geospatial domain; Rolta OneView for process and power industries; and Rolta iPerspective as a platform for IT integration and management.

Source:
- Rolta Annual Report 2010-11
- Articles on Livemint, Priyoda and Directionsmag
- Rolta Press release
- Rolta Chairman statement in Economic Times

Key Imperatives for Mergers and Acquisitions

Make bolder acquisitions; not necessarily bigger

Post Merger; Integrated or Federated?

Balance Acquisitions across the type of end-goals in mind

Acquire with a long term view, not for short term revenue

Evaluate and track success - Hive off if synergies are not realized

Key Imperatives

M&A is a route, which if executed successfully, can lead to targeted results which could take years to achieve if done in an organic fashion. Having said that, there have been numerous instances of spectacular M&A failures. The upshot is that M&A is a necessary evil, which companies need to embark after few years of existence for venturing into new direction and business models.

We explore some of the key imperatives which can be considered while venturing into M&A.

49. Company Press Release
50. “Google acquires 700,000 Android Devices Daily”, December 2011, Business Insider
51. “How will Google make money from Android?”, September 2011, Microviews
52. “Mobile generating equivalent of $2.5bn a year, says Google chief”, October 2011, The Guardian
53. Company Press Release
54. Company Annual Reports
55. Company Data
56. Company Financial Reports
Make bolder acquisitions; not necessarily bigger
Indian players will need to make bold bets – like acquiring a few startups which may seem completely irrelevant to what the company does; this will help them venture into disruptive technologies that will define the markets of the future. The previous economic downturn had given the Indian industry a good opportunity to acquire companies in western world owing to their attractive valuations. Indian firms, however, were conservative in their approach and did not leverage this opportunity.

Post Merger: Integrated Or Federated?
One of the key questions post M&A is ‘how fast and effective’ has been the post merger integration. This is the right question to ask in scenarios where the acquisitions were of companies that are similar to the parent in terms of business, culture, ecosystem and focus.

To take a leap now, companies will need to acquire companies that are going to be drastically different to them – culture, business model, ecosystem, probably geography, type of talent etc., will all be different. These could be startups or a company dealing in business lines of future that the parent company is not currently exposed to. For acquisitions such as these, the challenge will be to

- Keep the acquired company independent from the parent by having in place a federated structure
- Put in place a mechanism that allows the parent firm to leverage the benefits derived from the acquired company despite a decentralized structure in place

Balance acquisitions across the type of end-goals in mind
Indian players will need to balance their acquisitions to ensure that while they make bold moves in trying to transform their business model, they also need to continue to make acquisitions which help their conventional businesses grow through service line extensions, geographic expansions and the like.

Acquire with a long term view; not for short term revenue spurt
Though not necessarily limited to the IT industry, M&A has been used as a tool to achieve sudden revenue spurs, though the end goal might be different for each company.

• Strategic M&A – acquire high margin, niche expertise businesses e.g. cloud based receivables management, analytics in social media
• New Product Innovation - leverage solution and services which can be created, packaged and sold as ‘products’ e.g. social media or supply chain analytics, anti-money laundering etc.
• Transaction based pricing – through BPaaS & standardized offerings – e.g. in HRO, OTC, insurance claims etc.
• Use SEP (Smart Enterprise Processes) to drive Outcome based pricing
• Drive Smart Decision Services to get to high value added predictive analytics

Innovation in the IT-BPO/ITeS Sector in India: Views on the innovative models prevalent in the industry (products/services/business models) and the imperative for the industry to undertake innovation at multiple levels given the market realities
The potential for process innovation remains huge; there is significant client appetite, however, execution has been slow, hampered by disagreement on scope and lack of effective governance including shared investments and risks. At Genpact, our innovation efforts are focused around process disruption, smart decision support including advanced analytics and bundling service + technology into new productized solutions.

Government: Initiatives that the government needs to take in order to support innovation, in turn facilitating non-linear growth in the industry
The Government needs to enable an environment that helps improve ‘innovation intensity’ of the service industry working with industry bodies, institutes, investors and service providers. Few specific areas that should be worked upon are:

- Improve transparency and regulations around private-public partnerships in the field of higher/ vocational education and research
- Facilitate building technology and service focused ‘incubators’ and forums bringing together entrepreneurs, investors, companies, and institutes focused around IP creation
- Simplify regulations and procedures required to establish businesses, conduct research and file for IPR especially for entrepreneurs and SMBs in technology and services

Mr. N.V. ‘Tiger’ Tyagarajan
President and CEO, Genpact

Non-linear growth: Trends in the industry today, what is working and what is not.
Also, your company’s current initiatives for non-linear growth
Most players including large BPO and ITO players have placed strategic focus on non-linear growth, but it hasn’t grown as fast as one would have assumed. We continue to see significant risk aversion to truly going outcome based especially in developed markets vs. emerging economies. The latter seems completely irrelevant to what the company does; this will help them venture into disruptive technologies that will define the markets of the future.

At Genpact, we’re looking specifically at 5 levers for non-linear growth
- Make bolder acquisitions; not necessarily bigger
- Post Merger: Integrated Or Federated?
- Balance acquisitions across the type of end-goals in mind
- Acquire with a long term view; not for short term revenue spurt
- Innovation in the IT-BPO/ITeS Sector in India: Views on the innovative models prevalent in the industry (products/services/business models) and the imperative for the industry to undertake innovation at multiple levels given the market realities

For example, in recent times a few Indian IT Players acquired companies to reach the billion dollar threshold to be able to qualify for the larger transformational deals in the marketplace along with the leaders. In other cases, companies corted to M&A primarily to give a boost to their revenue owing to pressure from investors.

In summary, companies need to be cognizant of the value a particular deal brings in – both to the parent, to the acquired company and to the industry as a whole; latter being an important factor especially in the coming decade.

Evaluate and track success - Hive off if synergies are not realized
Conventional tenet of acquisition is to acquire a company and merge it with the parent so that it gets subsumed and becomes a part of the parent company for life. However, the list of M&A disasters is fairly large and not all M&As turns out to be a success. In cases where companies are acquiring out of their comfort zone, the probability of failures increases as there could be cases when synergies aren’t realized even with a long wait. In such situations, the companies should be in a position to hive off the acquired business unit (Eg.: eBay sold Skype in 2009 which was acquired in 2005).
Software service providers can accelerate their growth and reposition themselves in the market place by adopting certain non linear initiatives. However, apart from software companies, we believe that a transformation of this magnitude can happen with support of other players in the ecosystem – which in our case constitutes government, industry bodies, academia, clients, PE/VC Funds and consultants.

**Government**

The Government’s role in the future of this sector is multi-fold:

- Help create an environment that is conducive to innovation and growth
- Rationalize taxation structures and transfer Pricing Laws
- Provide adequate future-ready infrastructure to nurture the industry
- Help develop the domestic market

Favorable policy actions by the government around these four aspects will encourage the Indian players to strengthen their services for the global marketplace and foster innovation that can be taken global. In addition, MNCs will be encouraged to invest more in R&D specific work in India, helping build the ecosystem and talent pool required for idea incubation and development.

**Create conducive environment for innovation and growth**

- **IP protection**: With companies increasingly focusing on new business models and investing in IP/patents/products, software patent disputes are bound to rise. Hence, there is a strong need to evaluate and update current patent protection laws to avoid future litigation and provide global clients the confidence to work with Indian companies.

- **Cybercrime**: With the phenomenal growth of the industry, the last few years witnessed a sharp spurt in cybercrime. The Government needs to proactively frame policies to facilitate investigation and prosecution in cases of cybercrimes by corporate and individuals. The redressal mechanisms in particular needs to fast, simple and convenient.

- **Funding**: Government should encourage public-private investment vehicles to channel large sources of funds towards start-ups, small and mid-sized firms for promoting entrepreneurship in the country. The government could also review restrictions on non-corporate organization structures for venture investing.

- **Global outreach**: The government could explore partnerships with countries of strategic importance to establish bi-national/multi-national funds for investing in product ideas in designated areas of mutual importance.

**Rationalize taxation structures and transfer pricing laws**

- **Transfer pricing**: While on one hand the Indian revenue authorities have been aggressive on the IT-BPO Sector, on the other hand several new measures introduced by the government in the
recent years which hint at the underlying positive mindset that the Government is aiming at relieving the taxpayers from the operational burden of transfer pricing compliance as well as faster solutions to the disputes. We believe once APA is introduced in the DTC, it will definitely help bring more certainty to the players.

- **Tax**: While the original tax exemption (Section 10A/10B) for the industry has now expired, given the state of global economy and the Indian IT Industry, the government should frame policies around selectively providing tax relief to companies within the sector.
  - **Tax rebates on new growth models**: Favorable tax rebates could be provided to both the suppliers as well as users of software (e.g.: cloud, mobility, etc.) by rationalizing the tax and duty structures viz. state levies such as VAT, CST, entry tax.
  - **Tax rebates on R&D investments by IT-BPO Companies**: Under the provisions of the Act,1 tax rebate is available on carrying out in-house R&D to eligible companies. A clarification by the government regarding the availability of this tax rebate to IT-BPO companies would be a welcome move. IP/Product R&D is a nascent and capital intensive area. A huge tax burden will only dissuade the organizations from making large investments in IP and other intangible assets.

**Develop infrastructure**
- **Infrastructure development**: The Government can give a boost to the industry by making IT hubs in tier-2/3 cities and developing satellite townships around these hubs, thus, creating a self-sustaining ecosystem. Several academic institutions could be established around these townships ensuring sufficient availability of skilled talent pool, critical for the sustenance and growth of the industry. This will help the industry tap into entrepreneurial talent in the hinterlands.
  - **Broadband connectivity and computing infrastructure**: The Government needs to invest in increasing broadband penetration and provide computing infrastructure at subsidized rates to schools, universities, large corporate, SMBs etc. This would ensure the accelerated development of a large market for emerging technologies like cloud, social computing, analytics, etc.
  - **Framing policies for establishing world-class institutions**: Government needs to evaluate the effectiveness of regulating top institutions and could explore easing regulatory controls over issues like faculty salaries, R&D, admissions etc. providing them greater autonomy. Further, increased role of private partnerships in setting up institutions of higher education can be explored.

**Incentivize institutions of higher learning**: In order to encourage R&D and innovation, government can incentivize the government-funded institutions based on patents filed, R&D effort, research papers published, research work done for corporate and similar initiatives.

**Help develop the domestic market**
- **Government investment will be vital to encourage increased technology usage through e-governance initiatives. The government needs to expand the scale and scope of its existing efforts to provide citizen services online. This may either be facilitated through public-private partnerships or incentivizing the private sector to undertake these projects. The government should also encourage greater industry participation in sectors such as healthcare, education, public services, financial services, defense, space, nuclear energy, etc.**

**Industry bodies / Associations**
- **Industry bodies and associations can play a significant role in encouraging entrepreneurship, bringing innovation and facilitating policy decisions. They would need to make concerted marketing and branding efforts to showcase the non-linear expertise of Indian companies; erstwhile known only for providing cost arbitrage. This will significantly enhance the value proposition and brand perception of Indian software providers. In addition, they would need to highlight the emerging opportunities in domestic market and help establish connections between customers, academia and Indian companies.**

**Governance of IPR**
- **Industry bodies can play a critical role in IP governance and create awareness on Intellectual property rights and patents issues. They can help establish links with IP/ patent experts in the industry.**

**Branding and promotion**
- **Industry bodies need to make focused efforts to promote Indian IP brand value. This could be done through focused branding events and trade development initiatives. Also, collaboration with international or overseas associations and investor-groups in key targeted overseas markets can help facilitate establish appropriate linkages between Indian players and overseas investors. Further, establishing a process to recognize, acknowledge and highlight the success stories of Indian companies, entrepreneurs, investors and associated organizations (e.g. incubators) would go a long way in promotion the Indian “IP” brand.**

**Idea incubation through mentorship and funding**
- **Industry bodies can catalyze the setting up of incubation cells and development of broad ecosystem into which entrepreneurs, SMBs and innovators can plug into and develop innovative solutions, products and platforms. Apart from this, they could also potentially collaborate on setting industry standards and integration frameworks for technology development. Industry bodies can play a pivotal role in providing greater access to alternate sources of public and private funds which would provide immense opportunities for startups to get funding in seed, early and growth stages propelling their growth.**

**Establish and strengthen linkages between academia**
- **To ensure that the talent pool required for the industry is ‘relevant’ and of highest quality, it is imperative that industry bodies act as facilitators in establishing close linkages between academic institutions, government bodies and corporate. Providing a platform to interact and exchange ideas would help bridge the demand-supply gap of talent pool.**

**Academia**
- **Academia plays an active role in the software ecosystem by providing the talent pool which forms the backbone of software industry. Skill shortage is the single most disabling factor in the industry today, impeding the innovation cycle and causing a slower adoption to non-linear growth among providers. The academia needs to complement industry efforts by introducing new relevant modules, as well as building entrepreneurial and soft skills.**

**Teaching to think**
- **Most Indian institutions have been encouraged on “Teaching” methodology and emphasized on “memorization” rather than encouraging a “Thinking” mindset. Students are not usually encouraged to think creatively or exercise critical thinking skills. This could be because Indian industries in the 60s and 70s required certain basic skill sets and a majority of the students incubated only those before they moved into the labor pool. But while the earlier forms of teaching helped serve the basic needs of the nation and industry, the education system now needs to transform itself to address the reality of a rapidly changing marketplace by developing ‘thinking minds’ with an emphasis on research and innovation.**

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1. Section 352(AB) of the Act
Partnership between Industry and academia – research and curriculum
Joint efforts by industry and academia will ensure that there is sufficiently skilled manpower to drive the software story into its next phase of growth. Industry participation on a continual basis is vital for relevant curriculum design and focus areas for research. Accordingly, academia should reach out to industry for guidance on curriculum formation – including increased ‘internship’ time for students within the industry. Further, academia-industry interactions through forums would help in reducing the demand-supply gap and address the issue of ‘quality’ of talent. Industry players should also come forth and provide support and funding for research initiatives, especially in areas that are relevant to their business. Further, encouraging industry players to own or sponsor institutes can lead to setting up of increased industry-academia interactions.

Use of technology to enhance value and spread of education
Academic institutions could become part of the new digital revolution and leverage technology innovations in cloud, mobility, web-based delivery for expanding the breadth and depth of its reach.

Vocational training for ‘Ready to Work’ human capital
While R&D and Product Development takes center stage in this phase of growth, the industry will still need to be supplied with resources skilled in the basic IT skills to carry on business as usual work. As new technologies start becoming more common in the service delivery process, the academia in partnership with the industry will need to set up the infrastructure to train people in the new technologies. Given the rapid expansion and growing needs of this industry, the infrastructure will need to be rapidly scalable and will need to have its reach across India’s geographical expanse. This is particularly important since all the major centers (Tier 1 cities) have almost completely exhausted their local talent pool.

Clients
The clients, while they sit on the other side of the table, constitute a stakeholder of paramount importance in the ecosystem.

Vendors as ‘Partners’
Clients would need to look at their erstwhile vendors as strategic “partners” and advisors who can play an integral part in their growth story. Close collaboration between the two will be key to ensuring success in the large transformational initiatives that will be undertaken by clients in the near future – especially with the new technologies and service delivery frameworks.

Open mindset
Clients would need to have an open mindset with respect to the changing realities in the marketplace. They would need to be more receptive in the adoption of new technologies like cloud, mobility, platforms, etc. Investments in adoption of these technologies at early stage can help draw the long-term benefits in their growth story.

Joint Initiatives for new technologies
The changes we will witness during this transformation will not be evolutionary. It will have impact on every aspect of the service model – right from the solution to the mode of delivery and pricing. This will require the clients and their technology partners to work very closely, as it is impossible for the technology provider or the client to single handedly bring about a change of this magnitude.

Transparency
Transparency has traditionally been demanded from service providers; but we believe that for the kind of changes the industry is bracing itself up for, the clients – especially large ones and the service providers will have to work together as a team, be open about their mutual objectives and discuss limitations and business goals.

Take calculated risks – Engage with consultants
As some of the non-linear models are disruptive in nature, customers will need help and guidance before they invest heavily in these areas. Challenges in areas of change, process, and technology can only be dealt with holistic approach and not by dealing with issues in isolation as these changes would be impacting an organization and would not be limited to a specific business unit. To avoid taking an imprudent risk, both, the service provider and the clients will need to know the ramifications that the change will bring about. Consultants, with their exposure and their ability to closely track the changes in the market can be of immense value in such situations.

PE/VC
In the current scenario, VCs and PEs are primarily involved in late stage or growth stage which constitutes ~49 percent of the total deals (72 percent in value) while funds invested in early stage deals constitute ~25 percent of total deals (4 percent in value)2. Also, PE/VC firms in India are sector agnostic and prefer to be opportunistic with respect to investments. To foster and bolster the growth of technology start-ups in the country, PE/VC firms would proactively need to be involved in identifying the early-stage technology startups and nurture them for better returns. Apart from developing the ecosystem to create and grow start-ups, creating an exit ecosystem is critical for sustainability of early-stage investments in India.

Consultants – Business, process and financial
Consultants, whether they cater to the issues at strategic, financial or process levels, have always been at the forefront of bringing thought leadership in the industry. Their role is getting increasingly relevant in an era where India wishes to lead from the front. Consultants will play a critical role in engaging with IT players and clients and guide them through this major change over next few years. They will need to play the role of partners and help their customers frame and execute their next stage of business and financial growth plans.

Keep ahead of the curve
The consultants will need to proactively keep track of the developments in these new emerging models and engage with customers to help them stay ahead of the curve. They will need to be aware of the increasing complexities arising in the marketplace and enable their customers to address these challenges through proper planning and execution on business as well as financial front.

Help conceptualize products and new markets based on experience and exposure
Consulting organizations will need to assist companies in conceptualizing non-linear models relevant to the market and devise strategies for new market development and penetration. They should bring to table thought leadership in the various components of the changing technology landscape - new solutions and offerings, product ideas, platforms, pricing and branding strategies so as to enable Indian players leverage opportunities for non linear growth effectively.

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2. Venture Intelligence accessed January 3, 2012. Data does not include real estate deals

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Case Example

Zhongguancun used to be a small farming village tucked away in the northwestern part of Beijing city in the 1950s, largely off the administrative and public radar. It all changed fifty years later, in June of 1999, under the guidance of the government’s strategy of Developing the Nation through Science and Education, when the Zhongguancun Scientific and Technological Garden was established. It was the first state-level hi-tech industrial development zone to be founded in China. Thus began the story of a remarkable transformation of a farming village into what is now known as “China’s Silicon Valley”, home to locally spawned globally known firms like the Stone Group, Founder, and Lenovo and as research and development base of majors such as Google, Intel, AMD, Oracle Corporation, Motorola, Sony, and Ericsson.

This remarkable transformation came through concentrative efforts of the government, academia and industry. When it began, Zhongguancun Technology Park was a tiny village. Entrepreneurs survived by taking in government contracts, and hiring students to do the work. Gradually, it expanded to include a number of other high-tech zones and parks throughout Beijing, integrating a number of sectors including education, R&D and manufacturing. The next milestone came with approval by the State Council as a national innovation demonstration zone. Today, the Zhongguancun Scientific and Technological Garden has more than 8,000 hi-tech enterprises, with 23 world-famous transnational corporations, 4 of the top 10 international software companies, and 43 of the world’s 500 most powerful enterprises. In addition, the city has 40 universities and colleges, 200-odd research institutions, 67 State-level laboratories, 24 university-sponsored science parks and 29 innovation parks.

To aid in sustainable growth, the administration committee at Zhongguancun National Innovation Demonstration Zone recently proposed the area for designation as a “special zone for talent development”, the first in China to make a formal proposal for talent development. This is expected to position Zhongguancun as a “one-stop shop” for attracting skilled professionals, helping them set up businesses, and promoting research. The Beijing municipal government has established a special fund of up to 10 billion yuan a year to subsidize high-tech R&D professionals and promote industrialization of their research. In addition to the government, Bank of China, Bank of Beijing and Shenzhen Development Bank, as well as a number of venture capital companies, are also offering financial backing for new startups in the area. Through such preferential policies, Zhongguancun is expected to attract 30,000 new high-profile professionals from 2011 to 2012 and another 50,000 from 2013 to 2015.

Source:
2. www.china.org.cn
About KPMG

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 150 countries and have 138,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

Our Audit practice endeavors to provide robust and risk based audit services that address our firms’ clients’ strategic priorities and business processes.

KPMG’s Tax services are designed to reflect the unique needs and objectives of each client, whether we are dealing with the tax aspects of a cross-border acquisition or developing and helping to implement a global transfer pricing strategy. In practical terms, that means KPMG firms work with their clients to assist them in achieving effective tax compliance and managing tax risks, while helping to control costs.

KPMG Advisory professionals provide advice and assistance to enable companies, intermediaries and public sector bodies to mitigate risk, improve performance, and create value. KPMG firms provide a wide range of Risk Consulting and Management Consulting that can help clients respond to immediate needs as well as put in place the strategies for the longer term.

KPMG in India, a professional services firm, is the Indian member firm of KPMG International and was established in September 1993. Our professionals leverage the global network of firms, providing detailed knowledge of local laws, regulations, markets and competition. We provide services to over 5,000 international and national clients, in India. KPMG has offices across India in Delhi, Chandigarh, Ahmedabad, Mumbai, Pune, Bangalore, Chennai, Kochi, Hyderabad and Kolkata. The firms in India have access to more than 5,000 Indian and expatriate professionals, many of whom are internationally trained. We strive to provide rapid, performance-based, industry-focused and technology-enabled services, which reflect a shared knowledge of global and local industries and our experience of the Indian business environment.

kpmg.com/in
The Confederation of Indian Industry (CII) is a non-government, not-for-profit, industry led and industry managed organisation, playing a proactive role in India’s development process. Founded over 116 years ago, it is India’s premier business association, with a direct membership of over 8100 organisations from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 90,000 companies from around 400 national and regional sectoral associations.

CII catalyses change by working closely with government on policy issues, enhancing efficiency, competitiveness and expanding business opportunities for industry through a range of specialised services and global linkages. It also provides a platform for sectoral consensus building and networking. Major emphasis is laid on projecting a positive image of business, assisting industry to identify and execute corporate citizenship programmes. Partnerships with over 120 NGOs across the country, CII carries forward its initiatives in integrated and inclusive development, which include health, education, livelihood, diversity management, skill development and water, to name a few.

With 64 offices and 10 Centres of Excellence in India, and 7 overseas offices in Australia, China, France, Singapore, South Africa, UK, and USA, as well as institutional partnerships with 223 counterpart organisations in 90 countries, CII serves as a reference point for Indian industry and the international business community.
## Glossary

| ADM | Application Development and Maintenance |
| APA | Advanced Pricing Agreement |
| APAC | Asia-Pacific |
| ARPU | Average Revenue Per User |
| BFSI | Banking, Financial Services and Insurance |
| BI | Business Intelligence |
| BPaaS | Business Process-as-a-Service |
| BPO | Business Process Outsourcing |
| CAGR | Compounded Annual Growth Rate |
| CAD | Computer Aided Design |
| CAM | Computer Aided Mapping |
| Capex | Capital Expenditure |
| CIMS | Census Information Management System |
| CIO | Chief Information Officer |
| CMM | Capability Maturity Model |
| CoE | Centre of Excellence |
| CRM | Customer Relationship Management |
| CST | Central Sales Tax |
| DTC | Direct Tax Code |
| EBIT | Earnings Before Interest and Taxes |
| EOU | Export Oriented Unit |
| ER & D | Engineering Research and Development |
| ERM | Enterprise Resource Management |
| ERP | Enterprise Resource Planning |
| FDI | Foreign Direct Investment |
| Forex | Foreign Exchange |
| FP | Fixed Price |
| GDP | Gross Domestic Product |
| GIS | Geographic Information System |
| GPS | Global Positioning System |
| HR | Human Resource |
| IaaS | Infrastructure-as-a-Service |
| ICT | Information and Communications Technology |
| ILD | International Long Distance |
| IMS | Infrastructure Management Services |
| IP | Intellectual Property |
| IPR | Intellectual Property Rights |
| IRA | India Revenue Authorities |
| ISV | Internet |
| IT | Information Technology |
| ITeS | Information Technology Enabled Services |
| JV | Joint Venture |
| KM | Knowledge Management |
| KPI | Key Performance Indicator |
| M & A | Mergers and Acquisitions |
| MAT | Minimum Alternate Tax |
| MDM | Master Data Management |
| MNC | Multinational Companies |
| NASSCOM | National Association of Software and Services Companies |
| NCP | New Computer Policy |
| NGO | Non-Governmental Organization |
| NIC | National Informatics Centre |
| NiIT | India based IT training institute |
| NLD | National Long Distance |
| NSE | National Stock Exchange |
| Opex | Operating Expenditure |
| PaaS | Platform-as-a-Service |
| PE | Private Equity |
| R&D | Research and Development |
| RPE | Revenue per employee |
| SaaS | Software-as-a-Service |
| SEZ | Special Economic Zone |
| SI | System Integration |
| SLA | Service-Level Agreement |
| SMB | Small and Medium Business |
| SRM | Supplier Relationship Management |
| STP | Software Technology Park |
| T&M | Time and Material |
| TCO | Total Cost of Ownership |
| US | United States |
| USD | United States Dollars |
| VAS | Value Added Services |
| VAT | Value Added Tax |
| VC | Venture Capital |
| VPN | Virtual Private Network |
# Definitions

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
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<tbody>
<tr>
<td>Accelerators</td>
<td>Frameworks designed to automate repeatable tasks</td>
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<tr>
<td>Amortization</td>
<td>Spreading payments over multiple periods</td>
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<tr>
<td>Arbitrage</td>
<td>The simultaneous purchase and sale of an asset in order to profit from a difference in the price</td>
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<tr>
<td>Attrition</td>
<td>Also called employee turnover - it is the rate at which an employer gains and loses employees</td>
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<tr>
<td>Automation</td>
<td>The use of control systems and information technologies to reduce the need for human work in the production of goods and services</td>
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<tr>
<td>Bottomline</td>
<td>Net Income</td>
</tr>
<tr>
<td>Business-continuity</td>
<td>Identifies organization’s exposure to internal and external threats and synthesizes hard and soft assets to provide effective prevention and recovery for the organization, whilst maintaining competitive advantage and value system integrity</td>
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<tr>
<td>Captive</td>
<td>Wholly owned subsidiary</td>
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<tr>
<td>Cloud computing</td>
<td>The delivery of computing as a service rather than a product, whereby shared resources, software, and information are provided to computers and other devices as a utility (like the electricity grid) over a network (typically the Internet)</td>
</tr>
<tr>
<td>Commoditized</td>
<td>Process, good or service easy to obtain by making it as uniform, plentiful and affordable as possible</td>
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<tr>
<td>Deployment</td>
<td>Software deployment includes all activities that make a software system available for use. These activities can occur at the producer site or at the consumer site or both</td>
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<tr>
<td>Discretionary spend</td>
<td>Spending that must be done for the long term profitability of a company, but may be postponed from the current period(s). This includes equipment replacement, equipment upkeep (often referred to as repairs and maintenance), marketing, research and development and training</td>
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<tr>
<td>Domain expertise</td>
<td>Knowledge, experience and competence that have been acquired through a consistent track record of successful projects accomplished in various domain areas</td>
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<tr>
<td>e-Commerce</td>
<td>Buying and selling of products or services over electronic systems</td>
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<tr>
<td>e-governance</td>
<td>Technology driven governance</td>
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<tr>
<td>Enablers</td>
<td>Suite of software that facilitates the development of applications and adapt changes</td>
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<tr>
<td>Enterprise Mobility</td>
<td>The ability of an enterprise to connect to people and control assets from any location</td>
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<tr>
<td>Fixed Price</td>
<td>A contract where the payment does not depend on the amount of resources or time expended</td>
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<tr>
<td>Hub and spoke model</td>
<td>System of connections (spokes) arranged around a central node (hub)</td>
</tr>
<tr>
<td>Incubator</td>
<td>Programs designed to support the development of entrepreneurial companies</td>
</tr>
<tr>
<td>Inflation</td>
<td>A rise in the general level of prices of goods and services in an economy over a period of time</td>
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<tr>
<td>Intellectual Property</td>
<td>Refers to the ownership of intangible and non-physical goods. This includes ideas, names, designs, symbols, artwork, writings, and other creations</td>
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<tr>
<td>Knowledge management</td>
<td>A range of strategies and practices used in an organization to identify, create, represent, distribute, and enable adoption of insights and experiences. Such insights and experiences comprise knowledge, either embodied in individuals or embedded in organizations as processes or practices</td>
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<td>Linear Growth</td>
<td>The linear model of growth implies the outcome is exactly proportional to the input. With respect to the software industry it assumes that company revenues will grow in direct proportion to employee addition</td>
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<tr>
<td>Migration</td>
<td>Process of moving from the use of one operating environment to another operating environment that is, in most cases, is thought to be a better one</td>
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<td>Multimedia</td>
<td>Media and content that uses a combination of different content forms</td>
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<tr>
<td>Non-linear Growth</td>
<td>Implies a disproportionate increase in revenues relative to the increase in operating costs, thus having a salutary effect on profitability</td>
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<tr>
<td>Offshore</td>
<td>Offshore outsourcing is the practice of hiring an external organization to perform some business functions in a country other than the one where the products or services are actually developed or manufactured</td>
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<tr>
<td>Outcome-based pricing</td>
<td>Pricing model where clients are charged based on business results achieved</td>
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<tr>
<td>Patent</td>
<td>A form of intellectual property. It consists of a set of exclusive rights granted by a sovereign state to an inventor or their assignee for a limited period of time in exchange for the public disclosure of an invention</td>
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</table>
Pay-per-use | Pricing model where the client is charged based on its usage of services
---|---
Piracy | Unauthorized duplication of an original for commercial gain
Platform | A computing platform includes some sort of hardware architecture and a software framework (including application frameworks), where the combination allows software, particularly application software, to run. Typical platforms include a computer’s architecture, operating system, programming languages and related user interface (run-time system libraries or graphical user interface)
Private cloud | Proprietary computing architecture that provides hosted services to a limited number of people behind a firewall
Protectionism | The economic policy of restraining trade between states through methods such as tariffs on imported goods, restrictive quotas, and a variety of government regulations designed to allow (according to proponents) “fair competition” between imports and goods and services produced domestically
Public cloud | Based on the standard cloud computing model, in which a service provider makes resources, such as applications and storage, available to the general public over the Internet
Silicon Valley | Refers to the southern part of the San Francisco Bay Area in Northern California in the United States. The region is home to many of the world’s largest technology corporations
Smartphone | A high-end mobile phone built on a mobile computing platform, with more advanced computing ability and connectivity than a contemporary feature phone
Social Media | Includes web-based and mobile technologies used to turn communication into interactive dialogue
Standardization | A framework of agreements to which all relevant parties in an industry or organization must adhere to ensure that all processes associated with the creation of a good or performance of a service are performed within set guidelines
System Integration | Bringing together of the component subsystems into one system and ensuring that the subsystems function together as a system. In information technology, systems integration is the process of linking together different computing systems and software applications physically or functionally, to act as a coordinated whole
Third-party implementation | A situation where an IT services vendor utilizes a third-party’s product offering to offer a customized solution to its client
Time and Material | A project billing type whereby the customer is charged for all of the hours of work performed, any direct expenses incurred, and material purchased during project delivery
Topline | Net Sales
Transformational deals | These are major contracts involving business process improvements and re-engineering to overhaul an organization operations to drive productivity
Utilization rates | Also known as chargeability ratio, it is the percentage of total labor dollars or hours spent or ‘charged’ to project production
Virtualization | A technique for hiding the physical characteristics of computing resources to simplify the way in which other systems, applications, or end users interact with those resources. Virtualization lets a single physical resource (such as a server, an operating system, an application, or storage device) appear as multiple logical resources; or making multiple physical resources (such as storage devices or servers) appear as a single logical resource
Y2K | The Year 2000 problem (also known as the Y2K problem, the millennium bug, the Y2K bug, or simply Y2K) was a problem for both digital and non-digital documentation and data storage situations which resulted from the practice of abbreviating a four-digit year to two digits.
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